農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

ABCI China / HK Equity Research

2H23 Economic Outlook & Investment Strategy

CHINA’S REBOUND TO OUTPACE DEVELOPED ECONOMIES

30.6.2023

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ABC INTERNATIONAL
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Note: Published on Jun 30, 2023
Stocks selected and mentioned in this report are limited and may not be exhaustive due to ABCI's internal policy

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Economic Outlook

2H23

2H23 Global Economic Outlook

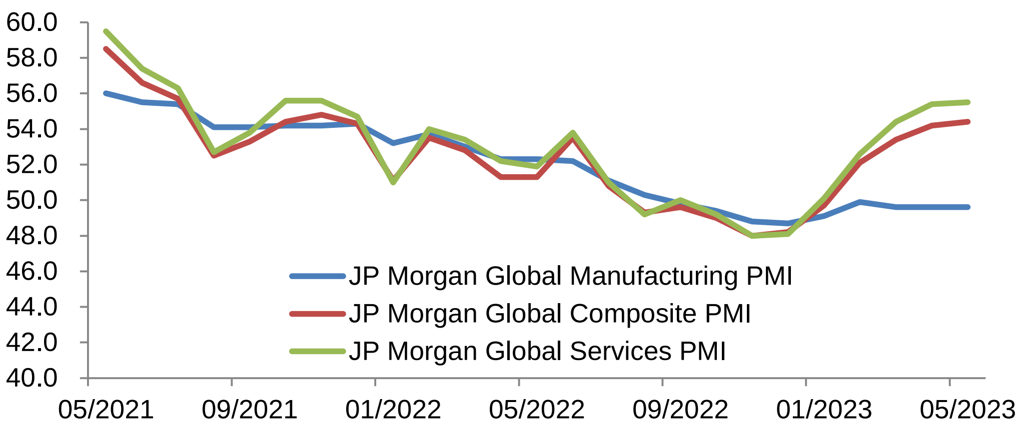
Economist: Andy Yao

- Global economic growth was fragile in 1H23 as monetary policy tightening adversely affected the financial sector. Labor markets in major economies remained tight in 1H23, with low unemployment rates and recurrent worker shortages
- Headline inflation in many countries eased in 1H23 on monetary tightening, improved supply chains, and lower energy and food prices. However, core inflation, excluding the volatile energy and food components, is yet to peak in many countries
- Looking ahead, global economic growth is expected to remain slow in 2H23, mainly due to tightening financial conditions in most regions, high debt level, still-elevated core inflation, and continued turmoil in Ukraine
- We expect economies in the US, China, Eurozone, Japan, and the UK to grow by 1.1%, 5.0%, 0.8%, 1.2%, and 0.2% in 2023E, respectively, compared with 2.1%, 3.0%, 3.5%, 1.1%, and 4.1% in 2022

A fragile recovery of global economy in 1H23

In 1H23, the global economy underwent a fragile recovery as monetary policy tightening started to take a toll on the financial sector. Several small and medium banks in the US collapsed, exposing the financial sector to significant duration risks. The loss of confidence in Credit Suisse resulted in a brokered takeover. Even though the JP Morgan global composite PMI was above 50 in 1H23 due to the service sector, the JP Morgan global manufacturing PMI stayed in the contraction interval, suggesting an uneven recovery between manufacturing and service providers (Exhibit 1). World merchandise trade growth appeared to have lost momentum in 1H23, according to the latest WTO Goods Trade Barometer issued on May 31. The overall barometer index continued to point to weakening trade growth in volume terms, which was 95.6 and well below the baseline value of 100.

Exhibit 1: JP Morgan Global PMIs (%)



Source(s): Bloomberg, ABCI Securities

1Q23 GDP growth in major countries was uneven. Economies in the US, China, Eurozone, Japan, and the UK expanded by 1.8%[1], 4.5%, 1.0%, 1.9% and 0.2%, respectively, in 1Q23, compared with 0.9%, 2.9%, 1.8%, 0.4% and 0.6% in 4Q22 (Exhibit 2). Major economies experienced tight labor markets in 1H23, with low unemployment rates and recurrent shortages of workers.

Exhibit 2: GDP growth of global major economies (%)

Real GDP Growth (YoY)	2022	4Q22	1Q23
US	2.1	0.9	1.8
China	3.0	2.9	4.5
Eurozone	3.5	1.8	1.0
Japan	1.1	0.4	1.9
UK	4.3	0.6	0.2

Source(s): Bloomberg, ABCI Securities

Headline inflation in many countries eased in 1H23 on monetary tightening, improved supply chains, and lower energy and food prices. However, core inflation, excluding the volatile energy and food components, is yet to peak in many countries. According to the IMF estimates, global headline inflation is set to fall from 8.7% in 2022 to 7.0% in 2023 on the back of lower food and energy prices and softening global demand, but core inflation is likely to decline more slowly. Inflation is unlikely to return to target before 2025 in most countries. While wage pressure remains contained in most developing countries, certain advanced economies have seen wages rise in 1H23 due to tight labor markets.

Except for PBOC and BOJ, most central banks tightened monetary policies in 1H23 amid high inflation, which has led to the marked rise in government bond yields. The Fed raised the target range for the Fed Funds rate by 75 bps to 5.00%-5.25% in 1H23 while reducing the size of its balance sheet. With the headline inflation easing, the Fed left interest rates unchanged in Jun FOMC meeting, but signaled additional two rate hikes in 2H23. At its Jun meeting, the ECB hiked the main refinancing operations rate, the marginal lending facility, and the deposit facility rates by 25 basis points to 4.00%, 4.25%, and 3.50%, respectively. The ECB stated it will continue raise policy rates in 2H23. The BOE, the Bank of Canada, and the Reserve Bank of Australia have all raised their main policy rates since the start of 2023. However, both the BOJ and the PBOC have maintained a loose monetary policy to boost economic growth amid the mild inflation pressure.

Subdued global growth in 2H23

Looking ahead, global economic growth is expected to remain slow in 2H23, mainly due to tightening financial conditions in most regions, high debt level, still-elevated core inflation, and ongoing turmoil in Ukraine. In the Apr trade forecast, WTO estimated the volume growth of global trade in goods in 2023E will fall to 1.7% from 2.7% in 2022. According to the latest Global Economic Prospects released by the World Bank in Jun 2023, global economy is projected to grow by 2.1% in 2023E, down from the 3.1% growth in 2022 (Exhibit 3). In OECD's latest Economic Outlook released in Jun 2023, the global economy is projected to expand by 2.7% in 2023E, down from 3.3% in 2022.

[1] All growth rates are year-on-year except specified otherwise

We expect the US economy to grow by 1.1% in 2023E, down from 2.1% in 2022, due to tighter financial conditions, still-high core inflation, and the withdrawal of fiscal stimulus. Although a low unemployment rate and a rising wage level should support household spending, weak consumer confidence and further adjustments in house prices will hinder household consumption. The significant withdrawal of fiscal support will also weigh on growth. Higher interest rates slash spending, especially the ones on residential investment. Although headline inflation is expected to ease in 2H23, core inflation is likely to remain high and well above the Fed's 2% target. On the monetary front, we expect the Fed to raise interest rate once in 2H23 with the Fed Funds rate reaching at 5.25%-5.50% by end-2023. The Fed will continue reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities in 2H23.

In 2023, China's economic growth is expected to rebound due to supportive macro policies and a low base effect. We believe its economy will expand by 5.0% for 2023E, up from 3.0% for 2022. The main drivers will be a significant rebound in consumption and a moderate increase in property investment in 2H23. Inflation in expected to be mild in 2H23E, so macro policies should not be constrained by inflation. On the monetary front, PBOC will maintain a neutral monetary policy with a loosening bias. It is likely to keep liquidity abundant to support loan growth for manufacturing firms and SMEs. RRRs and benchmark interest rates are expected to trend lower in 2H23E. Through tax and fee reductions, measures to boost infrastructure investment, and initiatives targeting consumption, the Chinese government is likely to adopt an active fiscal policy in 2H23 to support economic growth.

We project Eurozone's GDP growth to fall to 0.8% in 2023E from 3.5% growth in 2022 as a result of the lagged effects of ECB's previous rate hikes; declining savings and purchasing power will be taking a toll on the economy. Private consumption will be supported by strong labor markets in 2H23, but higher costs of financing and uncertainty will weigh on private investment. The tight labor market will continue to support wage growth in 2H23. Lower energy and food prices will continue to ease headline inflation in 2H23, but core inflation will remain elevated. The main refinancing rate is expected to rise to 4.50% in 3Q23 and remain unchanged for the remainder of the year. Meanwhile, the UK economy would expand by 0.2% in 2023E, down from 4.1% for 2022 as tighter monetary policy dampens consumer spending and business investment. Monetary policy will continue to tighten, with the policy rate set by BOE increasing to 5.50% at the end of 2023.

In 2023E, Japan's economic growth is forecast to rebound from 1.1% in 2022 to 1.2%, thanks to strong domestic demand and loose monetary policy. External demand, however, will be weighed down by the lagged effects of synchronized monetary policy tightening in advanced economies. Japan's inflation pressures should remain moderate compared to other advanced economies in 2H23, while core inflation is expected to ease to ~2%. With the inflation outlook remaining subdued, the country's loose monetary stance would be held firmly in place throughout 2H23 with yield curve control maintaining 10-year Japanese government bond yields at around 0, plus or minus 50 basis points. The short-term policy rate is likely to remain at -0.10% till the end of 2023.

Exhibit 3: GDP growth forecasts for global major economies (%)

Real GDP Growth (YoY)	2022	2023E
US	2.1	1.1
China	3.0	5.0
Eurozone	3.5	0.8
Japan	1.1	1.2
UK	4.1	0.2
World	3.1*	2.1*

*Denotes World Bank estimates and forecasts

Source(s): World Bank, Bloomberg, ABCI Securities estimates

2H23 China Economic Outlook

Economist: Andy Yao

- With the easing of pandemic-related restrictions, China's economy grew 4.5% in 1Q23, up from 2.9% in 4Q22, higher than the market forecast of 4.0%. However, the economy eased significantly in 2Q23 as pent-up demand faded and the property industry remained weak
- Despite the anemic GDP growth in 2Q23 on a quarterly basis, we believe China's economy will rebound moderately in 2H23 on a series of policies to stabilize growth. Overall, we expect the economy to expand 5.0% for 2023E, unchanged from our previous estimate
- We expect the inflation to remain mild in 2H23. CPI inflation would only rise by 1.5% in 2023E, down from 2.0% in 2022. Core CPI is likely to rebound slightly as China's economic growth quicken in 2H23. We forecast PPI inflation to drop 1.0% in 2023E from an increase of 4.2% in 2022
- We expect PBOC to maintain a supportive monetary policy stance in 2H23 with RRR and interest rate cuts. The rates for 1Y LPR and 5Y LPR are expected to fall to 3.50% and 4.10% by end-2023E from 3.55% and 4.20% at end -1H23. RRR for large banks would be 9.00% and 7.00% for medium banks by end-2023E, while RRR for small banks is likely to stay at 5.0%
- The central government will continue with its proactive fiscal policy in 2H23 with cuts and deferrals of taxes and fees, consumption-specific stimulative measures, as well as programs to boost infrastructure investment. It is expected that the issuance of new special bonds to be largely completed in 3Q23. Subsequent policies will focus on supporting the special bonds to swiftly form physical workloads , improving the efficiency of fund utilization, and stabilizing growth

China's economy eased significantly in 2Q23

With the easing of pandemic-related restrictions, China's economy grew 4.5%[2] in 1Q23, up from 2.9% in 4Q22, higher than the market forecast of 4.0% (Exhibit 1). However, the economy eased significantly in 2Q23 as pent-up demand eased and the property industry remained weak. MoM-wise, economic activity in Apr and May showed a weak momentum. FAI in urban areas, retail sales, and industrial production only grew 0.1%, 0.4% and 0.6% in May after growing by -0.8%, 0.2% and -0.3% in Apr.

However, some economic data rebounded significantly in Apr and May by YoY growth as pandemic-related restrictions last year led to a low base. For example, retail sales rose 18.4% and 12.7% in Apr and May YoY, compared with the 11.1% and 6.7% decrease in the same period of 2022 and the 5.8% increase in 1Q23.

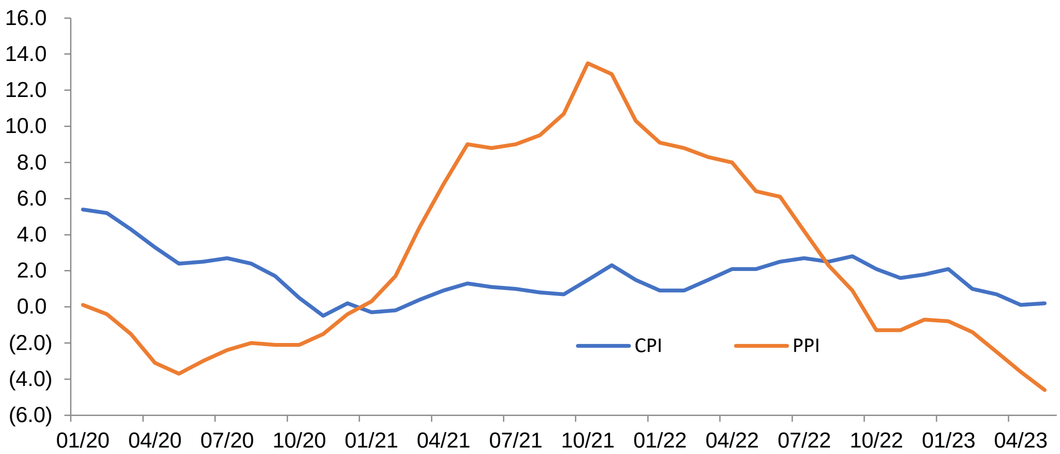
[2] All growth rates are year-on-year except specified otherwise

Exhibit 1: China's GDP growth (%)

Source(s): NBS, ABCI Securities

The pressure of deflation was increasing in 1H23 due to weak demand of overall economic activity (Exhibit 2). CPI only rose by 0.1% in Apr and 0.2% in May after increasing 0.7% in 1Q23 as non-food inflation eased and food inflation slowed, especially for pork prices. Core CPI inflation, excluding food and energy, remained low at 0.7% in Apr and 0.6% in May, compared with 0.8% in 1Q23. PPI dropped by 3.6% in Apr and 4.6% in May, down from 1.6% decrease in 1Q23. The significant slowdown in PPI was mainly due to the high base effect and the moderation in commodity prices, including those of oil, non-ferrous metals, and ferrous metals.

