25 January 2016

Lion Global Investors:
China Not In For Hard Landing

THE ASIAN
ASSET SPECIALIST
lionglobalinvestors.com

Lion Global Investors Limited
65 Chulia Street #18-01
OCBC Centre, Singapore 049513

T: +65 6417 6800
F: +65 6417 6806

Co Reg No:198601745D

For more information, visit: lionglobalinvestors.com
or email: ContactUs@lionglobalinvestors.com

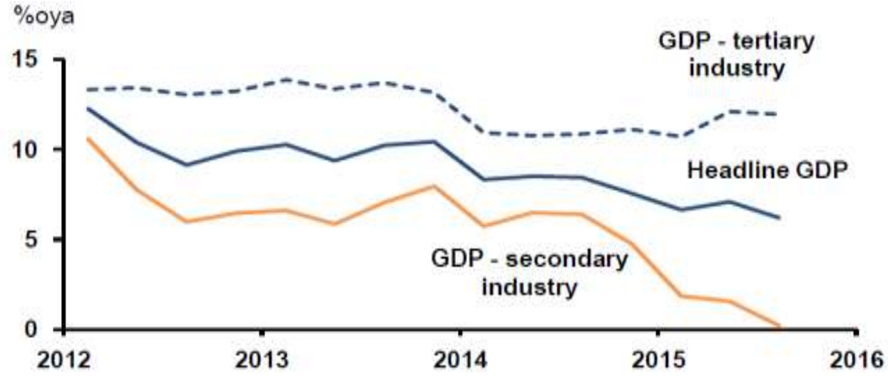
CHINA NOT IN FOR HARD LANDING

In recent months, China has been a source of market volatility, and unfortunately, we are likely to see further volatility from China in 2016. Nonetheless, we think there will be no hard landing in China. Some China sceptics have been writing about a hard landing for many years but this has not materialised.

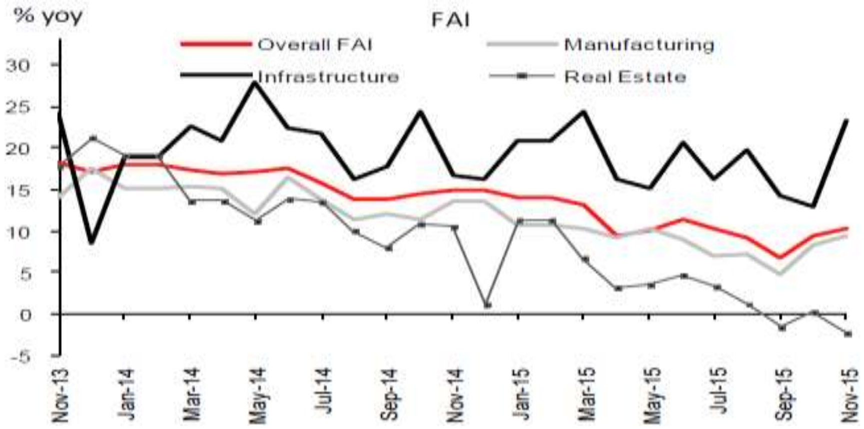
GROWTH CONCERNS

China needs to rebalance its economy and while the transition has been and will be painful, it has started to yield results. In 2015, we have already seen the tertiary (services) sector's share of GDP rise 2.4 percentage points to 50.5% and final consumption's contribution to real GDP growth rise more significantly by 15.4 percentage points to 66.4%. However, the ongoing transition will be painful as investments will slow whilst consumption still insufficient to offset the slowdown. In addition, China's long-term sustainable economic growth pulled down due to the aging population, deleveraging and unwinding SOE dominance. To cushion the negative short term impact on aggregate demand, China has adopted proactive, flexible fiscal and monetary policies to avoid a hard landing. Other than continuously easing interest rates and the reserve requirement ratio, local government infrastructure spending has increased.

China Nominal GDP Growth by Industry



%oya: % One Year Average
Source: JP Morgan, January 2016



FAI: Fixed Asset Investment
Source: HSBC, January 2016

A member of the OCBC Group

While we are encouraged that the Chinese government has embarked on supply side reforms of tax cuts, urbanisation and elimination of excess capacity, progress has been painfully slow. Cutting overcapacity in state-owned enterprises remains high on the agenda in 2016 and requires careful coordination between central and local governments to manage the impact on employment and banks' non-performing loans. This can be supported by fiscal expansion as the budget deficit is likely to exceed 3% of GDP in the next few years (from an estimated 2.3% in 2015), likely through tax cuts and increases in social expenditure.

Overall, China will not miss its 6.5% average growth target by a big margin during its 13th five year plan (2016-2020). However, weak growth momentum could probably persist for another two years before gathering pace from 2018 after the politburo renewal and a new political cycle begins.

At the moment, property sales have recovered in tier 1 and 2 cities but tier 3 and 4 cities continue to struggle with high inventory levels that need to see property destocking take place in the midst of urbanisation. The government has not run out of policy tools to support the housing sector and possible policy tools include further down payment cuts, extension of hukou (housing registration) to migrant workers or government buyout of inventory units for conversion to social housing. As property investment may not pick up meaningfully in 2016, infrastructure investments continue to be the key supporting factor.

The local government debt swap program (which swaps high-cost debt issued by local government funding vehicles for municipal bonds issued at rates nearer to risk-free rate) is a step in supporting infrastructure investments. On the monetary policy front, the PBoC (People's Bank of China) also has tools to maintain its accommodative stance while keeping risk-free interest rates low to support the economy. With nominal interest rates above zero and major bank RRRs (reserve requirement ratios) high at 17.5%, there is sufficient room for further interest rate and RRR cuts.

