

Further Opening Up and Reform of China's Capital Market



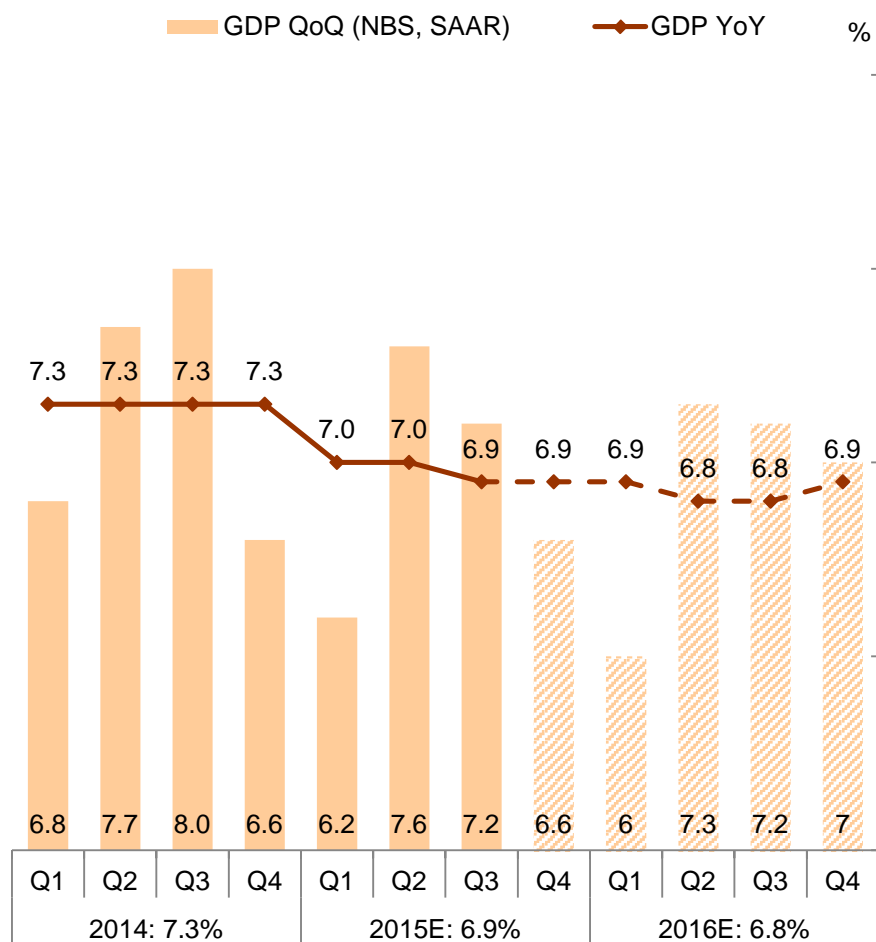
Haizhou Huang

January 7, 2016

China economy and capital market: Finding “new normal”

Macro: We expect China GDP to grow 6.9% in 2015 and 6.8% in 2016

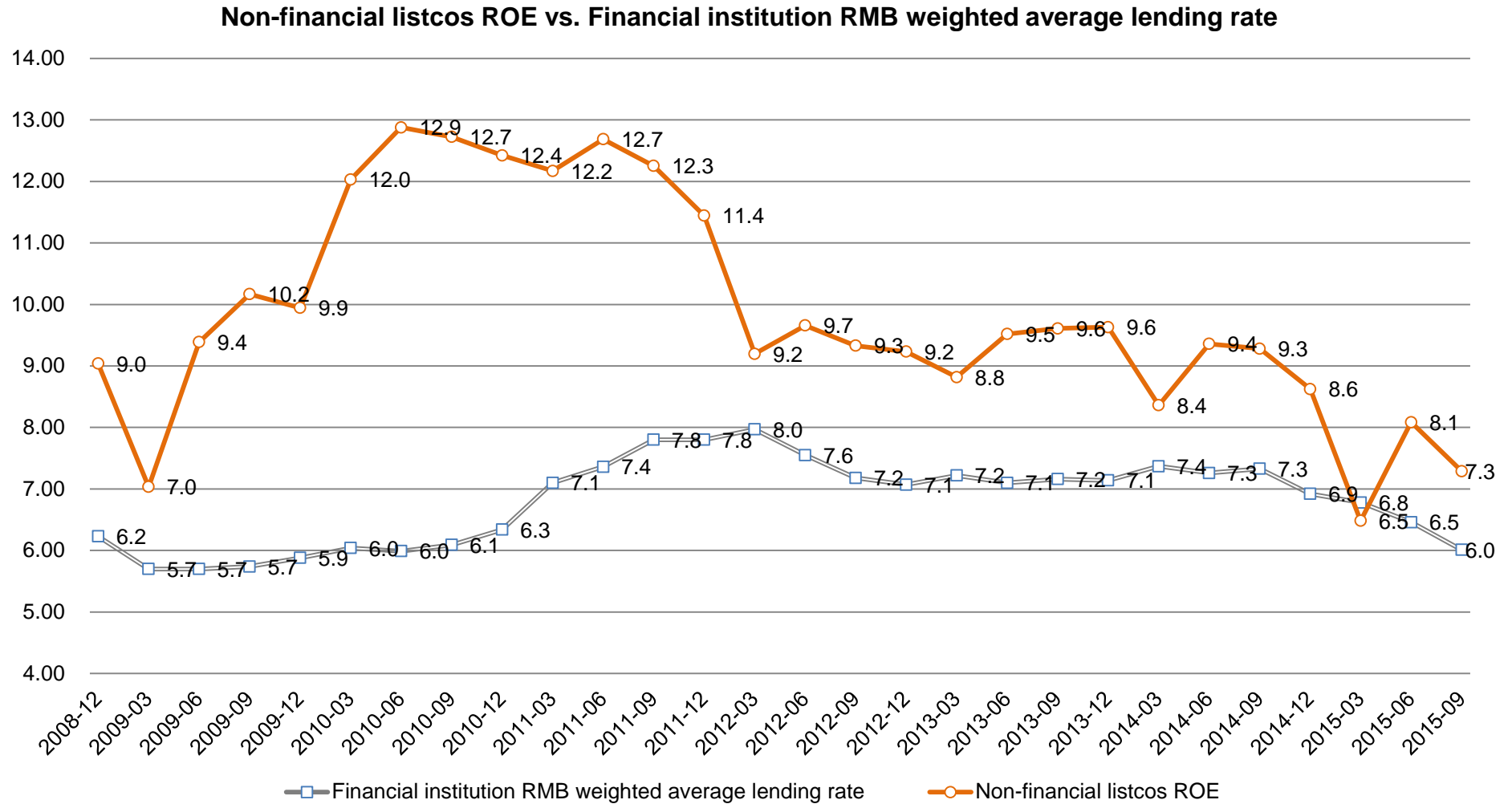
CICC economists' forecast



Macro Forecast (%)	2013A	2014A	2015E	2016E
Real GDP	7.7	7.3	6.9	6.8
Nominal GDP	10.1	8.2	6.6	7.0
CPI	2.6	2.0	1.5	1.3
PPI	-1.9	-1.9	-4.8	-1.3
IP	9.5	8.3	6.2	6.4
Nominal Retail Sales	13.1	11.9	10.6	10.9
Nominal urban FAI	19.7	15.0	10.0	10.1
Customs Exports	7.8	6.0	-2.6	1.3
Customs Imports	7.3	0.7	-14.7	0.2
USD/CNY	6.1	6.2	6.5	6.5

