

China Weekly Economic Focus

Are reforms still on track in China?

Economics

China

Reforms are still on track, and could complement growth in 2014

Four months have passed since China's new reform blueprint was unveiled at the Third Plenum, but market concerns of reform going off track have risen noticeably. Signs of a mini stimulus for protecting growth haven't helped. What evidence is there to prove that reforms remain on track in China, especially if policy continues to slant more towards protecting growth in light of a softer Q1 GDP reading? What indicators can investors assess, to ascertain whether the long-term reform story unveiled at November's Plenum has not been jettisoned?

Far from it. We think reforms remain on track and a lot has already happened. Indeed, there is more to come. We think reforms in the near-term are complementary, not contradictory, to protecting China's bottom line growth.

In this report, we highlight key reform actions and announcements that have occurred in the last four months, and identify key areas in China's overall reform blueprint which have seen material progress over the same period in the latest instalment of our China Reform Tracker. We also list a few growth-enhancing reforms to be expected this coming year. This issue is becoming increasingly relevant as Q1 and April/May's economic data test the government's "lower bound" on growth.

Weekly update on reforms

Financial reform: The State Council outlined several measures for railway investment financing, highlights of which include plans to: establish a railway development fund to provide annual financing of RMB 200-300 billion; issue RMB 150 billion of railway construction bonds to the public in 2014, with favourable tax credit policies; encourage banks and other financial institutions to increase financing for railway construction.

Property reform: The State Council announced plans to create a special entity under the China Development Bank to issue social housing financing bonds in support of shanty town renovation.

Weekly price, rates and exchange rate monitor

Liquidity: Repo-rates have moderated since the end of March, with the 7-day repo rate closing at 3.60% on April 8, below March 31's 4.19%. The PBC conducted repo purchases totalling RMB 63 billion on April 8.

Price: Food prices edged down by 0.5% w/w during the week of March 24-30.

RMB: The onshore RMB exchange rate has stabilized, although depreciation expectations in both the NDF and CNH markets have strengthened marginally over the past week.

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Reforms are still on track, and could complement growth in 2014

Recent data points coming out of China have renewed fears of a potential growth wobble. The government has prepared a contingency plan to protect growth, and the recent acceleration in project approvals and construction has been perceived as signs of a mini-stimulus by the market. Investors are now becoming increasingly concerned that China is reverting back to its old ways, and hence derailing its ambitious plan for reforms. We think keeping reform progress on track and protecting growth are not necessarily contradictory in the near term, and any support provided for growth this time will be intertwined with reforms as well. Indeed, material progress has been made on reforms since November, and more will come. How can reforms coexist with maintenance of growth? To answer this, we highlight four key points.

1. The sequencing of reforms means growth-negative ones will likely be delayed. As we have written in previous reports, the principle of reforms sequencing is simply "the easier ones first". As such, we think the easier or more growth-neutral/enhancing reforms such as the decentralization and reduction of investment approvals, opening up of service sector for private investment, relaxation of the hukou and one-child policy, and development of new financial products will continue to proceed more quickly, as they have been doing so in recent months. More painful or growth-negative reforms such as the hardening of local government budget constraints, SOE restructuring, launching a nationwide property tax and land reforms will progress more slowly. While such a sequencing of reforms may not be ideal and could heighten the risks associated with continued rapid growth in investment and leverage in the long run, in the near term it does help to stabilize growth, and is the more feasible approach.

2. Plenty of reforms have already started and are ongoing. The breadth and frequency of reform announcements has picked up materially since November's Third Plenum. Examples that we would highlight include:

Price reforms: 1) an 11% increase in average rail freight rates and an official shift in the national rail freight pricing system from a government-determined to government-guided system; 2) designation of a market-determined rail cargo pricing system to the Huai-Chi railway after its completion; and 3) creation of a progressive pricing mechanism for household gas usage by the end of 2015 that is determined by how much each household consumes.

SOE reforms: 1) starting with Sinopec's restructuring and divestment of its oil product marketing business, reforms to promote private participation and mixed ownership are progressing, including to some local SOEs in Shanghai, Zhuhai and other areas; 2) Central SOEs' dividend payment to the state shareholder has been raised by 5 percentage points.

Financial reforms: 1) large-denomination negotiable certificates of deposit (aka interbank CDs) are allowed to be priced freely; 2) release of new rules for the IPO process, preferred stock issuance and dividend payments in China's A-share market; 3) a widening of the USDCNY daily trading band from +/- 1% to +/- 2%; and 4) CSRC's confirmation of plans to raise both QFII and RQFII's program capacity, and is working with other agencies to clarify QFII-related tax policy details.

Tax & Fiscal reforms: 1) expanding the business-for-VAT tax pilot scheme to China's rail transportation, telecoms and postal service sectors; 2) expanding China's resource tax reform to the coal sector; 3) bringing more spending and revenue items onto government balances sheets for a more comprehensive and transparent budgeting system; and 4) tax cuts for small and micro businesses (SMEs).

For more details and further highlights, see Figure 1.

3. What to expect this coming year: more reforms to support growth. In addition to the "usual" policies such as increased fiscal spending on infrastructure and social housing to support growth, we think the government will rely more heavily on growth-enhancing reforms to support growth this time around. A further acceleration of near-term reforms lined up in the pipeline that would be conducive to growth include: 1) quicker cuts to government regulations and approval procedures ("red tape") to encourage private investment; 2) reform of financing channels (for example through policy banks and long term bond issuance) to ensure faster delivery of "pipeline" infrastructure investment, in particular railway, subway, urban infrastructure (waste and water treatment, pipelines), rural roads and highways, slum renovation / social housing, and new energy related projects; 3) speedier reduction of regulations and entrance barriers to SMEs and private businesses in the services sector to bolster job creation; (4) quicker expansion of pension and health care insurance coverage and reforms in labour training; and (5) faster relaxation of "hukou" rules in small and medium-sized cities".