Exhibit 2: China's CPI and PPI (%)



Source(s): NBS, ABCI Securities

On the monetary front, PBOC has adopted a loose monetary policy to support economic growth since the start of 2023. It slashed RRR and LPR to lower financing costs for the real economy, especially for small/medium enterprises and private companies. Growth in broad money supply (M2) accelerated to 11.6% in May from 11.1% in the same month of 2022, while total social financing− a comprehensive measure of all types of financing for the real economy, increased to RMB 17.3tr in 5M23 from RMB 15.7tr during the same period last year.

Economic activity to rebound in 2H23

Despite the anemic GDP growth in 2Q23 on a quarterly basis, we believe China's economy will still rebound moderately in 2H23 on a series of policies to stabilize growth. A steady recovery of consumption and a moderate pickup in property investment will be the main growth drivers. On the contrary, frail external demand and high debt level for some local governments will be the major challenge in 2H23.

Domestically, the overall investment growth will accelerate in 2H23 as growth in property investment would quicken moderately on the back of significant financing support for property companies and lower mortgage rates for property purchasers. Property sales are likely to regain some strength amid improving consumer confidence. Manufacturing investment and private investment are likely to slow slightly in 2H23 amid soft external demand. However, high-tech manufacturing investment will increase substantially with the support of macro policies. Infrastructure investment will remain high in 2H23 as fiscal policy support would continue throughout whole year. Increasing income and lower unemployment rate would support consumer spending. Driven by the central and local policies to promote automobile consumption, automobile retail sales, which accounted for 10% of overall retail sales, are expected to remain high in 2H23.

Externally, export growth, especially for the advanced countries, is expected to ease in 2H23 as the global economy would slow on tightening financial conditions in most regions, the still-elevated inflation, and ongoing turmoil in Ukraine. With the agreement of Regional Comprehensive Economic Partnership (RECP) coming into force, China's exports to Asian economies in 2H23, especially Japan, will increase. Meanwhile, with the deepening of economic cooperation, China's exports to Africa, countries for the Belt and Road, especially Russia, will maintain rapid growth. Reopening will boost tourism imports and raw material imports will be kept high by infrastructure investment.

With the support of macro policies and recovery of economic momentum, we believe China's economic growth will likely rebound on a quarterly basis in 2H23. Overall, we expect the economy to expand by 5.0% for 2023E, unchanged with our previous estimate (Exhibit 3).

We expect the inflation to remain mild in 2H23. CPI inflation would only rise by 1.5% in 2023E, down from 2.0% in 2022. Core CPI is likely to rebound slightly as China's economic growth would quicken in 2H23. We forecast PPI inflation to drop by -1.0% in 2023E from an increase of 4.2% in 2022 with the moderating commodity prices, softening domestic demand, and the high base effect. Macro policy is unlikely to be constrained by inflation in 2H23.

On the monetary front, PBOC will maintain a supportive monetary policy in 2H23. The authority is likely to keep liquidity abundant to support loan growth for manufacturing firms, property companies, and SMEs. We predict new RMB-denominated loans and new aggregate financing to be ~RMB 23.0tr and ~RMB 35.5tr in 2023E. Meanwhile, the authority will continue slashing the benchmark interest rates in 2H23 to lower financing costs for real economy. The rates for 1Y LPR and 5Y LPR would fall to 3.50% and 4.10% by end-2023E. RRR would be cut once in order to increase liquidity for financial market; RRR would be

9.00% for large banks and 7.00% for medium banks by end-2023E, while RRR for small banks is likely to stay at 5.0%. Broad money supply (M2) is set to grow by about 11.0% in 2023E. Regarding the exchange rate, we expect spot USD/CNY rate to approach 6.8000 by end-2023E with China’s economy rebounding and still-high trade surplus, as compared with 6.8986 for end-2022E.

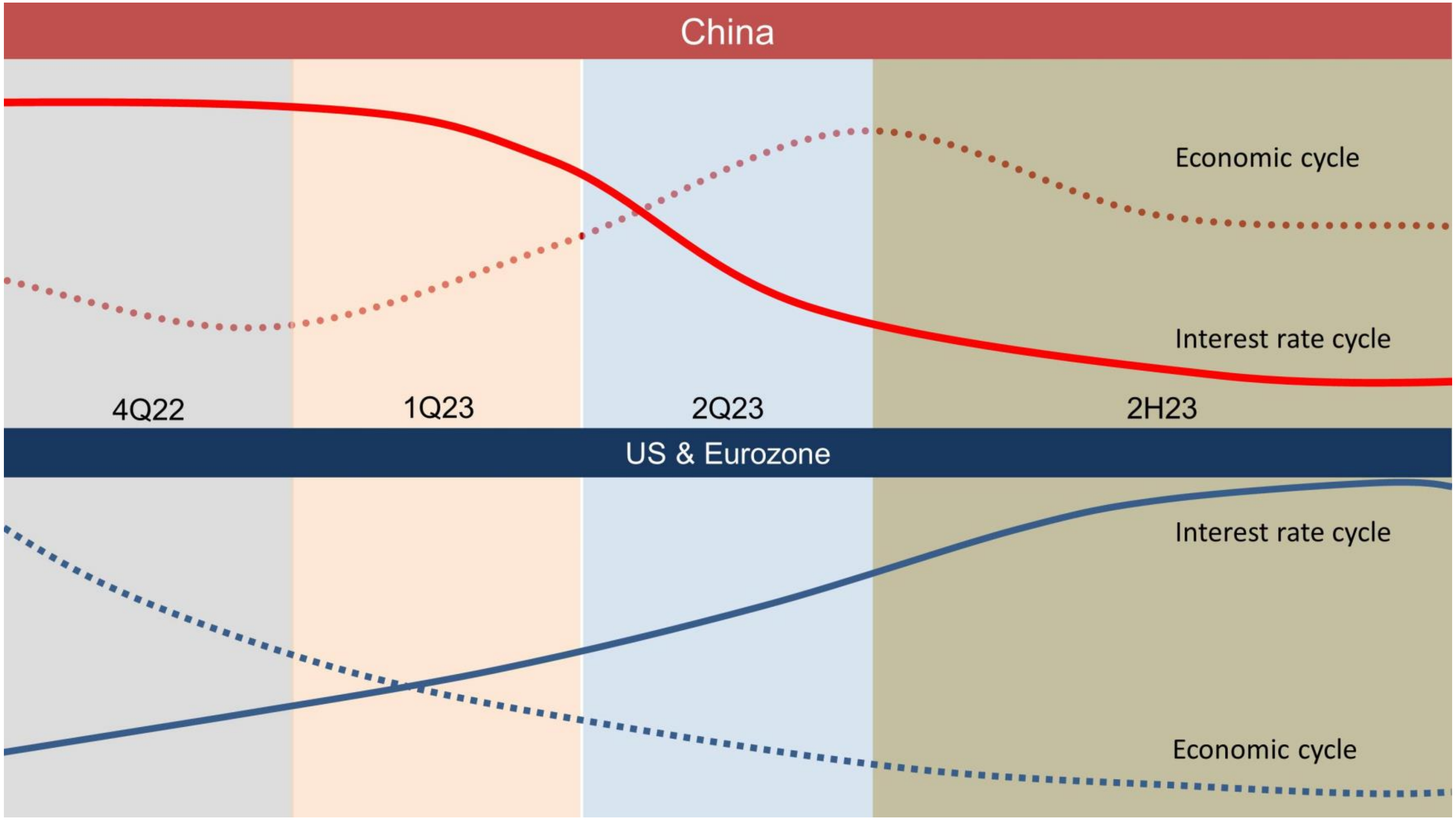
The central government will continue to adopt a proactive fiscal policy in 2H23 to support economic growth through cuts and deferrals of taxes and fees, consumption-specific stimulative measures, and programs to boost infrastructure investment. Muted land market will squeeze revenue of local government funds. As such, since mid-May, the Ministry of Finance has allocated the remaining local government bond quota for 2023 to various provinces and cities to support the issuance and use of special bonds. It is expected that the issuance of new special bonds to be largely completed in 3Q23. Subsequent policies will focus on supporting the special bonds to form physical workloads, improving the efficiency of fund utilization, and stabilizing growth.

Exhibit 3: Economic forecasts

Economic indicators	2021	2022	2023E
Real GDP growth, %	8.1	3.0	5.0
FAI growth, %	4.9	5.1	5.0
Retail Sales growth, %	12.5	-0.2	8.0
Export growth in USD terms, %	29.9	7.0	1.5
Import growth in USD terms, %	30.1	1.1	2.5
Industrial Production growth, %	9.6	3.6	4.5
CPI, %	0.9	2.0	1.5
PPI, %	8.1	4.2	-1.0
M2 growth, %	9.0	11.8	11.0
Aggregate Financing, RMB bn	31,400	32,010	35,500
New Yuan Loans, RMB bn	19,900	21,310	23,000
Spot CNY per USD, End-year	6.3561	6.8986	6.8000
One-year LPR, %	3.80	3.65	3.50
Five-year LPR, %	4.65	4.30	4.10

Source(s): NBS, PBOC, ABCI Securities estimates

Economic/Interest Rate Cycles of China and Developed Economies



Source(s): ABCI Securities estimates

Head of Research: Philip Chan

Investment Strategy

2H23

2H23 Investment Strategies

Cash return to stay high; Bargain-hunting for China/HK stocks

Head of Research: Philip Chan

- **Maintain cash, prioritize short-term investment grade bonds - stock markets in developed markets are not at cheapest yet**
- **Bargain hunting in China/HK stock markets: HSI is at 9.3x forward P/E, 20% lower than its 5Y average**
- **The Fed will fine-tune monetary policy instead of making aggressive moves in 2H23, containing recession risk and maintaining inflation in downward channel**
- **Further marginal interest rate increases in the US and Eurozone in 2H23 are expected to have limited impact due to diminishing effectiveness**
- **In 2H23, declining inflation rates in the US and Eurozone will likely be countered by less elastic service prices such as wages and rent**
- **Low economic growth is anticipated as the US and Eurozone. Prices of risk assets and commodities are suppressed**

Know the market expectations but don't fully rely on them. Market expectations affect futures market of assets (interest rates, exchange rates, bond prices, stock prices and commodity prices), while futures market affects spot markets.

Expectations regarding the US interest rates have been inaccurate and subject to frequent revisions. In 4Q22, the market expected US Fed Funds rates to peak in 1Q23, which did not happen. In 1Q23, the market once again expected the US Fed Funds rate to peak in 2Q23 and interest rates would decline in 4Q23. These expectations have been proven wrong as well. Currently, market expected US Fed Funds rate will peak in Jul 2023 and remain unchanged till 4Q23.

The expectation of consistently high global crude and food prices following the outbreak of the Russia-Ukraine war was proven wrong

- As of now, the US WTI crude spot price is approximately US$69/barrel, a 44% decline from its peak in 2022 and nearly 10% below the average price of US$77/barrel in 4Q21.

- As of now, Brent crude's spot price clocks in at about US $74 per barrel. This is approximately 44% lower than its 2022 peak, and roughly 6% lower than the average price of US $79 per barrel from 4Q21.

- The current crude oil prices in the US and Europe are dipping below the average price level observed in 4Q21, prior to the turmoil between Russia and Ukraine.

- The United Nation's FAO reports that the World Food Price Index experienced a 21.3% decrease YoY in May 2023, following a 34% YoY surge in Mar 2022. As of May 2023, the World Food Price Index rests at 123.06, representing a 22-month low since Jul 2021.

Why were some of the major market predictions for 2022 proven wrong in 2023?

- The Fed and the ECB are attempting to increase money costs in the financial markets, as well as increase opportunity costs in the capital and commodity markets. However, they are not aggressively withdrawing liquidity from the financial market. While abundant liquidity helps to mitigate the risk of recession, it diminishes the effectiveness of interest rate hikes in the US and Europe. Consequently, an extended high-interest environment is the price that must be paid to gradually suppress demand.

  - Central banks in developed economies adopt flexible monetary policies to control inflation and prevent economies from slipping into recession. Despite the Fed's upward adjustment of interest rates by 500bp since the end of 2021, it merely contracted its balance sheet by 3.4% in the same period. This cautious approach to balance sheet contraction mitigated the adverse effects of rising interest rates. Moreover, the Fed's balance sheet is still 101% larger than at the end of 2019, or 13.6% larger than at the end of 2021.

  - The ECB increased its deposit facility rate by 400bp since the end of 2021 and managed to shrink its balance sheet by 9.8%. Nonetheless, its balance sheet remains 66% larger than it was at the end of 2019, and 10% larger than it was at the end of 2021.

- The US and its allies' crude oil export ban on Russia has fallen short of expectations. Although OPEC crude oil production has decreased, the rise in US crude oil production has outpaced this decline. Manufacturing activity in developed countries has been dampened by high interest rates, causing a decrease in energy demand. The reduction in demand has exceeded the expected decline in supply, resulting in a downward trend in crude oil prices in 2H22-1H23.

  - Despite OPEC's repeated calls for reduction in output supply to support crude prices, crude output remained strong. In May 2023, global crude oil output in OPEC dipped by only 1.6% YoY to reach 25.26mn bbl/day, while average crude oil output in the US surged by 6.7% YoY to 12.41mn bbl/day. The ascend in US production surpassed the decline in OPEC's output, further chipping away at their market share. Unsurprisingly, this deterioration in market share is causing tensions between the US and Middle Eastern oil-exporting countries.

  - Although the US and its allies banned the export of Russia's crude, Russia has refused to release any relevant crude output and export data. This makes it hard for the market to evaluate the impact of the ban. Despite this, the trend of global crude prices suggests that Russia is able to maintain its crude export to a large extent. In May 2023, the manufacturing PMI of Russia has increased to 53.5, marking the 16th consecutive month of staying above 50 since May 2022, as reported by S&P Global. Furthermore, monthly average import of Russia's crude and LNG into China have also increased significantly when compared to

5M22, reaching 8.42mn metric tonne and 0.61mn metric tonne respectively in 5M23, according to China Customs.

- The manufacturing sector has been hit hard due to high interest rates in developed countries, causing a decline in the demand for energy resources. As of May 2023, the global manufacturing PMI remained below 50 for the ninth consecutive month since Aug 2022.

