CNY/CNH – Another Deeper Dive into Chinese Credit, Money and Prices

13 March 2018

CLIFF TAN

East Asian Head of Global Markets Research
Global Markets Division for the East Asian Region
T: +852 2862 7005
E: cliff_tan@hk.mufg.jp

Bank of Tokyo-Mitsubishi UFJ
A member of MUFG, a global financial group

Key Points:

- **Chinese credit slowed in February**
- **Much more important is we have enough data to confirm actual (as opposed to trumpeted) de-leveraging, from the end of the Party Congress**
- **To de-leverage as in 2013 would mean another two years of this**
- **But within a few months, serious de-leveraging should lead to slowing in Chinese growth**
- **Policymakers will then have to decide whether to de-risk or revive growth**
- **Some February money #s too neat to be true**
- **CPI inflation spurted higher but underlying price pressures contained**
- **PPI inflation slowed, possibly suggesting slower smokestack growth ahead**

We take another deeper dive into (Friday) Chinese data, similar to what we did in *Asia Cross Current: CNY/CNH – Caixin Zigged while NBS/CFLP Zagged*, 8 March 2018.

Credit

Chinese credit slowed in February

China's February credit/money numbers showed: **Total Social Financing[1]/new bank loans = CNY1,170bn/CNY839.3bn < last upwardly revised CNY3,060.3bn/CNY2,900bn.**

Much more important, evidence in the past four months seem conclusive trend credit growth is slowing

For us, key impressions were: 1) Signs continue that after talking de-leveraging throughout 2017 with little evidence to show for it, since the October 2017 Party Congress ended technocrats put in charge are actually de-leveraging. 2) But the scale of de-leveraging so far can still be reversed in just a couple of months but if de-leveraging continues, we should begin to see evidence of its effects in slowing real indicators soon (again, see our 8 March *ACC*).

That should mean some real slowing in the economy soon

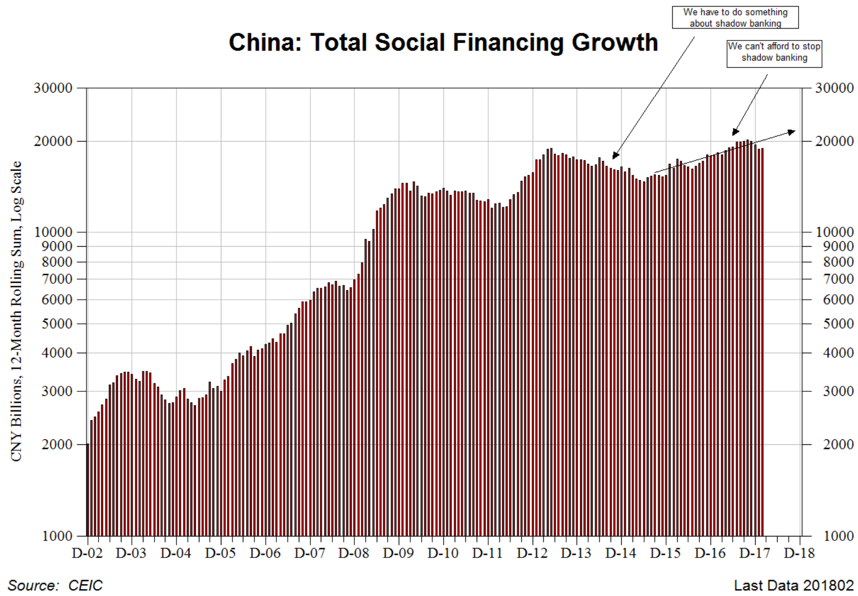
For de-leveraging, we tend to look at 12-month growth trends to get away from seasonalities (including those for Chinese New Year). Authorities were keen to guide that January-February data this year should be (especially?) read together because of the Chinese New Year timing effect (holiday in February this year but January in 2017): **PBOC:JAN.-FEB. LOAN DATA SHOULD BE READ TOGETHER DUE TO HOLIDAY* (Bloomberg).

Something immediately changed after the Party Congress

In the chart overleaf (which we've used a number of times before), bars are 12-month rolling sums of TSF shown on a log scale, so there is depicted a trend growth arrow we'd originally drawn from later 2015 and which hasn't been moved since.

[1] Chinese authorities no longer use the TSF terminology but now call it "aggregate financing to the real economy," but we choose to stay with the older terminology for the sake of continuity with prior published work.