In addition, we expect the following reforms this coming year: 1) speeding up plans to divest SOE assets or to increase private participation to help improve SOE performance and attract private capital; 2) allowing large corporate CDs to be priced freely; 3) establishing a deposit insurance scheme to help accelerate deposit rate liberalization; 4) pushing through further energy price reforms; and 5) amending China's budget law legislation and progressing on the environmental protection act. While we expect improved regulation and supervision in China's shadow banking sector, we do not expect a wholesale tightening of conditions in the shadow banking system this year given that the government is still looking to the financial sector to support growth.

4. A more systematic anti-corruption campaign is good for growth in the long run. This past year, as western media focused on high-profile corruption related arrests in China and questioned the sustainability of the anti-corruption campaign, investors have been more concerned about the negative impact on consumption spending. We think the anti-corruption drive is here to stay, not through increasing numbers of high-level official arrests, but through systematic changes designed to reduce rent seeking opportunities and to put government spending under more public scrutiny. Some of these latter measures have already been implemented, such as: 1) scrapping and reducing of administrative government approvals for investment projects and businesses; 2) reforming resource, transport and factor price mechanisms to reduce "dual track" pricing and rent-seeking opportunities; 3) establishing new rules on public official (and the Party and Military) spending such as the use of public cars and offices, meals and banquets, and standardizing official expenditure budgets; 4) requiring more spending to be included in budgets at various levels of the government; and 5) requiring newly appointed or promoted officials to disclose information on their personal asset holdings.

China's anti-corruption measures had a notable impact on public and luxury spending in 2013. Despite expecting the campaign to continue, we also expect this negative effect to fade over time since consumption has effectively been "re-based" from a lower level of comparison last year. Moreover, we believe the more systematic measures being introduced will not only help ease public angst over official excess, but also help to boost long term growth. For example, reducing administrative government approvals lowers transaction costs for private sector business activities to encourage more private sector investment. The introduction of explicit rules on public official spending and more transparent expenditure budgets also supports fiscal reforms, giving the central government a better grasp of local governments' true balance sheets before any fiscal capacity adjustments are made. The government budgetary reforms and price reforms will also both help to improve the efficiency of resource allocation over the long term, which of course is also good for growth.

Figure 1: China Reform Tracker
A summary of Post-Plenum Reform Policy Updates

(NB: New items since our last weekly China reform update of April 1 are highlighted in italics)

Reform Area	Summary of China's Key Post-Plenum Reform Policies
Financial Sector	
Shanghai Free-trade-zone (FTZ)	PBC financial reform pilot directive: The PBC issued a directive to support financial reform pilots in Shanghai FTZ in Dec, 2013, including measures to promote free capital flows, capital account opening, RMB internationalization, interest rate liberalization in Shanghai FTZ.
	Cross-border RMB business: A detailed directive for cross-border RMB business in Shanghai's FTZ was released in Feb by the PBC, with guidance and rules on overseas RMB borrowing, cross-border RMB payment, two-way RMB capital pool, etc.
	FX transactions: China's State Administration of Foreign Exchange (SAFE) released a detailed directive simplified administrative approvals and procedures and relaxed FX management rules in a detailed directive concerning the treatment of foreign exchange transactions in Shanghai's FTZ in late Feb.
	Favourable tax policies: The Ministry of Finance (MoF) released a favourable corporate income tax rules in Dec, 2013, with gains made by FTZ firms from overseas non-monetary investment eligible for distribution over 5 years in their income tax treatment.
Interest rate liberalization	Interbank CDs: The PBC announced in Dec, 2013 that depository financial institutions (banks) can start issuing large-denomination negotiable certificates of deposit (i.e. interbank CDs).
	Timeline: PBC Governor Zhou confirmed during the NPC that China's interest rate liberalization can be moved faster than other financial reform items, and expects deposit rates to be fully liberalized in the next 1-2 years.
	National deposit insurance scheme: The government confirmed plans to establish a deposit insurance mechanism in 2014 during the NPC.
Capital market	New IPO rules: The CSRC released new rules for the IPO process, preferred stock issuance and dividend payments in China's A-share market in late Nov 2013: 1) Listcos are required to pay out 80% of net earnings as cash dividends if their business is mature and does not need significant capex; 2) Both listcos and non-listcos are allowed to issue up to 50% of common equities in preferred shares; 3) Listcos are prohibited from initiating a public offering if their net profits drop by over 50% in the first year after an IPO; 4) top 10% of IPO subscriptions with the highest bidding prices will be excluded from final pricing calculations.
	Preferred shares: The CSRC released a plan for its preferred shares issuance pilot program, allowing both listed and non-listed companies to issue preferred shares. The three types of listed companies qualified for preferred share issuance include: 1) companies in the Shanghai Stock Exchange 50 A-share index; 2) companies issuing preferred shares to merge and acquire other listed companies; and 3) companies issuing preferred shares to buyback common shares to reduce registered capital.
	Investor protection: The State Council issued a directive in Dec, 2013 to protect small and medium investors' rights and interests, taking steps to improve listco's disclosure requirements, support the voting power of small and medium investors, and establish/refine dispute resolution and compensation mechanisms in China's capital markets.
	Equity exchange system: The National Equities Exchange and Quotations system for small and medium enterprise was officially rolled out nation-wide, to promote SME equity exchange's OTC market development, effective Dec 31, 2013.
	Capital Market blueprint: The State Council outlined China's plans to develop a multi-layered capital market during the NPC, focusing upon: furthering stock market reform with the introduction of a registration-based IPO system & exit mechanism; cultivating China's bond, private equity, and futures markets; promoting the development of financial intermediary institutions/agencies; and broadening the liberalization of China's capital markets.
Capital account opening & RMB internationalization	FX loan transfers: SAFE released a directive simplifying administrative processes for the transfer of FX loans between different business entities, effective Mar.
	Confirmed government plans: PBC Governor Zhou confirmed at the NPC that China's RMB internationalization process and capital account opening will continue their steady progress. The China Securities Regulatory Commission (CSRC) also confirmed plans to increase the capacity of both the QFII and RQFII programs, and is working with other agencies to clarify QFII-related tax policy details. Plans to further open China's capital markets to foreign securities (brokerage) firms, fund management and futures institutions were also confirmed.
	Foreign central bank cooperation: The PBC signed a cooperation memorandum with the Deutsche Bundesbank and Bank of England in Mar for offshore RMB clearing arrangements in Frankfurt and London. RMB clearing banks will be designated at a later date.
	Band widening: The PBC widened the USDCNY daily trading band from +/- 1% to +/- 2%, effective March, 17.
Financial reform	Private banks: The China Banking Regulatory Commission (CBRC) kicked off a pilot to create China's first five private banks at the NPC, each with at least two joint investors, in Tianjin, Shanghai, Zhejiang and Guangdong. The pilot is still at a preparatory stage and awaits later regulatory review.
	Reform pilot: The Yunnan-Guangxi Financial Reform Pilot Zone was established in Nov, 2013 to push for cooperation with ASEAN countries.
Financial regulation	Non-financing guarantee companies: Eight regulatory agencies issued a joint directive at the end of 2013 to promote financial and economic stability, specifically to standardize and tighten regulation rules on activities of non-financing guarantee companies. Local government must now review and rectify before the end of Aug.
Financing mechanism	SME Refinancing: The PBC launched a new SME refinancing loan program in Mar to support further expansion of financial institution's lending to small and micro enterprises, with an initial quota of RMB 50 billion. Such loans are meant to be issued to small city commercial banks, rural commercial banks, rural cooperative banks, and village banks, at a rate less than the benchmark lending rate.

