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Previous reports

U.S. interest rate outlook in 2017

Sep 29, 2016

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Sep 26, 2016

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China's residential property market: a new down-cycle ensues

- Reduced land supply in past years, relaxation of home purchase restrictions in 2015, and changes in lending policy fuel the home price boom in 2016
- Housing mortgage loans increased by RMB 2,370 bn to RMB 16,550bn in 1H16, representing 16.1% of total loans in the system
- Over 23 cities have implemented a new round of demand-side management policies to cool off the property market
- Home price is entering into a new down-cycle till 2018E
- Rising U.S. interest rates may weigh on China's home prices in 2017E

Falling land supply in 2014-15 has reduced new homes for presale in 2016. Land supply for property development has been declining since 2011. Based on the construction cycle, supply of new homes for presale is determined by land supply 1-2 years prior to selling. Land supply dropped 14.0% YoY, 31.7% YoY and 8.5% YoY in 2014, 2015, and 8M16. New home construction starts have also fallen by 14.4%YoY and 14.6%YoY in 2014 and 2015. Hence, supply of new home for presale has been lower in 2016. New home construction starts in 8M16 rebounded by 11.7%YoY; however, presale in 2017 could be adversely affected by the latest tightening policies to rein in demand (Exhibits 1-3).

Surging home prices in tier-1/2 cities have resulted in government policies to suppress demand. According to NBS, the national average price of new homes was RMB 7,362/sqm in 8M16., up 11.5% YoY, which is not unreasonable in our view. New home prices in major cities such as Shenzhen, Beijing, and Shanghai, however, exceeded RMB 50K/sqm., which is ~6.8x the national average home price. To curb the price hike, over 23 cities have implemented measures to manage demand (Exhibit 2).

New home inventory stays at a relatively low level. Completed but unsold GFA of new homes reached 425.4mn sqm at end-Aug 2016, representing 4.4 months of average monthly home sales for 8M16. GFA of new homes under construction was up 2.9% YoY to 4,799.54mn sqm at end-Aug 2016, representing 50 months of the average monthly home sales for 8M16. We believe the asset turnover ratio of property developers will slow down in the next 12 months when effects of the demand-side management policies become apparent (Exhibits 5-6).

The depth of the home price adjustment will depend on banks' lending attitude. Effectiveness of the latest demand-side management policies will depend on the banks' attitude on granting long-term loans to households. Banks have turned more aggressive in approving such loans since mid-2015. The liquidity injected by banks into the property market through loans to households has been inflating the home prices since mid-2015. Net housing mortgage loans were up 74%YoY in 1Q16 and 150% YoY in 2Q16; total outstanding balance of housing mortgage loans increased 30.9% YoY or 16.7% from end-2015 to RMB 16,550 bn at end-June 2016 (or

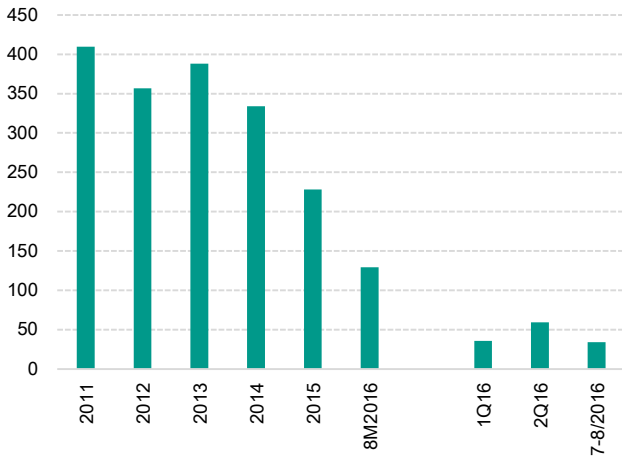


16.1% of total outstanding RMB-denominated loans in the financial system). With the latest round of demand-side management policies, banks will tighten their lending requirements on housing mortgage loans and subsequently reduce the amount liquidity injected in the property market. We believe when home prices start to correct downward in late-2016, banks will tighten lending requirements further to reduce risk in 2017. In 1H16, net new housing mortgage loans increased by RMB 2,370bn (or 2.3% of total outstanding RMB-denominated loans in the financial system). We believe default risk will increase for such mortgage loans when home prices soften (Exhibits 7-9).