Our Judgments

- Elevated food and energy prices caused inflationary pressures in the US and Eurozone in 2H22, but these have now eased back in 1H23. Moving into 2H23, the decline in inflation rates will likely be resisted by service prices, such as wages and rent. These two factors are less elastic in the short term and highly politically sensitive in the medium-term.

- After raising interest rates steeply in the last 18 months in the US and Eurozone, further marginal increases in 2H23 are unlikely to have much impact. This is because the effectiveness of rate hikes is diminishing. Unless any unexpected occurrences or the so-called “black swan” events occur, central banks are unlikely to reduce interest rates easily. In 1H23, during the regional banks crisis in the US, the Fed opted to expand its balance sheet, rather than slashing the interest rate. This has explicitly illustrated to the financial market that balance-sheet expansion is the preferred choice to handle financial crises of similar scales in the future.

- The Fed monetary policy will be in a fine-tuning phase in 2H23 to avoid a recession while keeping inflation rates in a downtrend. Shrinking the services sector is the quickest way to curb inflation, but it may lead to higher unemployment, lower wages, and reduced rents, which is not preferred by the Fed and ECB.

- It's reasonable to anticipate a drawn-out spell of sluggish economic growth, with the US and the Eurozone likely to contend with high interest rates and a gradual decline in inflationary pressures. The Fed has successfully influenced inflation expectations in the bond market. According to the Treasury Inflation-Protected Securities (TIPS) market, the bond market expects the inflation rate to drop to ~2% in the next 12 months and remain stable at this level beyond. Simply put, the bond market anticipates a significant decrease in inflation fears over the next 12 months. However, deflation fears are not currently the main concern. This situation gives the Fed the flexibility to fine-tune monetary policy instead of making aggressive moves.

- US-China inflation gap is narrowing and US-China nominal interest rate gap is expanding, adding devaluation pressure to RMB against USD.

    - The shrinking US-China inflation gap is positive to USD against RMB. In 2022, China urban CPI peaked at 2.7% YoY in Sep; after that, urban CPI was in a downtrend. Urban CPI was at 0.2%YoY in May 2023. US urban CPI is also going down but its CPI is declining faster than that in China. The US CPI fell from 8.2%YoY in Sep 2022 to 4.0%YoY in May 2023. The US-China urban CPI gap narrowed from 6.9ppt in Mar 2022 to 5.5ppt in Sep 2022, 4.7ppt in Dec 2022, 4.3ppt in Mar 2023, and 3.8ppt in May 2023. (Note: US-China inflation gap refers to US inflation rate minus China inflation rate.)

- The expanding US-China nominal interest rate gap is positive to USD against RMB. The Fed has delivered a clear message to the financial market that the Fed Funds rate will go up further in 2H23. Hence, the US is still in an upward interest rate cycle. Meanwhile, banks in China lowered deposit interest rates and LPR in June. After the rate cuts in China, some economists still expect the PBOC to enforce marginal rate cut in 2H23. Interest rates in the US and China , in divergent directions, widens the US-China nominal interest rate gap. For illustration, let's take notice of the US-China 1Y treasury yield gap. The US-China 1Y nominal yield gap expanded from 2.59ppt at end-2022 to 3.32ppt at Jun 21, 2023. (Note: US-China nominal interest gap refers to US interest rate minus China interest rate.)

- An expanding US-China real interest rate gap is positive to USD against RMB. The widening gap will drive currency traders to sell RMB and buy USD. The currency trading activities will accentuate devaluation pressure in RMB against USD.

US-China real interest rate gap
= US real interest rate minus China real interest rate
= (US nominal interest rate minus US inflation rate) - (China nominal interest rate minus China inflation rate)
= (US nominal interest rate minus China nominal interest rate) - (US inflation rate minus China inflation rate)
=US-China nominal interest rate gap - US-China inflation rate gap

Asset allocation strategies

- **Maintain sufficient cash in portfolio.** The USD and Euro cash return rate may slightly increase in 2H23.

- **Prioritize short-term investment grade bonds**. Although "black swan" events leading to aggressive interest rate cuts by the Fed or ECB cannot be ruled out, we believe fine-tuning monetary policy is a more probable scenario for 2H23. During this period, the US and Eurozone central banks will continue to contract their balance sheets. Therefore, we expect short-term interest rates to remain firm.

- **Stock markets in developed countries are not as cheap as it could be**
  - On Jun 26, 2023, the MSCI World Index was valued at 2895, with a forward P/E of 17.4x, which was 7% lower than its five-year average P/E of 18.7x. Additionally, the bargain valuation numbers around 15.0x, approximately 1 SD below its average P/E over the past five years.
  - On Jun 26, 2023, the S&P 500 Index stood at 4328 and traded at a forward P/E of 19.8x. This is 3% lower than its 5Y average P/E of 20.4x. Bargain valuation is pegged at roughly 16.9x, which sits just shy of its 5Y average P/E minus 1 SD.
  - Bargain valuation in A-share and HK stock markets. On Jun 26, 2023, HSI was at 9.3x forward P/E, 20% lower than its 5Y average P/E of 11.6x. FTSE China A50 Index was at 10.6x forward P/E, 10% lower than its 5Y average P/E of 11.7x.

Exhibit 1: Market Valuation of Benchmark Stock Market Indices

	26/6/2023 Index	Forward P/E	5Y P/E Average	5Y P/E High/Low
MSCI World Index	2895	17.4	18.7	29.3/13.0
MSCI Asia Pacific (excluding Japan)	512	14.2	15.1	23.7/11.0
MSCI Emerging Market Asia Index	529	14.3	13.5	21.4/9.6
S&P 500 Index	4328	19.8	20.4	31.3/14.0
Nasdaq 100 Index	14689	27.8	25.6	38.5/16.7
DJIA Index	33715	18.3	19.2	28.0/13.5
Stoxx 50 Index	4280	12.2	15.4	25.5/9.9
FTSE 100 Index	7453	10.4	13.7	27.5/8.3
Nikkei 225 Index	32699	20.4	21.4	40.4/14.3
Hang Seng Index	18794	9.3	11.6	17.1/8.3
FTSE China A50 Index	12457	10.6	11.7	16.9/8.5

Source(s): Bloomberg, ABCI Securities

Hang Seng Index (HSI)

- **Reasonable trading range in 2H23: 17,700-23,600 (8.7-11.6x est. 2023 P/E)**
- **Cumulation range: 17,700-20,700 (or 8.7x-10.2x est. 2023 P/E)**
- **Profit-taking range: 20,700-23,600 (10.2-11.6x est. 2023 P/E)**

We project that the P/E valuation range of the HSI to be at 8.7x-11.6x in 2H23 with the reasons stated below.

1. The five-year average P/E valuation is at 11.6x with a standard deviation (SD) of 1.43;

2. In view of the global economic risks in 2H23 and estimated earnings growth of HSI stocks, P/E valuation of the index will likely stay below the historical average;

3. Market consensus indicates an expected 2023 earnings growth of 9-10% on average for the index stocks. In our view, the following factors will affect the earnings growth:

   a) Earnings comparison base in 2022 is low after declining for three consecutive years in 2020-22.

   b) Enhanced cost efficiency of large-cap Internet stocks helps improve profitability of core businesses in 2023. Large-cap Internet stocks account for ~ 26% of total weighting in HSI.

   c) Large-cap SOE banks will reduce provisions on credit loss to offset the adverse impacts on NIM contraction to maintain profit growth, assuming China's economy will recover at a faster pace in 2H23. The Chinese commercial banks account for ~11% of total weighting in HSI.

   d) Insurance firms will adopt new accounting treatments in 2023 and will restate 2022 financial statements. As such, profit growth for 2023 can be affected in both directions and will be reflected in their half-year results. Insurance stocks account for ~11% of total weighting in HSI.

   e) High interest rates environment in HK and overseas raises profitability of HK-based banks, which account for ~10% of total weighting in HSI.

   f) Earnings outlook of China property stocks is dim, but they account for less than 2.5% of total weighting of the index; therefore, their influence on the index is minimal despite news in this sector to capture a significant amount of market attention.

   g) The decline of prices of crude and coal will drag down profits of SOE in the industry in 2H23 but will boost profitability of power generation stocks. Crude and coal stocks account for less than 5% of total weighting in HSI.

   h) China consumption-related stocks will be the swing factor due to uneven recovery among consumer subsegments. Profits of telecom services stocks will grow at ~10%; profitability of F&B stocks will rebound, as suggested by the 22.6% YoY growth of catering retail sales in 5M23, according to NBSC. Since subsegments of the consumer sector will differentiate in growth.

4. In view of the expected earnings growth, the fair PE/earnings growth ratio (PEG ratio) will be at ~0.9-1.1x, which represents 8.1-11.0x 2023 expected earnings of the index.

5. Considering the PEG ratio and historical P/E range, we set HSI's fair valuation range at 8.7-11.6x est. 2023 P/E or rounding to 17,700-23,600.

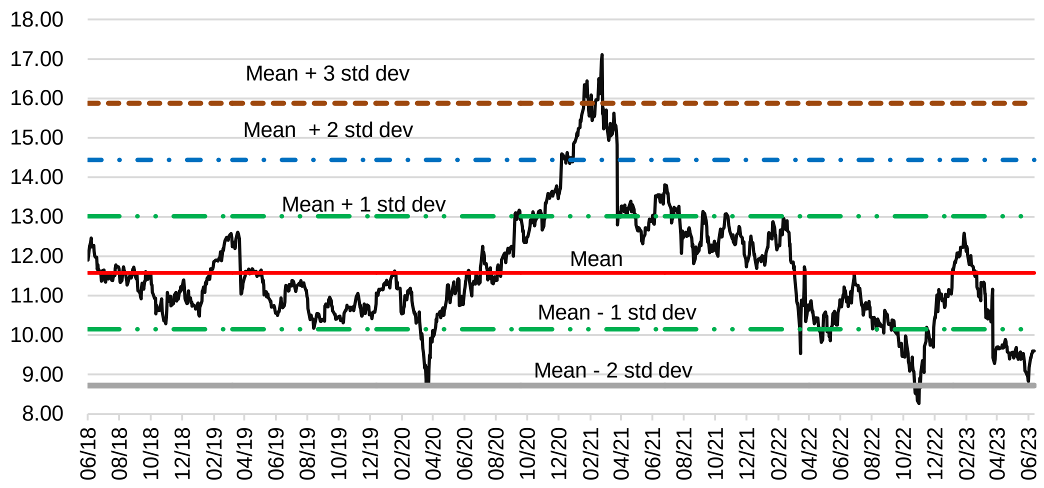
6. We set 17,700-20,700 (or 8.7x-10.2x 2023 P/E) as the cumulating zone and 20,700-23,600 (10.2-11.6x) as the profit-taking zone.

Exhibit 2: HSI Financial and Valuation Projection Summary

	2019	2020	2021	2022	2023E	2024E
EPS (HK$)	2,443.1	2,146.1	2,091.7	1,856.9	2,030.2	2,223.6
Chg	1.7%	-12.2%	-2.5%	-11.2%	9.3%	9.5%
P/E	**-**	**-**	**-**	**10.12**	**9.26**	**8.45**
NBV (HK$)	22,344.9	23,720.1	20,813.2	17,908.0	18,360.0	19,905.9
Chg	10.1%	6.2%	-12.3%	-14.0%	2.5%	8.4%
P/B	**-**	**-**	**-**	**1.05**	**1.02**	**0.94**
DPS (HK$)	992.53	653.7	593.53	665.86	720.64	784.63
Chg	-1.0%	-34.1%	-9.2%	12.2%	8.2%	8.9%
Dividend Yield	**-**	**-**	**-**	**3.54%**	**3.83%**	**4.17%**
EPS / Average NBV	11.5%	9.3%	9.4%	9.6%	11.2%	11.6%

Hang Seng Index: 18,794 (26/6/2023)
Source(s): Bloomberg estimates, ABCI Securities

Exhibit 3: P/E valuation range (6/2018-6/2023)



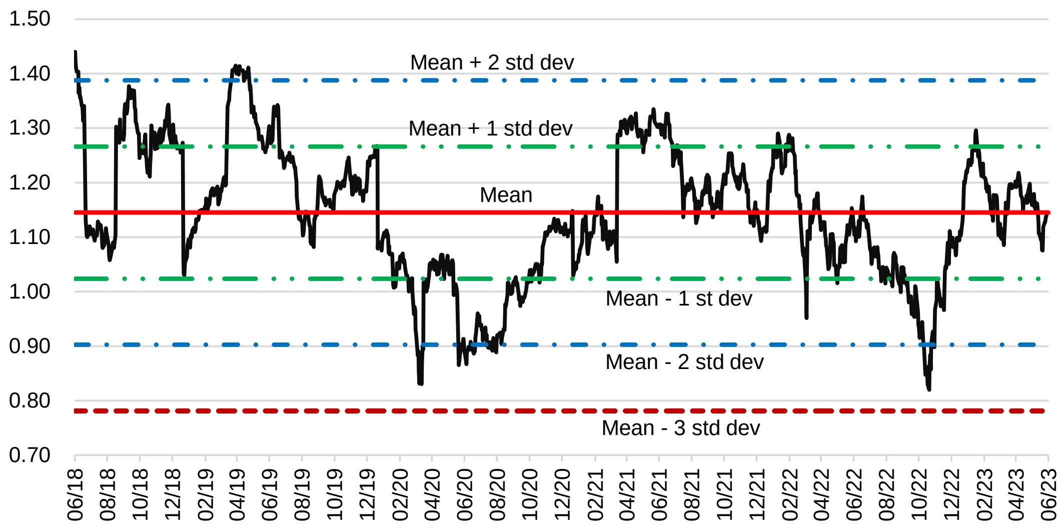
Source(s): Bloomberg, ABCI Securities

Exhibit 4: P/E statistics

Forward P/E (5Y high)	17.11
Forward P/E (5Y low)	8.26
Forward P/E (5Y avg.)	11.58
SD	1.43
Mean + 3 SD	15.87
Mean + 2 SD	14.44
Mean + 1 SD	13.01
Mean	11.58
Mean - 1 SD	10.15
Mean - 2 SD	8.72
Mean - 3 SD	7.29

Source(s): Bloomberg, ABCI Securities

Exhibit 5: P/B valuation range (6/2018-6/2023)



Source(s): Bloomberg, ABCI Securities

Exhibit 6: P/B statistics

Rolling P/B (5Y high)	1.44
Rolling P/B (5Y low)	0.82
Rolling P/B (5Y average)	1.15
SD	0.12
Mean + 3 SD	1.51
Mean + 2 SD	1.39
Mean + 1 SD	1.27
Mean	1.15
Mean - 1 SD	1.02
Mean - 2 SD	0.90
Mean - 3 SD	0.78

Source(s): Bloomberg, ABCI Securities

Hong Kong IPO Market

Analyst: Steve Chow

- **In 1H23, Hong Kong IPO market has raised US$2.1bn vs. US$ 13.4bn in 2022**
- **Weakened economic backdrop, volatility in HK/China equity markets, among others, have reduced IPO activities**
- **We expect the market to improve in 2023 driven by internet/technology sector**

In 1H23 (up to Jun 26, 2023), the Hong Kong IPO market has raised US$ 2.1bn vs. US$ 13.3bn in 2022. In 1H23, a total of 26 IPOs were issued, with an average issue size of US$ 83mn each. IPO activities have been heavily impacted by various factors including weakened economic environment, volatility in HK/China equity market, global geopolitical risk, etc.