	Railway investment financing: The State Council outlined several measures for railway investment financing, highlights of which include plans to: establish a railway development fund to provide annual financing of RMB 200-300 billion; issue RMB 150 billion of railway construction bonds to the public in 2014, with favourable tax credit policies, etc.
Fiscal and tax system	
Tax reform	Tax reform structure: The State Council planned to expand the business-for-VAT tax pilot scheme to the rail transportation and postal service sectors effective Jan, and to the telecoms sector effective Apr. China's resource tax reform will also be expanded to the coal sector, with tax to be levied on value rather than quantity as before.
	Tax legislation: The NPC has reportedly confirmed that amendments to China's budget law and environmental protection act will proceed as planned and have been officially included in the 2014 legislative agenda. Legislative drafting work for China's real estate tax bill and environmental protection tax law will be accelerated this year, for eventual review by the State Council.
	Tax reduction for SMEs: The State Council expanded the coverage of its reduced corporate income tax policy for small and micro businesses (SMEs) in Apr, and extended this favourable tax policy until end-2016.
	Favourable Shanghai FTZ policies: See Shanghai FTZ section before.
Budget reform	Budget coverage expansion: The government plans to bring more spending and revenue items onto government balances sheets for a more comprehensive and transparent budgeting system.
	Fiscal funding management: The State Council announced changes to the central government R&D management in Jan, including measures to: decentralize and streamline associated approval processes, improve researcher incentive plans, and promote a "government-supported; corporate-driven" participation model.
Local government debt	MoF guidelines: The MoF released guidelines for a pilot program to tackle the local government debt issue at the NPC, including proposals to: encourage the Public-Private-Partnership structure in urban infrastructure development; grant local governments the right to raise moderate amounts of debt (for now, the MoF continues to issue local government bonds on their behalf); create a fiscal debt alert and resolution mechanism; categorize local government debt to enable differentiated management and quota control; and further regulating LGFVs. The pilots will initially start in some but not all localities, with progress expected to be gradual.
Fiscal capacity at county level	MoF directive: The MoF issued a directive in Dec, 2013 to standardize fiscal capacity at the country level. Key targets and measures will be set by the central government to ensure that local governments adhere to a basic national standard for fiscal spending on wages, social welfare, and other public expenses.
Social benefit system	
Pension	Favourable tax policies: Preferable tax policies to be applied to China's version of the 401K, with its coverage expanded to public institutions. Deferred tax payment will also be allowed.
	Urban-rural pension scheme: The State Council announced plans to integrate China's current basic rural and urban pension schemes, with equal access for all rural residents and retired company employees in urban areas, to promote labor mobility and anchor social expectations.
Medical care	Medical care reform: The State Council outlined the main areas of its medical care reform plans in Mar, with proposals to: establish a universal medical care insurance system; accelerate public hospital reform; gradually relax entry restrictions for private capital in operating hospitals; improve China's basic drug system; and optimize and standardize the drug distribution regulatory system.
Family planning	
One-child policy	Relaxation: The People's Congress approved the National Council's proposal for relaxing family planning policies in late Dec, 2013. More than 20 provinces have already approved or set up agenda to relax one-child policy so far.
Property & Land reform	
Rural land reform	Reform pilot: Anhui Province released a directive to push forward a rural and agricultural reform pilot on in Nov, 2013, designed to: 1) accelerate the development of large-scale operations (agricultural farm, rural cooperative, agricultural products enterprise); 2) push to finish a complete registry of rural land use rights before end-2015; 3) improve the current rural land transaction mechanism.
	Principles: Senior leaders from China's central group of agricultural affairs and the Ministry of Agriculture clarified the key principles underlying China's rural land reform process. Of collective land designated for business construction purposes, only those that meet stipulated land-plan and land-use requirements can be transacted in the construction land market. The circulation of contracted farm land is encouraged and should follow two principles: voluntary circulation with compensation and no change to registered land-use purpose.
	Contracts reaffirmation: The Minister of Agriculture indicated in Dec, 2013 that rural land contracts of farmers will be reaffirmed within the next 5 years.
Real estate registration	Registration system: The State Council announced to establish a consolidated real estate registration system in the coming years and created a joint-conference mechanism to push forward establishment of such system. The joint-conference is led by the Minister of Land Resources alongside senior staff members from nine government ministries and agencies.
	Timeline: The Ministry of Land Resources said that an ordinance of China's national real estate registration system will be released by mid-2014. It also confirmed plans to establish a national real estate registration system within 3 years, and to launch an information management platform for this system within 4 years.
Shanty-town renovation	Financing mechanism: The State Council will create a special entity under the China Development Bank to issue social housing financing bonds in support of shanty town renovation, to be sold to public via the Postal Saving Bank and other financial institutions.
Administration reform and performance evaluation	

