Geopolitical concerns boost global oil prices
Petrochemicals B8
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Mainland home prices rise the most in six months
Property B3
Companies

Hang Seng Index: +35.61 points, 0.15%
23,482.95

H-share index: -25.8 points, 0.21%
12,534.86

Top blue-chip mover: Li & Fung
▼2.97%

Snapshot

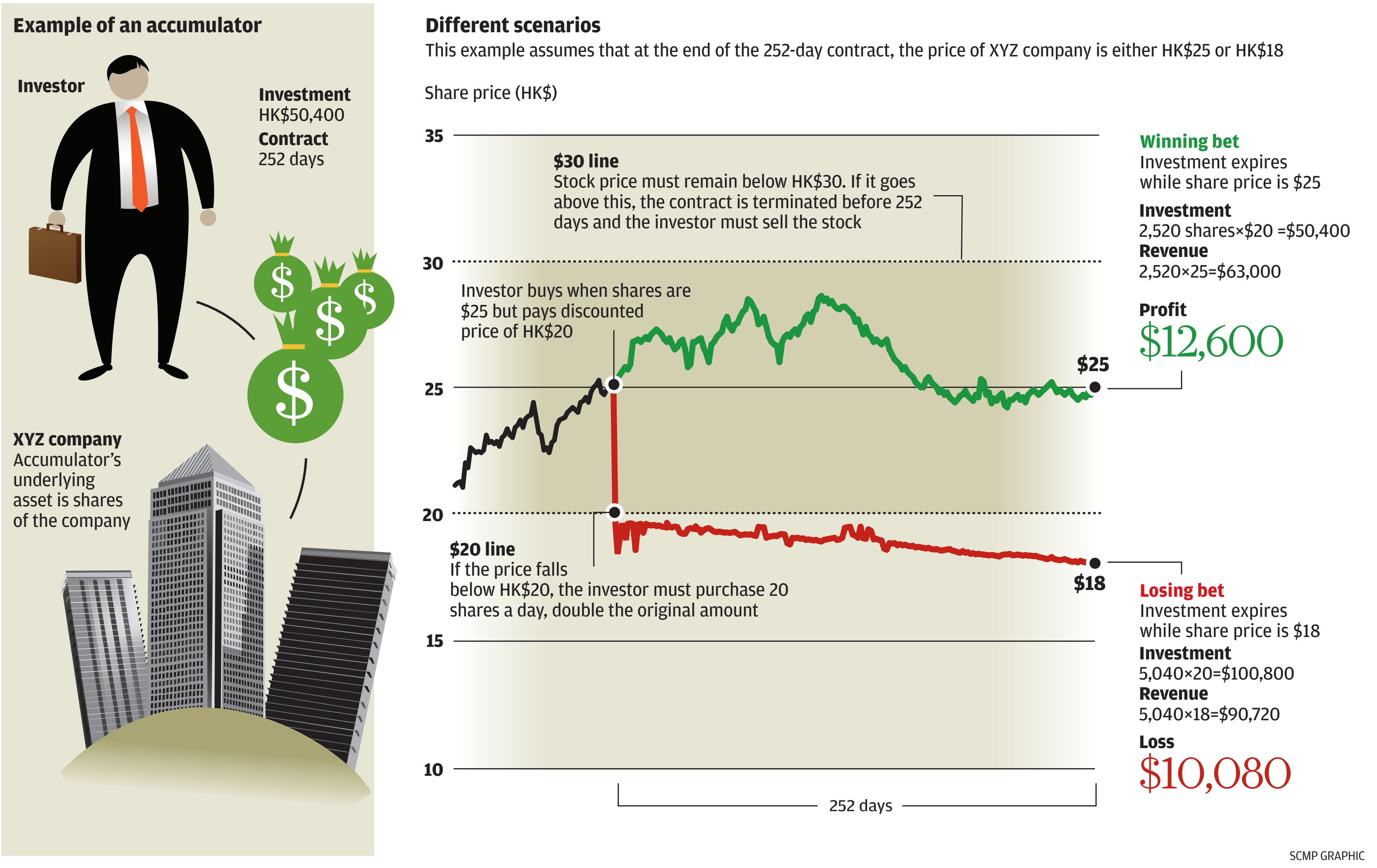
Business

www.scmp.com

WORLD BP posts first loss since 1992 **B4**

SOUTH CHINA MORNING POST WEDNESDAY, FEBRUARY 2, 2011 **B**

Playing the game



Mainlander on quest to reclaim derivative losses

Investors see downside of stock accumulators

Lulu Chen

Last month, Qi Weibao boarded a plane in his hometown of Tianjin bound for Hong Kong. It was his 11th trip in two years. His mission was not to shop or see the sights but to continue his battle with HSBC, one of the world's largest banks.

A 37-year-old businessman with a young autistic son to support, Qi contends that HSBC sold him a complicated investment called an accumulator without sufficient warning of the risks.

Qi is among a group of mostly Hong Kong and mainland investors who bought into the hot investment products in 2007 only to see them go sour a year later as the global financial crisis unfolded. Some banks that sold the products are still facing lawsuits. But that is not stopping them from once again marketing accumulators, which are tied to market performance, and yield-hungry investors are snapping them up.

In a sign that accumulators are on a comeback, the Hong Kong Monetary Authority sent out letters in late December to various financial institutions reminding them of the importance of clearly stating the risks involved with the products.

"For the coming year, the market is expected to go up, so investors are buying accumulators again," says Chim Pui-chung, a Hong Kong lawmaker representing financial-services interests. Still, he warned that history could repeat itself. "If the market goes down, there will be problems."

Accumulators are basically derivative contracts that enable investors to buy stocks or currencies or commodities at a fixed price – usually at a discount to the market price – over a certain period of time, typically three to 12 months. If the price of the underlying asset goes up over the lifetime of the contract, investors profit. To limit the ultimate payout by the seller of the product, the contracts always have a cap as to how much the price of the underlying asset can rise before it triggers the termination of the contract.

