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Co-head of Research

Banny Lam

Tel: 852-21478863

Email: bannylam@abci.com.hk

China's rate and RRR cuts to stimulate economic growth

The People's Bank of China (PBOC) announced the sixth interest rate cut since November 2014 (first rate cut of 40 bps in November 2014; second rate cut of 25 bps in March 2015; third rate cut of 25 bps in May 2015; fourth rate cut of 25 bps in June 2015 and fifth rate cut in August 2015) by further slashing the 1-year lending rate and deposit rate by 25bps to 4.35% and 1.5%, effective October 24, 2015. At the same time, PBOC will further lower the reserve requirement ratio (RRR) by 50 bps for all banks, taking the ratio to 17.5% for the biggest lenders. Banks lending to agricultural firms and small companies will receive an additional reduction of 50 bps in RRR. In general, the latest rate cuts, which were announced after the release of 3Q15 GDP growth data and prior to the opening of the Fifth Plenary Session of the 18th CPC Central Committee, showed that momentum in China has remained stagnant and additional monetary easing is crucial for stabilizing and reviving the economy in 4Q15.

Interest rate and RRR cuts to stabilize economy. The interest rate cut and RRR cut, which came after the release of 3Q15 GDP growth figures and prior to the opening of the Fifth Plenary Session of the 18th CPC Central Committee, aims to provide support to the slowing economy. In our view, the Chinese government will roll out more monetary and fiscal stimulus to ensure the growth target of 7% for 2015 would be reached.

Keeping real interest rate low enough to boost investment and consumption. The focus of the interest rate cut is to keep real interest rate levels low to revive growth. As 9M15 CPI inflation stood mildly at 1.4%, real interest rate has remained high. Economic indicators show slackening growth in manufacturing and investment. Hence, further rate cut is called for. The reduction of real interest rate would lower the cost of capital and financial costs of enterprises, thus stimulating economic growth.

Additional RRR cut targeted to support agricultural borrowers and small and micro businesses. The additional 50 bps RRR cut allows qualified financial institutions to provide lending to rural, agricultural, and small businesses. The larger RRR cut for the financial companies will enhance their financial support to enterprises. In general, the RRR cut works in conjunction with earlier liquidity injection through the "reverse-repo" operations. The objective is to avoid further slowdown in the economy by adjustments with policy tools.

Continuous fine-tuning of macro loosening policies in 4Q15. Moderating domestic demand and subdued manufacturing activities are adding to the downside risks in the economy. The slowing economic momentum calls for a lower interest rate and a larger RRR cut to lessen financial burden and propel economic activities. Given the moderating trend in inflation and the mounting pressure to expand liquidity, we expect PBOC to assume an accommodative approach to pursue stimulus measures and inject liquidity through different monetary tools in 4Q15.



China Economic Indicators

	2014							2015								
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Real GDP (YoY%)	7.5	--	---	7.3	---	---	7.3	---	---	7.0	---	---	7.0	---	---	6.9
Export Growth (YoY%)	7.2	14.5	9.4	15.3	11.6	4.7	9.7	(3.2)	48.3	(15.0)	(6.4)	(2.5)	2.8	(8.3)	(5.5)	(3.7)
Import Growth (YoY%)	5.5	(1.6)	(2.4)	7.0	4.6	(6.7)	(2.4)	(19.7)	(20.5)	(12.7)	(16.2)	(17.6)	(6.1)	(8.1)	(13.8)	(20.4)
Trade Balance (USD/bn)	31.6	47.3	49.8	30.9	45.4	54.5	49.6	60.0	60.6	3.1	34.1	59.49	46.6	43.0	60.2	60.3
Retail Sales Growth (YoY%)	12.4	12.2	11.9	11.6	11.5	11.7	11.9	10.7		10.2	10.0	10.1	10.6	10.5	10.8	10.9
Industrial Production (YoY%)	9.2	9.0	6.9	8.0	7.7	7.2	7.9	6.8		5.6	5.9	6.1	6.8	6.0	6.1	5.7
PMI - Manufacturing (%)	51.0	51.7	51.1	51.1	50.8	50.3	50.1	49.8	49.9	50.1	50.1	50.2	50.2	50.0	49.7	49.8
PMI - Non-manufacturing (%)	55.0	54.2	54.4	54.0	53.8	53.9	54.1	53.7	53.9	53.7	53.4	53.2	53.8	53.9	53.4	53.4
FAI(YTD) (YoY%)	17.3	17.0	16.5	16.1	15.9	15.8	15.7	13.9		13.5	12.0	11.4	11.4	11.2	10.9	10.3
CPI (YoY%)	2.3	2.3	2.0	1.6	1.6	1.4	1.5	0.8	1.4	1.4	1.5	1.2	1.4	1.6	2.0	1.6
PPI (YoY%)	(1.1)	(0.9)	(1.2)	(1.8)	(2.2)	(2.7)	(3.3)	(4.3)	(4.8)	(4.6)	(4.6)	(4.6)	(4.8)	(5.4)	(5.9)	(5.9)
M2(YoY%)	14.7	13.5	12.8	12.9	12.6	12.3	12.2	10.8	12.5	11.6	10.1	10.8	11.8	13.3	13.3	13.1
New Lending (RMB/bn)	1,080	385.2	702.5	857.2	548.3	852.7	697.3	1,470	1,020	1,180	707.9	900.8	1,280.6	1,480	809.6	1,050
Aggregate Financing (RMB bn)	1,970	273.7	957.7	1,135.5	662.7	1,146.3	1,690	2,047	1,356	1,241	1,056	1,236	1,833	742	1,082	1,300