CURRENCY CONCERNS

In recent weeks, the market has returned to focus on the RMB devaluation despite the PBoC's efforts to explain that the currency should be measured against the new trade-weighted basket of currencies rather than solely against the USD.

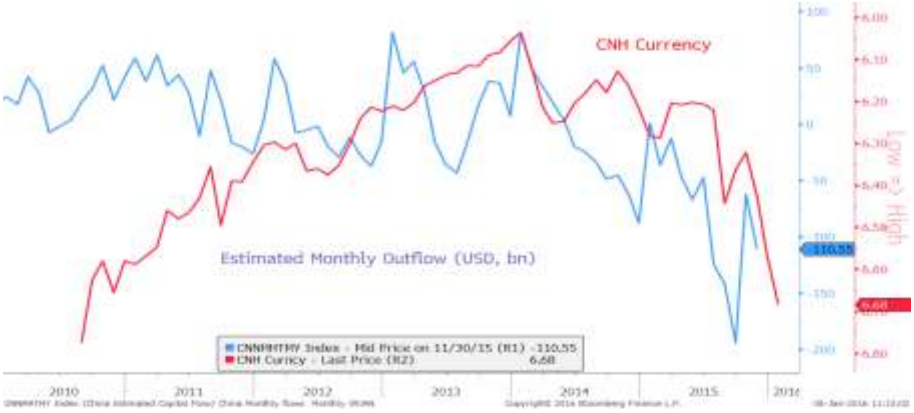
While it seems apparent that China has no intention to keep the RMB strong like the USD, we believe it will remain stable on a trade-weighted basis. China's economic fundamentals remain strong with US$3.3 trillion of foreign reserves and a manageable amount of USD debt.

Within Asia, China, Taiwan and Korea each have less than 20% their loans and debt denominated in the USD. Boosting exports cannot be China's key motivation when global trade volume is anaemic. In a year of the US Presidential elections, China will not want to be accused of competitive currency devaluation.

The RMB, despite appreciating for the past 10 years in real effective exchange rate terms, has not stopped China from gaining global market share and amassing huge trade surplus yearly. Conversely, unwinding of previous carry trades and Chinese citizens moving money offshore have resulted in large capital outflows and reduction in foreign reserves.

LION GLOBAL INVESTORS

China Estimated Capital Flow vs Exchange Rate



Source: Bloomberg, January 2016

Chinese Foreign Reserves

Source: Bloomberg, January 2016

The jitters over the sharp drop in foreign reserves and the lack of communication from the PBoC have continued to unnerve investors, which could push more capital to leave mainland China. In response, China tightened its capital controls further, suspending quotas that allow money to leave China on the pretext of investments and intervened in the onshore money market. Herein lies China's other long term challenge – China's transition to a market economy remains incomplete and the hands on the wheels appear inexperienced at times.

Until the various regulators and agencies learn to coordinate and communicate better, investors have to brace for policy missteps and be vigilant on how this could affect the global economy. Nonetheless, Chinese policymakers have learned quickly and are nimble enough to deploy monetary and fiscal tools to address previous missteps.

China is not in for a hard landing: the economy is rebalancing and the transition to more stable and sustainable growth will be painful. Fundamentally, there are no reasons for the RMB to devalue aggressively. However, market volatility is likely to continue in 2016.

DISCLAIMER

Lion Global Investors Limited ("LGI") is a company incorporated in Singapore and a member of the OCBC group.

This publication is for information only. It is not an offer or solicitation for the purchase or sale of any securities/investments and does not have regard to your specific investment objectives, financial situation or particular needs. All applications for units in our funds must be made on application forms accompanying the prospectus. You should read the prospectus for details, available and may be obtained from Lion Global Investors Limited ("LGI") or any of its approved distributors, before deciding whether to subscribe for or purchase units of the Fund. Investments in the Fund are not obligations of, deposits in, guaranteed or insured by LGI or any of its affiliates and are subject to investment risks including the possible loss of the principal amount invested. The performance of the funds is not guaranteed and the value of units in Fund and the income accruing to the units, if any, may rise or fall. Past performance, as well as any prediction, projection, or forecast on the economy, securities market, or the economic trends of the markets are not necessarily indicative of the future or likely performance of the funds. Any opinion or estimate provided in the publication is made on a general basis and is not to be relied on by investors as advice. Investors must make their own assessment of the relevance, accuracy, adequacy and reliability of the information provided and make such independent investigations as they may consider necessary or appropriate for the purpose of such assessment. LGI reserves the right to make changes and corrections to its opinions expressed here at any time, without notice. Accordingly, no warranty is given and no liability is accepted for any loss arising directly or indirectly as a result of you acting on any information, opinion, forecast, or estimate contained herein. You may wish to seek advice from a financial adviser before making a commitment to purchase the Fund. In the event that you choose not to seek advice from a financial adviser, you should consider carefully whether the Fund is suitable for you.

LGI, its related companies, their directors and/or employees (collectively known as "Related Persons") may have positions in the products mentioned in this publication. LGI and its Related Persons may be engaged in purchasing or selling the products mentioned in this publication for themselves or their client. LGI does not take into consideration the tax implications of the income earned as the tax position of each person is different. Investors are advised to seek independent tax advice on their personal tax position arising from investing in the fund.

THE ASIAN
ASSET SPECIALIST
lionglobalinvestors.com

Lion Global Investors Limited
65 Chulia Street #18-01
OCBC Centre, Singapore 049513

T: +65 6417 6800
F: +65 6417 6806

Co Reg No:198601745D

For more information, visit: lionglobalinvestors.com
or email: ContactUs@lionglobalinvestors.com

A member of the OCBC Group