Previous property cycles suggest the current downtrend in home price would persist till early-2018. Based on the previous property cycles in China, changes in home price bottomed in Jan 2009, June 2012, Mar 2015, and peaked in Oct 2007, Mar 2010, Nov 2013, and Apr 2016. The duration of the downtrend was ~16 months. In previous cycles, local governments also implemented various policies to curb housing demand (Exhibit 10).

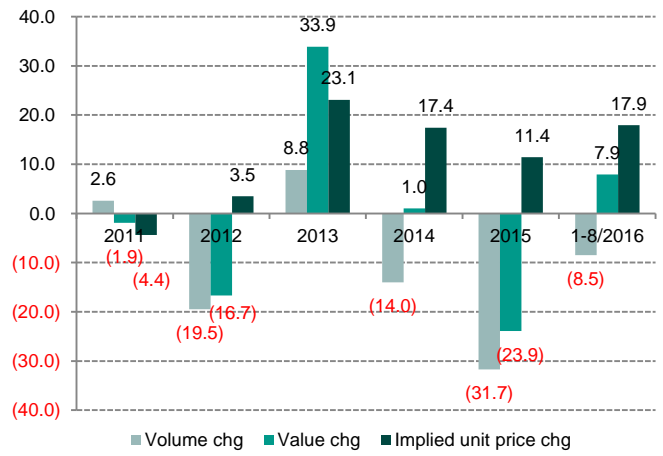
The U.S. interest rate cycle may have indirect impacts on China's residential market. We have identified a strong correlation between home price changes in the U.S. and China in 2008-15. The U.S. interest rate cycle affects interest rates in China and consequently, the property cycle in China. If the Fed raises interest rate in Dec 2016 and 2017, interest rate cycle in China would also be affected in the next 12 months. In our view, downward pressure on China's home prices will increase in 2017 (Exhibit 11).

Exhibit 1: Land sales (mn sqm)



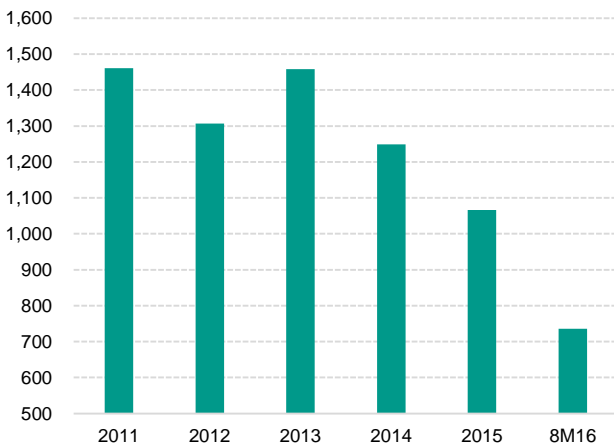
Source(s): NBS, ABCI Securities

Exhibit 2: Land sales (% YoY)



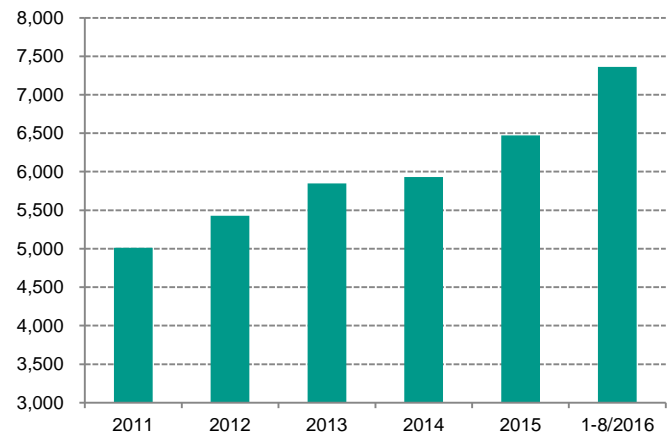
Source(s): NBS, ABCI Securities

Exhibit 3: New home construction starts (Mn sqm.)



