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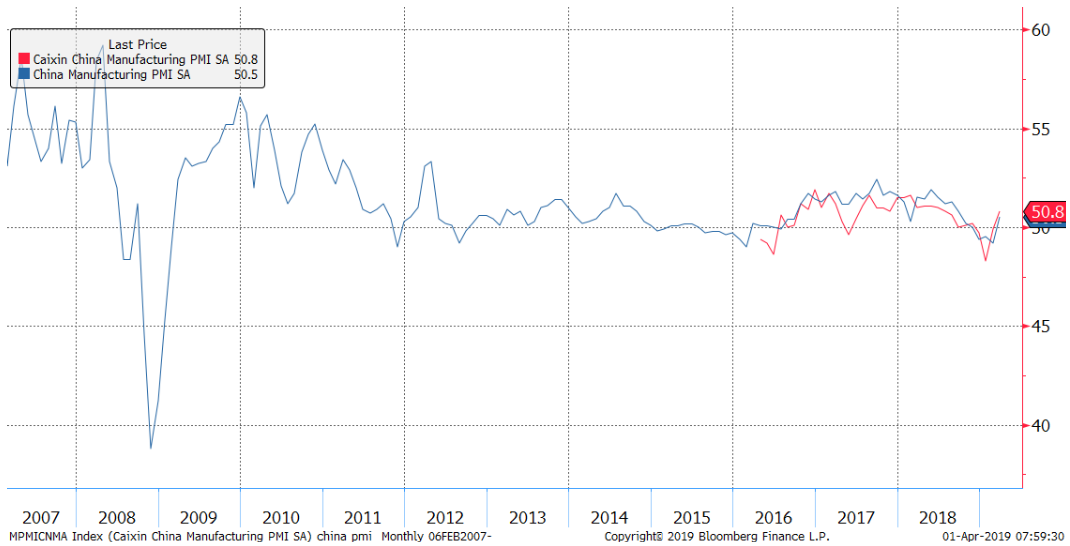
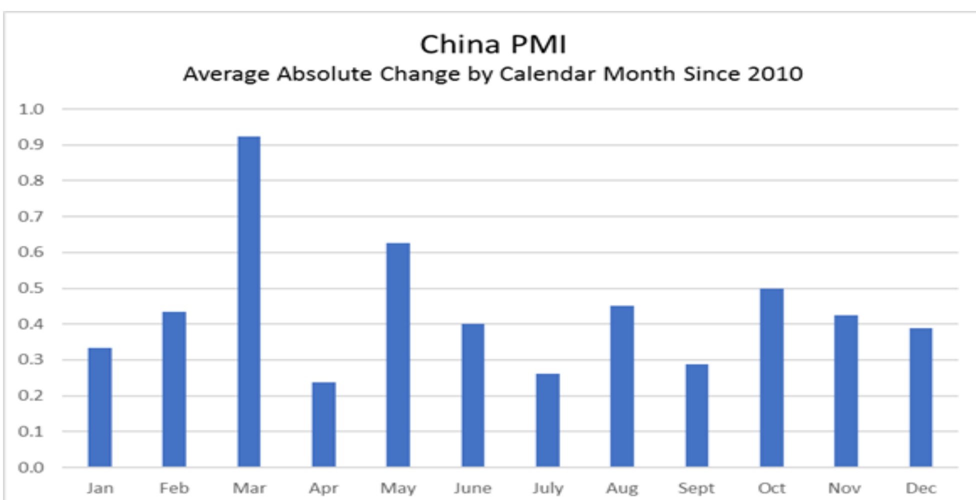
The China Sentiment Bounce

The March PMI results will set the tone for sentiment towards China this month and that sentiment can be summed up as “yeah stimulus!!!”



Chinese equities will be a raging short opportunity at some point in coming weeks or months but that point is not today. The strong PMI readings suggest upside risk this month’s TSF figure and the monthly data dump on April 16 (which will include Q1 GDP).

That said, caveats abound. For one, March PMI readings tend to the extreme (while the index is seasonally adjusted its less clear whether respondents themselves might also seasonally adjust their answers to the survey.)



