19 Jan 2016

# Weekly Economic Snapshot



## Slowed, to Ensure Better Growth in the Longer Run

### — A Comment on China's 4Q15 Economic Data

Wenjie Ding, PhD
(852) 3900 0856
dingwenjie@cmbi.com.hk


## Summary

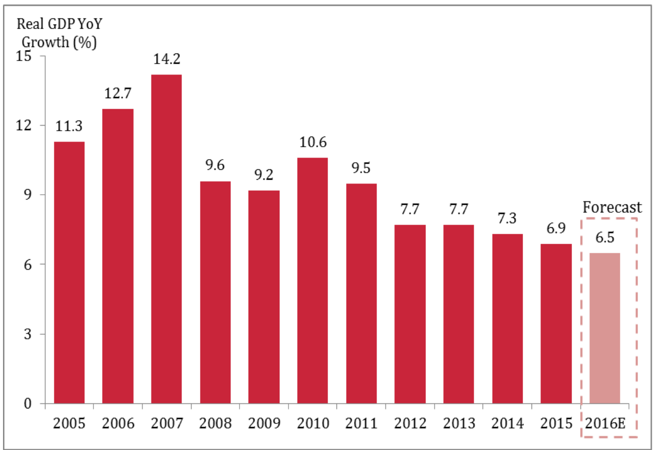
- **China's GDP growth slowed to 6.9% yoy in 2015.**
- **The service sector provided major boost to economic growth.**
- **Consumption maintained solid growth with retail sales value increased 10.7% in 2015. Fixed asset investment growth slid overall, and was mainly boosted by infrastructure spending. Such trends are expected to continue into 2016.**
- **Combating manufacturing overcapacity and housing oversupply would place further downward pressure on the economy and on the job market.**
- **Regarding monetary policies,**
  - **We do not expect benchmark interest rate cuts until the Rmb exchange rate becomes stable. We do expect a RRR cut in the near future to offset FI's declining FX purchase position.**
  - **Even without 'double cuts', the PBoC could use a set of tools, such as open market operations, SLF, SLO, MLF and PSL, to inject liquidity and provide guidance for the interest rate corridor. The role of benchmark interest rate would be weakened in the future.**
  - **The Total Social Financing data in 2015 suggests (1) a declining portion of shadow banking; and (2) a rising share of direct financing. These together reduced the average financing cost of firms by 169bps to 5.38% in 2015.**

## China's GDP Growth Slowed to 6.9% YoY in 2015

China's gross domestic product totaled Rmb67.7tn and grew 6.9% yoy in real terms, missing the annual target of 7.0%. The service sector, which expanded 8.3% yoy in 2015, was the main support for China's economy growth. Annual growth rate of the secondary sector fell to 6.0% from 7.3% in 2014, reflecting chills of combating overcapacity and promoting industry upgrade on this sector.

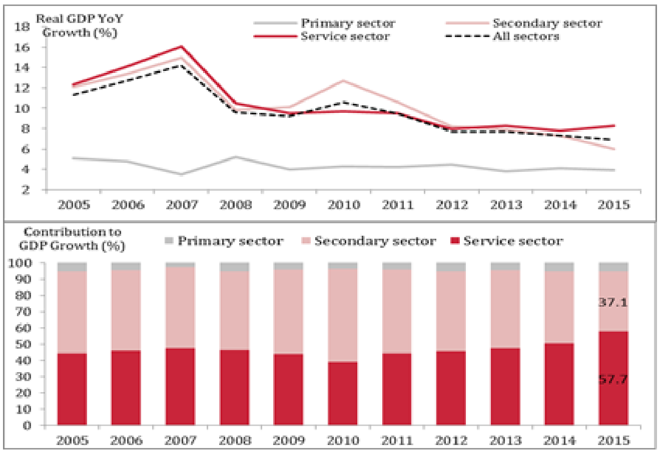
Since the government is committed to pushing forward structural changes to ensure long-term economic prospects rather than sacrificing future for massive stimulus, the Chinese economy will be under further downward pressure this year. We expect China's GDP growth would slow to 6.5% in 2016.

