MACROLENS
Markets in High Resolution

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February 21, 2019

Contents

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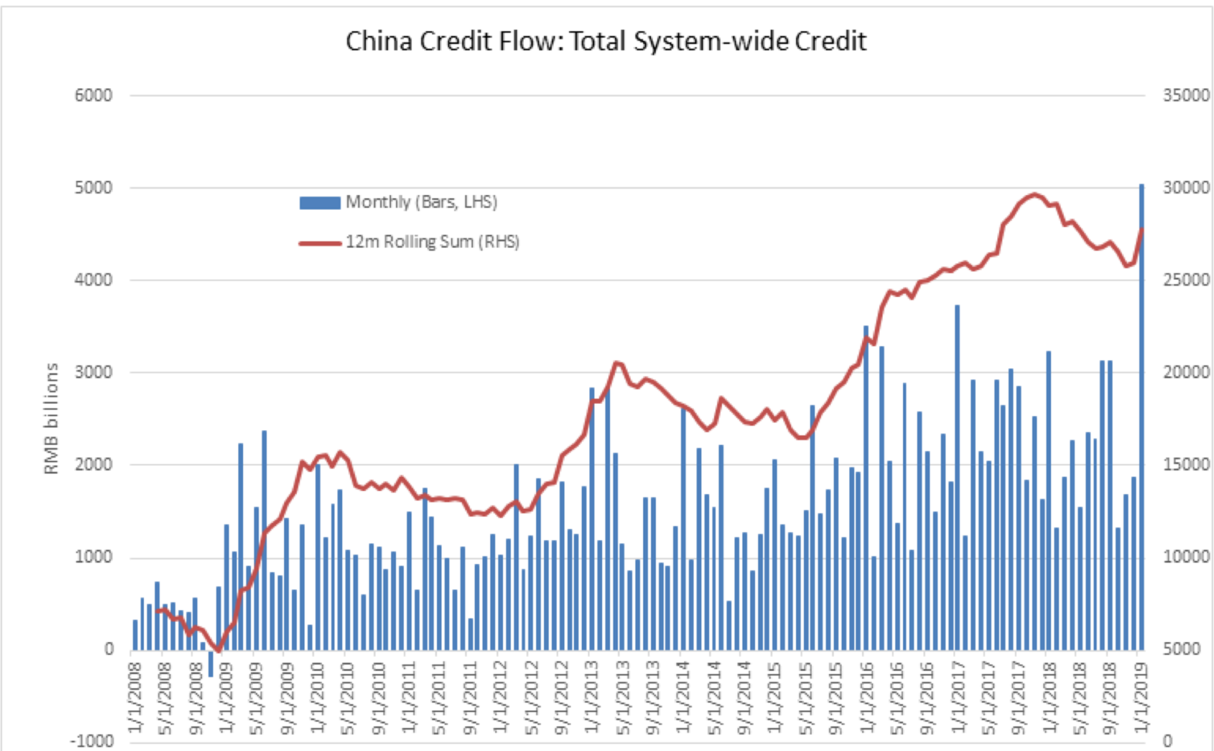
January Credit Blowout

- There is heavy "front-loading" of annual credit quotas in January
- An early-Feb New Year holiday makes seasonals very tricky – expect some payback in Feb



Source: PBoC

- Still…
- **Rmb 5T in a month is a monster number**
- Even while "deleveraging," China continues to crank out >$4T in new credit per year