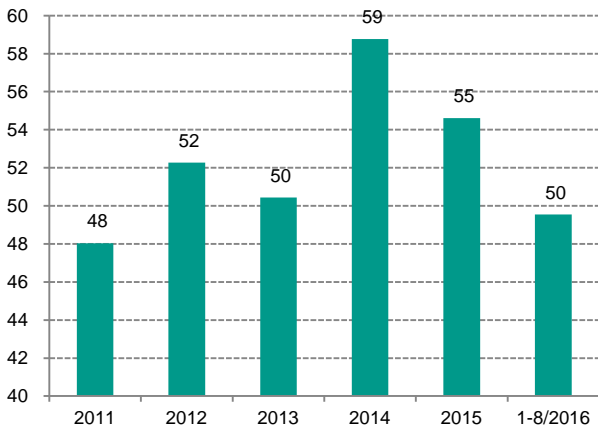
Source(s): NBS, ABCI Securities

Exhibit 4: National avg. new home price (RMB/sqm)



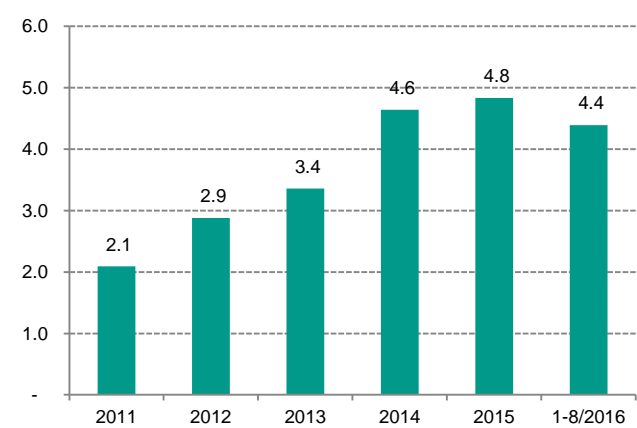
Source(s): NBS, ABCI Securities

Exhibit 5: New home GFA under construction /average monthly new home GFA sold (mths)



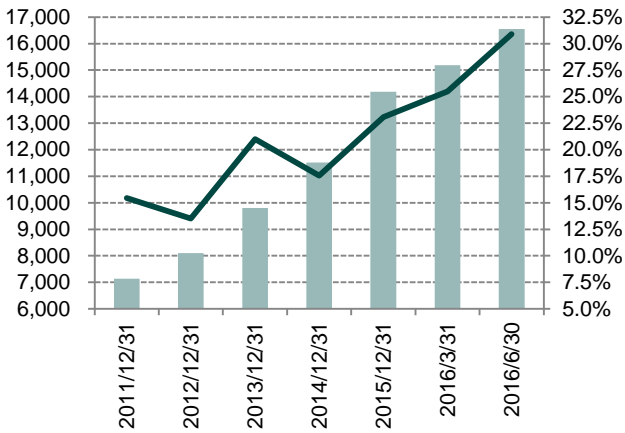
Source(s): NBS, ABCI Securities

Exhibit 6: Completed but unsold new home GFA/average monthly new home GFA sold (mths)



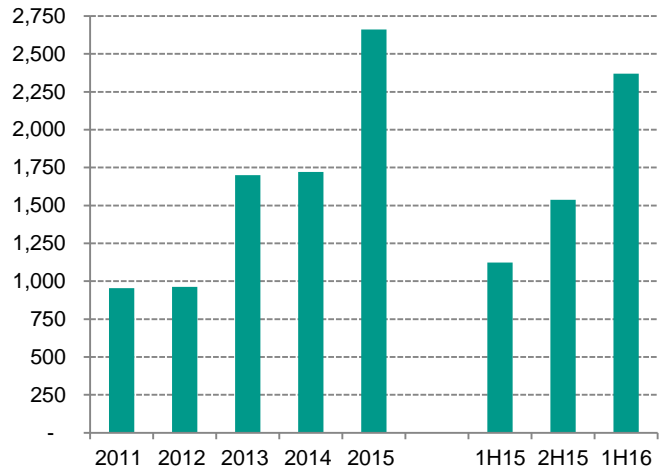
Source(s): NBS, ABCI Securities

Exhibit 7: Outstanding balance of housing mortgage loans (RMB bn) and changes (% YoY)



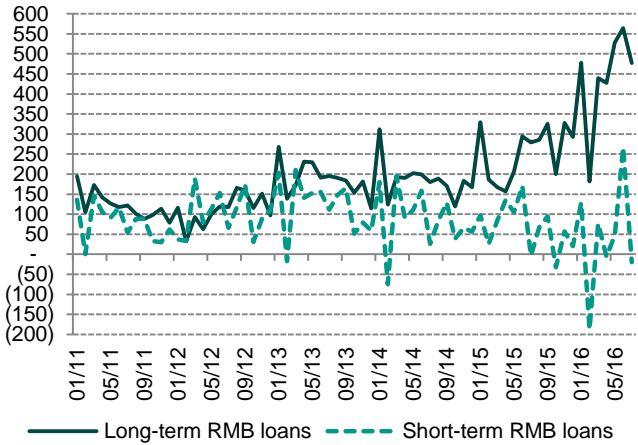
Source(s): PBOC, Bloomberg, ABCI Securities