**Figure 1: China GDP Expanded 6.9% yoy in 2015**




*Source: National Bureau of Statistics, China. CMBIS forecast.*

**Figure 2: Service Sector Explained 57.5% of GDP Growth**



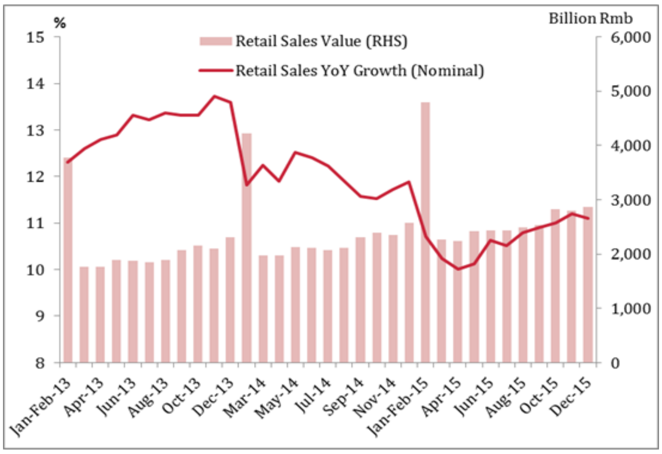

*Source: National Bureau of Statistics, China. WIND. CMBIS.*

## Consumption Growth Remained Solid

**Consumption has sustained solid growth during 2015.** The value of retail sales totaled Rmb30.09tn in 2015, expanding 10.7% from a year earlier. On a monthly basis, the yoy growth rate of retail sales dropped in 1Q15, but soon picked up gradually to 11% in Dec-15 (Figure 3).

**We think consumption will keep growing steadily in 2016.** Although an economy-wide slowdown is likely to weigh on consumption through various channels, the wealth channel in particular, we believe the emergence of new types of retail business (such as cross-border retail and online retail), the improvement of logistics & supply chain network and a growing popularity of online shopping in rural areas will imply huge potentials for consumption growth. Online retail sales, for example, increased 33.3% in 2015, accounting for 12.9% of the entire retail sales value.

**Figure 3: Retail Sales Value Expanded 11.1% in Dec-15**

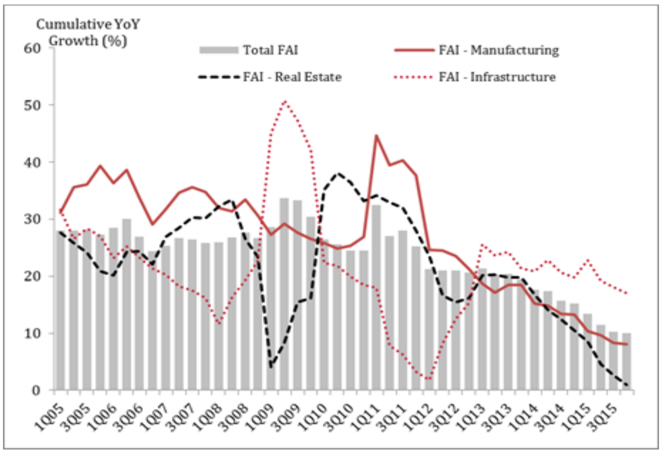



*Source: NBS. CMBIS.*

## Investment Growth Count on Infrastructure Spending

Fixed asset investment increased 10.0% yoy 2015. Suffering from overcapacity and oversupply, both manufacturing and real estate FAI growth declined considerably in 2015. Infrastructure FAI expanded 17% yoy in 2015 and is expected to remain aggressive in 2016. Infrastructure investment carries positive externalities, which benefit people's life and improve efficiency of the economy in the long run. Overall, we expect FAI to growth at about 10% in 2016.

**Figure 4: Fixed Asset Investment Grew 10.0% yoy in 2015**



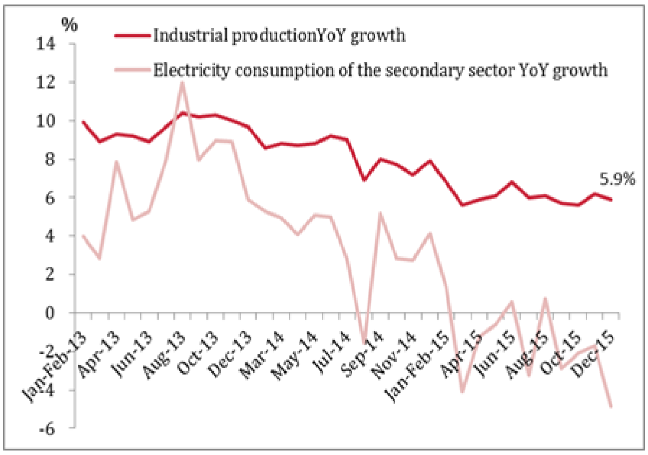

*Source: NBS. WIND. CMBIS.*

## Main Challenge in 2016: Combating Overcapacity and Oversupply Placing Downward Pressure on the Economy

Reducing overcapacity has depressed and will continue to depress the manufacturing sector in general. Growth in industrial production, moving in tandem with the growth in electricity consumption by the secondary sector, slid to 5.9% yoy in Dec-15 from 6.2% in Nov-15.