In terms of industry mix, consumer staple accounted for 27% of the IPO volume in 1H23, followed by consumer discretionary (16%), industrial (15%), health care (9%), telecom (9%), and others (23%). In particular, there were fewer sizable IPOs during the period, as illustrated by the small average deal size of US$ 83mn in 1H23 vs. US$ 165mn in 2022.

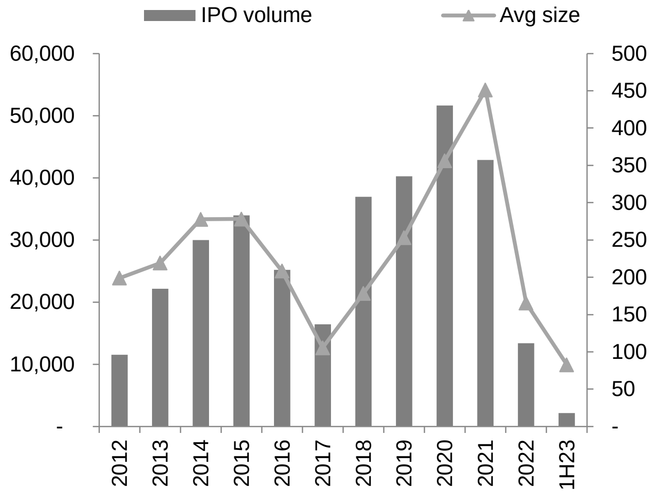
Nonetheless, we expect the Hong Kong IPO market is expected to gradually improve in the coming months. The Hong Kong Stock Exchange has recently introduced a new listing regime for "specialist" technology companies, including next-generation information technology, advanced hardware and software, advanced materials, new energy and environment protection, and new food and agriculture technologies. In addition, Alibaba (9988 HK) has announced business restructuring and spin-off plans which could lead to separate listings of various business units such as Cloud, Cainiao, and Hema in the near future. These developments can contribute to growth of the Hong Kong IPO market in the coming quarters.

Exhibit 1: 1H23 HK IPO Overview *

Industry	Volume (US$ mn)	Avg deal size (US$ mn)
Consumer Staple	575	192
Consumer Discretionary	352	88
Industrial	331	66
Health Care	204	68
Telecom	203	41
Others	486	81

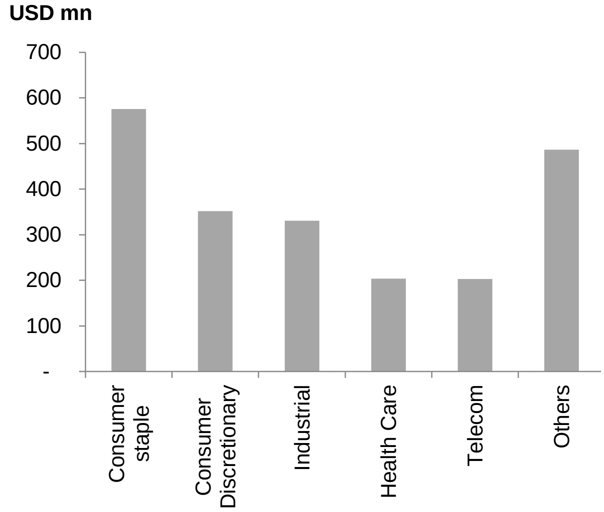
*Up to Jun 26, 2023
Source(s): Bloomberg, ABCI Securities

Exhibit 2: HK IPO volume and average deal size* (USD mn)



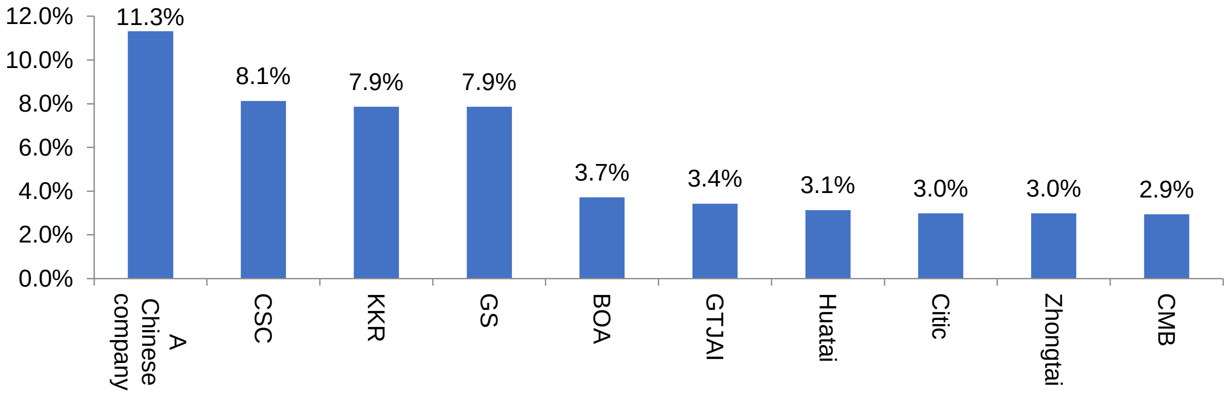
*Up to Jun 26, 2023
Source(s): Bloomberg, ABCI Securities

Exhibit 3: HK IPO volume by industry (1H23)*



Source(s): Bloomberg, ABCI Securities

Exhibit 4 : Market share of HK IPO underwriters by volume (1H23)*



* Up to Jun 26, 2023
Source(s): Bloomberg, ABCI Securities

ABCI Analysts

Sector Outlook

2H23

Note: Stocks selected and mentioned in this report are limited and may not be exhaustive due to ABCI's internal policy

OVERWEIGHT
China Banks Sector – Macro recovery as key to sector fundamentals
Johannes Au

Key Data		**Sector Performance**	**Absolute (%)**	**Relative (%)**
H-shr		**H-shr (relative to MXCN)**		
Avg. 23E P/E (x)	3.56	1-mth	(1.88)	(2.24)
Avg. 23E P/B(x)	0.38	3-mth	0.75	8.18
Avg. 23E div yield (%)	8.64	6-mth	6.28	12.14
A-shr		**A-shr (relative to CSI300)**		
Avg. 23E P/E (x)	4.80	1-mth	(4.37)	(3.33)
Avg. 23E P/B(x)	0.52	3-mth	(2.30)	2.91
Avg. 23E div yield (%)	6.45	6-mth	(3.18)	(1.18)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

- NIM pressure on the ease, assuming further LPR cut in 2H23
- Net fee income growth momentum will be dependent on pace of macro recovery
- Asset quality risk lessens; investor focus shifts to topline growth outlook
- Reiterate **OVERWEIGHT** sector re-rating in both A&H markets. Prefer big banks for stable fundamental and promising dividend yield

NIM trend hinges on macro recovery. Macro recovery pace will be the greatest determinant of the fundamental outlook for the Chinese banks sector. Based on recent trends in average lending rate and deposit rate, we expect NIM pressure to ease in coming quarters after the major loan re-pricing in 1Q23. Specifically, according to the PBOC data, average lending rate of new loans in Mar 2023 rose 20bps QoQ to 4.34% from Dec 2022. Directed by policies, banks have been lowering their deposit rates since Sep 2022 to curb cost pressure from deposit migration. Theoretically, banks are in a better position with lessening NIM pressure in FY23; nonetheless, if macro recovery fails to accelerate, the possibility of further rate cuts could overshadow NIM outlook for another year due to loan re-pricing. 1Y and 5Y LPR have been cut from 3.65% and 4.30% in May-23 to 3.55% and 4.20% in Jun-23, according to National Interbank Funding Center. While our base case assumed 1Y and 5Y LPR further cut to 3.50% and 4.10% by end-23. According to the CBIRC data, system NIM narrowed by 17bps QoQ or 23bps YoY to 1.74% in 1Q23. By category, NIM shrinkage in big banks is more substantial due to greater social responsibility; their average NIM narrowed 21bps QoQ in1Q23, compared to the 16bps/4bps QoQ decline in JSBs/city commercial banks. Robust balance sheet growth and component optimization would remain as the core defensive factors against NIM pressure. All in all, we expect system NIM to lower by 8bps-15bps YoY for FY23E.

Net fee momentum to improve with positive growth. As reflected by banks' 1Q23 results, net fee growth were sluggish on weak capital market and soft retail consumption in past quarters. We believe a revival would be highly dependent on the pace of economic recovery. In addition to the reduction trend in average deposit rates, if capital market performs well, funds in time deposit would continue to shift back to WMPs. This could boost net fee income growth and reduce NIM pressure. On the other hand, more active economic activities could strengthen momentum for consumption and transaction-related fees in banks. Given the lackluster performance in 1Q23, we keep our expectation conservative for growth in FY23, and expect net fee growth to turn positive for some listed banks in 3Q23 when the economy picks up further in 2Q-3Q23. A better outlook could be seen in FY24.

Reducing concerns over asset quality risk. Asset quality risk has been less of a concern to investors since 1Q23. Most banks reported a stable NPL ratio QoQ in 1Q23, thanks to diligent handling. While new NPLs from the real estate sector continue to show, partially due to delayed effect, banks have turned more proactive to manage such portfolios in 1Q23. Overall we project system NPL ratio to remain stable in the rest of FY23 in our base case scenario. Asset quality is highly dependent on macro recovery in China, which means any downturn will shift the spotlight back to banks' risk profiles. As of Mar 2023, system NPL ratio was down QoQ by 1bps QoQ to 1.62%. System provisioning ratio dropped 4bps QoQ to 3.32% and system provision coverage ratio was down 61bps to 205.24% in 1Q23. According to the CBIRC statistics, system net profit rose 1.3% YoY, or increased 12.4% QoQ in 1Q23.

Long-term Outlook

Policy risk and macro outlook will be affecting the China Banks sector. Big banks are taking up social responsibility to support the country. On the policy front, a highly regulated and disciplined business environment is essential to strengthen industry fundamentals in the long run, but short-term share price volatility can increase on policy uncertainties.

Short-term Outlook

Market focus has been shifting from asset quality to topline growth, which is highly correlated with China's macro outlook. Economic growth in coming quarters would be a decisive factor in sector valuation. Still, we believe evidence of continuous improvement in fundamentals would be needed for a vote of confidence from value investors.

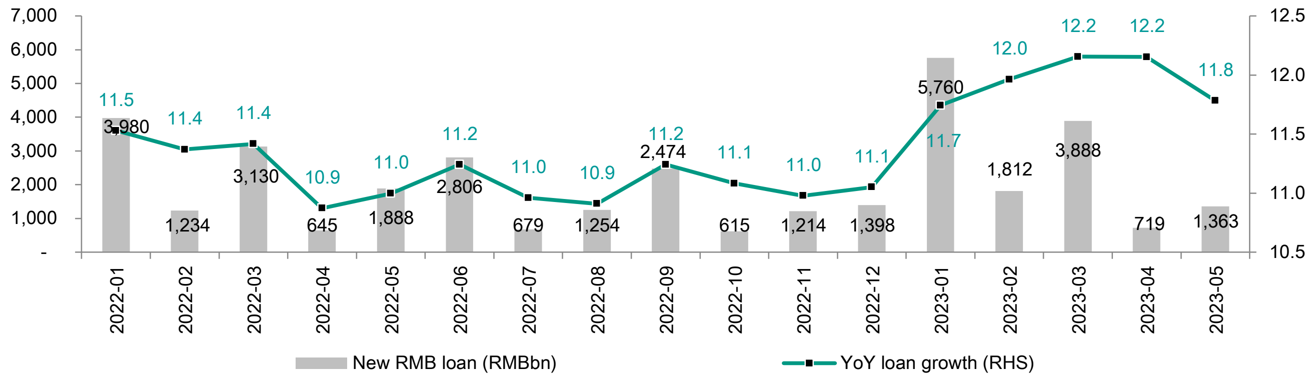
Stock Recommendations

We reiterate our **OVERWEIGHT** rating for the China banks sector in both A/H share markets at its current valuation, as we believe the sector valuation has yet to factor in the potential recovery in macro economy. Sector re-rating will depend on China's economic pace and policy visibility. We prefer leading big banks for their stable fundamentals and promising dividend yield. **CMB (3968 HK, 600036 CH)** is our preferred name among JSBs, given its sector leading profitability and risk buffers.

Risk Factors

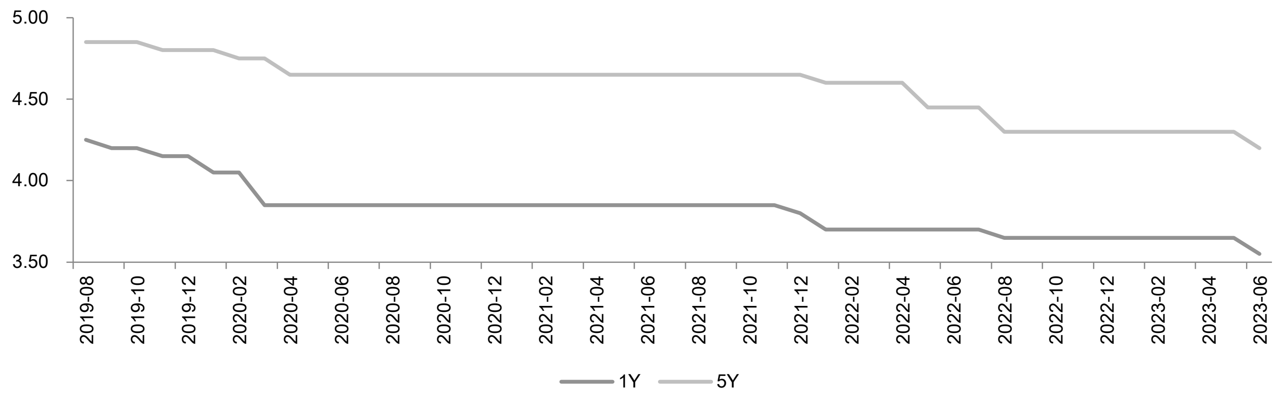
1) Fundamentals tie to macro uncertainties; 2) Sharp deterioration in asset quality in specific sectors; 3) Additional NIM pressure in case of further rate cuts, 4) Slow recovery in net fee income.