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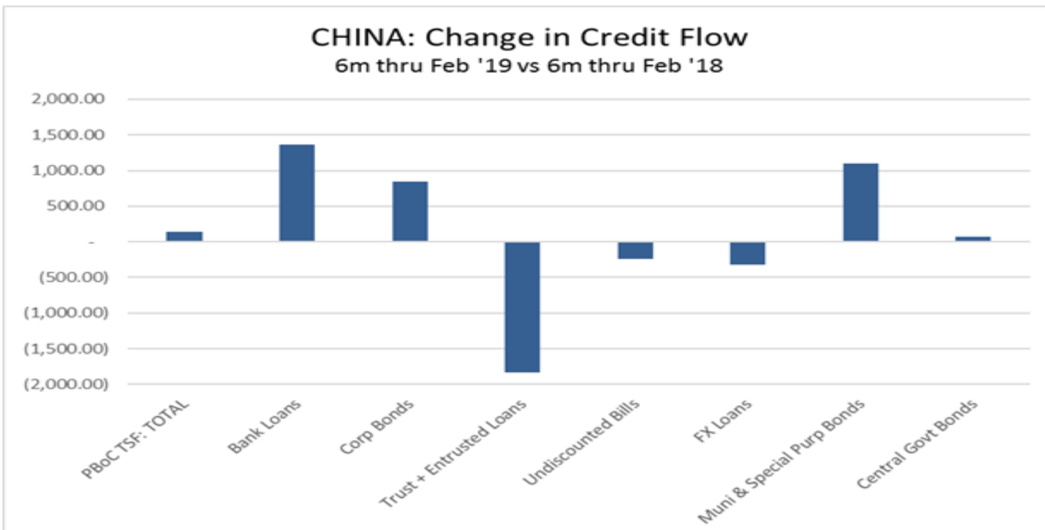
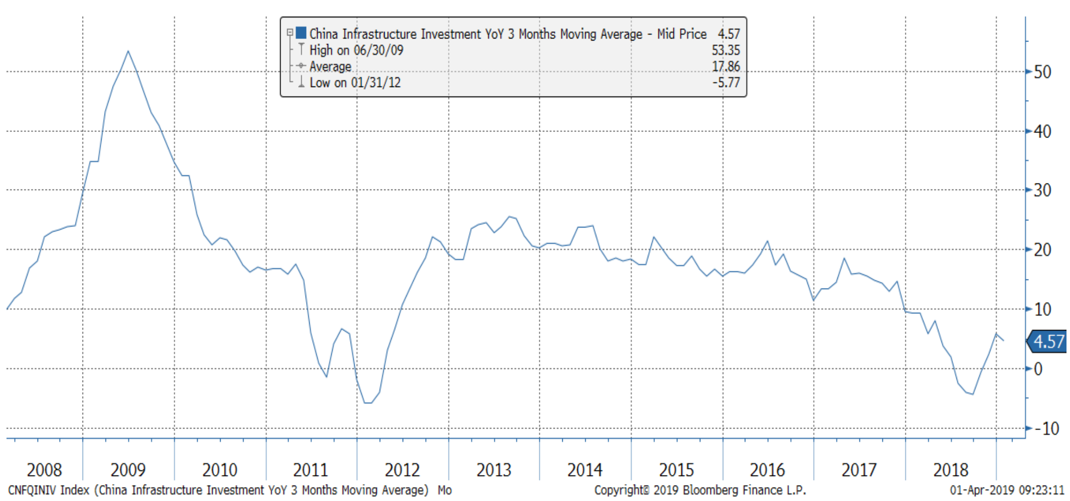
More fundamentally, this Q1 burst of activity (anecdotally confirmed by China Beige Book, amongst others) was fueled more by a reallocation of still-scarce credit rather than any broad opening of the taps:



True to policymakers' pledges, there has been no "flood-like stimulus." The chart above shows credit flow in the 6 months through Feb '19 vs the same period a year prior. In total, flows captured by PBoC's Total Social Financing series were little changed (first bar).

What wee see is a large reallocation of credit from the Trust and other "shadow" sectors into bank lending and corporate / municipal bond issuance. Given the predominance of real estate lending in the trust sector, and a reinforced implicit guarantee of local government loans and bond issuance, the objective is to accelerate infrastructure investment without igniting another round of housing speculation.



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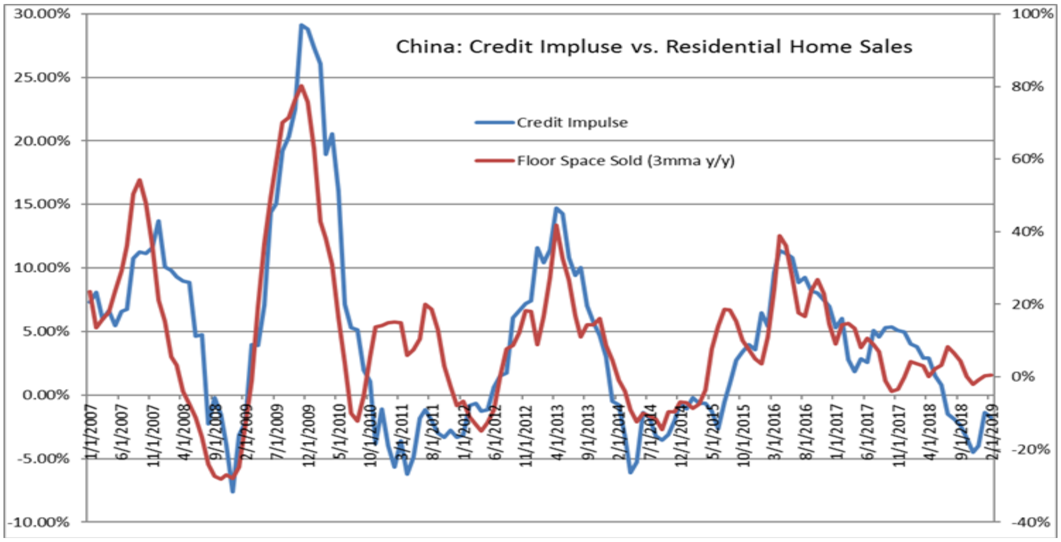
This looks like little more than a short-term program to get local government shovels in the ground in the midst of the trade negotiations. The credit data confirms the official rhetoric: President Xi's "deleveraging campaign" and his admonition that "houses are for living in, not speculation" remain the orders of the day.

While infrastructure investment (chart above) should continue to improve in March, the housing data should remain lackluster as the credit impulse remains slightly negative.



(credit impulse = 12-month increase in credit vs. same one year ago, as a percentage of GDP)

Given the primacy of land sales revenue in local government finance, I'm highly skeptical that China can engineer a sustained economic recovery without the heavy involvement of the real estate sector. And China has yet to commit to the kind of "flood-like stimulus" that would be necessary to generate another round of heated real estate speculation.

If a China-U.S. trade deal is consummated, policymakers are unlikely to see the need to ditch "deleveraging" for "flood-like stimulus."

And if a trade deal is not consummated then any credit stimulus will risk unhinging the RMB in an environment of dented local sentiment.

Ride the sentiment wave for now if you must, but keep in mind there is ultimately no "win-win" for Chinese equities this year.