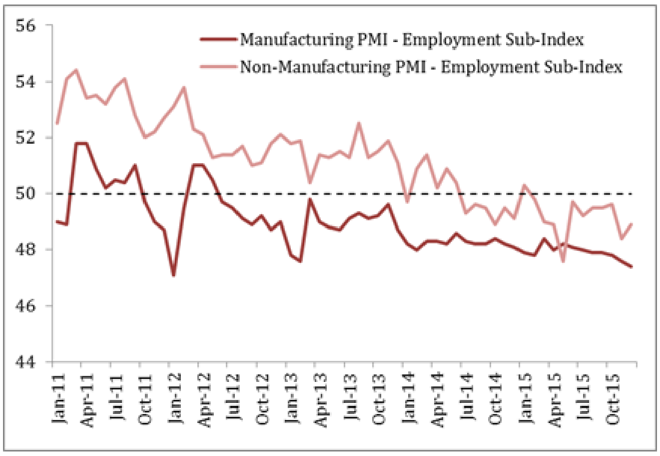
As some manufacturing firms are expected to go bankrupt this year, **we're worried about deteriorating employment conditions** which normally are not reflected timely in China's official job data. Manufacturing workers who lose their jobs may realize that (1) job vacancies on the market are becoming scarce; and (2) their own manufacturing-oriented skill set is difficult to be quickly adapted to new jobs. The declining employment sub-indices of PMI for both the manufacturing and non-manufacturing sectors seemed to prove our concern. We think that to keep employment solid while letting 'zombie enterprises' to fail would be one of the biggest challenges for the Chinese government in 2016.

**Figure 5: Industrial Production YoY Growth Slid to 5.9% in Dec-15**




*Source: NBS. National Energy Administration. CMBIS.*

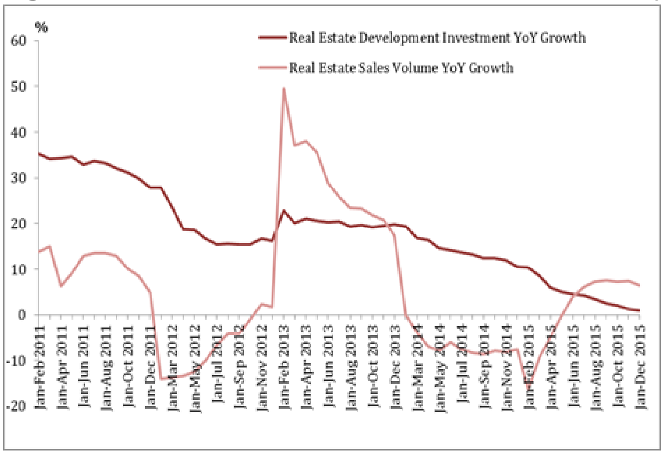
**Figure 6: Employment Conditions Worsened as Indicated by PMI Employment Index**




*Source: NBS. CMBIS.*

Oversupply in local housing market is likely to hold back real estate investment, the growth of which declined continuously to 1.0% yoy in 2015 despite sales pick-ups in some leading cities. At the end of 2015, at least 71,853 square meters of commodity housing were 'waiting to be sold', i.e., oversupplied. The process to de-stock existing commodity housing could take as long as 2-3 years in certain provinces and cities. We think a slowdown in real estate investment and real-estate-related industries will remain a big challenge for China in 2016.

**Figure 7: Real Estate Investment Growth Slid to 1.0% yoy in 2015**




*Source: NBS. WIND. CMBIS.*

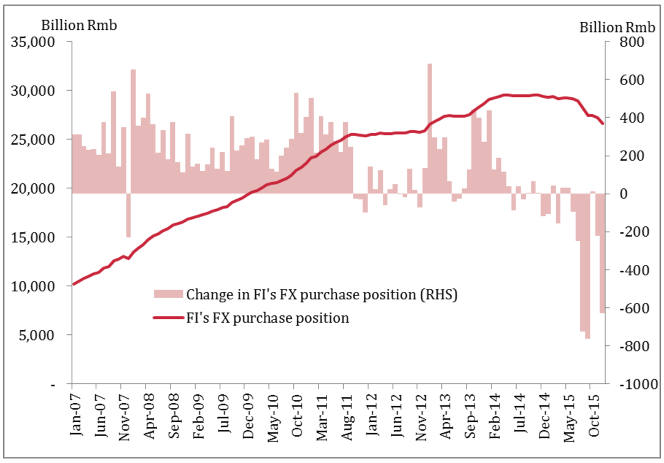
## On Monetary Policies

**'Double Cuts' again?**

Since the Rmb exchange rate has been under great downward pressure recently, we do NOT expect the PBoC to cut the benchmark interest rate in the near term. A lowered short-term interest rate would exacerbate capital outflow and add to depreciation pressure of the yuan. However, over the entire course of 2016, we still expect a cut in benchmark interest rate to directly lower the financing cost of firms. Such would occur only after the exchange rate moves back to a stable track.

