



The Strategist

Coordinated or Random Easings?

An interesting week for easing. The PBoC lowered the one-year lending and deposit rates by 0.25% to 4.35% and 1.5% respectively. It also cut the Reserve Requirement Ratio (RRR) by 0.5% to 17.5% for all banks, with an extra 0.5% reduction for some institutions.

This happened the day after the ECB hinted at more easing in December and it is currently in a state of 'work and assess' rather than 'wait and see'. These moves are consistent with what has been weak global demand and high inventory levels ([Bounce without earnings recovery, October 20, 2015](#)).

Beginnings of negative deposit rates in China. CPI inflation is about half the government's target and PPI inflation has been negative for 3 years. China's real 1-year deposit rate is now negative and there is scope to cut further.

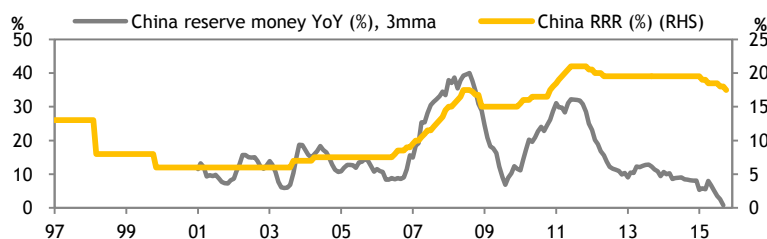
Indeed, we cannot rule out further easing. Our cover chart shows reserve money growth is currently running at 0.8% YoY. It remains to be seen whether tightening in the capital account can prevent continued outflows. We also continue to watch credit spreads and the yield curve. China's corporate bond spreads between 10-yr less AAA and 10-yr less BBB+ have widened since the RMB depreciated in August. China's 10yr-1yr yield curve has also flattened again while the 10yr-3mth SIBOR yield curve has even inverted.

Pressure on RMB again? The ECB move helped some EM currencies but also the USD where 2-year Treasuries still yield over 60bps. DXY hit 97 levels again and by virtue of the close link to the USD, the RMB effectively strengthened relative to the euro and yen again. While the RMB might be included into the SDR basket in November, we suspect the initial weighting probably may not be large.

We still reckon that a strong USD could attract capital from EM and this puts more pressure on the RMB. With Central Banks fixated on money and interest rates, we still think it's the FX markets that are creating the volatility.

Focus on policy-driven sectors. With gov't policy driving – in our view – sector rotation in China, we recommend investors to focus on the alternative energy, telco and machinery sectors. In the past 3 months, the biggest underperforming sectors relative to the MSCI China were brokers, food and beverage, energy and materials.

China RRR vs China reserve money, YoY, 3mma



Source: Bloomberg, CEIC, Maybank Kim Eng Research

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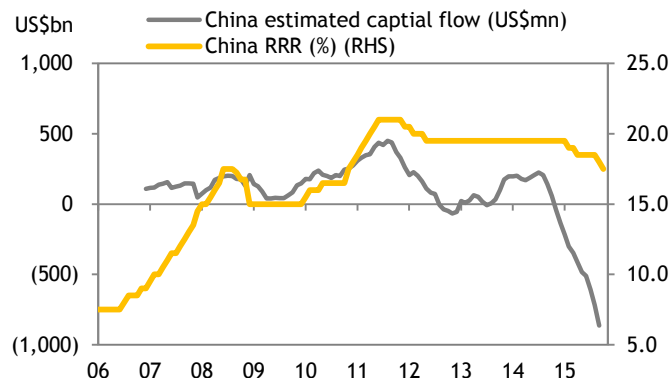
The left chart shows that China's reserve money has continued to fall sharply this year and hit only 0.8% YoY growth in September. The reason reserve money is falling is because capital outflows continue to increase.