Exhibit 8: Net increase in housing mortgage loans (RMB bn)



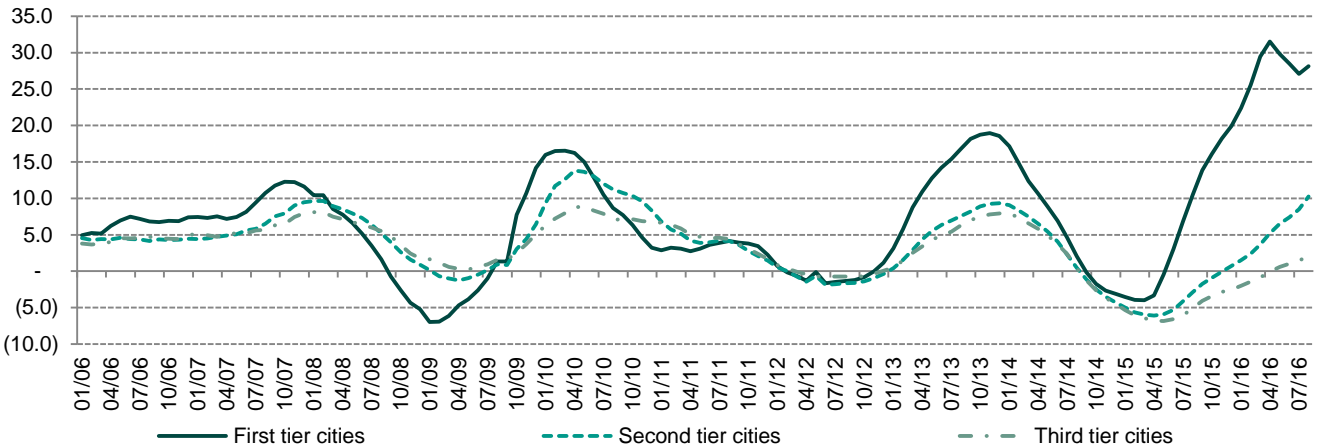
Source(s): PBOC, Bloomberg, ABCI Securities

Exhibit 9: Monthly new RMB loans to households (RMB bn, net basis)



Source(s): PBOC, Bloomberg, ABCI Securities

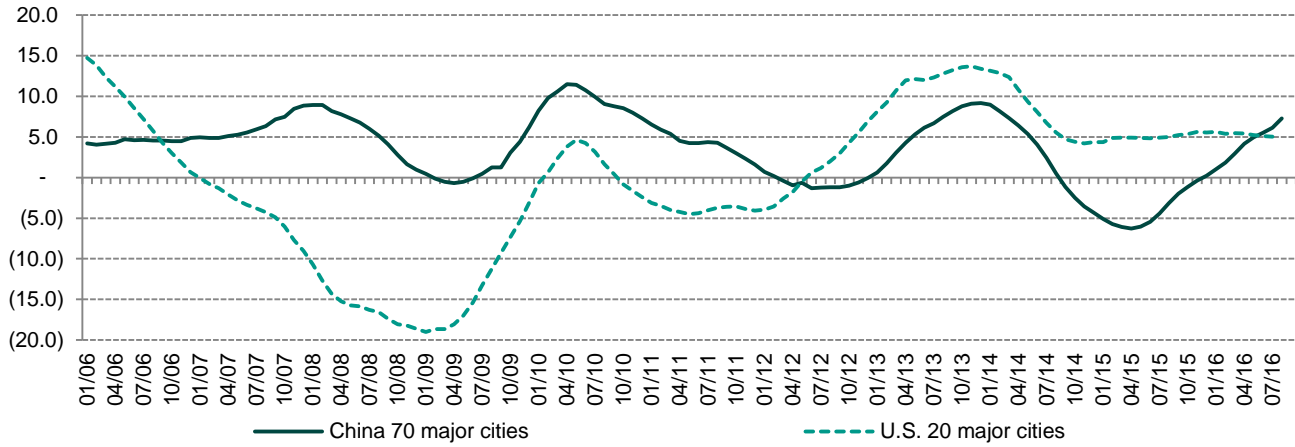
Exhibit 10: Changes in new home prices in major cities (%YoY)



Source(s): NBS, Bloomberg, ABCI Securities



Exhibit 11: Home price change (%YoY): China vs. the U.S.