Anti-corruption / Austerity Campaign	<p>Public officials' disclosure: Following the Third Plenum, the Central Committee for Discipline Inspection of the CPC initiated a pilot scheme requiring newly appointed or promoted officials to disclose information on their personal asset holdings, their family members' jobs, income and cross-border activities. Several more directives were issued in Jan to enforce the streamlined disclosure of spending by the Party, government administrative officials, and other public entities.</p> <p>Anti-corruption five year plan: A five-year working plan (2013-2017) was released by the Party last Dec, to improve the structure of China's ongoing anti-corruption campaign.</p>
List of central government approvals	Centralized government approvals list: The State Council released a full list of all administrative approval requirements currently required by 60 central government departments and agencies in mid-Mar. Approval requirements falling outside this list will no longer be allowed.
SOE & State asset management reform	
SOE Public-Private ownership structure	<p>SOE divestment: SINOPEC, one of the biggest SOEs, announced plans to restructure its oil product marketing business and allowing private investors to take up to a 30% stake in its business. The segment makes up about 22% of its total assets and about a third of operating profit.</p> <p>Local government asset divestment: The State Asset Supervision and Administration Commission of Zhuhai in Guangdong province announced plans to sell its 49% stake in the GREE (electrical appliances) group to strategic private investors.</p>
Shanghai SOE and state asset management reform pilot	Shanghai government directive: The Shanghai government issued a directive to clarify implementation of its SOE and state asset management reform pilot program. Main targets are expected to be achieved in 3 to 5 years, along the following policy directions: state owned assets to be concentrated in industries of strategic or social importance; SOEs to go public gradually; payments received from SOE dividends to be evenly distributed for the purposes of social welfare, infrastructure, and industrial development; management of SOEs to differ according to competitive, functional, or public services nature of business, and introduction of more market-driven recruitment and remuneration practices for senior management to improve SOE corporate governance.
Dividend payment	SOE dividend requirement: Share of central SOEs' profits deliverable to the central government has been lifted by 5 percentage points, effective 2014. Central SOEs are required to submit up to 25% of their profits to the central government. Share of profits to be paid as dividend to public finances will differ according to the competitive nature of the enterprise in question, falling into one of five categories: 25%, 20%, 15%, 10% and 0%.
Price reform	
Rail freight pricing	<p>Government-guided freight pricing: The National Development and Reform Commission (NDRC) increased average rail freight rates by RMB 0.015 per ton per km (11%) effective Feb 15, and officially shifted the national rail freight pricing system from a government-determined to government-guided system.</p> <p>Market-determined freight pricing: The NDRC approved the use of a market-determined rail cargo pricing system on the Huai-Chi railway, after its completion.</p>
Household gas price reform	Progressive price plan: The NDRC issued a directive for all cities to establish a progressive pricing mechanism for household gas use by the end of 2015, based upon how much each household consumes (three levels of 80%, 95% and >95% of the monthly national average household gas use).
Over-capacity	
Electricity pricing mechanism to curb aluminium production	Progressive pricing to curb over-capacity: The NDRC introduced a new progressive pricing system for electrolytic aluminium producers' electricity consumption. This follows an earlier State Council Directive issued in Oct, 2013, targeting over-capacity issues in the steel industry, electrolytic aluminium industry, cement industry and plate glass industry.
Environmental protection	
Ecology projects	Project approvals: The State Council on Dec 18 gave the go-ahead for several key ecology protection projects: an ecological protected zone in Qinghai's Three Rivers Source Region; an ecological protected zone in Gansu; a sand-control initiative in Beijing and Tianjin, and a water-environmental protection initiative in the Five Lake Regions.
Air pollution control	State Council governance measures: The State Council released further air pollution control measures in Feb, accelerating plans to: enhance energy consumption efficiency and minimize the resultant pollution generated; introduce fiscal support, price incentives and subsidies to minimize air pollution; and strengthen pollution accountability assessments.
Legal / Judicial	
Transparency	New rules: The Supreme Court issued new rules requiring the online disclosure and publication of all judicial documents (effective Jan, 1).
Abolishment of re-education labour camps	Legislative policy change: China's re-education-through-labour system was officially abolished by the People's Congress at end-2013.
Corporate / Private Sector development	
Creative & Cultural industries	Industry support: The State Council (Jan) established policy measures to promote/support development of China's creative and cultural industries, via: improved intellectual property rights protection; policies to encourage greater participation of SMEs and private capital, etc.
Labour-intensive SME sector	Industry support: On Dec 31, an official directive was released by multiple departments and agencies to support the development of China's labour-intensive SME sector. Policies issued focused on encouraging greater private capital participation, lower tax burdens, enhancement of fiscal and financial support, etc.
Directive to promote M&A	M&A Directive: The State Council issued a directive to promote and support M&A activities in China, with new measures to: 1) further abolish, decentralize and simplify associated administrative approvals; 2) improve bank loan and capital market financial services; 3) provide related fiscal and tax favourable policies; 4) lower entry barriers for private capital in M&A activity; and 5) accelerate related SOE reforms.