Exhibit 1: Monthly RMB loans (RMB bn) and total RMB loan balance YoY (%)



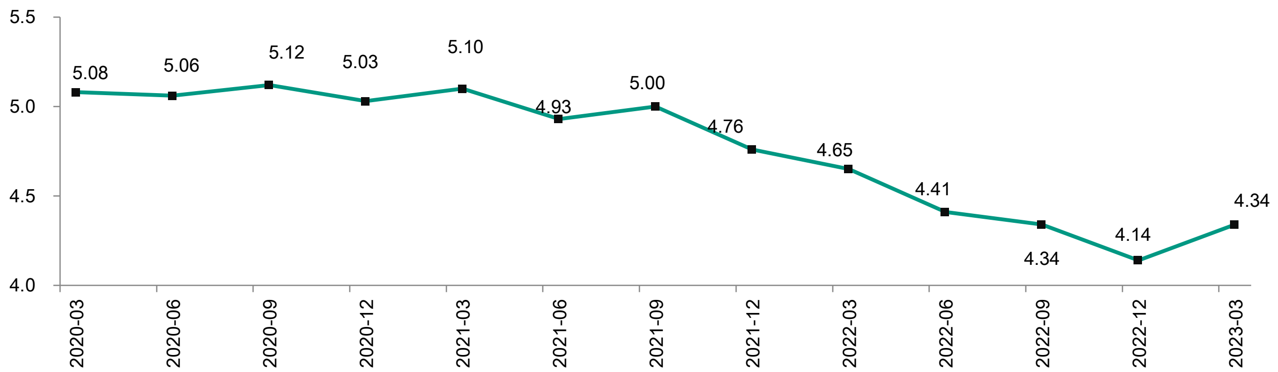
Source(s): PBOC, ABCI Securities

Exhibit 2: China LPR (%)



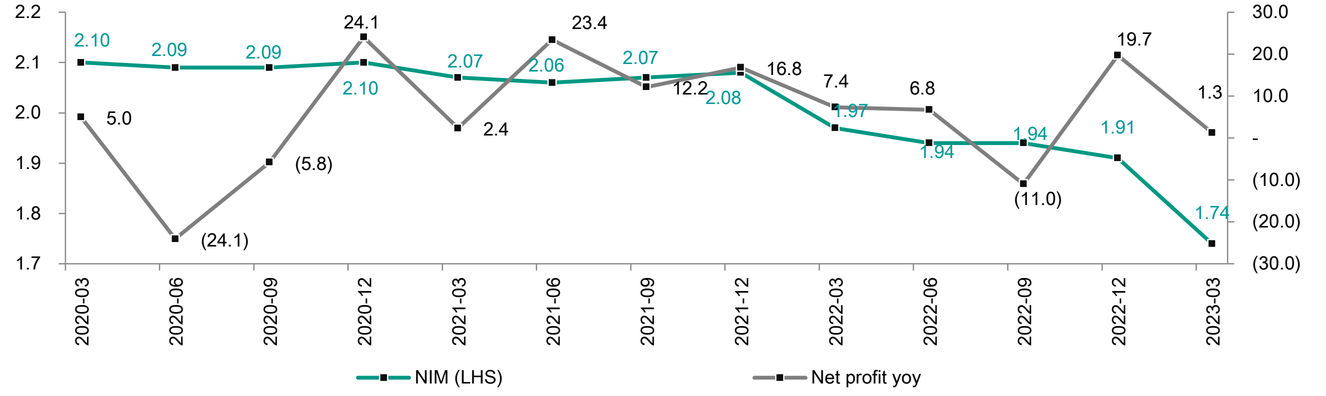
Source(s): PBOC, ABCI Securities

Exhibit 3: System monthly average lending rate (%)



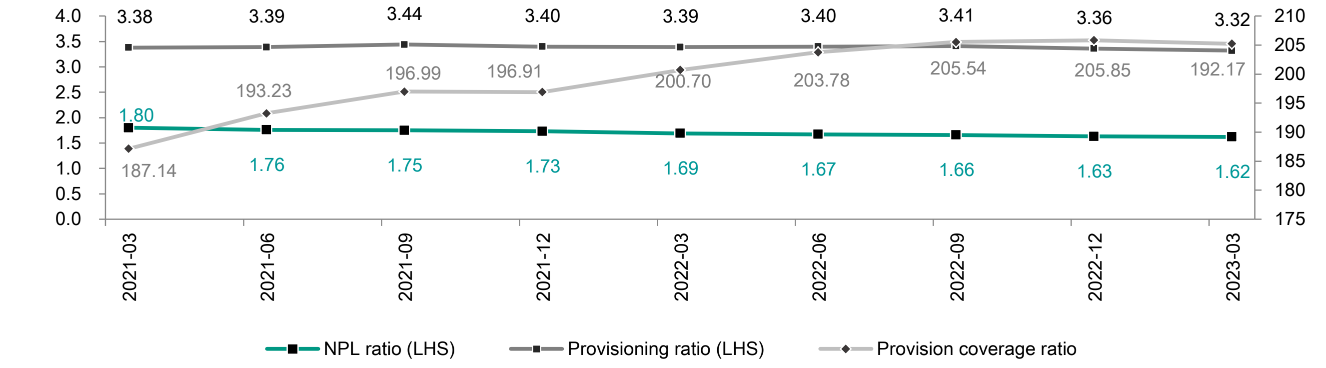
Source(s): PBOC, ABCI Securities

Exhibit 4: System NIM vs. system quarterly net profit YoY (%)



Source(s): NAFR, ABCI Securities

Exhibit 5: System asset quality indicators (%)



Source(s): NAFR, ABCI Securities

Valuation of sector top picks for H-shr market (Data as of Jun 26, 2023)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY23E P/E(x)	FY24E P/E (x)	FY23E P/B (x)	FY24E P/B (x)	FY23E Yield (%)	FY24E Yield (%)
CMB	3968 HK	BUY	53.05	51.36	5.42	4.80	0.87	0.77	6.09	6.87

*As of 26 Jun 2023, the big four Chinese banks are under compliance restriction
Source(s): Bloomberg, ABCI Securities estimates

Valuation of sector top picks for A-shr market (Data as of Jun 26, 2023)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY23E P/E(x)	FY24E P/E (x)	FY23E P/B (x)	FY24E P/B (x)	FY23E Yield (%)	FY24E Yield (%)
CMB	600036 CH	BUY	46.73	43.30	5.44	4.82	0.88	0.78	6.06	6.84

*As of 26 Jun 2023, the big four Chinese banks are under compliance restriction
Source(s): Bloomberg, ABCI Securities estimates

農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

OVERWEIGHT
China Property Sector –Policy stimulus needed
ABCI Securities

Key Data	
Avg. 23E P/E (x)	5.16
Avg. 23E P/B(x)	0.40
Avg. 23E div yield (%)	6.30

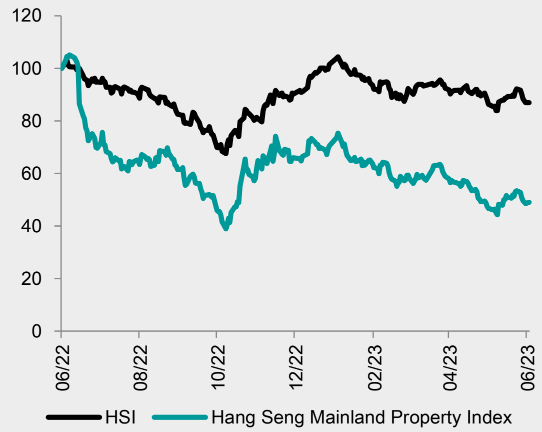
Source(s): Bloomberg, ABCI Securities estimates

Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
1-mth	5.1	4.3
3-mth	(12.7)	(9.3)
6-mth	(25.7)	(22.1)

Source(s): Bloomberg, ABCI Securities

- Expect potential rate and RRR cut to support developers' share price in near term
- Takes time to rebuild buyers' confidence
- We forecast 2H23 contracted sales to be flat, followed by a mild recovery of 5%YoY growth in 2024. Slow land acquisitions over past year will limit sales recovery
- We like **COLI (688 HK)** due to its strong financial position and superior sales performance compared to peers. For the PM sector, we favor **CR MIXC (1209 HK)** for its dominant role in shopping mall management and proactive M&A approach

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Sales momentum slowed; further stimulus needed. In Jan-May 2023, the commercial housing sales in China increased 8.4% YoY to 4.979tr RMB. YoY growth was lower than the 8.8% increase in Jan-Apr. Sales area of commercial housing decreased 0.9% YoY to 464mn sqm, indicating a larger decline compared to the 0.4% decrease in Jan-Apr.

Based on our calculations, sales volume of commercial housing in May increased 6.8% YoY to RMB 1.004tr, significantly lower than the 28.0% increase observed in Apr. Sales area of in May declined 3.0% YoY to 88mn sqm, compared to Apr's 5.5% YoY increase.

While sales in May still showed YoY growth, this can be attributed to the lower base caused by the COVID-related lockdowns in Shanghai and the Yangtze River Delta region in 2022. However, growth in sales volume has slowed significantly, indicating that pent-up demand from previous quarters affected by the pandemic has already been released. To maintain the momentum of recovery, more policy measures will be needed to stimulate demand.

Divergence in sales growth among real estate enterprises continues. Private developers are still hampered by overseas debt default, which affected buyer confidence in presales projects. The recovery of the real estate market still relies on SOEs, in our view.

In recent months, several domestic banks have lowered deposit interest rates, and the market interprets this move as preparation for interest rate cuts. The news of interest rate cuts and reserve requirement reductions may boost share prices of developers but it will take a considerable amount of time to restore buyer confidence and better sales figures.

Slowing property price offers room for further relaxation. In addition, in May 2023, the MoM growth of sales prices for newly built commercial residential properties in 70 large and medium-sized cities decreased while the prices of second-hand residential properties also declined. Among the 70 cities, the number of cities with a MoM price increase decreased. There were 46 cities with a MoM increase in sales prices for newly built commercial residential properties and 15 cities with a MoM increase in sales prices for second-hand residential properties. This represents a decrease of 16 cities and 21 cities, respectively, compared to the previous month.

Looking at newly built commercial residential properties, in May, the MoM increase in sales prices in first-tier cities was 0.1%, a decrease of 0.3ppt compared to the previous month. Among them, Beijing, Shanghai, and Guangzhou saw MoM increases of 0.2%, 0.3%, and 0.1%, respectively while Shenzhen saw a decrease of 0.2%. In second-tier cities; the MoM increase in sales prices was 0.2%, a decrease of 0.2ppt compared to Apr. In third-tier cities, the MoM increase in sales prices for newly built commercial residential properties changed from 0.2% in the previous month to flat.

Stock Recommendations

■ **Developers:**

Prefer SOEs to POEs. Homebuyers and investors will prefer SOEs instead of private names due to the former's ability to secure funding for project completion. SOE developers, **COLI**'s **(688 HK),** and **Yuexiu**'s **(123 HK),** rose 55% and 101% in 5M23 contracted sales (peer average at 8%YoY). Our top pick among large-cap stocks is **COLI** given its healthy net gearing of 43% and an average financing cost of 3.57% as of Dec 2022 (only ~2bp higher compared to the previous year). With its strong balance sheet, COLI is well-positioned for expanding its landbank and M&A. **Yuexiu (123 HK)** is also our preferred small/mid-cap pick due to its profitable Transit-Oriented Development (TOD) model and the support it receives from its strategic shareholder, GZ Metro.

■ **PMCs:**

Public projects reassure SOE players a better growth profile. We prefer SOE players for the PM sector given better prospect in securing new public projects. **CR MIXC (1209 HK)** is our top choice among large-cap stocks due to its dominant position in shopping mall management and its proactive M&A approach. Our small/mid-cap pick is **Yuexiu Services (6626 HK)**, which specializes in Transit-Oriented Development (TOD) management.

Risk Factors

■ **Developers:**

1) Margin erosion on price cut; 2) Impairment provision for unsold inventories due to steep decline in property prices; 3) Unsuccessful bond refinancing

■ **PMCs:**

1) Corporate governance issues on substantial related-party transactions; 2) Heavy reliance on parents for new projects; 3) Potential margin erosion caused by M&A; 4) Debt repayment of parent developers increases placement risks.

Valuation of sector top picks (Data as of Jun 26, 2023)

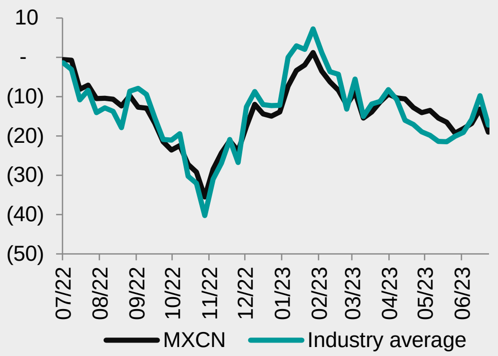
Company	Ticker	Rating	TP (HK$)	Upside (%)	FY23E P/E(x)	FY24E P/E (x)	FY23E P/B (x)	FY24E P/B (x)	FY23E Yield (%)	FY24E Yield (%)
COLI	688 HK	BUY	31.50	93.0	6.15	5.57	0.42	0.40	5.30	5.84
Yuexiu	123 HK	BUY	13.25	51.8	6.49	5.78	0.52	0.49	6.05	6.76
CR MIXC	1209 HK	BUY	36.60	(2.7)	28.1	22.0	4.86	4.21	1.56	1.99
Yuexiu Services	6626 HK	BUY	4.71	63.5	8.18	6.68	1.13	1.01	4.27	5.31

Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Internet Sector– A mixed bag
Steve Chow

Key Data		Sector Performance (relative to MXCN)	Absolute (%)	Relative (%)
Avg. 23E P/E (x)	25.5	1-mth	3.2	(0.3)
Avg. 23E P/B(x)	3.2	3-mth	(7.8)	(7.4)
Avg. 23E div yield (%)	1.3	6-mth	(9.4)	(5.8)
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

1-year sector performance



Source(s):Bloomberg, ABCI Securities

- Near-term margin pressure manageable for major e-commerce platforms
- Online gaming growth driven by new game launches
- Tencent and Alibaba have been the leaders in R&D spending with strong foundation in AI development

E-commerce – Manageable margin pressure. After implementing strict cost control during the pandemic, major e-commerce platforms are increasing their sales and marketing effort by increasing user incentives and price subsidies. In our view, online shoppers have turned price-sensitive in past years due to the pandemic and soft economic environment, prompting e-commerce platforms to enhance price competitiveness. In addition, selected short video platforms, such as Douyin, are entering the in-store market, leading to intensified competition in that segment. On a positive note, we believe near-term margin pressure could be manageable for major e-commerce platforms thanks to their operational improvement and cost control in the past years.