Source(s): NBS, S&P/Case-Shiller 20 City City Home Price Index, ABCI Securities



China Economic Indicators

| | 2015 | | | | | | 2016 | | | | | | | |
|-------------------------------|-------|--------|--------|--------|-------|---------|---------|--------|---------|--------|-------|---------|--------|--------|
| | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug |
| Real GDP (YoY %) | --- | --- | 6.9 | --- | --- | 6.8 | --- | --- | 6.7 | --- | --- | 6.7 | --- | --- |
| Export Growth (YoY %) | (8.3) | (5.5) | (3.7) | (6.9) | (6.8) | (1.4) | (11.2) | (25.4) | 11.5 | (1.8) | (4.1) | (4.8) | (4.4) | (2.8) |
| Import Growth (YoY %) | (8.1) | (13.8) | (20.4) | (18.8) | (8.7) | (7.6) | (18.8) | (13.8) | (7.6) | (10.9) | (0.4) | (8.4) | (12.5) | 1.5 |
| Trade Balance (USD/bn) | 43.0 | 60.2 | 60.3 | 61.6 | 54.1 | 60.9 | 63.3 | 32.6 | 29.9 | 45.56 | 49.98 | 48.11 | 52.31 | 52.05 |
| Retail Sales Growth (YoY %) | 10.5 | 10.8 | 10.9 | 11.0 | 11.2 | 11.1 | 10.2 | | 10.5 | 10.1 | 10.0 | 10.6 | 10.2 | 10.6 |
| Industrial Production (YoY %) | 6.0 | 6.1 | 5.7 | 5.6 | 6.2 | 5.9 | 5.4 | | 6.8 | 6.0 | 6.0 | 6.2 | 6.0 | 6.3 |
| PMI - Manufacturing (%) | 50.0 | 49.7 | 49.8 | 49.8 | 49.6 | 49.7 | 49.4 | 49.0 | 50.2 | 50.1 | 50.1 | 50.0 | 49.9 | 50.4 |
| PMI - Non-manufacturing (%) | 53.9 | 53.4 | 53.4 | 53.1 | 53.6 | 54.4 | 53.5 | 52.7 | 53.8 | 53.5 | 53.1 | 53.7 | 53.9 | 53.5 |
| FAI (YTD) (YoY %) | 11.2 | 10.9 | 10.3 | 10.2 | 10.2 | 10.0 | 10.2 | | 10.7 | 10.5 | 9.6 | 9.0 | 8.1 | 8.1 |
| CPI (YoY %) | 1.6 | 2.0 | 1.6 | 1.3 | 1.5 | 1.6 | 1.8 | 2.3 | 2.3 | 2.3 | 2.0 | 1.9 | 1.8 | 1.3 |
| PPI (YoY %) | (5.4) | (5.9) | (5.9) | (5.9) | (5.9) | (5.9) | (5.3) | (4.9) | (4.3) | (3.4) | (2.8) | (2.6) | (1.7) | (0.8) |
| M2 (YoY %) | 13.3 | 13.3 | 13.1 | 13.5 | 13.7 | 13.3 | 14.0 | 13.3 | 13.4 | 12.8 | 11.8 | 11.8 | 10.2 | 11.4 |
| New Lending (RMB/bn) | 1,480 | 809.6 | 1,050 | 513.6 | 708.9 | 597.8 | 2,510 | 726.6 | 1,370 | 555.6 | 985.5 | 1380 | 463.6 | 948.7 |
| Aggregate Financing (RMB bn) | 742 | 1,082 | 1,300 | 476.7 | 1,020 | 1,815.1 | 3,425.3 | 824.5 | 2,404.0 | 751.0 | 659.9 | 1,629.3 | 487.9 | 1470.0 |