Source: UBS estimates

Interest rate & liquidity monitor

— China's repo rates have declined since the end of March

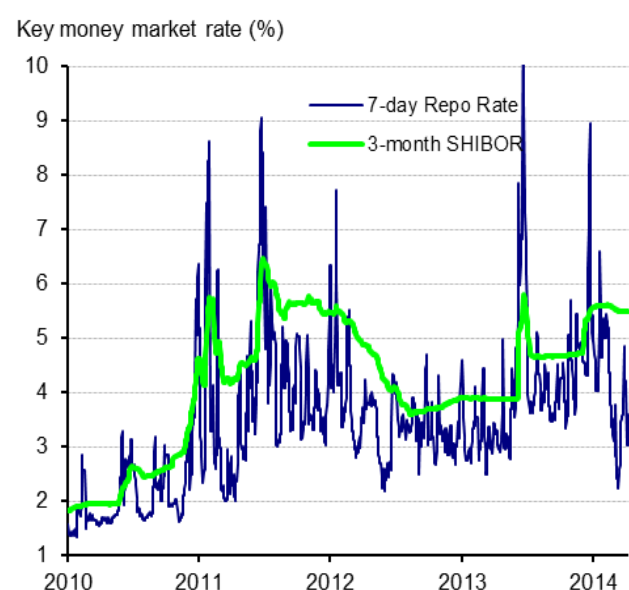
Repo rates edged down slightly

China's money markets stayed relatively sanguine for a while after the Chinese New Year, but started to rise again in mid-March. With the passing of the quarter-end effect, repo rates edged down for the first few days of April before resuming a modest upward trend. The 7-day repo rate closed at 3.60% on April 8, below March 31's level of 4.19%. Meanwhile, the PBC continues to withdraw liquidity with repo purchases, with RMB 63 billion of repo purchases on April 8. With RMB 232 billion of repo purchases due to mature this week, repo purchases will be conducted again on April 10 (last week's net liquidity withdrawal totalled RMB 62 billion and RMB 98 billion the week before). Looking ahead, short-term money market rates will likely edge up gradually — we maintain our forecast for the 7-day repo to average around 4-4.5% in 2014.

Bill rates stabilized

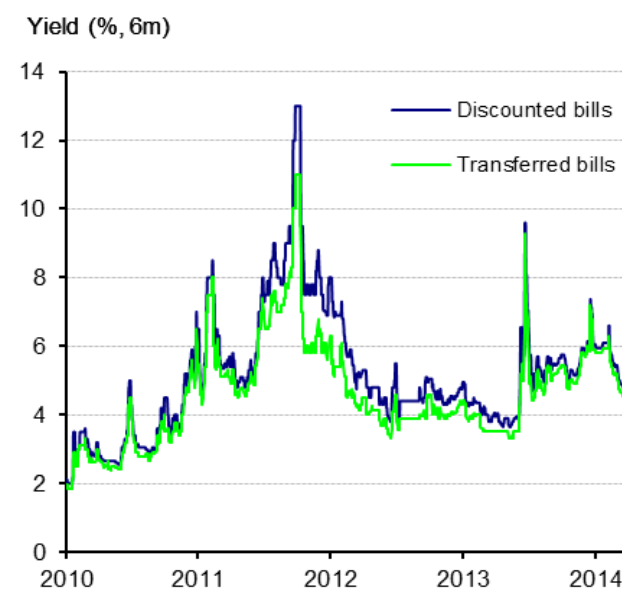
As a proxy for liquidity conditions at the enterprise level, yields of discounted and transferred bills have started to stabilize, suggesting that liquidity conditions in the real economy remain accommodative (Figure 3).

Figure 2: Repo rates have moderated since the end of March



Source: CEIC, UBS estimates

Figure 3: Discounted and transferred bill rates have stabilized of late



Source: CEIC, UBS estimates

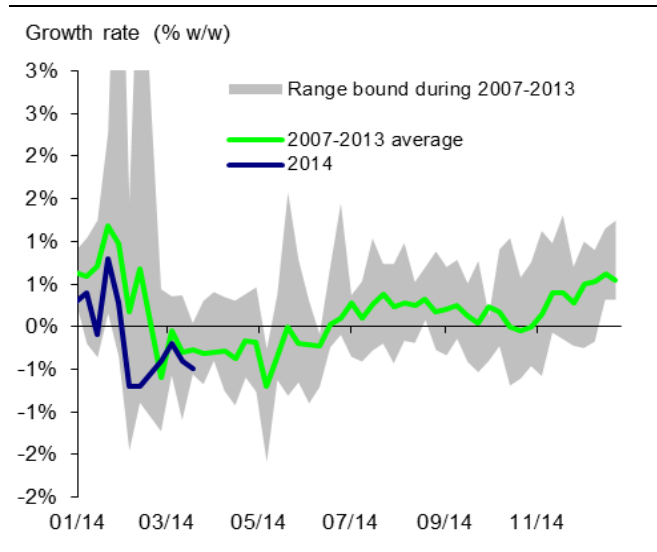
Inflation monitor

--- China's food prices continued to edge down

According to the Ministry of Commerce, food prices in the 36 large cities monitored declined by 0.5% w/w during the week March 24-30 (Figure 5). Vegetable prices led the decline, sliding by 2.6% w/w, as meat and aquatic prices edged down by 0.3% w/w and 0.2% w/w respectively. Contracted fruits and grain prices both rose slightly. (Figure 6-7).