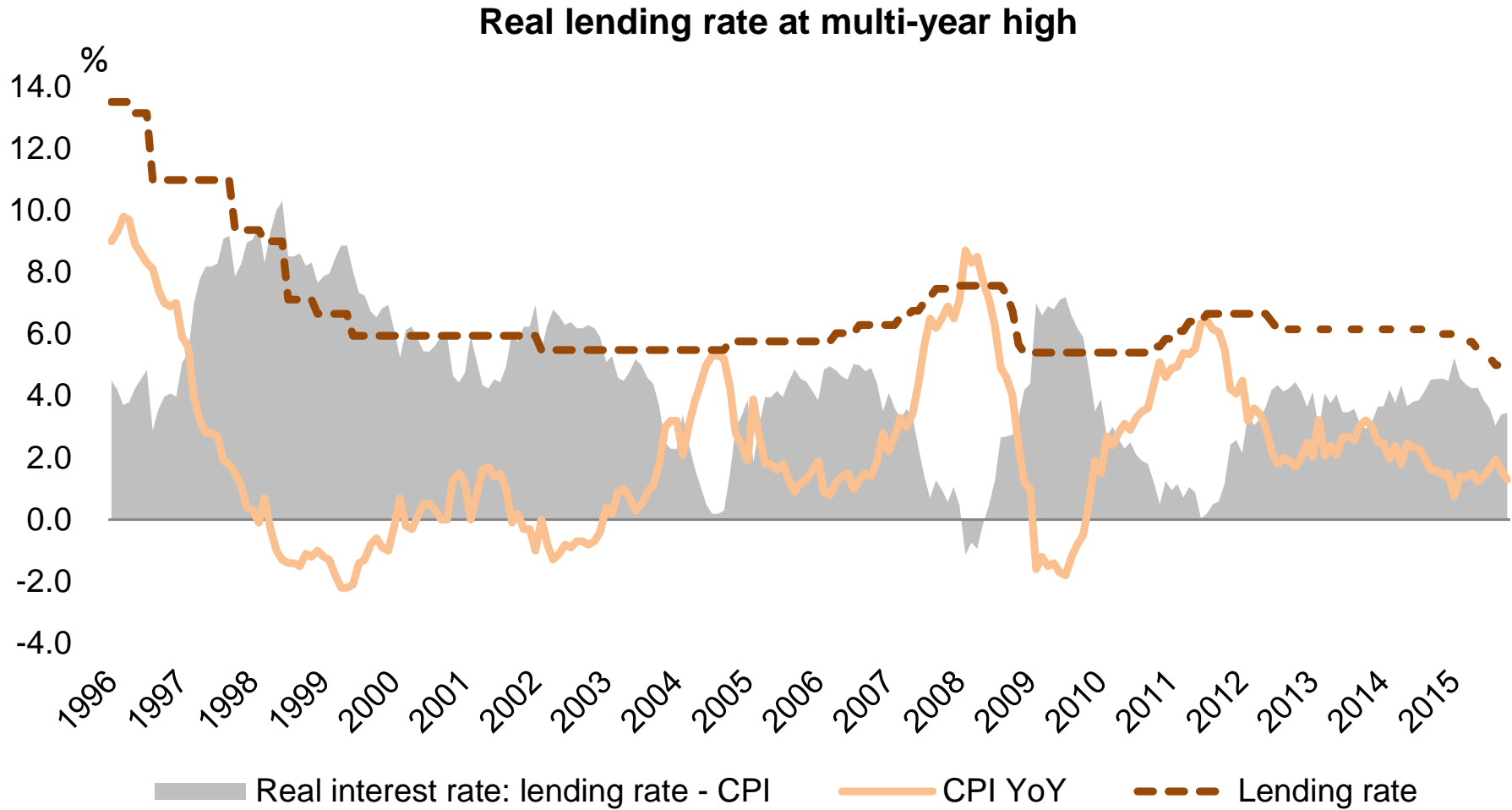
Source: Wind, CICC Research

Financing cost is still high



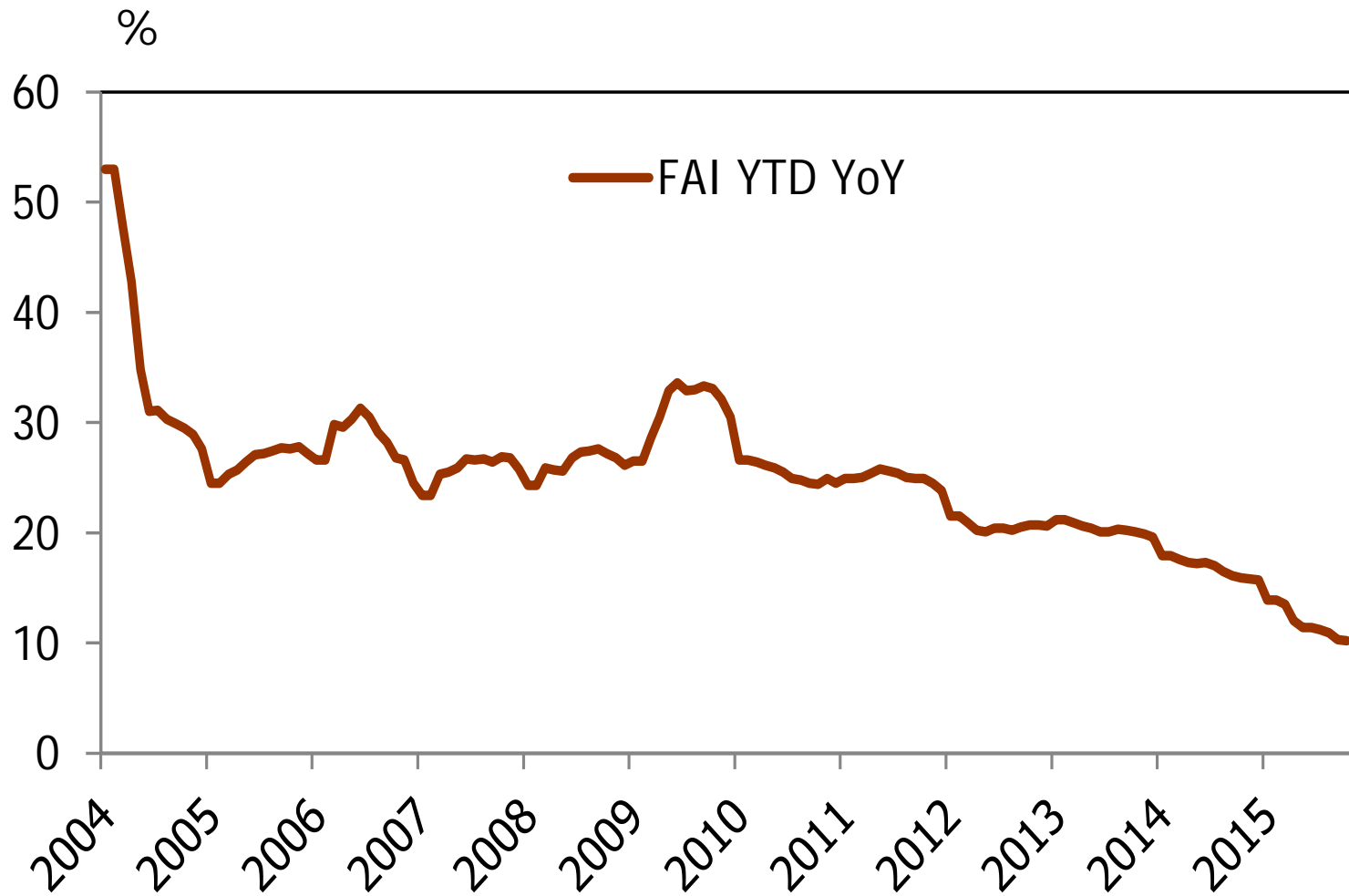
Source: Wind, CICC Research

Financial condition is still too restrictive for growth recovery....