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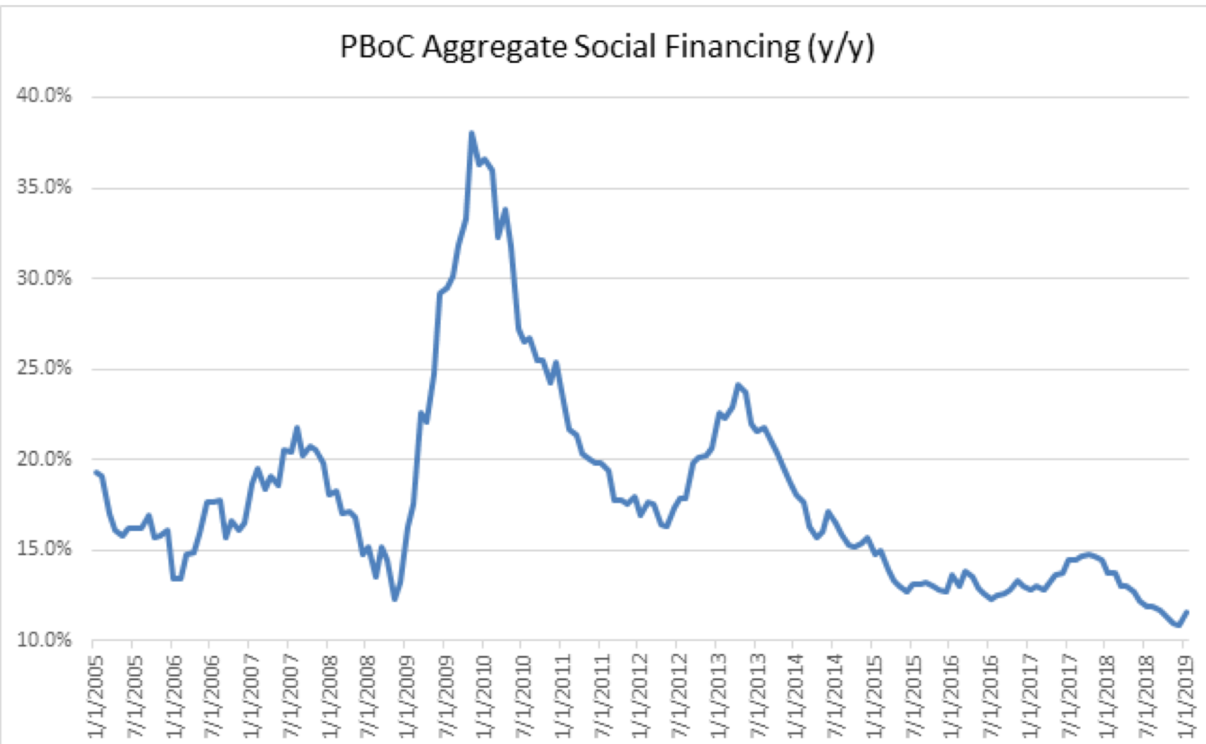
PBoC Headline Metric: "Total Social Financing"

- TSF measures credit to the private sector in the form of bank loans, bond issuance, and other "shadow" channels



Source: PBoC

- Finally an uptick in January, from 10.9% y/y to 11.6%

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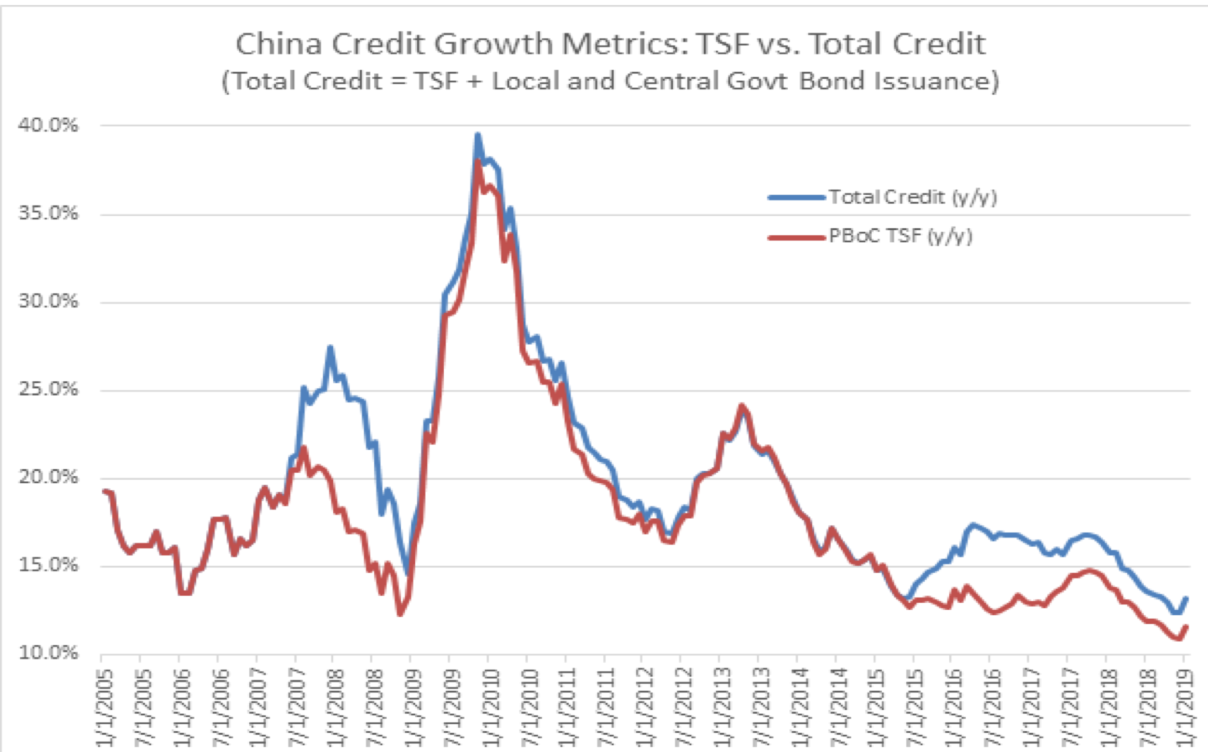
We Can Capture any "Fiscal Easing" by Adding Govt Bond Issuance to TSF