On the other hand, in order to offset a declining foreign exchange purchase position of financial institutions, a cut in Reserve Requirement Ratio (RRR) is necessary. The RRR is now 17.5% for large FIs, which is 200bps higher than its level during the financial crisis. We'd expect 3-4 RRR cuts in 2016.

**Figure 8: Financial Institution's FX Purchase Position Declined Rmb628.98bn in Dec-15**




*Source: The PBoC. CMBIS.*

**Monetary Easing is being Undertaken Without 'Double Cuts'**

Since the end of 2015, the PBoC has been frequently using a set of tools, other than the 'double cuts', to provide liquidity. These tools expand from conventional open market operations, to SLO, SLF, MLF and PSL. We expect the PBoC to lower the interest rates of such operations in the near future, to provide full guidance for an interest rate corridor. The interest rate of Standing Lending Facilities (SLF), in particular, will serve as the upper bound for short-term interest rate corridor. The role of current 'benchmark' interest rate would thus be weakened once the interest rate corridor mechanism is established.

**Table 1: The PBoC Expanded Monetary Easing in Jan-16**

| Tools | Date | Amount (in billion Rmb) | Duration | Interest rate |
|---|---|---|---|---|
| Reverse Repo | 5/1/2016 | 130 | 7d | 2.25% |
| | 7/1/2016 | 70 | 7d | 2.25% |
| | 12/1/2016 | 80 | 7d | 2.25% |
| | 14/1/2016 | 160 | 7d | 2.25% |
| | 19/1/2016 | 80 | 7d | 2.25% |
| | 19/1/2016 | 75 | 28d | 2.60% |
| MLF | 15/1/2016 | 100 | 6m | 3.25% |
| SLO | 18/1/2016 | 55 | 3d | 2.10% |
| Treasury Deposits | 19/1/2016 | 80 | 9m | 3.02% |

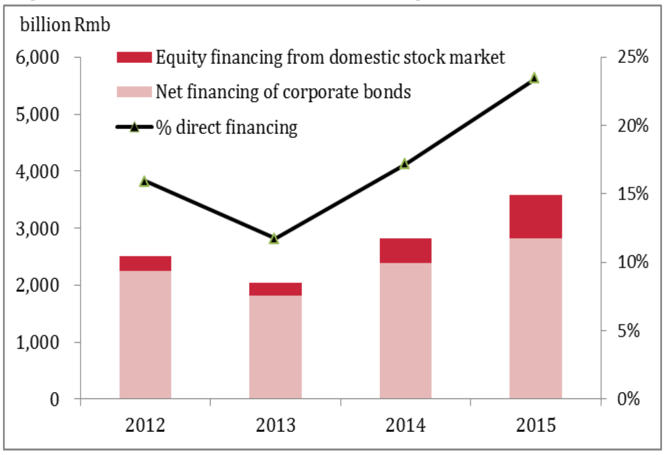
Source: The PBoC. CMBIS. Data till 19/1/2016.

**Several Trends from the 2015 Total Social Financing Report**

The total social financing (TSF) report of 2015 revealed several welcoming trends: (1) **a declining portion of shadow banking** (i.e., 'non-standard' lending) – entrusted loans and trust loans accounted for 10.7% of the net flows of TSF in 2015, compared to 18.4% last year; (2) **a rising share of direct financing** – net financing of corporate bonds and equity financing on domestic stock market totaled Rmb3.59tn, or 23.5% of the total net flows of TSF in 2015, compared to 17.2% in 2014, mainly as a result of burgeoning mainland stock market in 1H2015 and rekindled corporate bond issuance in 2H2015. The target ratio of direct financing in TSF is 25% by the end of 2020.

The above changes in TSF composition – a rising share of direct financing and a declining share of shadow banking, along with the PBoC's other tools, helped lower the financing cost of nonfinancial corporates. According to the PBoC, the weighted average financing cost of firms was 5.38% at 2015 year end, down 169bps from its level at 2014 year end.

**Figure 9: Share of Direct Financing in TSF Rose to 23.5% in 2015**




*Source: The PBoC. CMBIS. Note that the above chart considers equity financing on domestic stock market to non-financial enterprises.*

# Disclosures & Disclaimers

## Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.
Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

## CMBIS Ratings

| | |
|---|---|
| **BUY** | : Stock with potential return of over 15% over next 12 months |
| **HOLD** | : Stock with potential return of +15% to -10% over next 12 months |
| **SELL** | : Stock with potential loss of over 10% over next 12 months |
| **NOT RATED** | : Stock is not rated by CMBIS |

*CMB International Securities Limited*

**Address:**Units 1803-04, 18/F, Bank of America Tower, 12 Harcourt Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 39000800

**CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)**

## Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.
This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS and/or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.
The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.
CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.
Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom
This report has been provided only to persons (I)falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time)("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.,) of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US, institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.