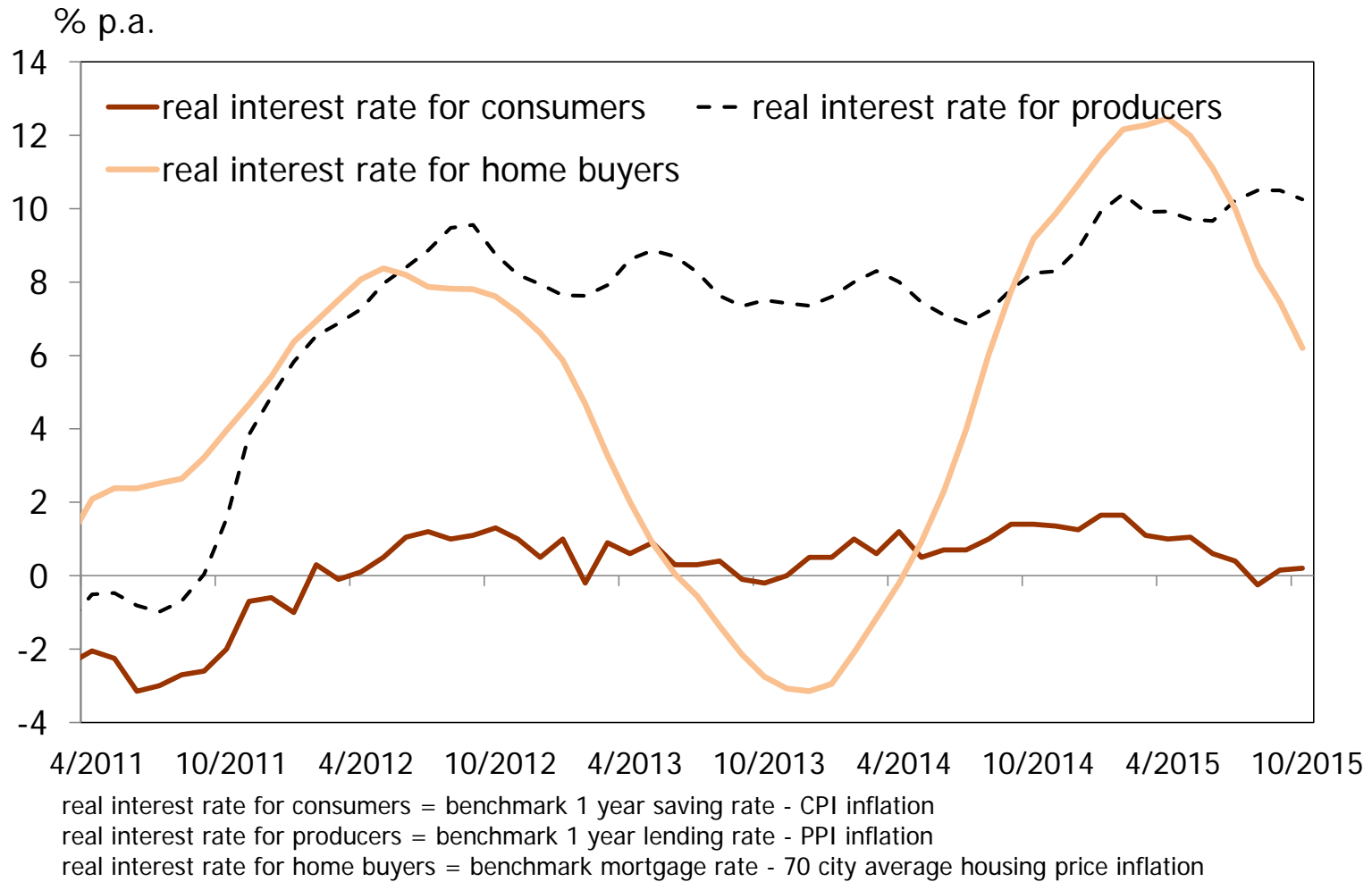
Source: Wind, CICC Research

Investment contracted



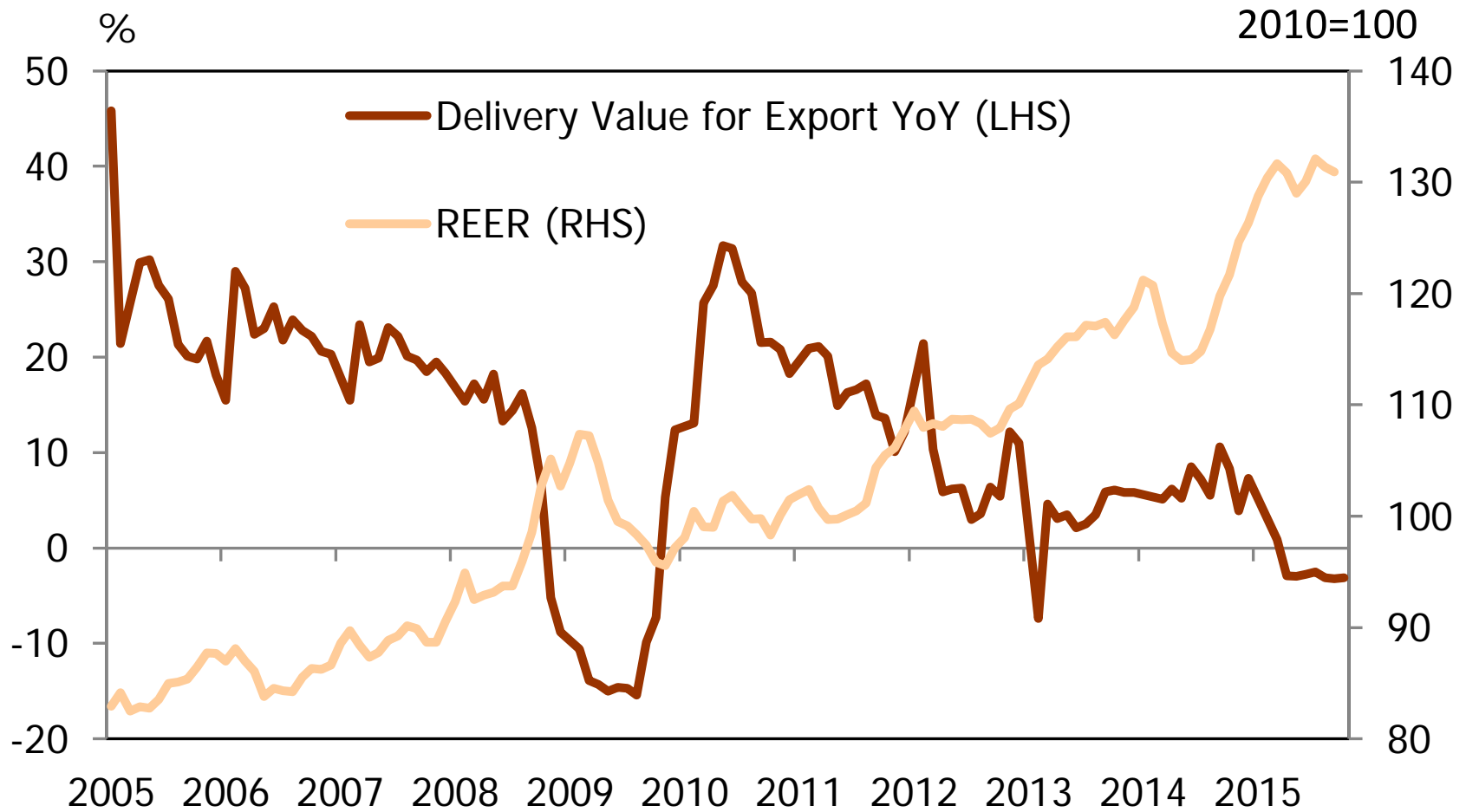
Source: CEIC, CICC Research

Diverging trends of real rates across sectors



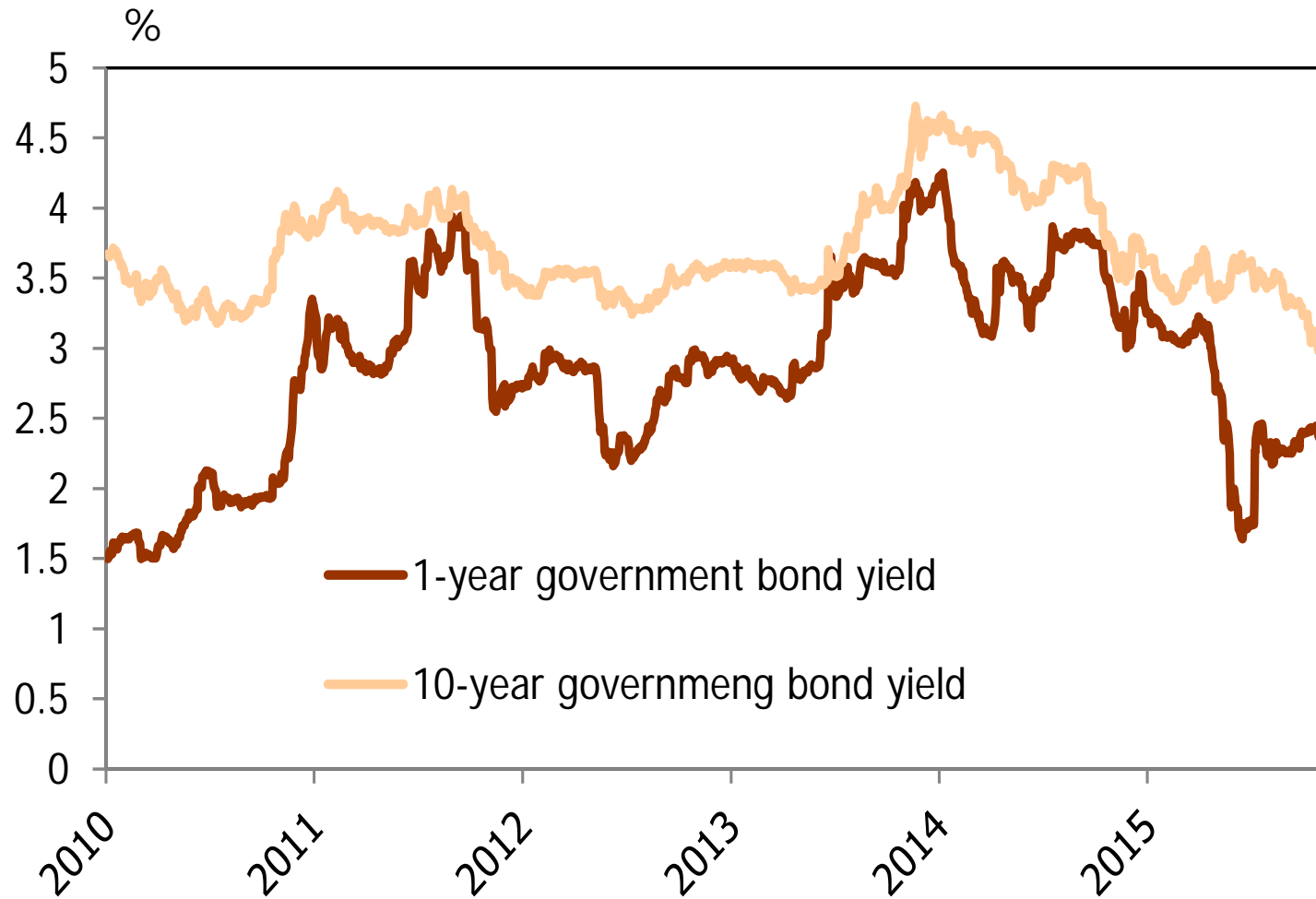
Source: CEIC, CICC Research

A stronger RMB suppressed exports



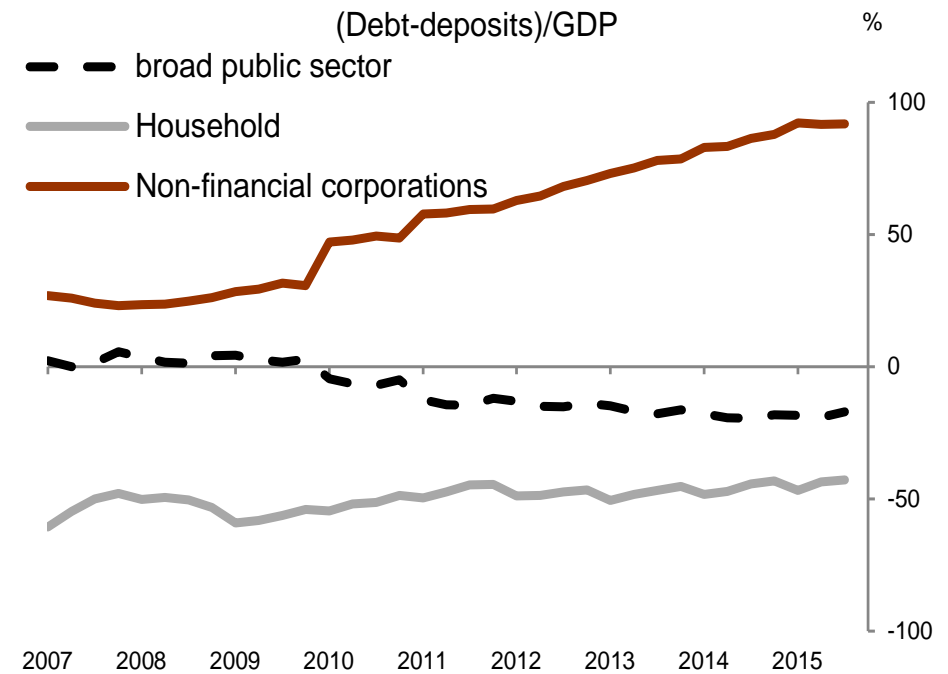
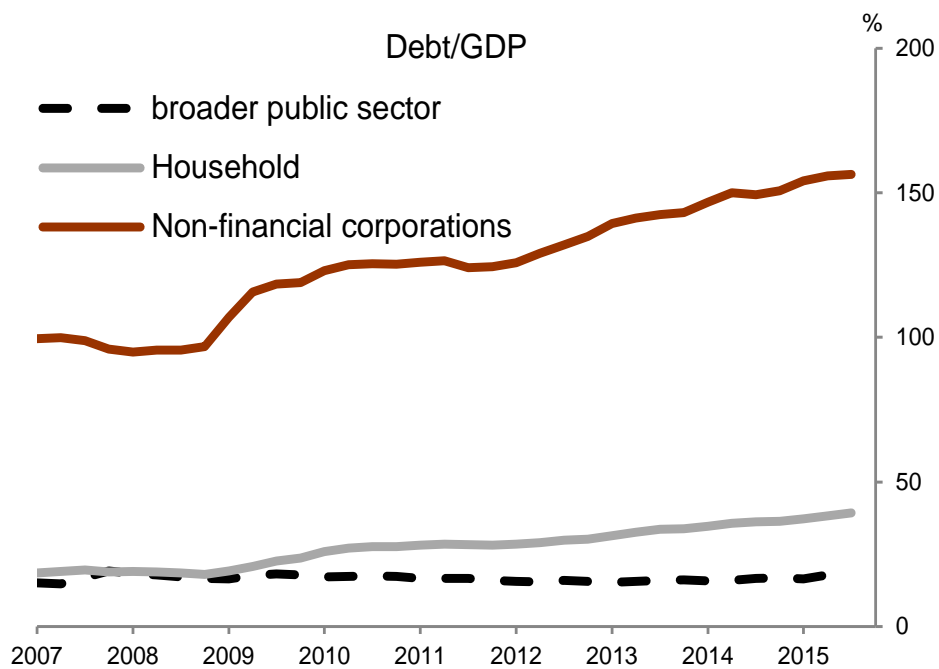
Source: CEIC, CICC Research