CHINA TSF: THE GROWTH TREND HAS BROKEN



Source: CEIC, MUFG Bank

Which looks very different than last year

One can immediately understand the reason for our skepticism last year when all the rage was of "de-leveraging" and yet the trend rate of TSF growth never budged. To us, seriously de-leveraging would be something like what we saw between mid-2013 to mid-2015, when trend TSF growth reversed course and became **negative.**

The only caveat is unobserved “dark matter” in Chinese credit

With now four months of data accumulated since the Party Congress ended it is apparent technocrats in charge are beginning to undertake actual de-leveraging as the trend of trend growth has become negative; actions speak louder than words. The main caveat we'd add to this, though, is that for about two years, we no longer have believed Total Social Financing is total; ie, we suspect there are other pools of credit that exist outside of official counting. This is very reminiscent of what occurred at the start of this decade, when new shadow banking products forced officials to start reporting not only new bank lending, which used to be the main credit #, but a much broader aggregate called TSF. As a joke, we sometimes now refer to TSF as Somewhat Total Social Financing. At some stage, we anticipate that Chinese authorities may have to introduce a new “Total TSF” to take account of further innovations and newer products in China's financial system.

By May, China’s policymakers may have to decide between slower growth and de-risking

Our expectations from the end of last year (eg, both the December 2017 and February 2018 issues of the *Foreign Exchange* Outlook) was for a new policy tact (controlling risks) to continue for about six months, say into May 2018. At that stage we also expect actual de-leveraging to have led to some slowdown in growth and key indicators and the key question for China's policymakers then will be whether they can tolerate growth costs in order to de-risk (one of the top three top leadership goals this year). The jury remains out.

No slowdown in bank lending, though

On the now rather old-fashioned new bank lending figures, there's no evidence to our eyes growth trends have been slowed since the Party Congress (chart overleaf).

Money

Suspicious M1/M2 growth rates in February

China also reported February money #s Friday, M0/M1/M2: 13.5%YoY/8.5%/8.8% > consensus 7.6%/11.0%/8.7% > last -13.8%/15.0%/8.6%. LNY timing effects are here obviously but we're suspicious of reported February M1/M2 growth rates. Because in each the implied %2Y growth rates were **identical** in both January and February, at

31.7% and 8.6%, respectively. Ie, pick a 2-year growth rate and decide what February %YoY growth rates you need to report to make January-February 2-year growth the same. We could, as authorities had urged, make judicious allowances for LNY timing effect in our analyses; or **the authorities can just do that for us.**

CHINA NEW BANK LENDING: STILL GROWING

Source: CEIC, MUFG Bank

Prices

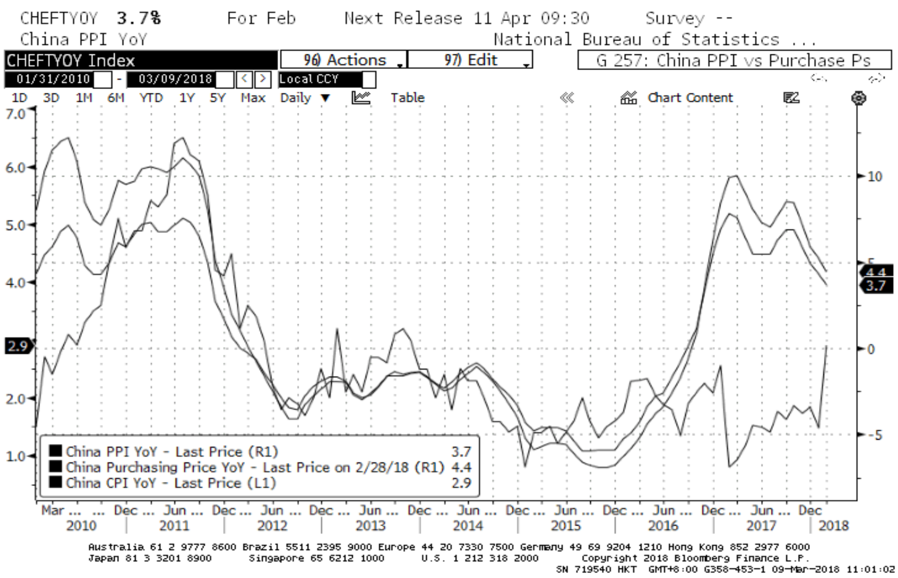
Headline CPI inflation spiked in February

China's two main February inflation measures, CPI/PPI, were reported out as: 2.9%YoY/3.7%; consensus was 2.5%/3.8%; last 1.5%/4.3%.

And CPI tends to lead PPI

Almost exactly a year ago in *Asia Cross Current: CNY - China's Inflation Will Remain Benign But Won't Comfort Bond Yields*, 7 March 2017 we said in our experience, it's more likely China PPI will follow CPI rather than the other way round; here's a history since 2010.