On the macro front, online sales of physical goods in China improved 11.8% YoY in 5M23 vs. 6.2% in 2022. Online shopping penetration rate was 25.6% in 5M23 vs. 27.2% in 2022, indicating normalization of consumption pattern online and offline at the post-pandemic stage. In particular, online sales of food products and groceries rose 8.4% and 11.5% in 5M23, lower than the sector average, meaning that consumers are no longer stocking food and groceries products as pandemic wanes.

Online gaming: A better picture. Compared to the e-commerce market, the online gaming market would have better near-term prospects due to 1) an easier comparable base due to the weak growth in 2022; 2) more game launch since approval for new games has resumed in recent months. E.g., Tencent's (700 HK) online gaming revenue grew 1% YoY in 1Q23 (down 2% YoY in 4Q22). In coming months, we estimate the Group to launch about five new games; 3) regulatory hurdle entailed in new game approvals and long development cycles of blockbuster games discourage potential new entrants such as short-video platforms. As a result, the competitions remain largely among the dominant players (Tencent, NetEase [9999 HK; NTES US] and MiHoYo) in the industry.

R&D spending is key to AI development. AI has become a key R&D focus lately and major internet platforms are planning to develop their own AI products. In our view, the industry is still in the early stage of a long-term race and R&D resources and capabilities will be the key winning factor. Among the major online platforms in China, Alibaba (9988 HK/ BABA US) and Tencent have been the biggest spenders in R&D. Their larger operational scale and stronger financial position will enable them to invest in new technologies, including AI, to increase long-term competitiveness.

Stock Recommendations

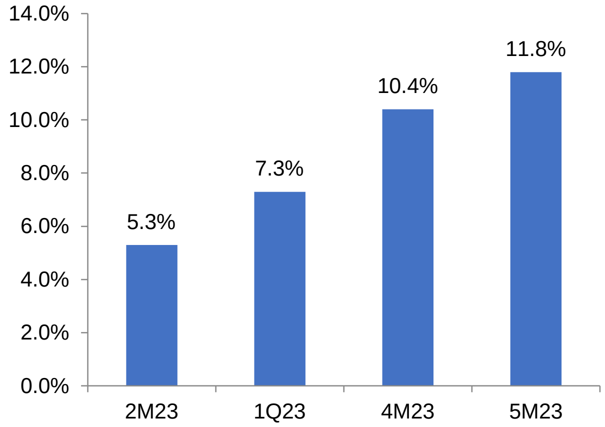
Tencent (700 HK): We like Tencent's leading position in online entertainment market and long-term potential in AI development. Tencent's core profit growth has seen sequential improvement in recent quarters (2%/19%/27% YoY in 3Q22/4Q22/1Q23), indicating an improving operating environment. Core net margin improved from 18.9% in 1Q22 to 21.7% in 1Q23, showing ongoing cost optimization. In addition, we see broad-based recovery in 1Q23. Online games turned around in 1Q23 with an 11% YoY revenue growth vs. the 2% YoY drop in the previous quarter. In the coming months, we estimate 5-6 new games will be launched. 1Q23 online advertising revenue grew 17% YoY, driven by broad-base recovery in advertising spending and continuous ramp-up in Video Accounts. Revenue of FinTech and business service went up 14% YoY in 1Q23 compared to the 1% drop in 4Q22, thanks to recovery in commercial payment.

Alibaba (9988 HK/ BABA US): As the largest ecommerce platform in China, we believe its current valuation at about 9.1x FY24E core P/E presents an entry point for long-term investors. It plans to fully divest its Cloud business via stock dividend distribution to shareholders within 12 months. For businesses with less synergy with its core e-commerce business, such as Digital media and Entertainment, we believe Alibaba might follow a similar route to divest most, if not all, stakes. For business units with higher e-commerce synergies (Cainiao/local services/global digital commerce), Alibaba will likely maintain a sizable ownership after their respective IPOs. Overall, potential room for enhancing shareholders' return will depend on the amount of funds raised via future IPOs/asset disposal.

Risk Factors

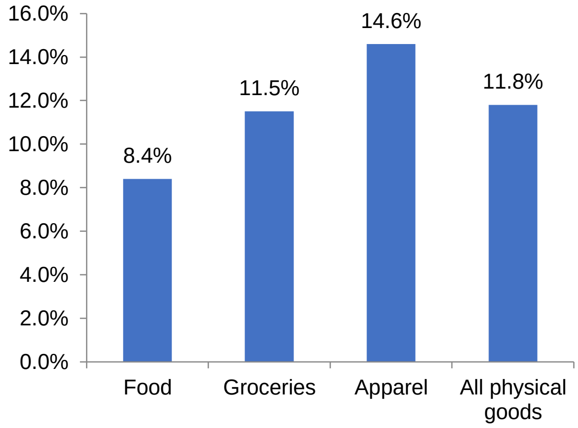
1) Regulatory risk such as anti-trust investigations; 2) Slowdown in ecommerce and internet finance; 3) Non-GAAP financials.

Exhibit 1: Online sales of physical goods (YoY)



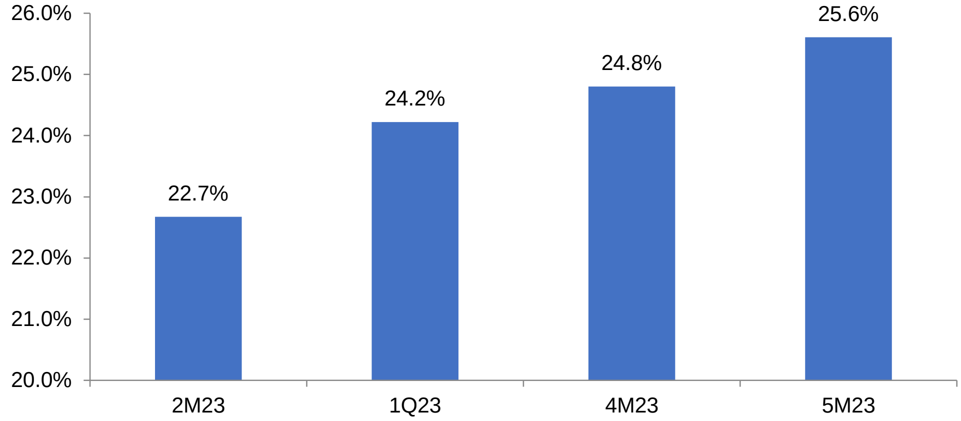
Source(s): NBS, ABCI Securities

Exhibit 2: Online sales of physical goods by category (5M23, YoY)



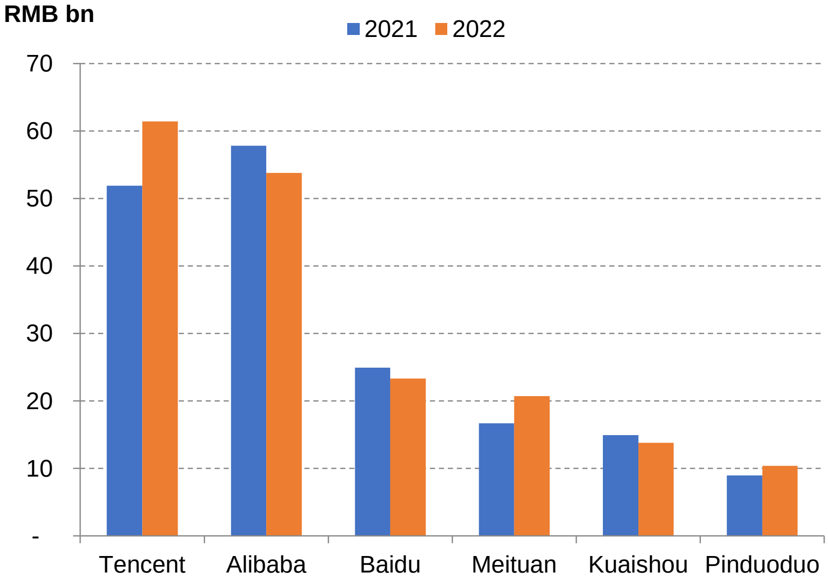
Source(s): NBS, ABCI Securities

Exhibit 3: Online shopping penetration rate



Source(s): NBS, ABCI Securities

Exhibit 4: R&D spending of major internet platforms



Source(s): Companies, ABCI Securities

Valuation of sector top picks (Data as of Jun 26, 2023)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY23E P/E(x)	FY24E P/E (x)	FY23E P/B (x)	FY24E P/B (x)	FY23E Yield (%)	FY24E Yield (%)
Alibaba	9988 HK	BUY	130	55.7%	10.2	9.1	1.4	1.3	NA	NA
Tencent	700 HK	BUY	450	35.5%	20.4	17.3	3.6	3.2	0.7%	0.7%

Source(s): Bloomberg, ABCI Securities estimates

ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

OVERWEIGHT
China Consumer Sector – Post-pandemic recovery needs luster
Paul Pan

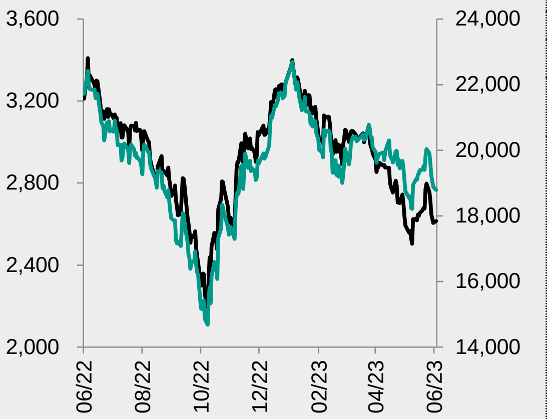
Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 23E P/E (x)	17.46	1-mth	0.8	0.6
Avg. 23E P/B(x)	2.88	3-mth	(14.4)	(8.8)
Avg. 23E div yield (%)	3.43	6-mth	(13.8)	(9.7)

Source(s):Bloomberg, ABCI Securities

Source(s):Bloomberg, ABCI Securities

- Post-pandemic recovery has shown waning momentum, though certain subsegments have been outperforming
- As expected, inflationary pressure has been mild since the beginning of 2023
- Anticipate further measures from local governments to stimulate consumption
- Changing dynamics of e-commerce space reflects intensifying competition among sector players
- Our top pick is **Yum China (YUMC US/9987 HK)**, backed by strong catering retail sales growth in 5M23 and its 1Q23 operating performance

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

Post-pandemic recovery has been an uphill battle despite initial boost. Although the removal of COVID-19 social-distancing measures sparked growth momentum in national retail sales during early 2023, this momentum quickly subsided. National retail sales growth, which hit 18.4% YoY in Apr 2023, decreased to 12.7% YoY in May 2023.Moreover, according to our calculations, retail sales of all commodities categories by enterprises above designated size encountered monthly decline in Apr. Specifically, "cosmetics" and "cultural and office appliances" witnessed monthly drops exceeding 25%. We believe that the degree of post-pandemic restoration and revenge spending was lower than anticipated, owing to uncertainties in the general economic prospects and state of employment. Nonetheless, certain subsegments showed consistent recovery. The catering industry, in particular, experienced a massive surge in retail sales growth with rates of 26.3% YoY, 43.8% YoY, and 35.1% YoY in March, Apr, and May 2023, respectively. This considerable boost in sales greatly outpaced other consumer goods categories, pointing towards an upswing in dine-out demand following the easing of pandemic restrictions.

Inflationary pressure turns mild. CPI has been declining since the beginning of 2023. Meat products in particular have seen price reductions. In May 2023, CPI reached 0.2% YoY and -0.2% MoM, compared to 2.1% YoY and 0.8% MoM in January 2023; CPI of pork was at -3.2% YoY, the lowest among all food product categories. In addition, according to MOA, the weekly average wholesale prices of pork, chicken, and egg as of the third week of Jun 2023 were down 28%, 5%, and 11% YTD. The mild inflationary pressure is expected to reduce consumers' cost of living, which would in turn support sector recovery.

More policies to boost consumption are expected. In an effort to stimulate consumption, certain provinces have announced policies and measures in recent months.

- In Apr 2023, the government of Hubei Province released "Policies to Serve Market Entities and Promote Stable Economic Development" ("Hubei Policies"). "Hubei Policies" unveiled a RMB 50bn consumption loan program. Of this, RMB 30bn is available in the first phase, with a focus on targeting provincial residents' consumption of automobiles, home appliances, and home decoration items. Moreover, “Hubei Policies” offer a maximum interest payment subsidy of RMB 3k and 1.5% APR for individuals applying for loans exceeding RMB 10k for a single transaction between Apr 1, 2023 and Dec 31, 2023.

- In Jun 2023, the government of Hainan Province released the "2023 Measures to Support Consumption" ("Hainan Measures"), which outlines several initiatives to bolster consumption. Examples of initiatives include hosting events, promoting cultural and tourism-based consumption, distributing consumption vouchers. In particular, “Hainan Measures” specified offshore duty-free shopping vouchers amounting to RMB 30mn would be provided by Department of Commerce of Hainan Province, and the first phase of such vouchers amounting to RMB 10mn will be distributed between Jun 22, 2023 and Jul 12, 2023 through the UnionPay app. In addition, RMB 70mn of funding allocated by Department of Finance of Hainan Province will be used to support municipal government and local enterprises organizing local-level activities to boost consumption.