Government bond yield dropped



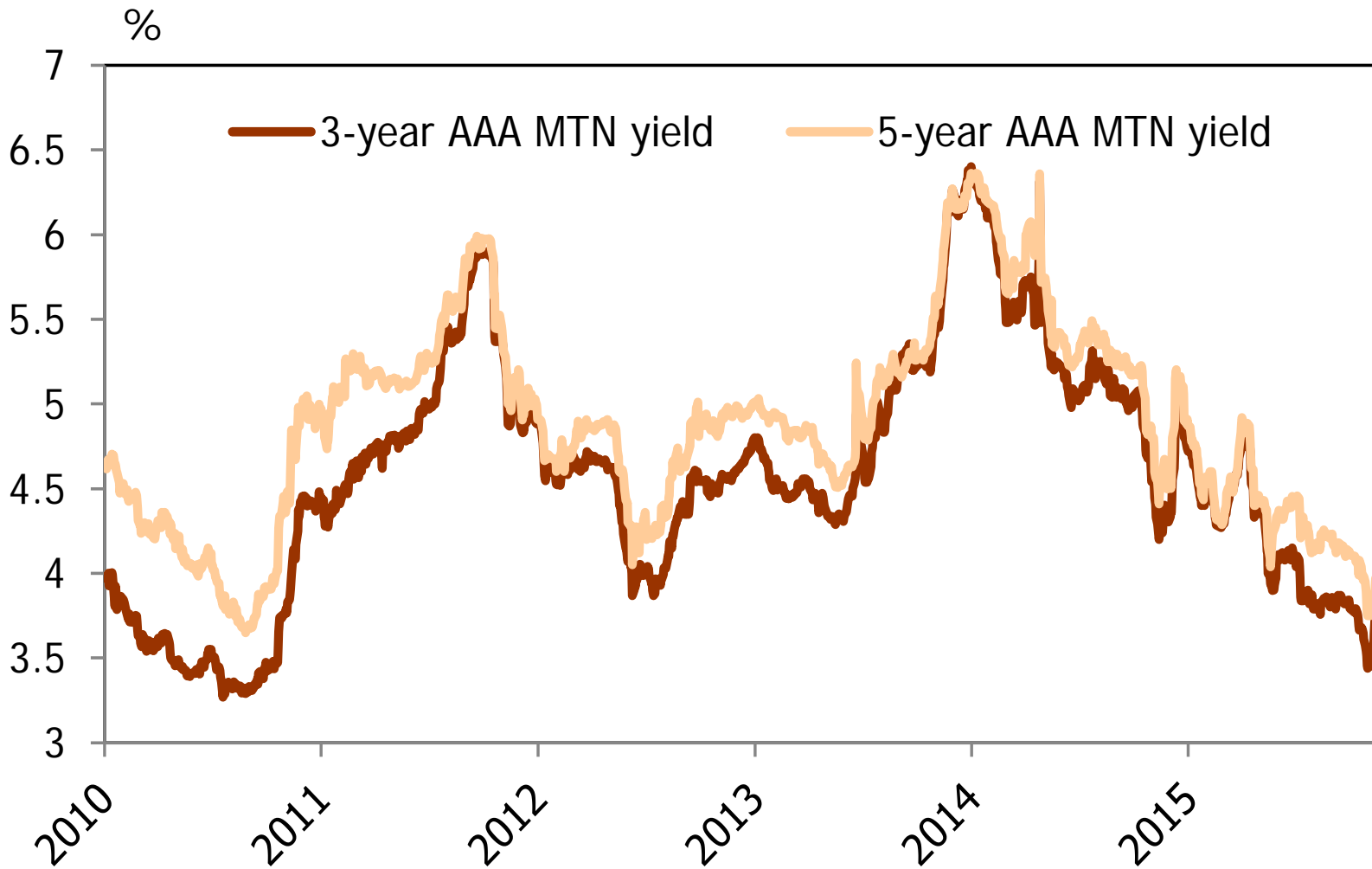
Source: CEIC, CICC Research

Corporations' leverage rising faster in recent years



Source: CEIC , CICC Research

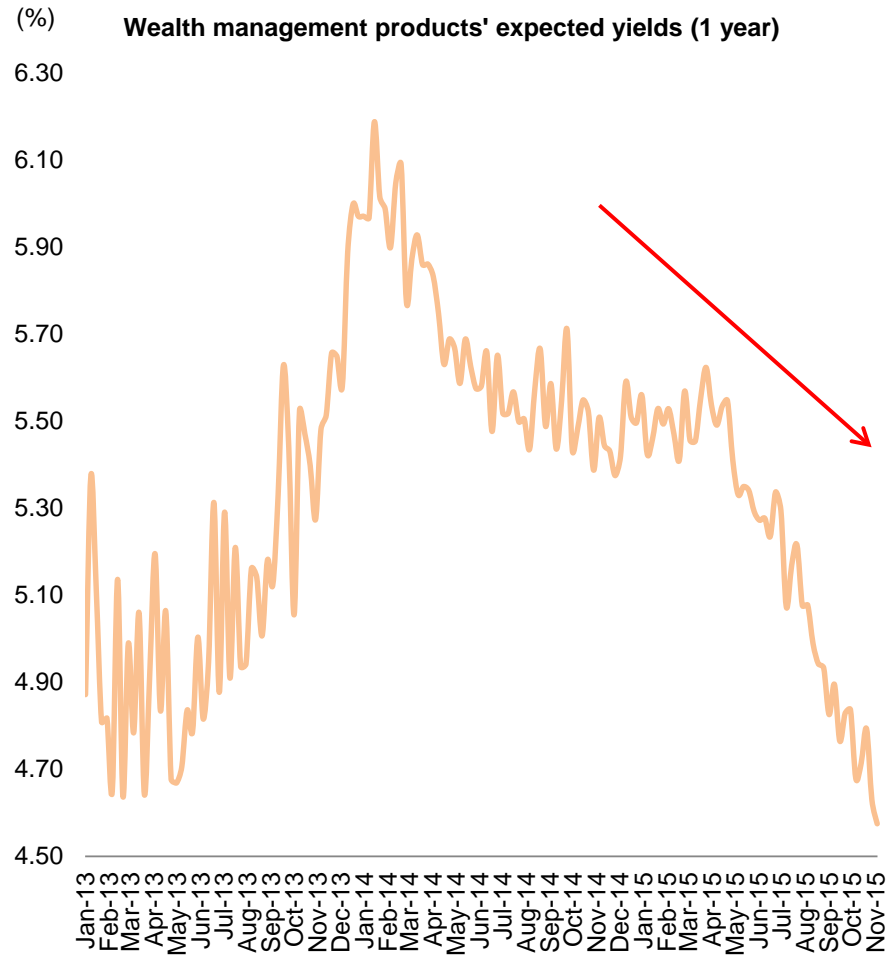
Corporate bond yields fell



Source: CEIC, CICC Research

But liquidity to gradually ease internally

Wealth management products' yields have been falling