World Economic/Financial Indicators

Equity Indices				Global Commodities				Bond Yields & Key Rates			
	Closing price	Chg. WTD (%)	P/E	Unit	Price	Chg. WTD (%)	Volume (5-day avg.)		Yield (%)	Chg. WTD (Bps)	
U.S.				Energy				US Fed Fund Rate			
DJIA	17,646.70	2.50	15.60	NYMEX WTI	USD/bbl	44.60	251,496	(5.63)	0.25	0.00	
S&P 500	2,075.15	2.07	18.43	ICE Brent Oil	USD/bbl	47.99	116,245	(4.89)	3.25	0.00	
NASDAQ	5,031.86	2.97	28.57	NYMEX Natural Gas	USD/MMBtu	2.29	128,160	(5.93)	0.75	0.00	
MSCI US	1,979.04	0.00	19.08	Australia Newcastle Steam Coal Spot fob ²	USD/Metric Tonne	61.80	N/A	N/A	0.24	4.35	
Europe				Basic Metals				US Treasury (1 Yr)			
FTSE 100	6,444.08	1.04	23.29	LME Aluminum Cash	USD/MT	1,459.75	49,081	(5.72)	1.43	5.15	
DAX	10,794.54	6.83	17.17	LME Aluminum 3 -mth. Rolling Fwd.	USD/MT	1,496.00	52,793	(4.86)	2.09	2.45	
CAC40	4,923.64	4.70	21.58	CMX Copper Active	USD/lb.	5,304.25	6,229	0.00	0.303	(5.31)	
IBEX 35	10,476.30	2.39	19.10	LME Copper 3- mth Rolling Fwd.	USD/MT	5,285.00	32,913	0.00	3.08	0.00	
FTSE MIB	22,736.86	1.79	N/A	Precious Metals				China 10-Yr Gov. Bond			
Stoxx 600	377.36	3.92	22.36	CMX Gold	USD/T. oz	1,162.8	124,737	(1.72)	0.05	0.00	
MSCI UK	1,882.06	0.00	23.88	CMX Silver	USD/T. oz	15.83	39,321	(1.78)	0.1935	(0.39)	
MSCI France	138.51	0.00	21.95	NYMEX Platinum	USD/T. oz	1,001.70	10,572	(2.15)	0.3229	1.81	
Asia				Agricultural Products				O/N SHIBOR			
NIKKEI 225	18825.3	2.92	19.86	CBOT Corn	USD/bu	379.75	161,857	0.8	1.909	0.53	
S&P/ASX 200	5351.565	1.58	19.76	CBOT Wheat	USD/bu	490.5	56,356	(0.36)	3.023	(1.4)	
HSI	23151.94	0.37	9.93	NYB-ICE Sugar	USD/lb.	14.28	61,673	0.07	0.3913	(2.53)	
HSCEI	10742.04	0.99	7.63	CBOT Soybeans	USD/bu.	895.5	148,487	(0.31)	Corporate Bonds (Moody's)		
CSI300	3571.241	1.05	14.68					Aaa		3.89	(1.02)
SSE Composite	3412.434	0.62	17.17					Baa		5.30	(0.56)
SZSE Composite	2016.738	2.53	46.06								
MSCI China	63.94	0.65	9.76								
MSCI Hong Kong	12650.09	0.72	10.08								
MSCI Japan	942.16	2.82	15.95								

* As of 12:00 AM closing

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1018	1.5314	0.7216	121.47	0.9786	6.3964	7.7500	6.5270
Chg. WTD (%)	(2.91)	(0.8)	(0.66)	1.70	2.61	0.50	0.00	0.21

Note:

- Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
- Australia Newcastle Steam Coal Spot fob is the Australia Newcastle 6700 kc GAD fob Steam Coal Spot price published by McCloskey



Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 \leq 180 day volatility/180 day benchmark index volatility
High	1.5 \leq 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 \leq 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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**Office address: ABCI Securities Company Limited, 13/F Fairmont House,
8 Cotton Tree Drive, Central, Hong Kong.**

Tel: (852) 2868 2183