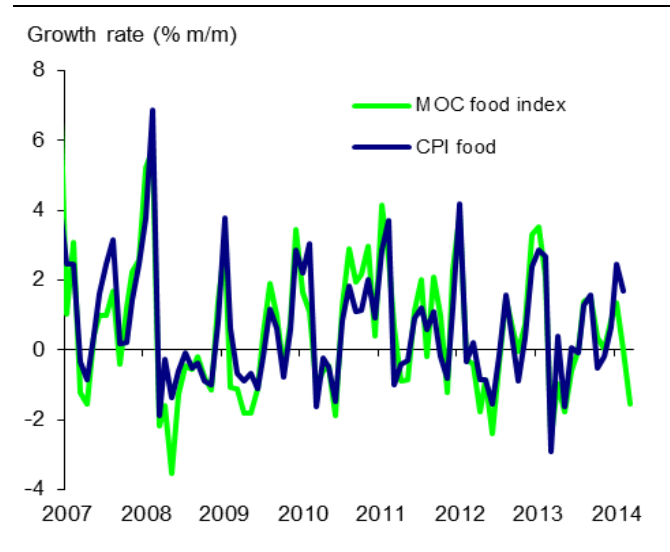
We cut China's 2014 CPI inflation forecast last month, from 3.0% to 2.7% due to a weaker starting point (see "2014 China CPI Inflation Forecast Cut to 2.7%", March 11), but do not think concerns of full-scale deflation are warranted. We expect CPI to rise by 2.4% y/y in Q1.

Figure 4: Food price growth versus historical pattern



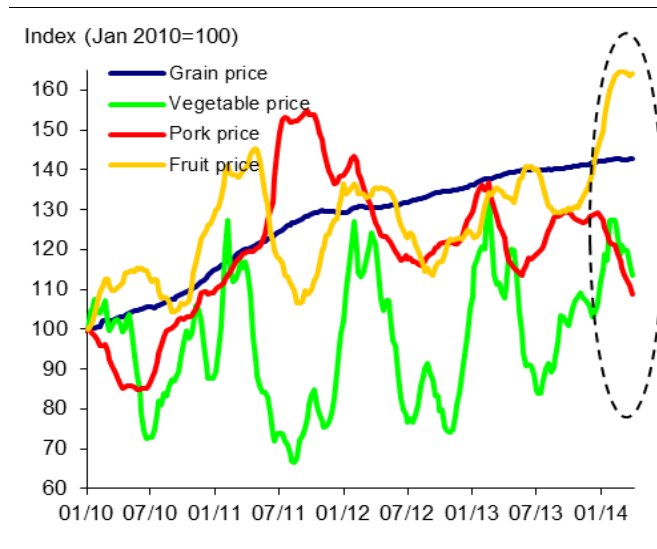
Source: CEIC, Ministry of Commerce, UBS estimates

Figure 5: Sequential momentum of food prices eased



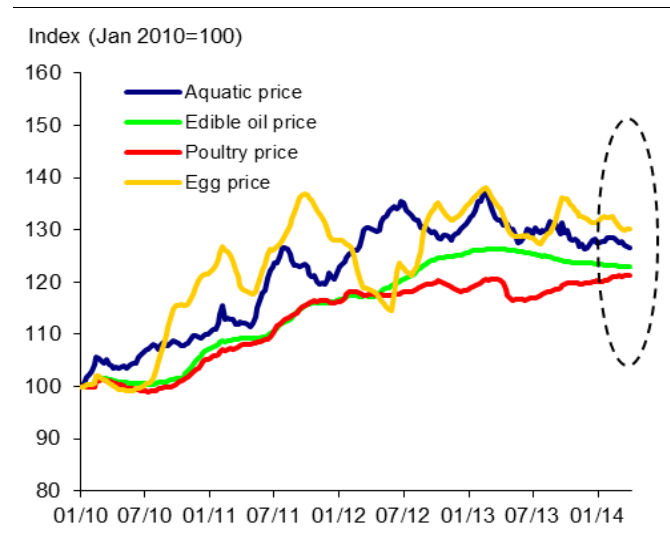
Source: CEIC, Ministry of Commerce, UBS estimates

Figure 6: Vegetable prices led the decline in food prices...



Source: CEIC, Ministry of Commerce, UBS estimates

Figure 7: ...while those of edible oil held steady



Source: CEIC, Ministry of Commerce, UBS estimates

Global commodity price monitor

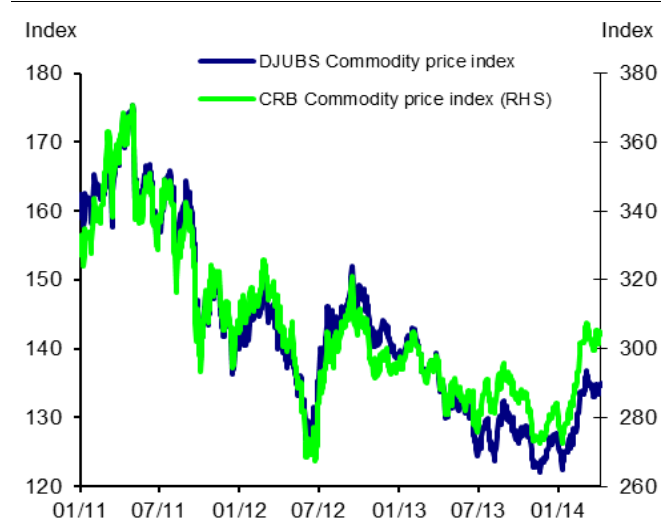
--- *Global commodity prices have stabilized, but domestic producer prices are still contracting y/y*

After almost 2 months of steady increase, global commodity prices have recently started to stabilize, as seen in both the DJUBS (Dow Jones-UBS) and CRY (Thomson Reuters/Jeffries CRB) Commodity indices (Figure 8).