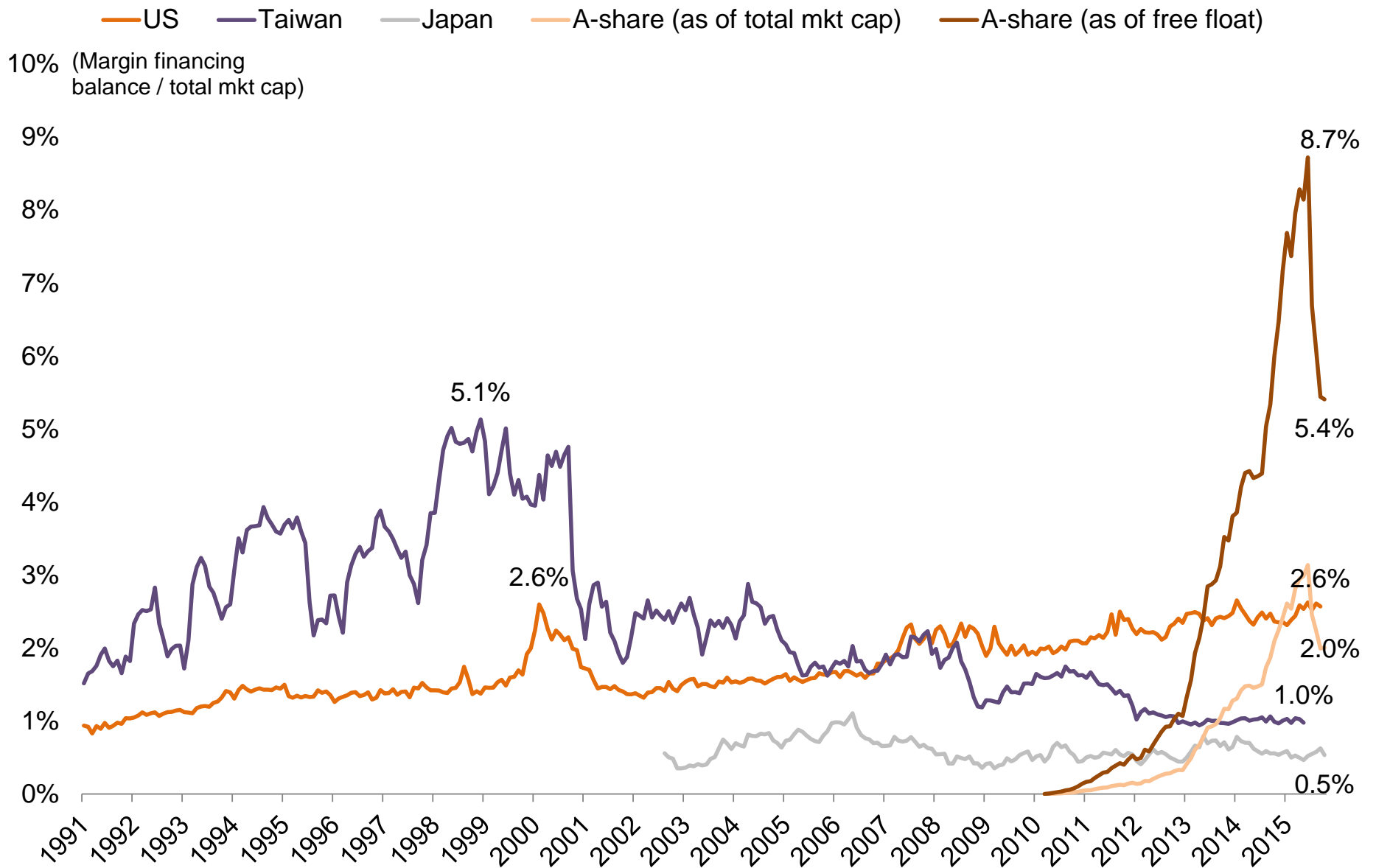


Bill-discount rate gradually down



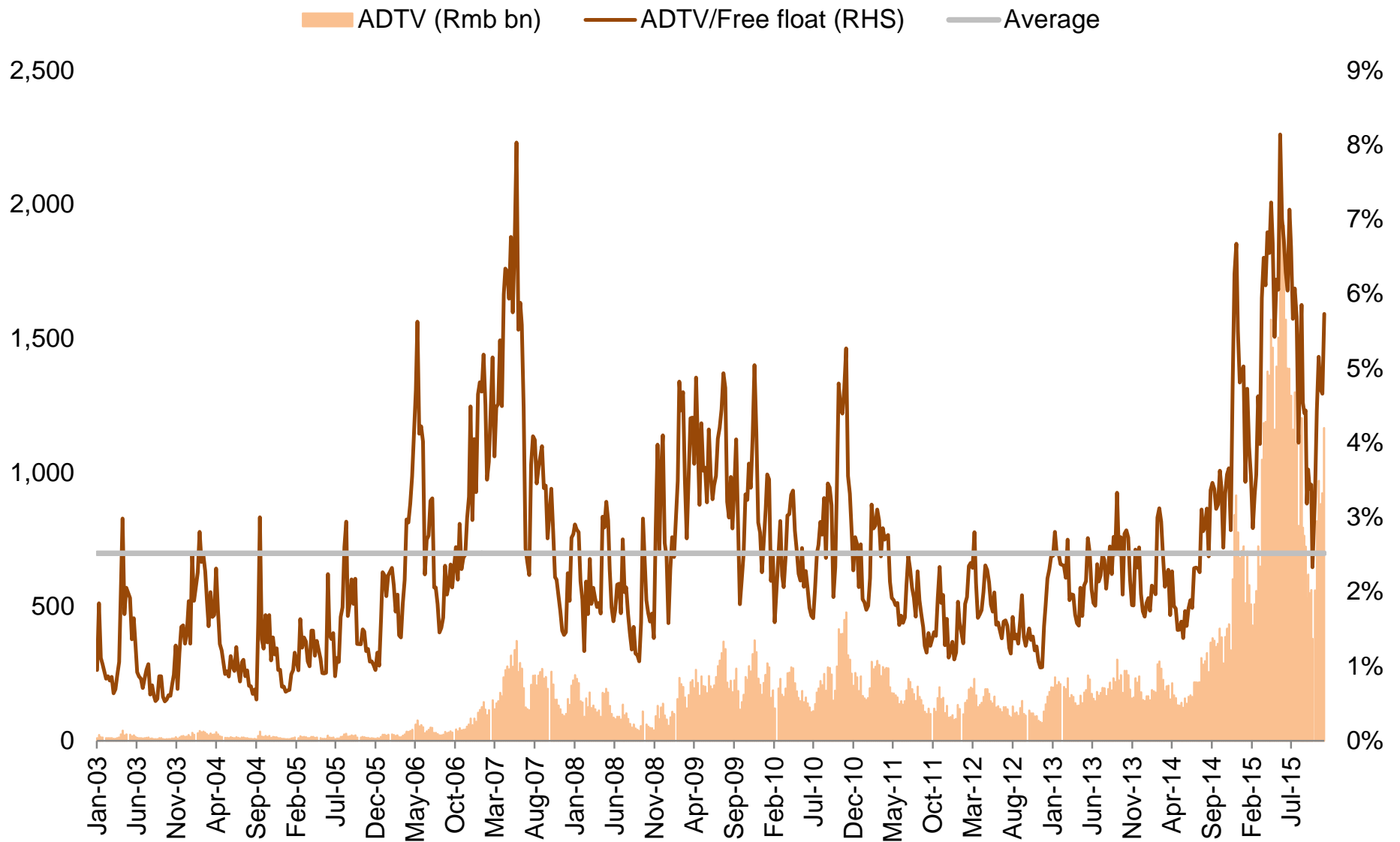
Source: Bloomberg, Wind, CICC Research

Liquidity in equity markets: margin financing: global



Source: Wind, CEIC, CICC Research

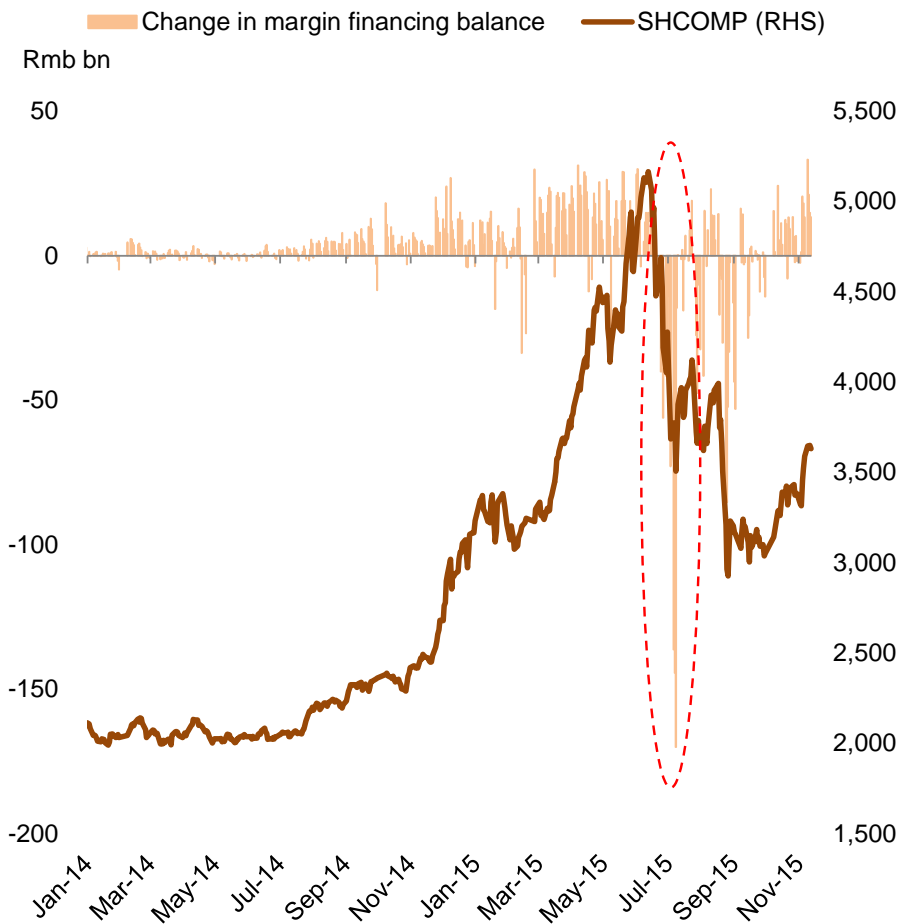
Liquidity in equity markets: market turnover rose from previous trough