But because of the way the product is leveraged, if the price falls, investor losses could be many times the initial investment.

Heavy exposure

Accumulators have caught on in Hong Kong like nowhere else

One estimate of the amount of local money now tied up in these devices, in US dollars, is

$5b

Some investors said they believed that if the price fell, they could still hold on until the market bounced back. Others had their positions wound up after they failed to pay the margin calls, thus losing their entire investment.

According to estimates by Hong Kong's Securities and Futures Commission, at the height of the market, accumulator contracts amounted to approximately US$23 billion, excluding the leveraging effect on some contracts. Besides HSBC, Switzerland's UBS and Singapore's DBS are among those banks that have drawn investor complaints. UBS said it still sold accumulators but "great care is taken" that investors understood the risks. DBS said it continued to offer accumulators in Hong Kong but would not comment on individual cases. HSBC said it continued to offer this type of investment arrangement where the appropriate risk-profile assessment had been completed.

Because accumulators are not traded on exchanges, it is unclear how many are outstanding today in Hong Kong. But Chern Lu, head of market risk at accountancy firm PricewaterhouseCoopers in Hong Kong, estimates the figure is about US$5 billion.

Originally, accumulators were created for corporate clients in Europe. The product was used to build up equity positions in other companies. Investment banks adapted them around 2000 for individuals in Asia, mainly Hong Kong and Singapore. They then promoted the products to private banks, with their wealthy clients. The sellers profit from the difference between the price they charge on the derivatives and the real cost of replicating or hedging such derivatives.

Ironically, accumulators never took off in Europe. The Hong Kong-based head of a large American investment bank said that his bank had not managed to sell a single accumulator in its European market, but was now selling them to Hong Kong investors.

In fact, nowhere have accumulators been more popular than in Hong Kong, where banks targeted customers who met Hong Kong's definition of a "professional investor", or someone with a portfolio of at least HK$8 million and two years of investment experience.

