

**Market  
Commentary****China's surprise cut in bank reserve  
requirement and 2012 outlook****RRR cut and latest PMI number**

China surprised the markets with an earlier-than-expected 50 basis point cut in required reserve ratio (RRR) for commercial banks on 30 November 2011. This is the first time in three years that the world's second largest economy has reduced RRR after a tightening cycle which saw RRR raised 12 times. The latest move signals a shift in China's policy focus from inflation-control to growth-stabilization.

Consumer price inflation (CPI) in China has already eased from a 37-month high of 6.5% in July 2011 to 5.5% in October 2011. Meanwhile, the government's tightening measures of the last two years have resulted in softer economic growth with GDP decelerating from 9.7% in Q1 to 9.1% in Q3. China's official Purchasing Manager's Index (PMI) released on 1 December 2011 also fell to 49 versus the previous month's 50.4, indicating that the country's manufacturing sector contracted in November.

Our China portfolio managers have been expecting some easing in monetary policy driven by the need to inject more liquidity as money supply and economic growth has been softening and inflationary pressures easing. Besides, certain sections of the economy were feeling the pressure of tight monetary conditions. There were concerns about the liquidity crunch at Small and Medium Enterprises (SMEs), railways as well as for local government funding. Here are some comments from Anthony Bolton, Martha Wang and Raymond Ma about China's prospects in 2012.

## Outlook for 2012



Anthony Bolton

**Anthony Bolton** “The next 12 months should be a defining moment for Chinese investment when investors realise the economy is not about to collapse and the tightening period is over. We have been through an extraordinary volatile year but I believe that when the dust settles and things calm down, investors will focus on relative growth rates they can get in different parts of the world. I feel very strongly that this will result in money flowing out of developed markets that have sovereign debt problems and very mediocre prospects over the next few years into the faster growing emerging markets like China.

I am not saying that China is not immune to a slowdown in the developed markets. The country’s growth rate will slow down but it will still expand by about 7.5% to 8%, which will still be attractive compared to the rest of the world.

Inflation has been a key issue in 2011 but it has already started to come down. A slowdown in inflation has allowed the Chinese authorities to stop tightening monetary policy. This should be positive for the markets. The speed and format of further loosening will depend partially on how the domestic situation develops from here and whether the developed world returns to recession.

Some of the other issues that investors in China have been focusing on are bank bad debts and falling residential property prices. There are some real challenges regarding potential future bad debts but the government has the financial resources to address these. The outlook for residential property in 2012 is poor. I also am more concerned about the uncertainty due to the important political changes that are due over the next 18 months and whether they will lead to a change in policy direction.

In terms of portfolio strategy going forward, I continue to be positive on the consumption and services sectors and remain underweight in exporters, commodities, infrastructure companies, banks and property companies. Consumption and services are not immune to any slowdown in China but I believe these are the areas with the best longer term outlook where structural trends favour them. Even with a slowdown in GDP growth, I expect these areas to outperform the general economy. If I am wrong about the world outlook, and a new recession were to commence leading to China embarking on another stimulus programme, these areas would likely be direct beneficiaries.”



Martha Wang

**Martha Wang** “China’s economic growth is expected to moderate as external demand from Europe and the US slows down and domestic economic activity falls. After tightening for the last two years, the policy environment will be more benign going forward. The recent fall in inflation pressure has given the government some room to ease its monetary policy. Going forward, headline GDP growth will depend on the balance between looser policies and weaker external demand.

I am positive on the outlook for the next 12 months. Indeed, there have only been a few periods in China’s stock market history when valuation levels have been as attractive as they are currently. Most of the macro risks have been largely priced in and the risk/reward outlook appears favourable. In terms of stock ideas, I favour the consumption space where I am finding opportunities with attractive valuations.”



Raymond Ma

**Raymond Ma** “The growth of the Chinese economy will be moderate in 2012, as the negative impacts from the European debt crisis and China’s tightening measures filter through. However, I believe that the risk of a hard landing in China is minimal. While the slowdown of growth in the western developed markets would hurt the outlook for export-related industries, the real impact on China’s GDP growth should be immaterial given the insignificant contribution of exports to GDP growth (~1%). Meanwhile, the growth of domestic consumption and infrastructure should remain resilient in light of a decent rise in income and continuing government support.

More importantly, the recent slowdown in inflation gives the Chinese government some room to spur growth by means of the monetary easing policy. After the surprise cut of banks’ reserve requirement ratio (RRR) yesterday, the RRR is expected to be further reduced in the first half of next year, improving the liquidity of the market.

Within equities, I believe the Chinese market would outperform their US and European counterparts in 2012 as growth will remain resilient in the former. In particular, Chinese equities have underperformed global equities since 4Q10 as a result of tightening measures. If an easing policy starts to kick in, the Chinese market should bottom out and start to lead the market.

Overall, Chinese corporates are expected to deliver top-line growth of around 15% in 2012. Sector-wise, consumer sectors are expected to outperform as they are driven by solid domestic demand and are less impacted by external and policy factors. While consumer staples were under huge margin pressures in 2011 on the back of soaring input costs, margins will once again expand in 2012, benefiting from falling commodities prices. Meanwhile, consumer discretionary should continue to benefit from robust income growth and the pro-consumption policy.”



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