

Greater China Market Commentary

December 2011

China's central bank indicates start of easing cycle

- Mainland China's headline inflation continues to cool down
- Hong Kong's GDP growth slowed but unemployment remains low
- Further RRR cuts might provide support to equity markets

Equities weakened in November as the ongoing sovereign debt crisis in Europe continued to weigh on sentiment. MSCI China fell 8.4% over the month. Hong Kong's Hang Seng Index and Taiwan's TAIEX declined 9.4% and 9.0% respectively, among the worst performers in the region. China's central bank reduced the portion of deposits banks must set aside, which might provide supports to Greater China equity markets.

Mainland China's inflation falling

The People's Bank of China announced that it would cut the reserve ratio requirements for major banks by 50 basis points to 21%. This action is to address signs of slowing growth, as evidenced by November Purchasing Manager Index, which fell to 49.0 from 50.4 in the previous month, indicating that manufacturing activity is softening amid global growth concerns. Inflation continued to subside in November, falling to 4.2% year-on-year from 5.5% in October and a peak of 6.5% in July. As global growth cools and inflation recedes, authorities have the latitude to further ease monetary policy and further reductions in the RRR are quite likely. Chinese equities are trading at 8.8 times 12-month forward price-to-earnings ratio, which is cheap relative to history.

In Hong Kong, GDP figures suggest sluggish growth but the economy continues to enjoy low unemployment. GDP for Q3 showed growth of 0.1% for the quarter, avoiding a second quarter of falling GDP and leaving it 4.3% higher than a year ago. Retail sales volume in October was up 15.0% from a year ago, roughly the same as previous month. The unemployment rate edged up to a still low 3.4% in November while inflation remained stubbornly high, coming in at 5.8% y-o-y in October. Valuations for Hong Kong equities remain attractive, trading at forward price-to-earnings ratio of 9.9x.

Taiwan's GDP revised up

We expect growth in Taiwan to maintain at a healthy rate but likely to be moderating. Industrial production growth was slightly below expectations at 1.41% y-o-y, while the final figure for third quarter GDP was revised up slightly to show growth of 3.42% from a year ago. The

HSBC Taiwan Manufacturing PMI fell for the second month, reaching 43.7 compared to 44.5 the month before. Looking into valuations, Taiwan's stocks are trading at a reasonable 12-month forward price-to-earnings of 14.0x.

Valuations of Greater China market still attractive

Previous policy tightening measures in China coupled with a subdued global growth profile are beginning to slow economic growth and bring inflation down. Worries over sovereign debt in the eurozone have dominated stock market sentiment in recent months and are likely to continue to do so. For Taiwan, increased trade with mainland China should keep exports growing. Overall, we reiterate our preference to Chinese equities over other Asian markets because of the attractive valuation and robust growth profile.

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