Domestic prices of mineral product and energy declined slightly again for the week March 31- April 6, whereas prices of non-ferrous metal and rubber gained momentum very marginally. (Figure 10-11).

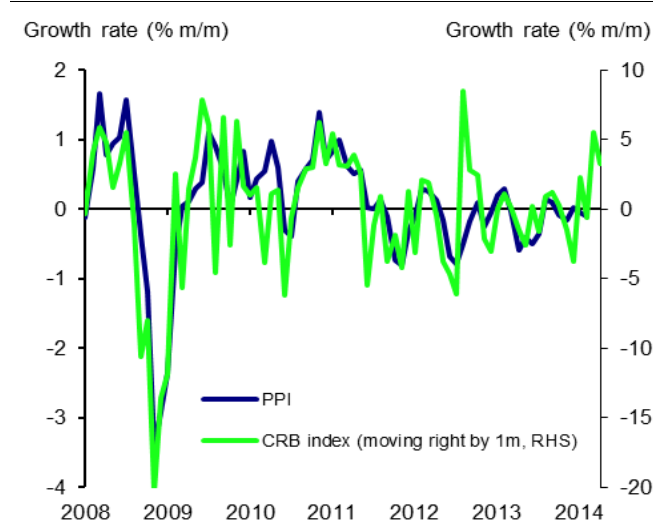
PPI showed a steep decline of 2% y/y in February, led by softening commodity prices. We expect PPI to contract by 2.1%y/y in March, before stabilizing to register positive m/m growth in H2 2014. For 2014, we expect PPI to average -0.6%, a smaller contraction compared with 2013 (-1.9%).

Figure 8: Global commodity prices stabilizing



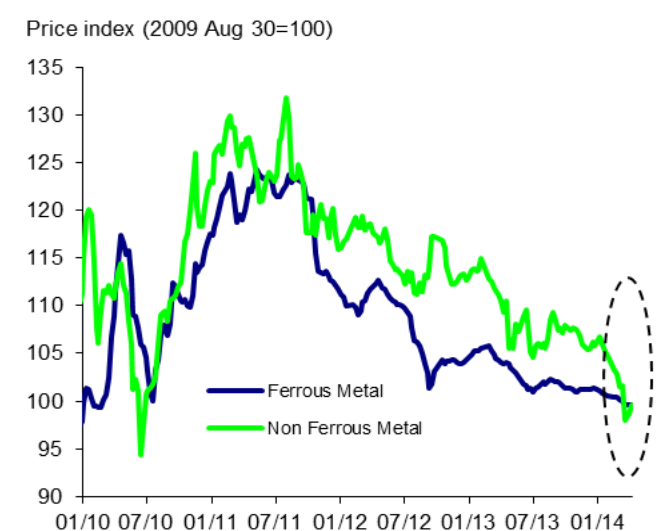
Source: Bloomberg, CEIC, UBS estimates

Figure 9: ... as China's PPI continues its marginal decline



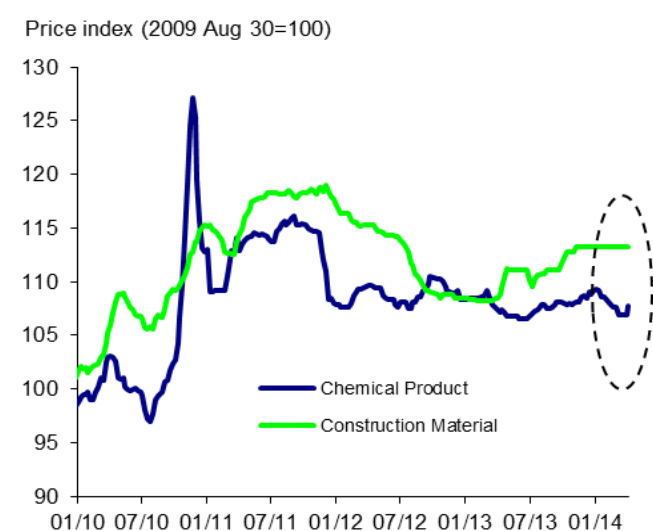
Source: Bloomberg, CEIC, UBS estimates

Figure 10: Non-ferrous metal prices gained momentum last week...