IN CHINA, PPI TENDS TO FOLLOW CPI



Source: Bloomberg, MUFG Bank

We think last year was a good demonstration of what we meant.

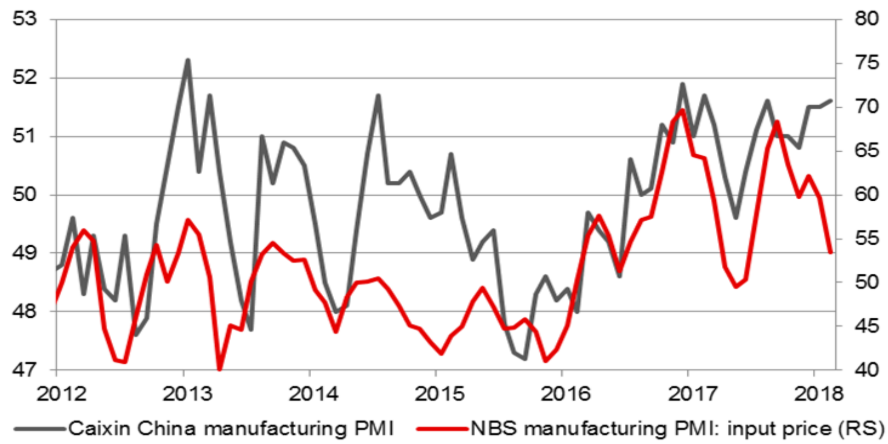
But the rise in consumer inflation seems 1-off

On CPI, though February headline is markedly faster, the underlying pace of consumer price changes does not seem all that changed to us. Though this headline rate may remain elevated another month or two, we still expect CPI inflation to stay well contained within the government's 3% cap for 2018. Our continuing thesis for CPI in China, for this and next year, is consumer price inflation will be constrained by two forces: i) Advances in improving the efficiency of the food supply chain, eg in pig husbandry; and, ii) the Alibaba effect, analogous to the Amazon effect.

PPI inflation slowed, implying possible slower smokestack growth ahead

We had actually been a little more interested in the PPI side, since we considered the rebound of global commodity/materials prices as key behind the recovery of China's smokestack industries from later 2016 on.

CHINA: CAIXIN MANUFACTURING PMI VS. CFLP INPUT PRICES

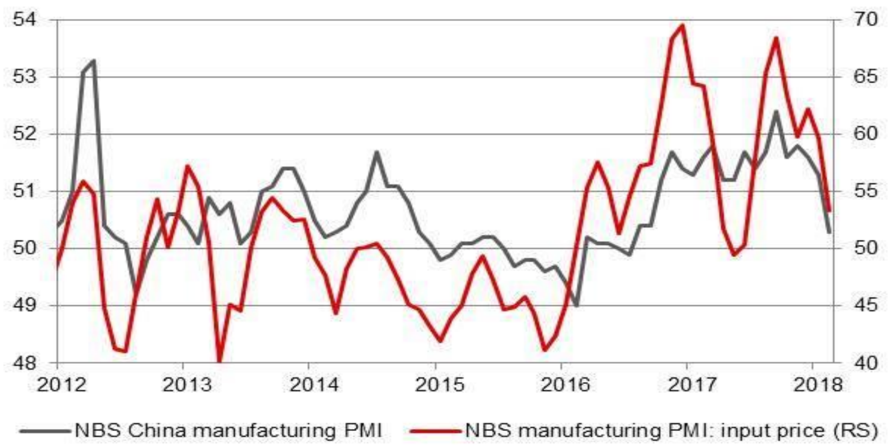


Source: MUFG Bank

A correlation that has re-appeared in the official PMI

In the chart above (which we had previously used) we had noted a dip in the input price sub-diffusion of the official CFLP manufacturing PMI during the first 1/3 of 2017, which we thought had been captured in the quasi-private Caixin/Markit manufacturing PMI last year but which **wasn't** captured well at all by the official NBS/CFLP measure. Our guess from last year was whatever dip there had been in commodity/materials prices in China in 1H17 was simply smoothed out of the official PMI.

CHINA: NBS/CFLP MANUFACTURING PMI AND INPUT PRICES



Source: Bloomberg, MUFG Bank

Though Caixin is now weirdly upbeat

But now official PMI and its input price sub-diffusion seem to be moving together again. That still begs the question of why the Caixin measure now seems so much more upbeat, particularly as it's known to cover smaller companies which don't seem to be faring nearly as well as larger enterprises in the official survey. So far as we know, this boost is also not coming from better pricing conditions in commodities/materials nor is it – above – coming from credit. On external demand, though February export growth was a HUGE surprise, in the 8 March note we had earlier noted declines in new export orders in the PMI measures.

So, watch this space.

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