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



Source: Bloomberg, CEIC, Maybank Kim Eng Research

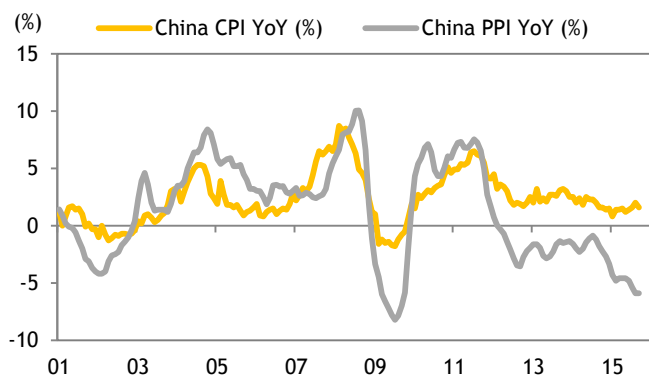
Figure 2: China-estimated capital flows & CNY 12-mth forward



Source: Bloomberg, Maybank Kim Eng Research

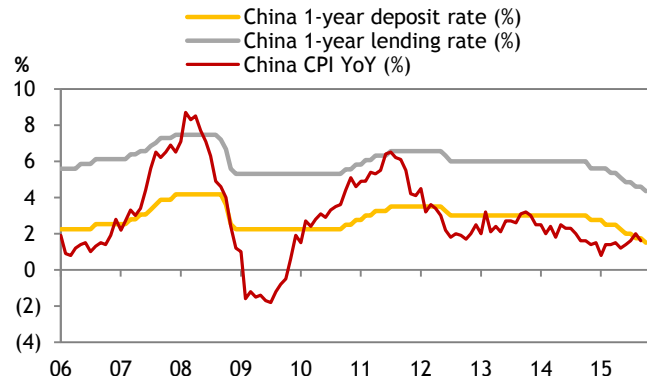
The following charts show that deflation pressure keeps rising. The CPI is about half the government's target and PPI has been negative for 3 years. If we look at China's 1-year deposit rate, after this rate cut, it is negative real interest rate already.

Figure 3: China CPI & PPI, YoY



Source: Bloomberg, CEIC, Maybank Kim Eng Research

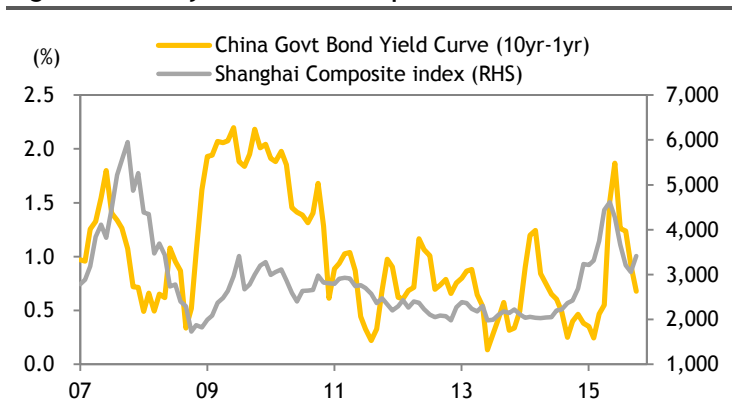
Figure 4: China CPI, 1-yr deposit & lending rates



Source: Bloomberg, Maybank Kim Eng Research

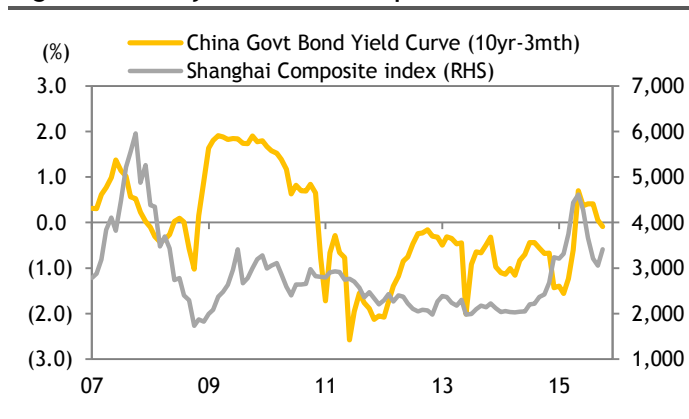
The following two charts show that China's yield curve has flattened again. The 10year-3-mth SIBOR yield curve is yet again inverted. This suggests the market expects economic conditions will remain weak. We shall continue to monitor these but at this stage, believe China needs to have more monetary easing.

