



The Strategist

Belated rate cut

A small step cut. In our last report ([‘Still just twiddling thumbs’](#)), we argued that China needs to cut the RRR to free up more capital for the economy, which we expect would happen at any moment. After the A-share market plunged almost 21% in two weeks and broke the 3500 level that the government has been defending the past six weeks, the PBoC finally lowered the one-year lending and deposit rates by 25bps to 4.6% and 1.75% respectively. It also trimmed the RRR by 0.5% to 18% for all banks. Even after the cuts, the PBoC is still behind the curve.

More rate cuts are needed. Foreign capital outflows continue to increase, and now that the interest rate is lower, we would not be surprised if capital outflows pick-up even more in the next few months. China’s FX reserves are down and the growth of reserve money has dropped to record low levels. This implies that monetary conditions are still tight and this will undermine economic growth. We believe China needs to have more monetary easing.

Market very oversold, short-term bounce. This cut won’t change our UW view on China. We still believe that redemption risk is rising and the coming economic growth data will be weaker than market expectations. The risk is not only within China, but also outside China ([RMB: The Force Awakens](#)).

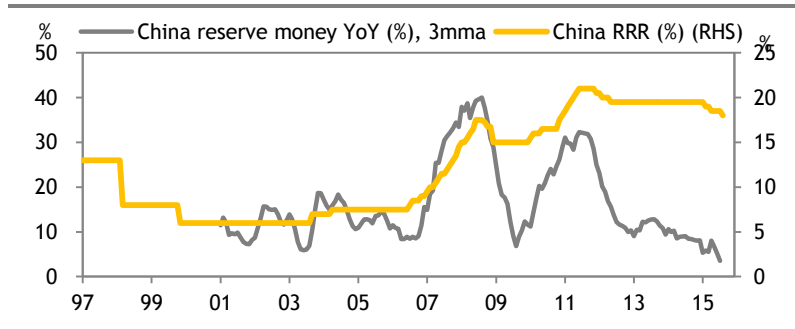
In the US, the 5-year, 5-year forward breakeven inflation rate has hit new lows, which will likely delay the Fed from hiking interest rates. The recent weakness in the USD also indicates that the market expects the Fed to delay the rate hike.

As we highlighted in our last report ([‘Still just twiddling thumbs’](#)), we need to see the Fed delay the interest rate hike and China roll out an integrated monetary and fiscal easing package to stabilize the market. The H-share index has already plunged nearly 36% from the peak in May. The 14D-RSI has hit the most oversold level in the past 28 years. Therefore, the market is likely to experience a short-term bounce. In the past three months, the biggest underperforming sectors relative to the MSCI China were brokers, autos, and tech hardware.

Strategist

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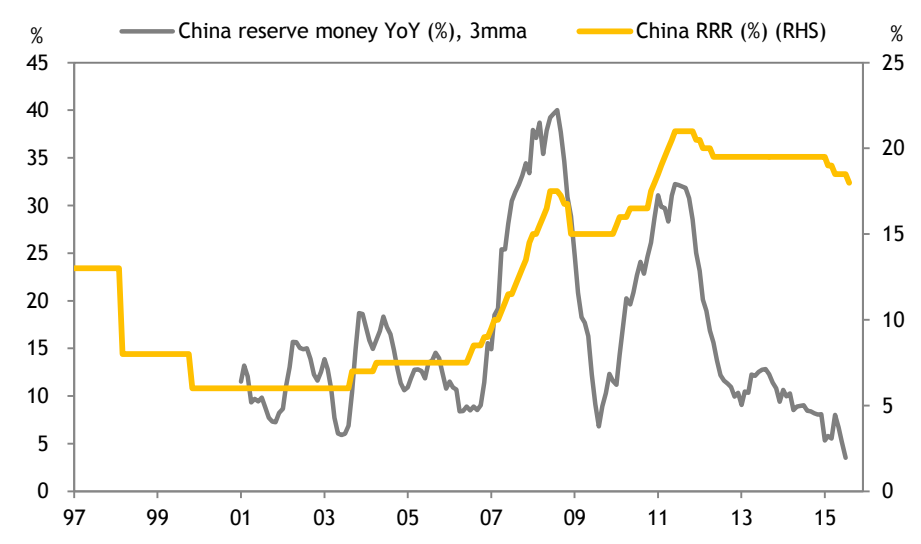
China RRR vs China reserve money, YoY 3mma



Source: CEIC, Bloomberg, Maybank Kim Eng Research

The following chart shows that reserve money keeps falling to record low levels. This implies that monetary conditions are still tight in China. Even after this rate cut, we think that the PBoC is still behind the curve.

