ASIA MACRO STRATEGY

Does January’s Credit Jump Signal China's QE?

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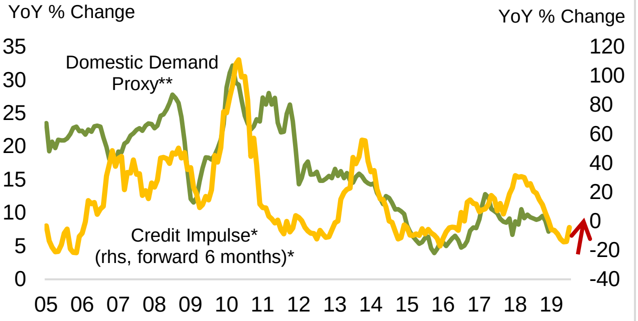
For Accredited Investors in Singapore and Professional Investors in Hong Kong only

China’s January total new credit (aggregate financing, flow data) reached a record high of RMB4.64trn ($690bn). Our China’s Credit Impulse Indicator finally turned around for the first time in 14 months. Does this signal a return of China’s aggressive reflation policy?

The market anticipated a January bounce due to seasonality (i.e. different Lunar New Year dates plus the usually big loan allocation at start of the year), but the size still looks incredible.

We can explain some of the upside surprises. Several one-off liquidity easing measures by the People’s Bank of China (PBOC) were announced and were lumped into late December and January, such as the 100 basis points reserve requirement ratio (RRR) cut, swapping medium-term lending facility (MLF) into the new targeted medium-term lending facility (TMLF) and the announcement of a central bank bills swap (CBS) for banks. This resulted in lower funding cost and fuelled expectations for easier credit ahead.

China Credit Impulse And Domestic Demand

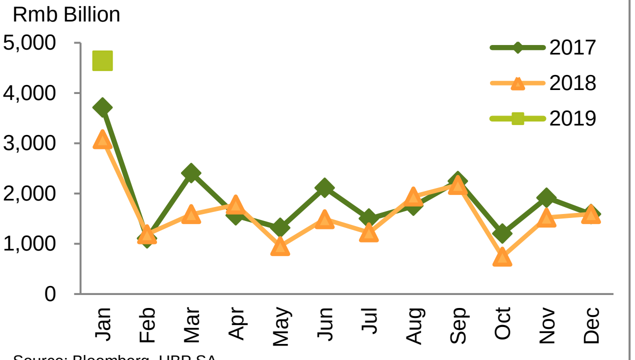


* Second devriative change of total credit stock ** average growth of fixed asset investment, retail sales and imports

Source: Bloomberg, UBP SA

When we look into the details, bank loans – especially corporate lending to small- and medium-sized enterprises (SMEs) – have resumed noticeably because of central policy directives. Shadow credits have also turned from the worst – this may be good for the short-term (i.e. China’s reflation) but bad for the long run (re-leveraging risk?).

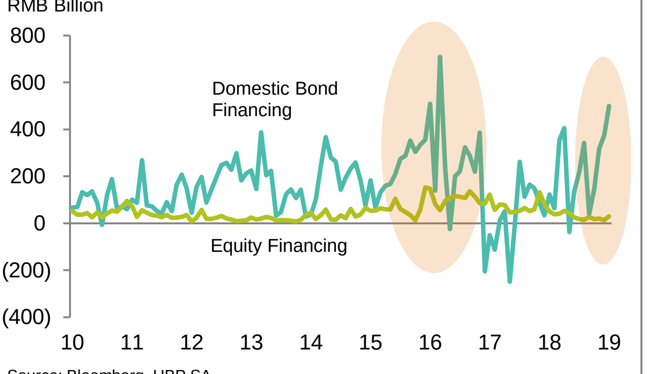
Aggregate Financing (Monthly Flow)



Source: Bloomberg, UBP SA

The massive resuming of domestic (RMB-denominated) corporate bond issuance continued unabated in January. Short-term banker’s acceptance bills have also rebounded markedly while trusted loans have stopped contracting (in flow terms) and have stabilised. Moreover, the 2019 quota for local government’s special bond issues was pre-approved as it is the key funding channel to sustain infrastructure investment.

Key Driver Of Shadow Credit Resumption



Source: Bloomberg, UBP SA

What do these trends mean to us?

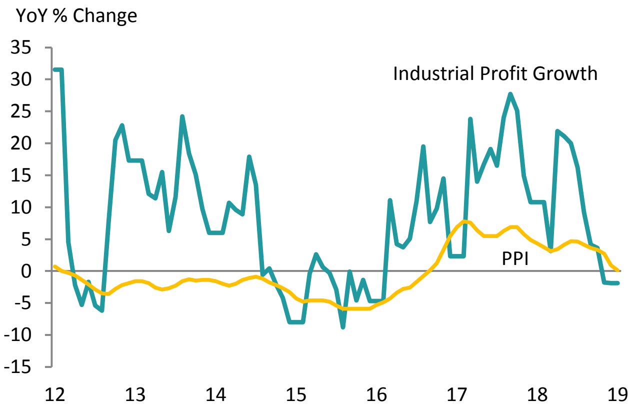
We still think the monetary policy stance to 'prevent excess liquidity flooding the economy', as stressed in the policy communique of December's Central Economic Works Conference, remains the order of the day. The surge in January credits may even be a surprise to PBOC so some subsequent adjustments are likely. In fact, February credit data will fall noticeably from January anyway because of the Chinese New Year holiday. We will need to check the Jan-Feb or 1Q/19 average trend to accurately assess the policy stance.

Some analysts have argued that the latest measure of allowing banks to swap perpetual bond issuance with PBOC bills is akin to 'stealth quantitative easing (QE)' in China. We remain conservative on this view as only Bank of China has done a RMB40bn swap from the RMB4trn needed for the Big Four banks to satisfy Basel III requirements by end-2022. We see this more as an innovative channel for new demand creation for Additional Tier-1 (AT1) bonds from secondary market liquidity, while improving the banks' capital quality and expanding their loan books without creating new money supply (i.e. the monetary base) in the process.

Furthermore, the head of PBOC's Monetary Policy Unit clarified over the weekend that this new perpetual bond channel is not China's QE. He argued that China needed de-leveraging in the long run not QE for reflation.

Without doubt, China's underlying growth should be much weaker than the reported gross domestic product (GDP) as see in the dramatic fall in producer price index (PPI) inflation down to 0% in December. This reflects two things: 1) domestic demand is quite soft; 2) industrial profits, especially upstream production, are waning.

China Industrial Profits And Producer Price Inflation (PPI)



Source: Bloomberg, UBP SA

We can expect another round of RRR cut and a first-time cut in benchmark lending rate in 1Q/19 but QE is still unlikely. Fiscal measures will come to the rescue with more tax cuts and incentives especially via the off-budget channels.

Overall, China is expected to have the sufficient policy response to cushion the current downturn while awaiting outcome of trade talks to judge the scale of necessary policy easing. We see this as a sound enough China backdrop for global and emerging market growth in 2019. This may be better than the scenario of a sharp V-shaped China recovery where the market may price in the negative consequences of a bold stimulus (re-leveraging, credit bubble, RMB devaluation) despite the potential hefty short-term rebound in demand.

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