The banks also homed in on sophisticated institutional investors, including Citic Pacific, a Chinese-backed conglomerate listed in Hong Kong. The company, which bet on an accumulator linked to the Australian dollar, ultimately suffered losses of HK$15.9 billion in 2008, according to the company's 2009 annual report.

Investors elsewhere in Asia were also affected. In South Korea, a number of small- and medium-sized companies were hammered by a product similar to accumulators, called a knock-in knock-out option, or Kiko. Singaporean investors also suffered losses from accumulators.

In Hong Kong, "the local market's super-high risk preference" and "tendency for speculation" helped fuel the popularity of the derivatives, said Lu of PricewaterhouseCoopers.

However, Ming Huang, a professor of finance at both Cornell University in the US and China Europe International Business School in Beijing, said: "The fundamental reason accumulators thrive in Hong Kong but never in the US or Europe is due to excessively loose regulation in Hong Kong."

Another reason accumulators did not take off in the US may have been that the threat of litigation in US markets created more of a deterrent, said Barbara Roper, director of investor protection at the Consumer Federation of America.

To appeal to new investors in Hong Kong, the terms of the accumulators have been revamped. Among other things, the multiplier feature – which obliges investors to buy twice as much or more if the price of the underlying asset falls – has been reduced and in some cases eliminated. To protect investors from unlimited losses, some accumulators now have a floor, so that if a price drops to a certain point investors do not have to keep buying. And in some cases, the

• CONTINUED ON B2

Inflation makes Beijing more expensive than HK

Celine Sun in Beijing

A humble dish of stir-fry noodles and a cup of coffee is likely to set you back more in Beijing than Hong Kong as vigorous inflation hits home in the capital.

Rising prices have made daily necessities in big mainland cities even more costly than in Hong Kong, which consistently rates as one of the most expensive cities in the world.

Hongkonger William Wong knows full well how prices rises are hitting the pocketbook.

Wong, who started work in Beijing for a Hong Kong-based trading company last year, is finding he needs to pay more in Beijing if he wants to maintain a similar quality of life to his home city.

Wong likes to shop in supermarkets near home for basic items like apples but also regularly dines at, or orders takeaways from Cantonese-style tea restaurants.

He is also a regular taker of taxis to his office and back home.

"Apart from the taxi expenses, almost all other things are more expensive in Beijing than in Hong Kong," said Wong, in his 50s.

One example is stir-fried noodles with beef from a tea restaurant he often visits.

In Beijing it costs 35 yuan (HK$41) while the same dish costs only HK$30 to HK$35 in Hong Kong.

A box of fresh pork chops sells for over 30 yuan in the Hualian Supermarket near his apartment, at least 10 per cent higher than similar products in Wellcome or ParknShop.

A pack of 10 imported gala apples costs as much as 70 to 80 yuan in Hualian, yet are no more than HK$20 in Hong Kong.

"I have compared my living expenses with that of a friend in Hong Kong. I spend more money than him on food and fruits, yet the quality of what I purchase is lower than his," he said.

Apart from taxi expenses, almost all other things are more expensive in Beijing than in Hong Kong
William Wong, a Hongkonger who works in Beijing

The National Bureau of Statistics announced earlier this month that the country's consumer price index rose 3.3 per cent last year, above the government's target of below 3 per cent.

Food prices, the major driver of inflation for the year, rose 9.6 per cent in December compared to 11.7 per cent in November.

Many economists believe the real consumer price index could be higher than official figures as the government calculation does not include rent and mortgage payments.

The mainland is likely to see an even higher CPI increase last month and this month, pushed up by food prices during the Lunar New Year. The *South China Morning Post* surveyed a Wal-mart supermarket in Beijing's Dawanglu district and a Wellcome store in Causeway Bay last week.

Customers shop for vegetables at a supermarket in Beijing, where prices are climbing steadily. Photo: AFP

Around one-third of the food products and groceries we selected randomly were more expensive in Beijing.

For example, bananas imported from the Philippines sell for HK$5.32 per 500 grams in Beijing compared to HK$4.18 in Hong Kong.