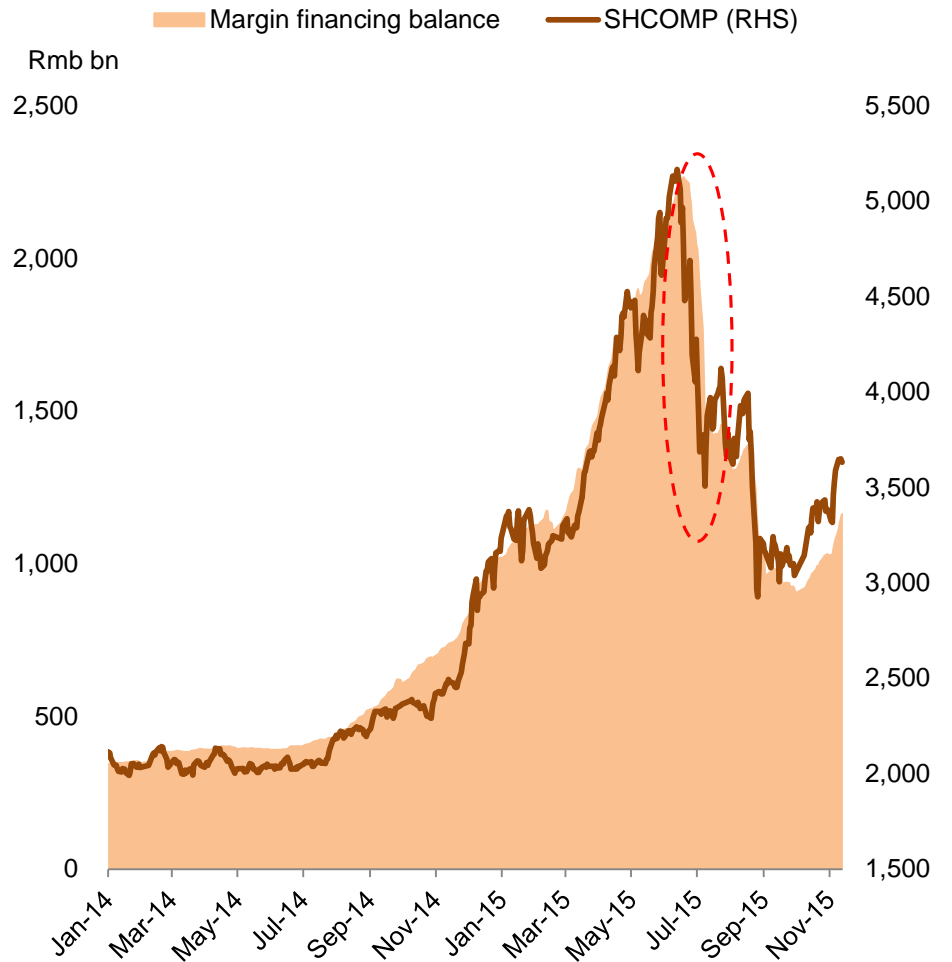
Source: Wind, CICC Research

Liquidity in equity markets: margin financing balance once declined sharply

Daily change of margin financing balance

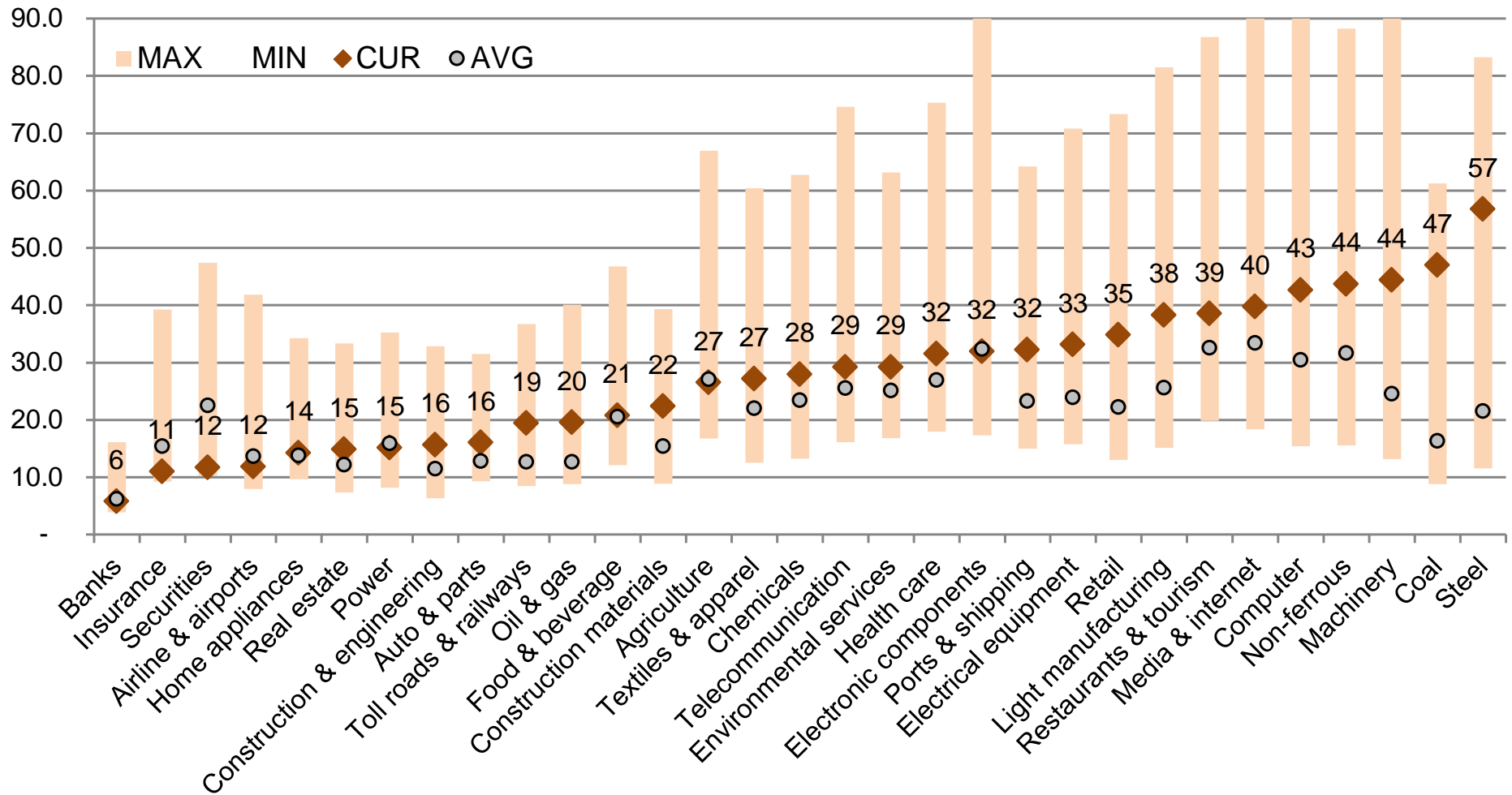


Margin financing balance



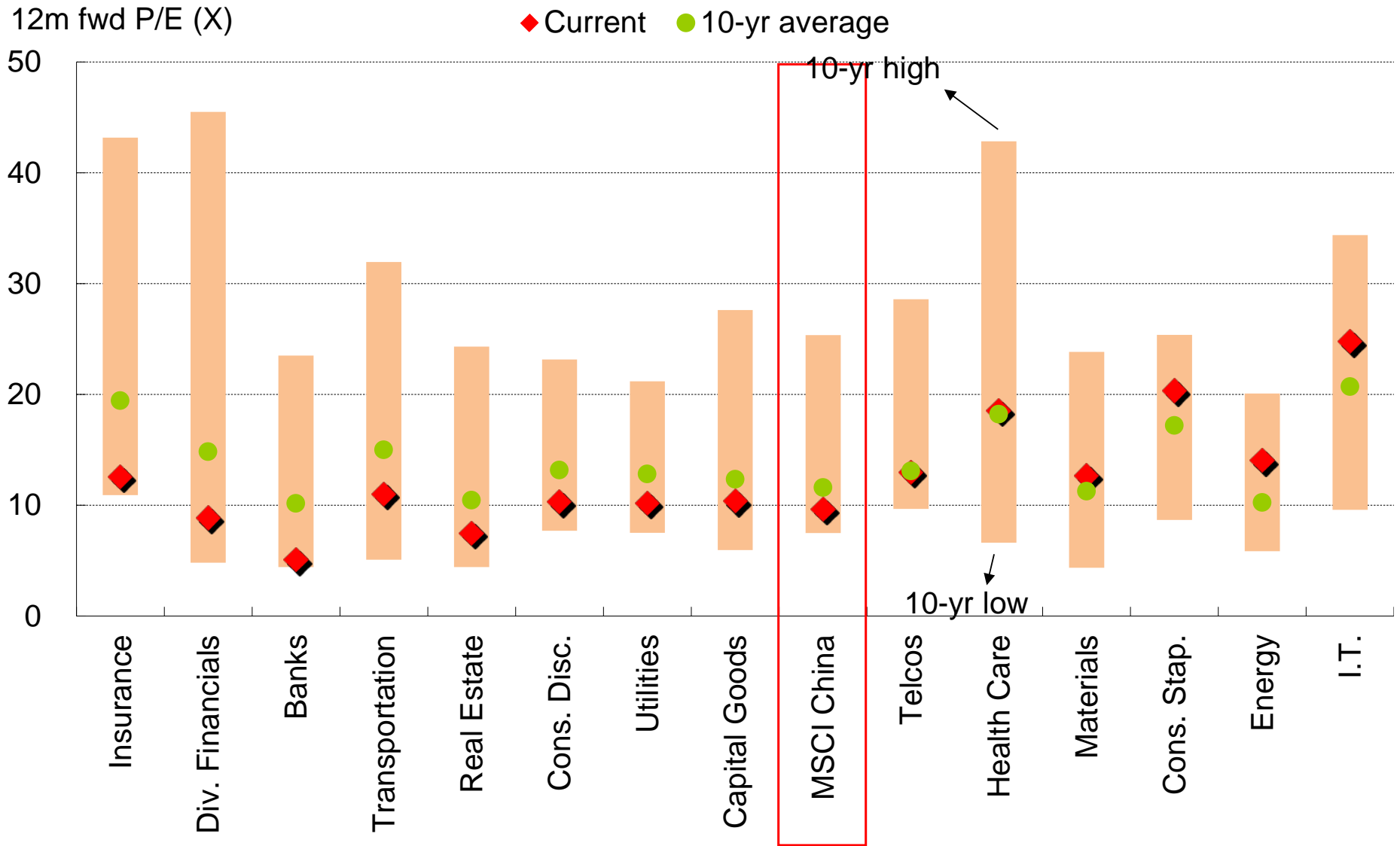
Source: Wind, CICC Research

A-shares' sector valuation: many sectors are above historical average (PE valuation)



Source: Wind, Go-goal, CICC Research

H-shares: most sectors' valuation are below historical average



Source: Bloomberg, Fact set, CICC Research

Rethinking of long-term issues:

Further Opening up and reform of capital market

China Story: Reform and Opening-up

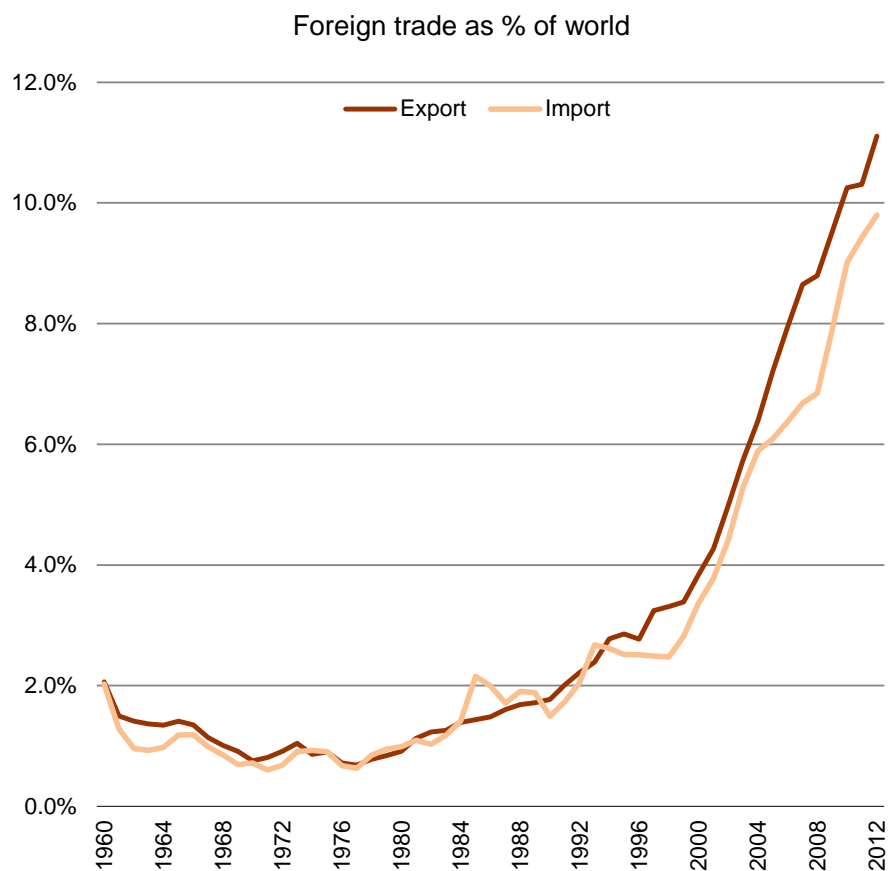
- In 1978, the third Plenary Session of the 11th CPC Central Committee launched China's historic reform and opening-up. Later, the 14th CPC National Congress and the third Plenary Session of 14th CPC Central Committee confirmed that the Chinese economy should be market-based and opened-up. Solid improvements in opening-up since China's WTO entry in 2001 have substantially boosted system reforms.
- According to Mr. DENG Xiaoping, China should open up both internally and externally in accordance with laws of socioeconomic development, and reform is in essence internal opening-up.