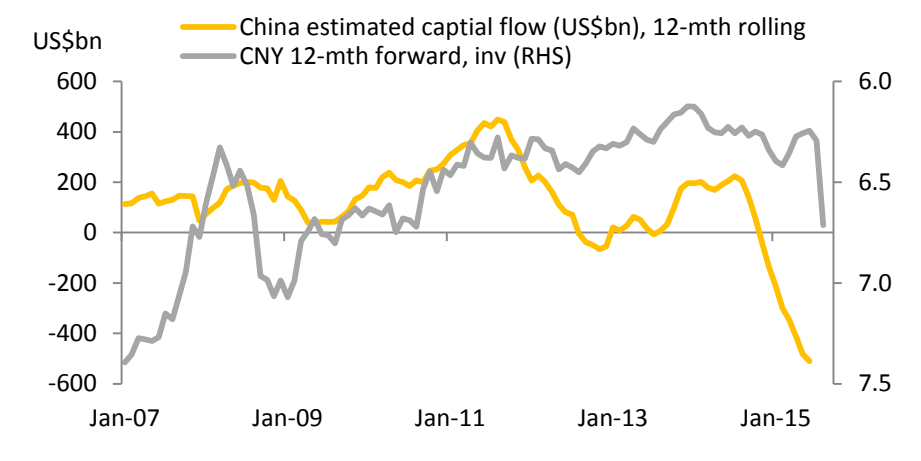
Figure 1: China RRR vs China reserve money, YoY 3mma



Source: CEIC, Maybank Kim Eng Research.

The following chart shows that foreign capital outflows continue to increase. Now that the interest rate is lower, we would not be surprised if capital outflows pick-up even more in the next few months.

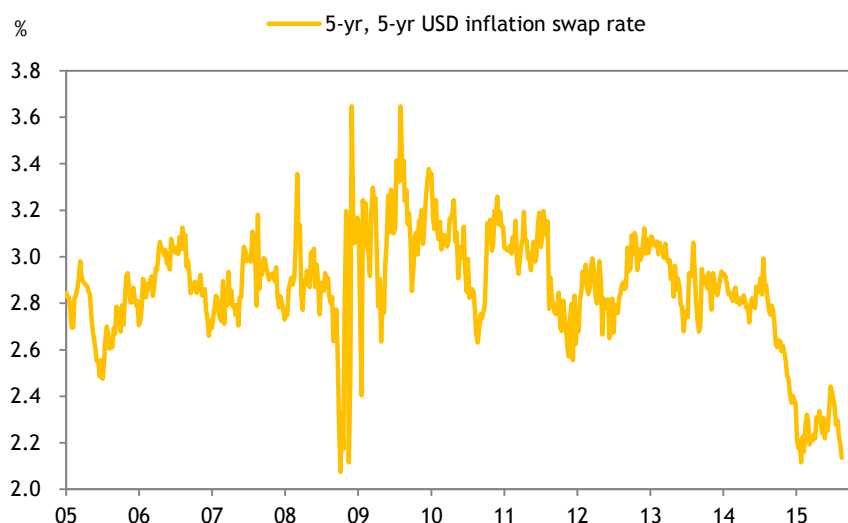
Figure 2: China - estimated capital flows & CNY 12-month forward



Source: CEIC, Bloomberg, Maybank Kim Eng Research.

The following chart shows that the US 5-year, 5-year forward breakeven inflation rate has hit new lows, which will likely delay the Fed from hiking interest rates.

Figure 3: US 5-year, 5-year forward breakeven inflation rate



Source: Bloomberg, Maybank Kim Eng Research.

The following table shows the sector performance of the MSCI China. The market is very oversold after falling 30% in the last three months. Brokers, autos, and tech hardware were the sectors that underperformed the most relative to the MSCI China in the last three months.

Figure 4: Equity performance by MSCI China sector - absolute and relative

Name	Index	Absolute performance (%)		Relative performance (%)	
		-1m	-3m	-1m	-3m
MSCI China	57	(17)	(30)		
Energy	402	(18)	(34)	(0)	(4)
Materials	558	(17)	(34)	(0)	(4)
Industrials	132	(18)	(34)	(1)	(4)
Capital Goods	77	(19)	(37)	(1)	(6)
Transportation	402	(14)	(27)	3	4
Consumer discretionary	156	(22)	(41)	(4)	(11)
Automobiles & components	1,087	(23)	(46)	(6)	(16)
Retailing	183	(25)	(50)	(7)	(19)
Consumer staples	941	(13)	(18)	4	12
Food/staples retail	69	(5)	(4)	13	26
Food/beverage/tobacco	636	(16)	(22)	1	9
Health care	118	(18)	(35)	(1)	(5)
Financials	413	(19)	(34)	(2)	(4)
Banks	224	(16)	(29)	1	1
Diversified financials	155	(28)	(52)	(11)	(21)
Insurance	408	(23)	(38)	(6)	(8)
Real estate	580	(22)	(35)	(5)	(5)
Technology	285	(18)	(24)	(1)	6
Software services	239	(18)	(22)	(1)	8
Tech hardware	161	(24)	(40)	(7)	(10)
Semiconductors/equipment	77	(11)	(18)	6	13
Telecoms	141	(8)	(16)	9	14
Utilities	595	(15)	(22)	2	8

Source: Maybank Kim Eng, MSCI, FactSet data as of August 24, 2015

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