It is not only in supermarkets where Beijing consumers are having to dig deeper into their pockets.

A Big Mac at McDonald's costs HK$16.5 in the city compared to HK$15.1 in Hong Kong, while a tall-size cappuccino or latte in Starbucks is HK$33 in Beijing compared to HK$28 in Hong Kong.

Yi Xianrong (易憲容), a researcher at the Chinese Academy of Social Sciences' Finance Research Centre, said the majority of customers shopping at big supermarkets like Wal-Mart are from middle-class families while lower-income people purchase their daily necessities at farm markets or small shops on the street.

"Besides inflation, taxes and retailers' manipulation of prices are part of the reason some products are more expensive on the mainland than in Hong Kong," said Yi.

"Some retailers take advantage of people's inflation expectations, raising prices to a higher level to seek more profits."

Soaring living expenses in big mainland cities mean people are increasingly hurting because of their relatively low incomes.

Figures from the Beijing Municipal Bureau of Statistics show the monthly per capita disposable income in the city was 2,422 yuan (HK$2,867) last year, around two fifths of the average monthly pay in

• CONTINUED ON B3

Inflation, tighter credit weigh on mainland manufacturing sector

May Chan

Manufacturing growth on the mainland continued to ease due to inflation and concerns about government tightening measures, according to the latest Purchasing Managers' Index.

The PMI, complied by the China Federation of Logistics and Purchasing on behalf of the National Bureau of Statistics, recorded a modest fall to 52.9 in January from 53.9 in December, which was a further drop from 55.2 in November.

January's figures were well below economists' consensus of 53.5.

Seven of the 11 sub-indices were lower than the previous month, particularly new export orders, which dropped sharply from 53.5 to 50.7, the lowest in 11 months. New orders also dropped from 55.4 to 54.9.

Four index components became stronger, especially the purchase of input index and the imports index.

A figure higher than 50 indicates growth, while a value below 50 is a sign of contraction.

"The index reading was the lowest in five months, indicating the relatively weak growth momentum of China's manufacturing sector," the report said. "We believe this was largely attributable to the tighter credit conditions in China and the slower foreign demand."

However, a competing survey, the HSBC/Markit PMI, indicated an increase to 54.5 in January from 54.4 in December, suggesting solid improvement in the manufacturing sector. HSBC surveyed more than 430 manufacturing companies; the official mainland report surveyed more than 800 manufacturing companies.

Of the 11 sub-indices of the HSBC/

Weaker momentum

The official mainland PMI fell from 53.9 in December to this figure in January

52.9

Markit PMI, four recorded a seasonally adjusted increase in January from December, particularly in new orders and new export orders. Seven other sub-indices showed a slight decline, including in input prices, quantity of purchases and output prices.

Economists agreed that growth momentum on the mainland was still robust and anticipated quantitative tightening measures from the government, amid strong inflationary pressure.

Qu Hongbin, chief China economist and co-head of Asian economic research at HSBC, attributed the difference between the HSBC/Markit PMI and the official PMI to different ways of weighting the seasonal adjustments of various components.

"China kick-started the new year with another upbeat manufacturing PMI reading, following the stronger-than-expected 4Q GDP growth release," Qu said.

"The strong growth momentum leaves room for Beijing to fully focus on checking liquidity and inflation pressure. Quantitative tightening in the form of reserve requirement ratio hikes will remain the most effective policy tools."

Bank of America-Merrill Lynch economist Lu Ting held a similar view, noting that the official PMI was heavily distorted by the Lunar New Year holiday, which had a downward effect on new export orders.

He expected monetary policy to be tightened, but ruled out an excessive squeeze on lending.

Tao Dong, managing director and head of non-Japan Asia economics at Credit Suisse, said the official PMI reading indicated slowing economic growth on the mainland, but still projected steady GDP growth of 9.2 per cent for this year.

But he predicted that the People's Bank of China might increase lending rates by 1.85 per cent, while saving interest rates and reserve ratio rates are expected to increase by 2 per cent.