Figure 5: China yield curve and equities I



Source: Bloomberg, CEIC, Maybank Kim Eng Research

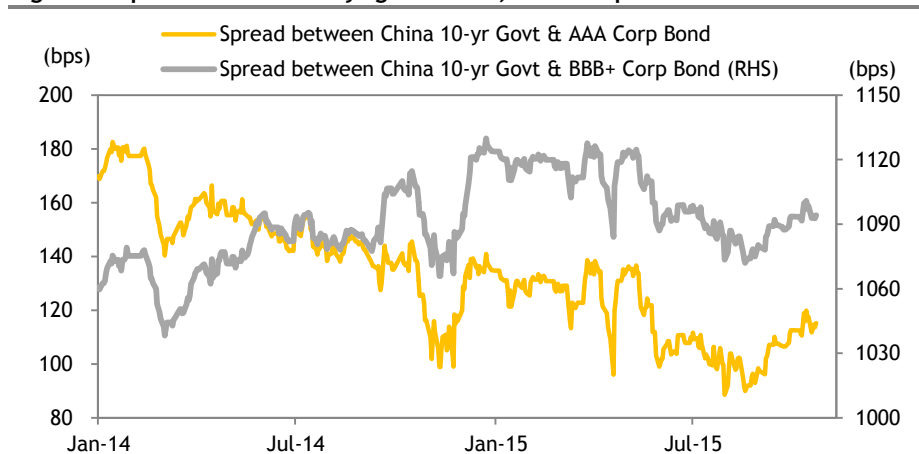
Figure 6: China yield curve and equities II



Source: Bloomberg, Maybank Kim Eng Research

The following chart shows that the corporate bond spreads between 10-yr & AAA and 10-yr & BBB+ have continued to widen in the last 2 months after the RMB depreciated in August. We will continue to watch spreads for signs of increasing credit risk.

Figure 7: Spread between 10-yr gov't & AAA, BBB+ corp bond



Source: Wind, Bloomberg, Maybank Kim Eng Research.

We maintain our view that this bounce is a “no-earnings-recovery” rebound. The government is driving sector rotation, therefore, we recommend investors to focus on the alternative energy, telco and machinery sectors. ([Bounce without earnings recovery, October 20, 2015](#))

The following table shows the sector performance of the MSCI China. Brokers, food and beverage, energy and materials were the sectors that underperformed the most relative to the MSCI China in the last three months.

Figure 8: Equity performance by MSCI China sector - absolute and relative

Name	Index	Absolute performance (%)		Relative performance (%)	
		-1m	-3m	-1m	-3m
MSCI China	64	10	(8)		
Energy	435	13	(12)	3	(3)
Materials	608	8	(11)	(2)	(3)
Industrials	153	8	(6)	(2)	2
Capital Goods	90	7	(7)	(3)	2
Transportation	450	11	(6)	0	2
Consumer discretionary	199	16	(1)	6	7
Automobiles & components	1,568	23	8	13	17
Retailing	228	15	(6)	5	2
Consumer staples	992	8	(9)	(2)	(1)
Food/staples retail	80	10	10	(0)	19
Food/beverage/tobacco	653	7	(15)	(3)	(6)
Health care	140	7	(4)	(3)	4
Financials	468	12	(9)	2	(1)
Banks	240	12	(11)	2	(2)
Diversified financials	182	15	(17)	5	(9)
Insurance	508	12	(6)	2	3
Real estate	699	13	(7)	3	2
Technology	321	13	(9)	3	(0)
Software services	285	14	(4)	4	5
Tech hardware	192	5	(9)	(5)	(0)
Telecoms	142	(1)	(8)	(11)	0
Utilities	682	10	(3)	(0)	5

Source: Maybank Kim Eng, MSCI, FactSet data as of October 23, 2015

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