Source: CEIC, Ministry of Commerce, UBS estimates

Figure 11: ...as did those of chemical products



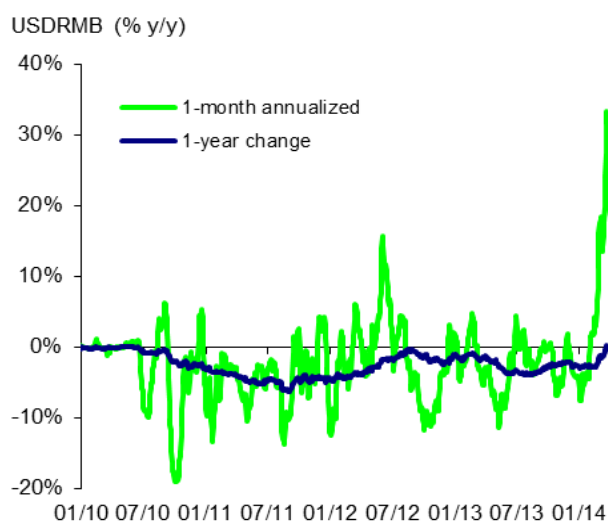
Source: CEIC, Ministry of Commerce, UBS estimates

Exchange rate monitor

--- Onshore RMB exchange rate has stabilized somewhat; depreciation expectations strengthened marginally in both the NDF and CNH markets

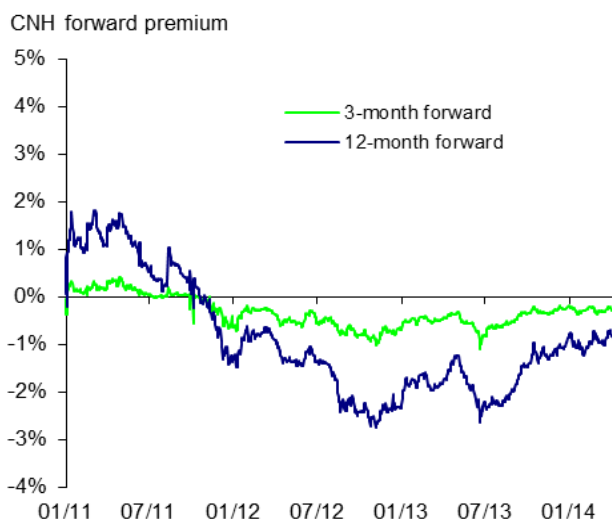
The onshore RMB spot exchange rate has hovered between 6.19 and 6.21 in the past week, closing at 6.197 on April 8. Depreciation expectations intensified somewhat both in the CNH market and in the NDF market.

Figure 12: RMB exchange rate has hovered between 6.19 and 6.21 in the past week



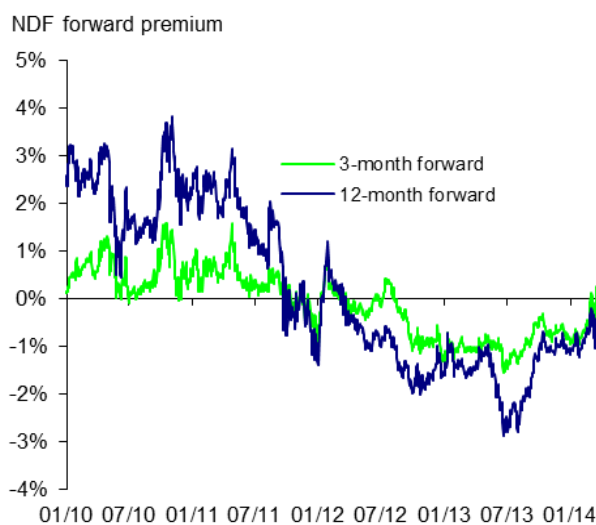
Source: Bloomberg, UBS estimates

Figure 13: Depreciation expectations intensified slightly in the CNH market...



Source: Bloomberg, UBS estimates

Figure 14: ...as did those in the NDF market



Source: Bloomberg, UBS estimates

UBS China Economic Outlook

Figure 15: China Key Economic Indicators

	2012	2013	2014E	2015E
National Accounts (% y/y)				
Real GDP	7.7	7.7	7.5	7.0
Domestic demand	8.5	8.1	7.7	7.2
Consumption	9.3	8.0	8.3	7.9
Fixed Investment	7.4	8.3	7.0	6.2
Net exports (contribution to GDP growth)	-0.2	-0.1	0.1	0.1
Nominal GDP (RMB bn)	51,947	56,885	62,802	69,214
Nominal GDP (USD bn)	8,229	9,185	10,262	11,347
Inflation (% y/y)				
CPI	2.6	2.6	2.7	3.0
Trade and Balance of Payment				
Exports of goods (BOP basis, USD bn)	2,057	2,219	2,414	2,644
Exports of goods (% y/y, in USD)	8.0	7.9	8.8	9.5
Imports of goods (BOP basis, USD bn)	1,735	1,859	2,026	2,209
Imports of goods (% y/y, in USD)	4.5	7.1	9.0	9.0
Trade balance (BOP basis, USD bn)	322	360	388	435
Current account balance (USD bn)	193	189	222	243
Current account balance (% of GDP)	2.3	2.1	2.2	2.1
FX reserves (end year, USD bn)	3,312	3,821	4,120	4,253
Money and Financial Market				
Broad money M2 (% y/y)	13.8	13.6	12.5	12.0
RMB loan (% y/y)	15.0	14.1	13.0	12.5
Interest rate (1-y deposit, end year)	3.00	3.00	3.00	3.00
Interest rate (1-y lending, end year)	6.00	6.00	6.00	6.00
RMB/USD exchange rate (end year)	6.23	6.05	6.10	6.10

Source: CEIC, UBS estimates

Figure 16: Quarterly Forecasts

	2014E				2015E			
	Q114E	Q214E	Q314E	Q414E	Q115E	Q215E	Q315E	Q415E
Real GDP (% y/y)	7.4	7.9	7.5	7.2	7.3	7.1	6.9	6.9
CPI (% y/y)	2.4	2.7	2.7	3.0	3.3	3.1	2.9	2.9
1-yr benchmark deposit rate (%)	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
1-yr benchmark lending rate (%)	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
7-day repo rate, average	4.00	4.10	4.20	4.40	4.25	4.25	4.25	4.25

Source: CEIC, UBS estimates

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