We anticipate local governments to accelerate policy rollouts in the coming months, as consumption recovery has been slower than initially anticipated. The efficacy of these measures will hinge on both consumers’ willingness to spend and macroeconomic improvement.

Changing e-commerce space reflects intensifying competition. For this year's 618 promotion period, figures revealed by the major platforms show live-streaming activities saw significant YoY growth. The number of live-streaming activities on Taobao has surged 139%, and the number of live-streaming events that generated sales over RMB 100mn increased by 66%. Douyin saw a healthy increase of 66% in sales volume. Kuaishou (1024 HK) had a staggering 210% YoY upsurge in order volume from short-form videos. As the interactive element of the online shopping experience gains importance, traditional e-commerce giants would face challenges from new market entrants, such as live-streaming and video platforms, due to changes in consumer behavior and active cultivation of new revenue streams by these platforms. We believe such changes in the e-commerce space reflects intensifying competition in the post-pandemic consumer market, where companies would need to be more proactive in capturing consumers' interest, increasing awareness of their products, and conducting promotions aimed at boosting sales. Sector players will need to invest on such activities to grow their market presence.

Sector development is uneven. The performance of companies in the consumer sector reflects the macroeconomic trends. While some companies in the catering industry experienced solid operating performance, companies in other subsegments faced lower growth. May 2023 macroeconomic data suggests players’ performance in the sector will further diverge. We anticipate sector growth recovery and changing fundamentals, including higher financial leverage, will contribute to higher stock price volatility.

Long-term Outlook

Despite the potential long-term overhangs resulting from a declining birth rate and population, companies in this sector will continue to benefit from a large and diverse consumer demand.

Short-term Outlook

The consumer market grapples with short-term challenges caused by macroeconomic uncertainties and a slower-than-anticipated recovery. Business performance of sector players is expected to vary, resulting in fluctuations in share prices. In this context, certain players may outperform based on their heightened sensitivity to post-pandemic recovery dynamics.

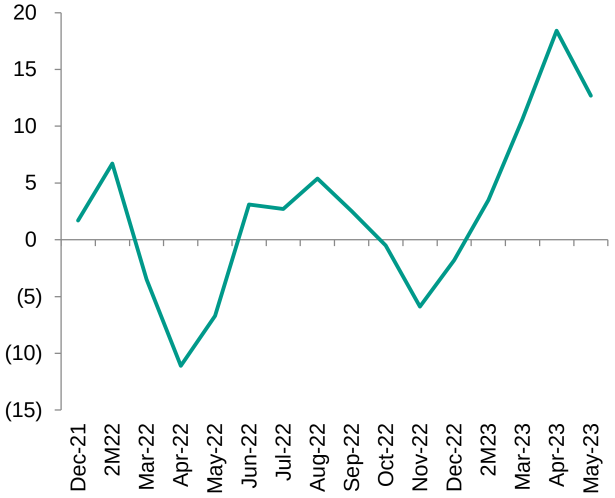
Stock Recommendation

Our sector rating stands at **OVERWEIGHT**. Restaurant operators would see better performance as catering industry enjoys continuous upsurge of post-pandemic demand. Aside from the macroeconomic condition, we believe stock price volatility would also be affected by changing fundamentals during the challenging recovery, which may include uneven margin performance, lower revenue growth momentum, and increase in financial leverage. We expect leading industry players to remain resilient. The suppressed valuation of the sector at present would improve once the macro condition shows signs of turning around. **Yum China (YUMC US/9987 HK)** is our top pick.

Risk Factors

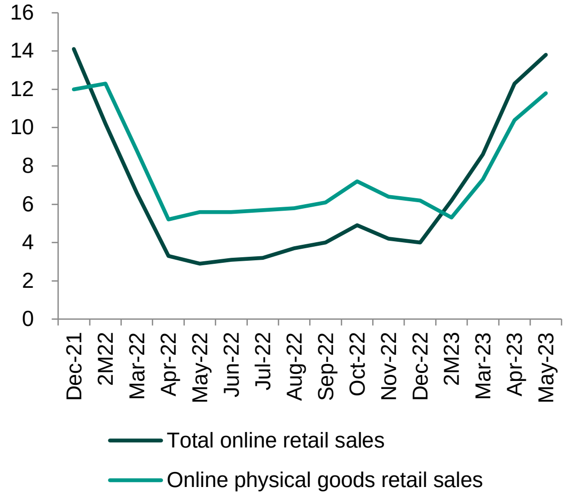
1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Product quality/safety risk; 4) Changing consumer tastes; 5) Higher financial leverage for some sector players.

Exhibit 1: National retail sales change (YoY %)



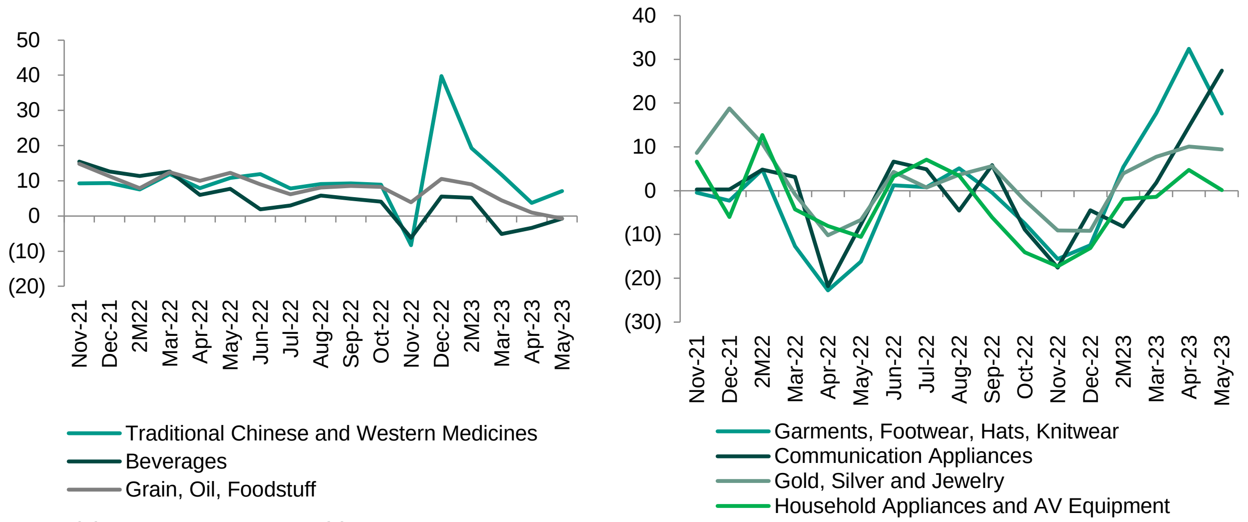
Source(s): NBS, ABCI Securities

Exhibit 2: Online retails sales change (YTD YoY %)



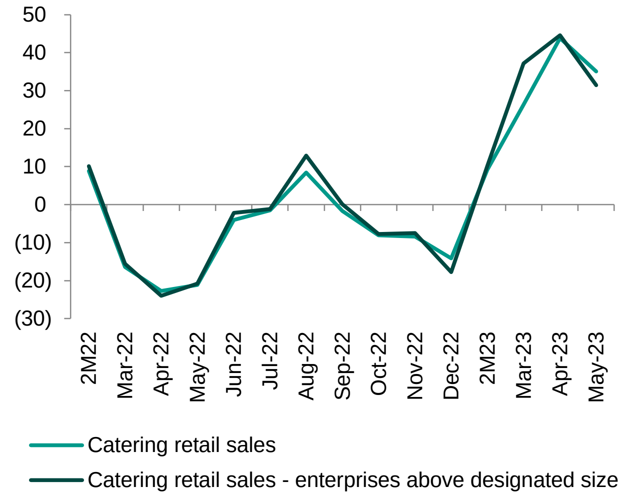
Source(s): NBS, ABCI Securities

Exhibit 3: Retail sales change of certain product categories (YoY %)



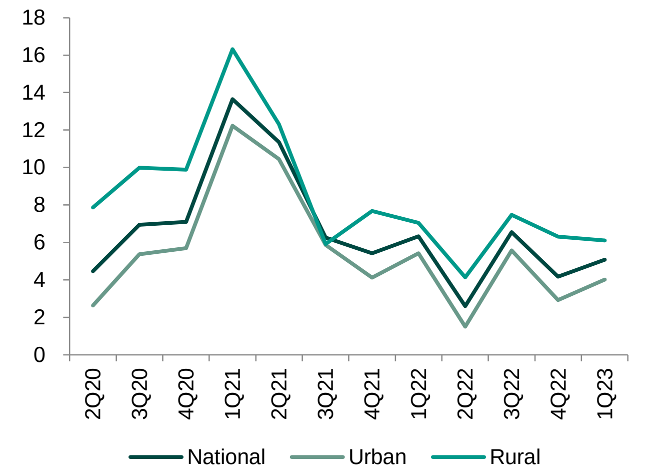
Source(s): NBS, ABCI Securities

Exhibit 4: Catering retail sales change (YoY %)



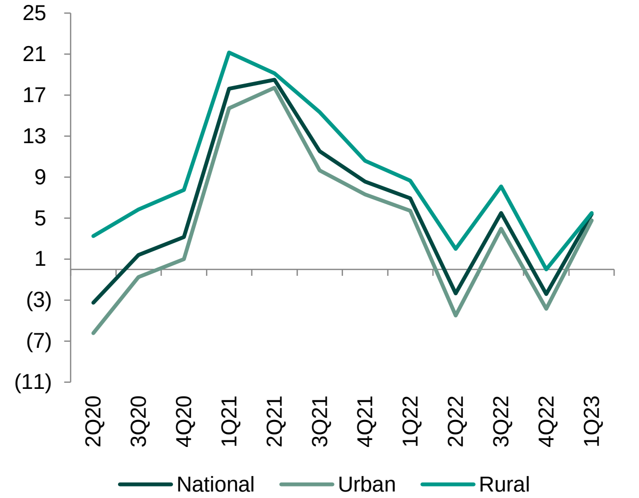
Source(s): NBS, ABCI Securities

Exhibit 5: Per capita income change (YoY %)



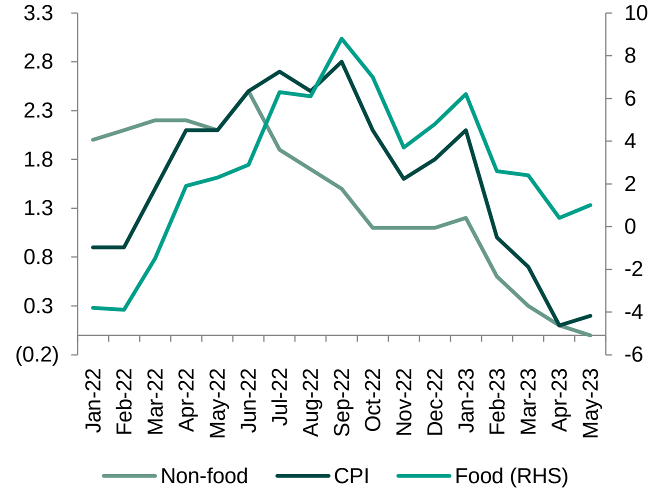
Source(s): NBS, ABCI Securities

Exhibit 6: Per capita spending change (YoY %)



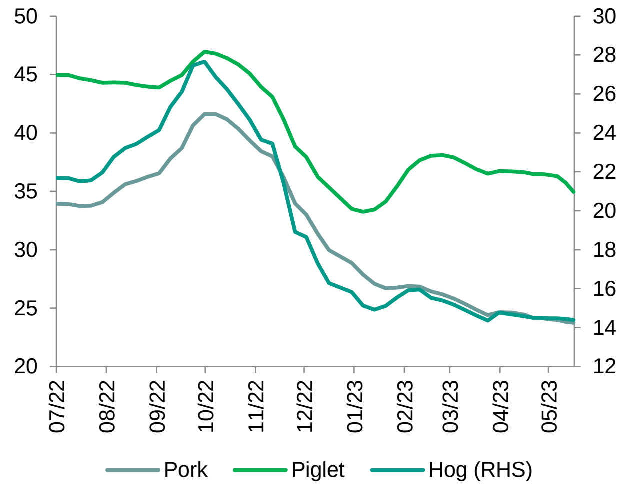
Source(s): NBS, ABCI Securities

Exhibit 7: CPI (YoY %)



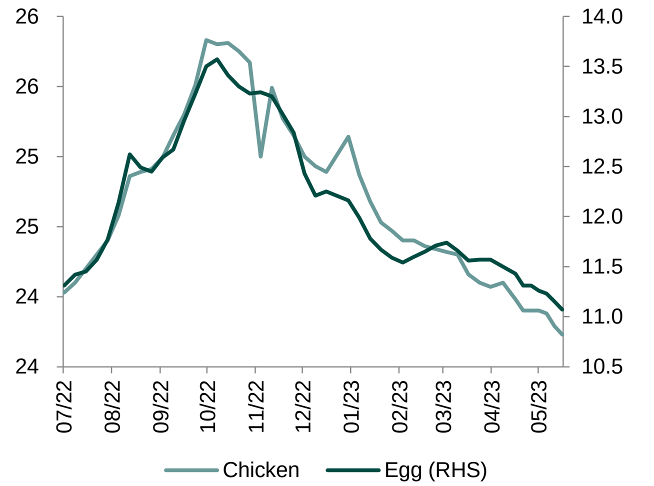
Source(s): NBS, ABCI Securities

Exhibit 8: Weekly average wholesale price of pork, piglet, and hog (RMB/kg)



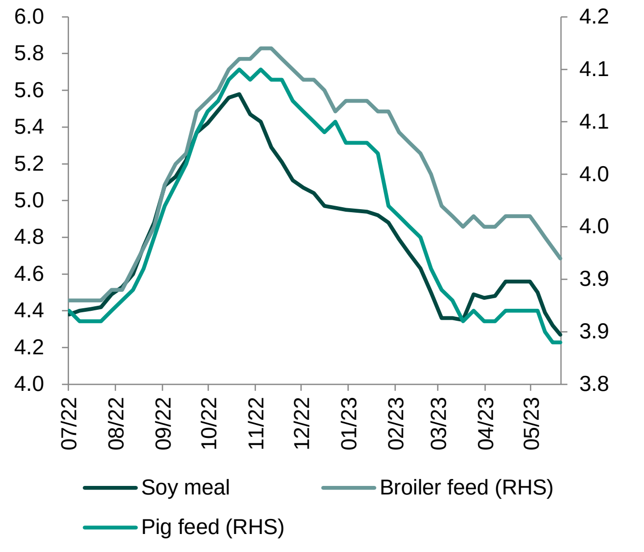
Source(s): MOA, ABCI Securities

Exhibit 9: Weekly average wholesale price of egg and chicken (RMB/kg)