- Chinese "Fiscal easing" is designed to "put money in people's pockets" – in entails little to no incentive effects
- We can capture the effect of any "fiscal easing" by simply adding local & central govt bond issuance to TSF



Source: PBoC, Chinabond, Macrolens calculations

- This measure of "total credit" rose 13.1% in Jan, up from 12.4% in Dec
- The 2015 "stimulus" was largely driven by muni bond issuance not captured in TSF

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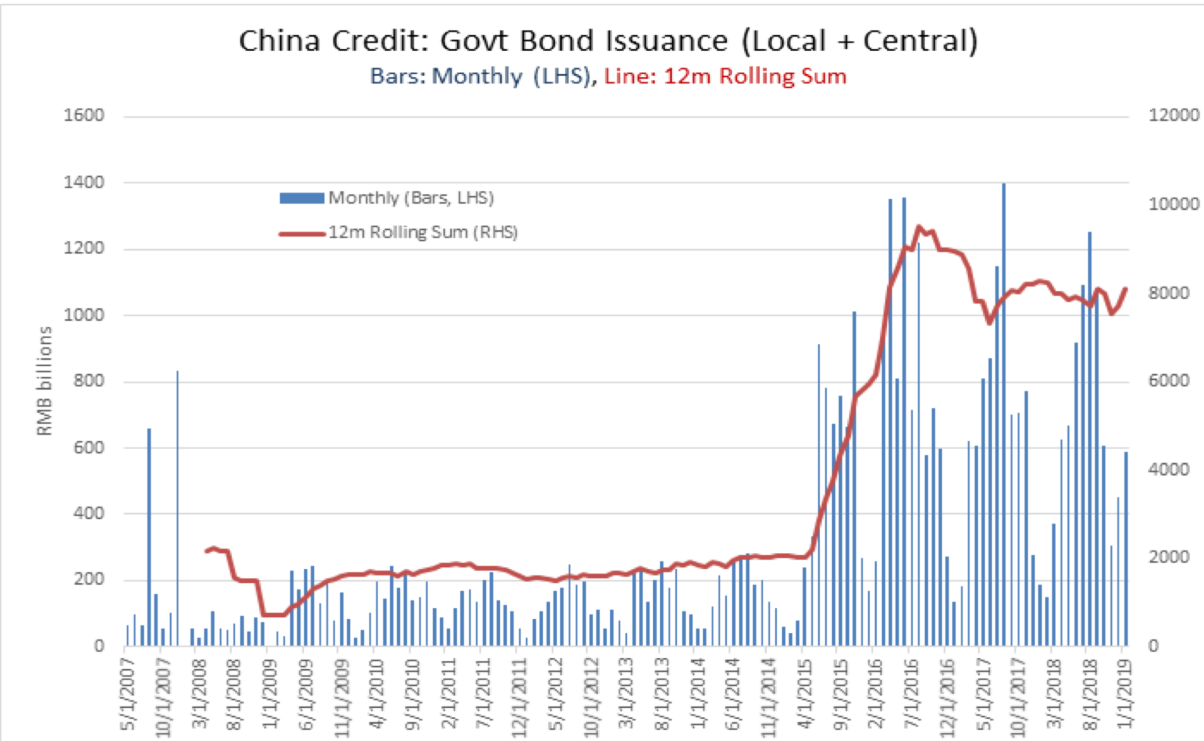
Fiscal Easing: YAWN