Source: CEIC, CICC Research

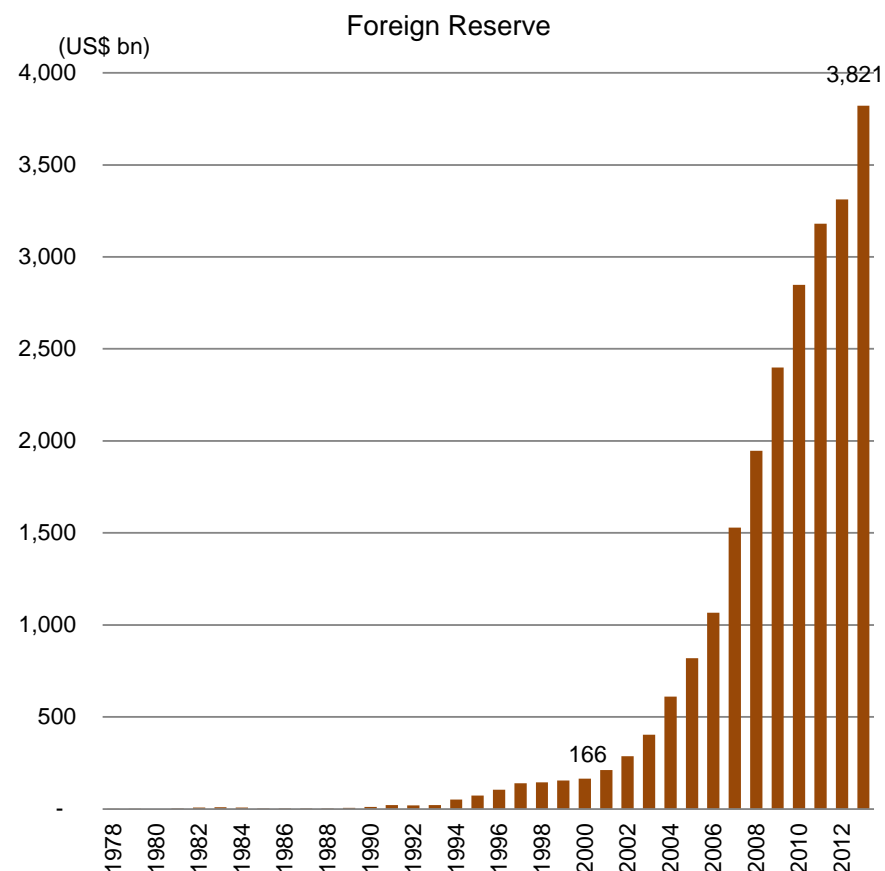
Benefits from reform and opening-up

China's growing importance in global trade



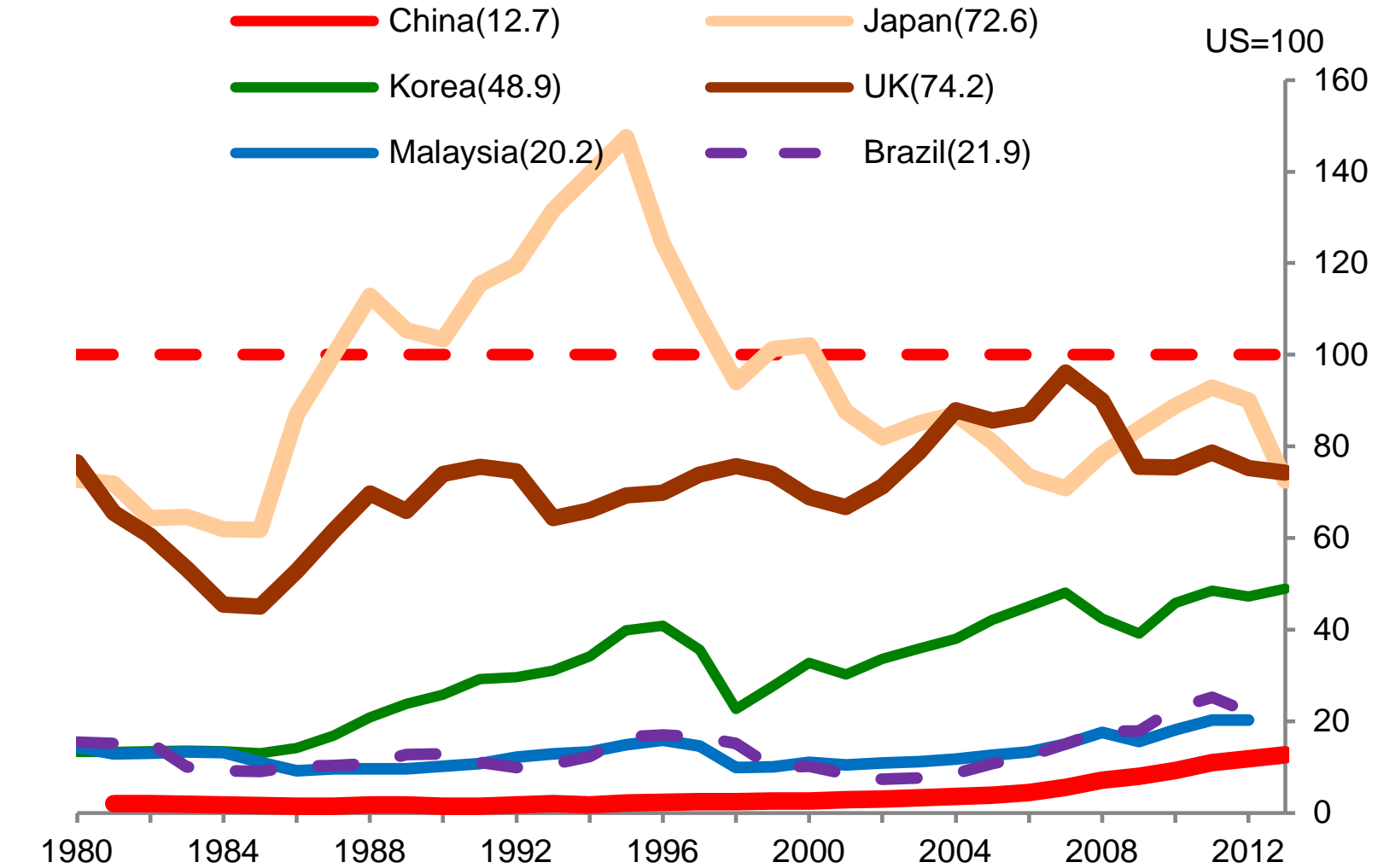
Source: Haver Analytics, CICC Research

China's foreign exchange reserves expanded rapidly



Source: Haver Analytics, CICC Research

Where is China now? (per capita GDP relative to US)



Source: CEIC, CICC Research

China in a four-dimensional glance

- Large economy: space to grow and gravity model
- Developing country: long way to catch up via industrialization and urbanization
- Transition economy with strong government: effectively implement policies under strong leaders
- Over insurance?

Deposits vs Debt held by households, corporate, and the government (as end of June 2015)

Deposits and Debts by sectors (as of June 2015)

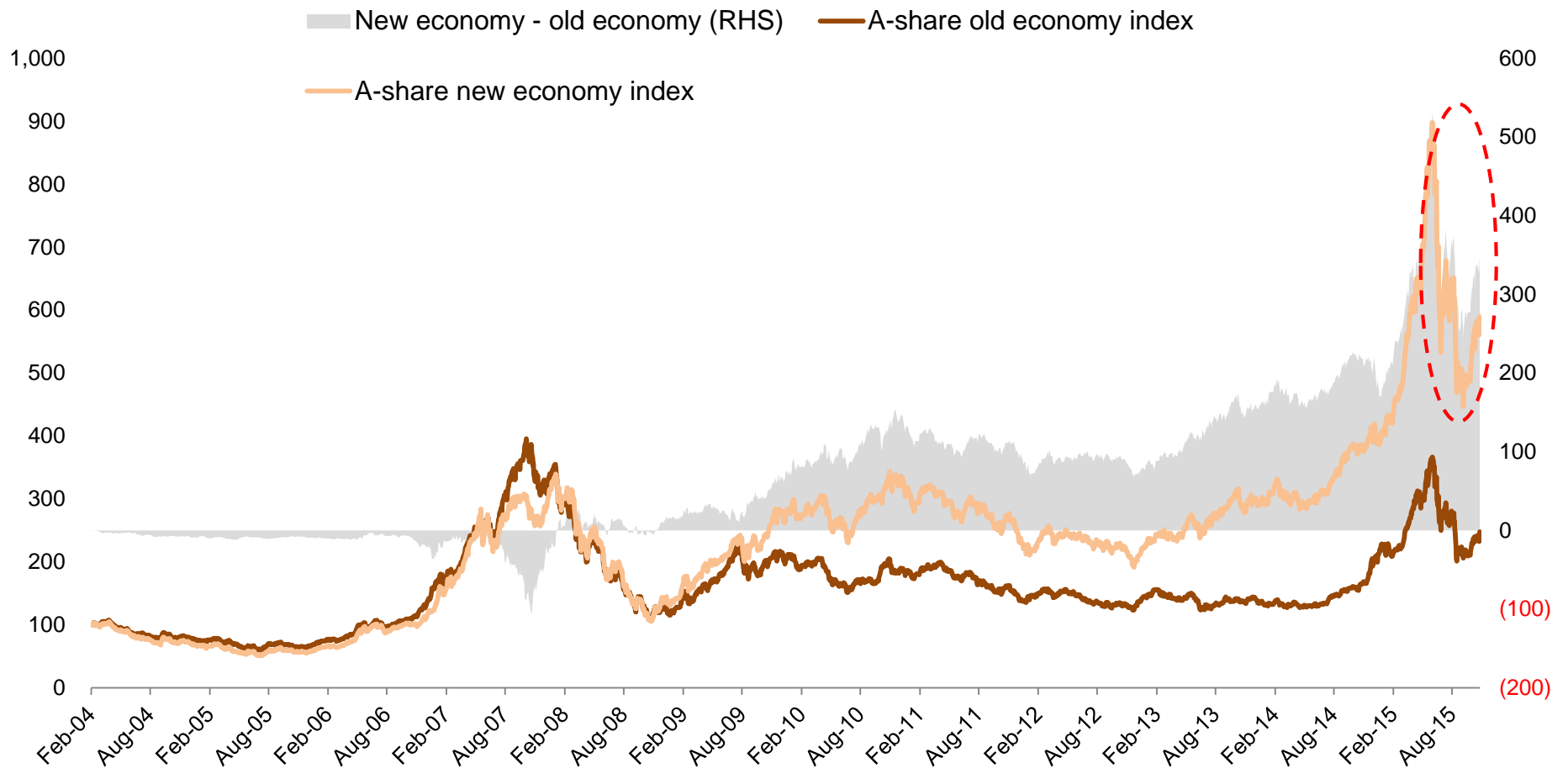
Households			
Deposits		Debts	
Rmb 53.7 trn	79% of GDP	Rmb 25.1 trn	37% of GDP
Non-financial corporations			
Deposits		Debts	
Rmb 42.2 trn	62% of GDP	<i>Total</i>	Rmb 98.5 trn 144% of GDP
		<i>Excluding debt of local govt</i>	Rmb 84.9 trn 124% of GDP
Government			
Deposits		Debts	
<i>RMB Deposits held by government entities</i>		<i>T-bond & Local govt bond</i>	
Rmb 20.2 trn	30% of GDP	Rmb 11.3 trn	17% of GDP
<i>RMB Fiscal Deposits</i>		<i>Policy financial bond</i>	
Rmb 4.1 trn	6% of GDP	Rmb 10.6 trn	16% of GDP
<i>Subtotal</i>		<i>Local govt debt</i>	
Rmb 24.3 trn	36% of GDP	Rmb 13.6 trn*	20% of GDP
<i>Foreign Exchange Reserves</i>			
USD 3.7 trn (Rmb 22.9 trn)	34% of GDP		
<i>Total (including FX reserves)</i>		<i>Total (including debt of local govt)</i>	
Rmb 47.2 trn	70% of GDP	Rmb 35.5 trn	52% of GDP