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 | 18,144.20 | (0.53) | 17.46 | NYMEX WTI | USD/bbl. | 49.75 | (0.12) | 623,568 | | 0.50 | 0.00 | |
| S&P 500 | 2,139.18 | (0.68) | 20.15 | ICE Brent Oil | USD/bbl | 51.42 | (0.98) | 313,348 | US Prime Rate | 3.50 | 0.00 | |
| NASDAQ | 5,239.02 | (1.01) | 31.30 | NYMEX Natural Gas | USD/MMBtu | 3.22 | 0.72 | 207,103 | US Discount Window | 1.00 | 0.00 | |
| MSCI US | 2,038.50 | (0.70) | 20.76 | China Qinhuangdao Port Thermal Coal ² | USD/Metric Tonne | 569.00 | 3.08 | N/A | US Treasury (1 Yr) | 0.2491 | 1.08 | |
| Europe | | | | Basic Metals | | | | US Treasury (5Yr) | | | | |
| FTSE 100 | 7,024.01 | (0.29) | 59.47 | LME Aluminum Cash | USD/MT | 1,680.75 | 0.63 | 8,323 | US Treasury (10 Yr) | 1.7393 | 2.12 | |
| DAX | 10,523.07 | 0.31 | 23.80 | LME Aluminum 3 -mth. Rolling Fwd. | USD/MT | 1,685.00 | 0.60 | 41,647 | Japan 10-Yr Gov. Bond | (0.06) | 0.10 | |
| CAC40 | 4,452.24 | 0.05 | 22.75 | CMX Copper Active | USD/lb. | 4,793.75 | 0.69 | 5,352 | China 10-Yr Gov. Bond | 2.7250 | (1.10) | |
| IBEX 35 | 8,686.50 | 0.72 | 21.52 | LME Copper 3- mth Rolling Fwd. | USD/MT | 4,814.00 | 0.75 | 29,439 | ECB Rate (Refinancing) | 0.00 | 0.00 | |
| FTSE MIB | 16,470.28 | 0.40 | 35.74 | Precious Metals | | | | 1-Month LIBOR | | | | |
| Stoxx 600 | 338.56 | (0.32) | 27.05 | CMX Gold | USD/T. oz | 1,261.80 | 0.79 | 173,720 | 3 Month LIBOR | 0.8775 | 0.14 | |
| MSCI UK | 2,046.11 | (0.33) | 62.73 | CMX Silver | USD/T. oz | 17.66 | 1.61 | 64,496 | O/N SHIBOR | 2.1510 | (17.6) | |
| MSCI France | 126.25 | 0.25 | 21.02 | NYMEX Platinum | USD/T. oz | 950.40 | (1.27) | 14,261 | 1-mth SHIBOR | 2.7125 | (2.85) | |
| Asia | | | | Agricultural Products | | | | 3-mth HIBOR | | | | |
| NIKKEI 225 | 16,919.92 | 4.09 | 20.98 | CBOT Corn | USD/bu | 338.50 | (0.37) | 163,080 | Corporate Bonds (Moody's) | | | |
| S&P/ASX 200 | 5,530.91 | 0.61 | 24.19 | CBOT Wheat | USD/bu | 398.25 | 0.89 | 75,131 | Aaa | 3.52 | 2.00 | |
| HSI | 22,766.91 | 2.80 | 11.62 | NYB-ICE Sugar | USD/lb. | 23.15 | (1.15) | 48,468 | Baa | 4.37 | 1.00 | |
| HSCEI | 9,554.85 | 4.64 | 7.52 | CBOT Soybeans | USD/bu. | 946.50 | (1.07) | 157,820 | Note: | | | |
| CSI300 | 3,294.23 | 2.78 | 14.37 | 1. Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report) | | | | | | | | |
| SSE Composite | 3,050.67 | 2.48 | 16.87 | 2. The price is Coal 5500 kcal/kg FOB Spot Price | | | | | | | | |
| SZSE Composite | 1,973.67 | 1.65 | 45.25 | | | | | | | | | |
| MSCI China | 60.31 | 3.24 | 12.05 | | | | | | | | | |
| MSCI Hong Kong | 12,865.95 | 1.13 | 14.18 | | | | | | | | | |
| MSCI Japan | 794.42 | 2.75 | 16.61 | | | | | | | | | |

Currency

| | Euro/USD | GBP/USD | AUD/USD | USD/JPY | USD/CHF | USD/CNY | USD/HKD | USD/CNY NDF 12-mth Spot pr. |
|--------------|----------|---------|---------|---------|---------|---------|---------|-----------------------------|
| Spot Rate | 1.1156 | 1.2954 | 0.7688 | 102.04 | 0.9747 | 6.6452 | 7.7563 | 6.7858 |
| Chg. WTD (%) | 0.63 | (0.91) | 0.91 | (0.22) | 0.62 | 0.23 | (0.02) | 0.17 |



Disclosures

Analyst Certification

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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

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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