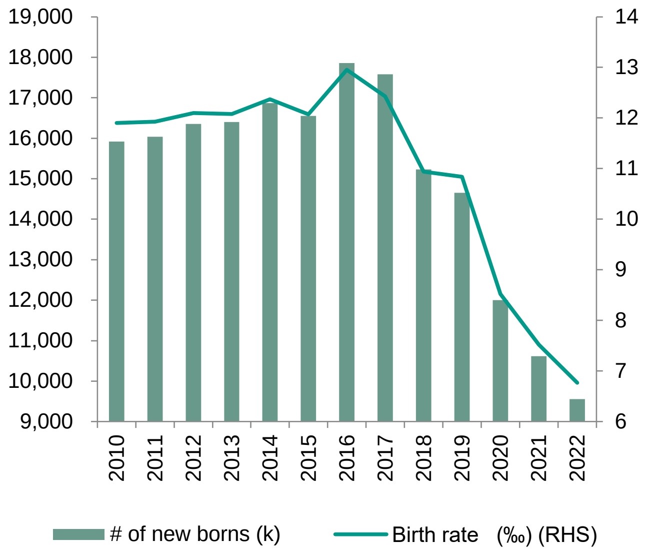
Source(s): MOA, ABCI Securities

Exhibit 10: Weekly average wholesale price of soy mean, pig feed, and broiler feed (RMB/kg)



Source(s): MOA, ABCI Securities

Exhibit 11: Birth rate and number of newborns



Source(s): NBS, ABCI Securities

Valuation of sector top picks (Data as of Jun 26, 2023)

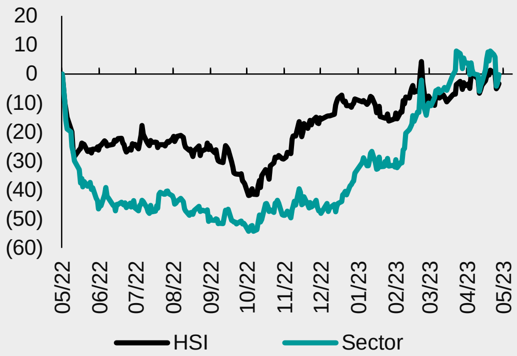
Company	Ticker	Rating	TP	Upside (%)	FY23E P/E(x)	FY24E P/E (x)	FY23E P/B (x)	FY24E P/B (x)	FY23E Yield (%)	FY24E Yield (%)
Yum China	YUMC US	BUY	US$ 72.7	29.09	27.31	22.37	3.35	2.96	0.9	0.9
Yum China	9987 HK	BUY	HK$ 570.3	27.93	27.58	22.57	3.38	2.99	0.9	0.8

USD/HKD = 7.85
Source(s): Bloomberg, ABCI Securities estimates

OVERWEIGHT
China Telecom Sector–Development of digital economy
Ricky Lai

Key Data		Sector Performance (relative to HSI)	Absolute (%)	Relative (%)
Avg. 23E P/E (x)	8.10	1-mth	(6.6%)	(0.8%)
Avg. 23E P/B(x)	1.10	3-mth	(2.4%)	3.7%
Avg. 23E div yield (%)	7.50	6-mth	1.6%	1.6%
Source(s):Bloomberg, ABCI Securities estimates		Source(s):Bloomberg, ABCI Securities		

1-year sector performance (%)



Source(s):Bloomberg, ABCI Securities

- China's development in digital economy will support the growth of new infrastructures (5G network, data centers, etc.)
- Telecom operators are benefiting from growth in emerging businesses (industrial internet, data center, cloud computing)
- Overall 5G base stations in China are estimated to reach 2.91mn in 2023E, improving 5G network coverage
- **China Mobile (941 HK/ 600941 CH)** is our top pick for its high dividend yield, healthy balance sheet, and dominant position in China's telecom market

Telecom operators to benefit from digital economy. In 2023, China's development in digital economy will support the growth of data centers and cloud computing. Emerging businesses revenue (industrial internet, data center, cloud computing) of telecom operators will surge in 2023E due to the proliferation of cloud platform applications and supportive policies. By teaming up with large corporations, telecom operators can ripe benefits of the scale effect in developing cloud platform solutions. Also, NDRC's "East-to-West Computing Resources Transfer" strategy to develop data centers in the western region will improve data processing capacity and boost cloud computing adoption.

5G user penetration rate to reach 39.0% in 2023E. We forecast 5G user penetration rate to reach 39.0% by the end of 2023E, driven by better 5G network coverage and aggressive pricing strategy. China Mobile maintains its dominant position in 5G market, thanks to improved 5G network coverage, abundant resources, and efficient marketing strategies. For 2023E, we expect the total number of 5G base stations to reach 2.91mn, which could support the business of base stations equipment providers. Overall mobile base stations are expected to reach 11.43mn in 2023E. Also, telecom operators are upgrading their 5G telecom network to standalone standard to improve network quality, which can support sales of telecom equipment providers.

Telecom operators' CAPEX are expected to rise 2.0% YoY in 2023E on cloud computing and data center. We estimate the 2023E aggregate CAPEX of the three major telecom operators (China Mobile [941 HK/ 60941 CH] / China Unicom [762 HK] / China Telecom [728 HK/601728 CH]) to be RMB 359.1 bn, up 2.0% YoY. The rise in CAPEX is expected to benefit telecom equipment makers and service providers.

Weak global smartphone shipments affect electronic components demand. According to IDC, global smartphone shipment declined 14.6% YoY to 268.6mn in 1Q23, the seventh consecutive quarter with YoY drop. The decrease can be attributed to inflation in overseas markets and softening economic environment. The weak smartphone shipments are expected to affect the upstream electronic components demand.

Long-term Outlook

In the long term, we expect telecom operators to benefit from 5G network development and emerging businesses. The higher 5G user penetration rate, higher average mobile data usage per user and mobile ARPU will bolster telecom operators' revenue. Telecom operators are introducing aggressive pricing strategies to grow new 5G users. A plethora of supportive policies are in place to encourage adoption of 5G services and emerging businesses, such as NDRC's "East-to-West Computing Resources Transfer" strategy to develop data centers in western regions to improve data processing capacity and boost cloud computing adoption.

Short-term Outlook

In the short term, we expect emerging businesses to drive growth in telecom operators. Many commercial companies are transferring their businesses to the cloud platform, which will push up adoption rate. We expect mobile service revenue to go up on higher mobile ARPU driven by increased mobile data usage and broadened 5G user base.

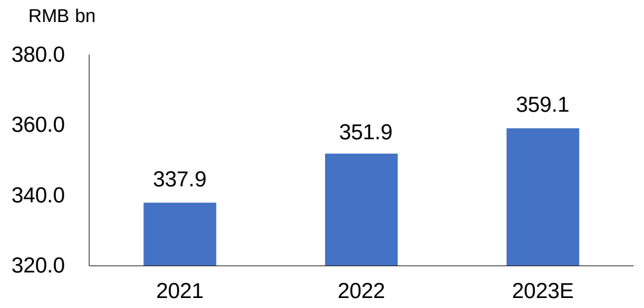
Stock Recommendations

China Mobile (941 HK) is our sector top pick. We expect China Mobile's mobile ARPU to grow on higher 5G user base and cloud computing development. The Group has the largest 5G market share thanks to its network advantage with better coverage and resources. Our TP is HK$ 88.00 for H-Share (941 HK), which implies 3.8x FY23E EV/EBITDA, and RMB128.00 for A-Share (600941 CH), which implies 6.6x FY23E EV/EBITDA.

Risk Factors

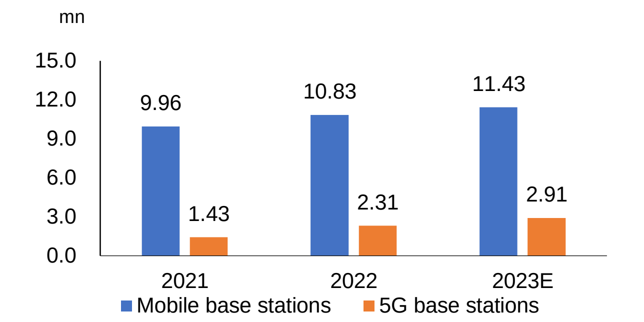
1) Further reduction in service tariff as requested by authorities; 2) User saturation; 3) Intensifying market competition; 4) Slower growth in smartphone shipments; 5) Slowdown in 5G network development.

Exhibit 1: Telecom operators' CAPEX



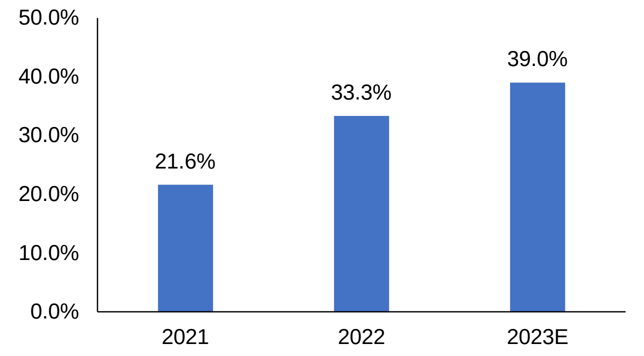
Source(s): MIIT, ABCI Securities estimates

Exhibit 2: The number of mobile and 5G base stations



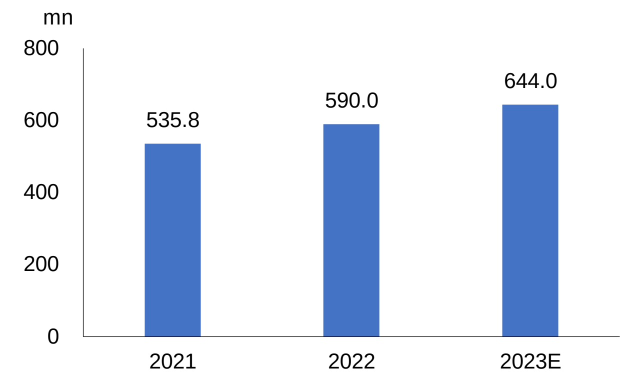
Source(s): MIIT, ABCI Securities estimates

Exhibit 3: 5G user penetration rate



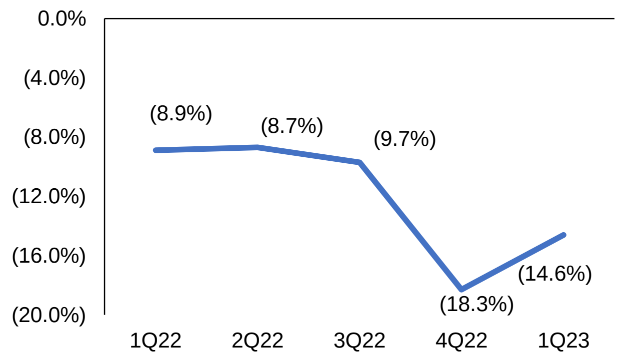
Source(s): Companies, ABCI Securities estimates

Exhibit 4: Wireline broadband users



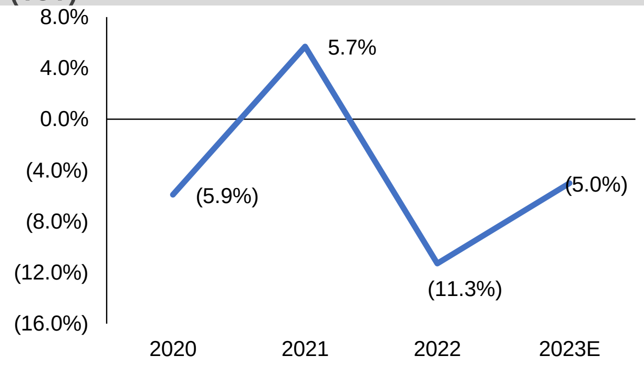
Source(s): Companies, ABCI Securities estimates

Exhibit 5: Quarter smartphone shipment growth (YoY)



Source(s): IDC, ABCI Securities

Exhibit 6: Yearly smartphone shipment growth (YoY)



Source(s): IDC, ABCI Securities estimates

Valuation of sector top picks (Data as of Jun 26, 2023)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY23E P/E(x)	FY24E P/E (x)	FY23E P/B (x)	FY24E P/B (x)	FY23E Yield (%)	FY24E Yield (%)
China Mobile	941 HK	BUY	88.00	38.8	8.6	7.2	0.98	0.89	8.0	9.5
China Mobile	600941 CH	BUY	RMB 128.00	37.6	14.5	12.0	1.51	1.40	4.8	5.9
China Unicom	762 HK	BUY	6.20	22.5	7.9	7.0	0.58	0.49	6.6	7.3
China Telecom	728 HK	BUY	4.80	29.7	10.1	8.4	0.82	0.71	5.8	6.1
China Telecom	601728 CH	BUY	RMB 7.70	36.3	17.6	15.1	1.30	1.21	4.9	5.2
AAC Tech	2018 HK	SELL	12.50	(28.7)	18.0	15.6	0.85	0.79	0.0	1.2
Sunny Optical	2382 HK	HOLD	93.00	27.5	25.0	22.5	1.90	1.40	1.2	1.4
China Tower	788 HK	BUY	1.10	27.9	14.2	11.9	0.83	0.75	3.7	4.6
Xiaomi	1810 HK	HOLD	12.00	15.2	12.4	11.8	1.50	1.39	0.0	0.0

Source(s): Bloomberg, ABCI Securities estimates

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Disclosures

Analyst Certification
The analysts, CHAN Sung Yan, AU Yu Hang, Johannes, CHOW Sau Shing, LAI Pak Kin, PAN Hongxing, YAO Shaohua, being the persons primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. We and/or our associates have no financial interests (except "Disclosures of Interests" below) in relation to the listed company(ies) covered in this report, and we and/or our associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationships with CSC (6066 HK) and Yuexiu (123 HK).

Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (~9%)
Hold	- Market return rate (~-9%) ≤ Stock return rate < Market return rate (~+9%)
Sell	Stock return < - Market return (~-9%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2006 (For reference: HSI total return index 2006-22 averaged at 8.4%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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