* The RMB 13.6 trn total outstanding local government debt is under review after the preliminary release of the updated local government debt audit in September 2015. We await for further details of contingent debt breakdown for an updated estimate of local government debt

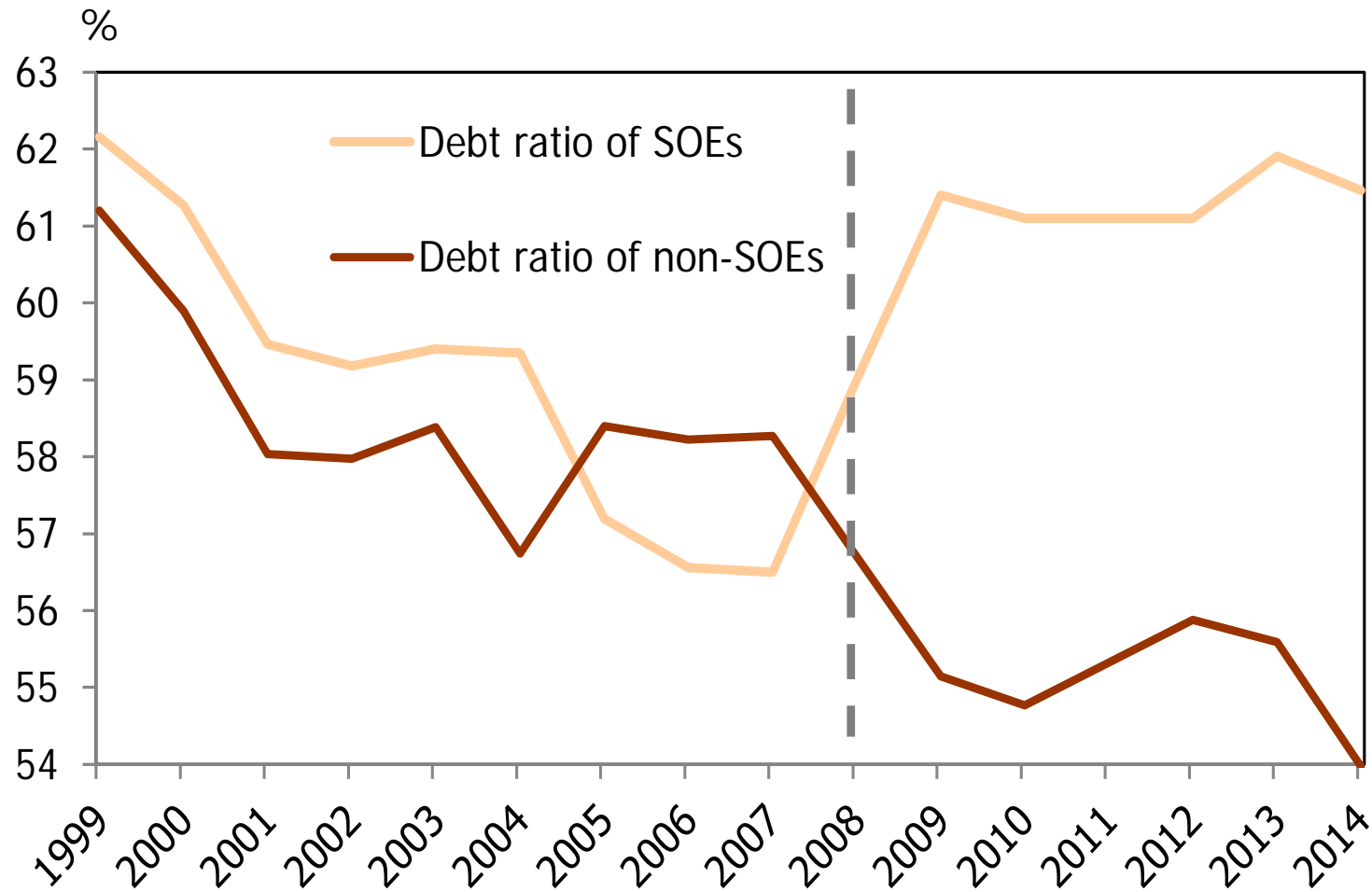
Source: CEIC, Wind, Official Audit Office, China Railway Corp., CICC Research

Note: The percentage to GDP ratios are divided by four consecutive quarters' GDP from 3Q12~2Q13.

“New economy” sectors outperformed in recent years



Debt ratio: a tale of two enterprises



Source: CEIC, CICC Research

Economic reforms after the third plenum

- Two main directions of reform
 - Market playing a decisive role in the allocation of resources
 - Economic development benefiting all people to a greater extent and in a more equitable manner

- Areas of reform
 - SOE reform
 - Change in the government's role
 - Fiscal and tax system: reforming the tax system, stabilizing the tax burden, making budget more transparent
 - Land system reform and integrated urban-rural development
 - A new round of opening-up
 - Easing of the family planning policy
 - Financial reforms on top of the agenda!

Path to financial reform

■ Market system

- Allowing the establishment of privately-owned small/mid-sized banks
- Registration-based IPO reform, tightened bond market regulation, increasing the proportion of direct financing
- Developing inclusive finance

■ Money rates

- More market-based exchange rate regime; accelerating interest rate liberalization
- Promoting two-way opening-up of capital markets
- Accelerating the process towards achieving RMB capital account convertibility
- Reducing FX reserves holding; increasing RMB bond issuance; 2% + 2%
- Implications on JGB; USD; etc.

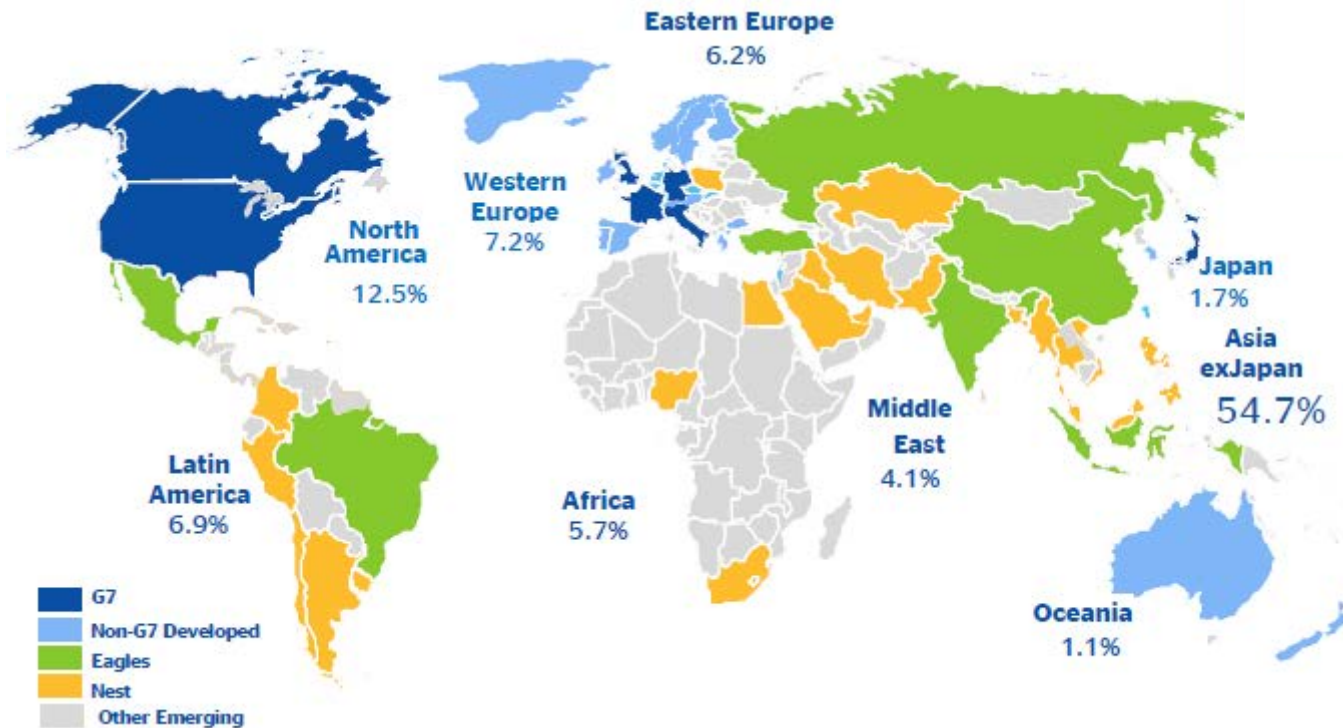
■ Financial regulation

- Improving regulatory coordination mechanism; establishing a deposit insurance system; introducing a market-oriented exit mechanism for financial institutions

Fast Forward: Global economic growth contributors

- Emerging Asian economies to contribute close to 55% to global growth in next 10 years
- US and EU to contribute less than 20%
- Two economies with double digit growth contributions

Contribution to World economic growth by region between 2013-2023



Source: IMF, BBVA

Thank you!