- Seriously, forget about fiscal policy…



- China shot its fiscal wad in 2015-16
- There has been no additional "fiscal impulse" since then
- RMB ***8T in govt bond issuance is 9% of GDP*** and that doesn't even include credit to Local Govt Financing Vehicles (registered as corporates)

Source: PBoC

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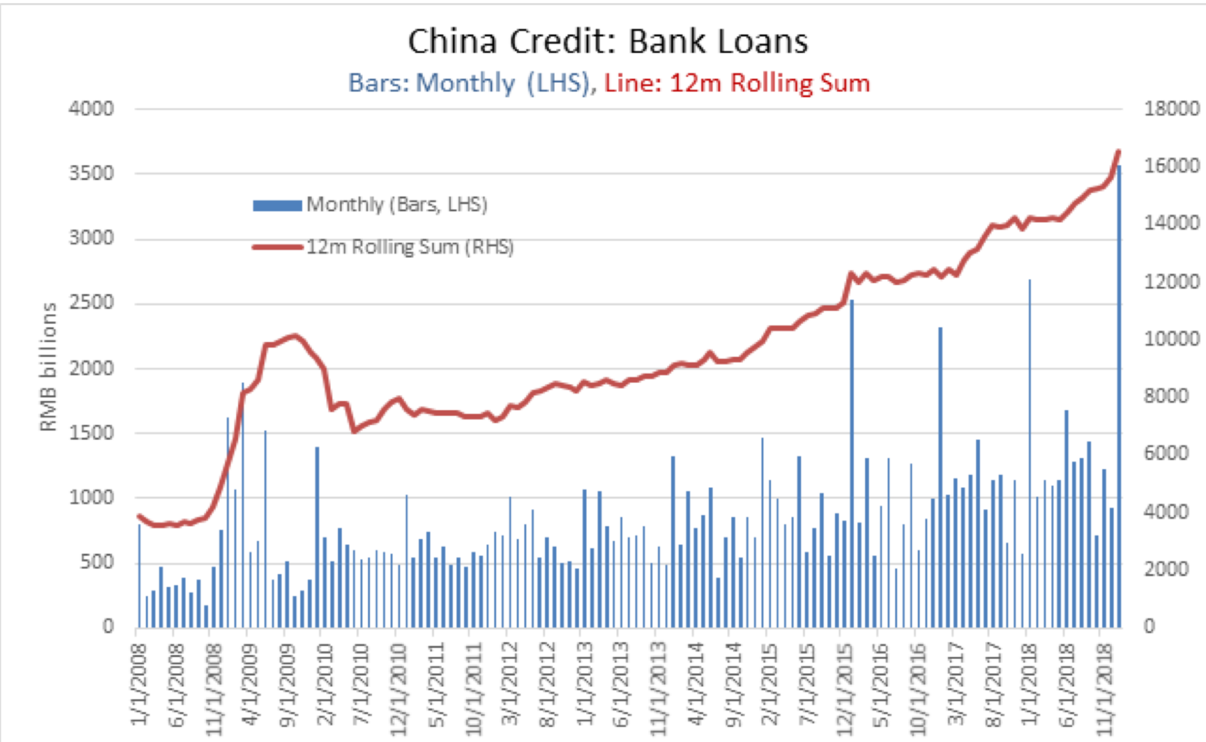
Bank Loans

- Bank Loans are the largest component of TSF



- RMB 3.5T in new loans in January is pretty juicy
- That's ***more than U.S. Banks increased lending in all of 2018***

Source: PBoC

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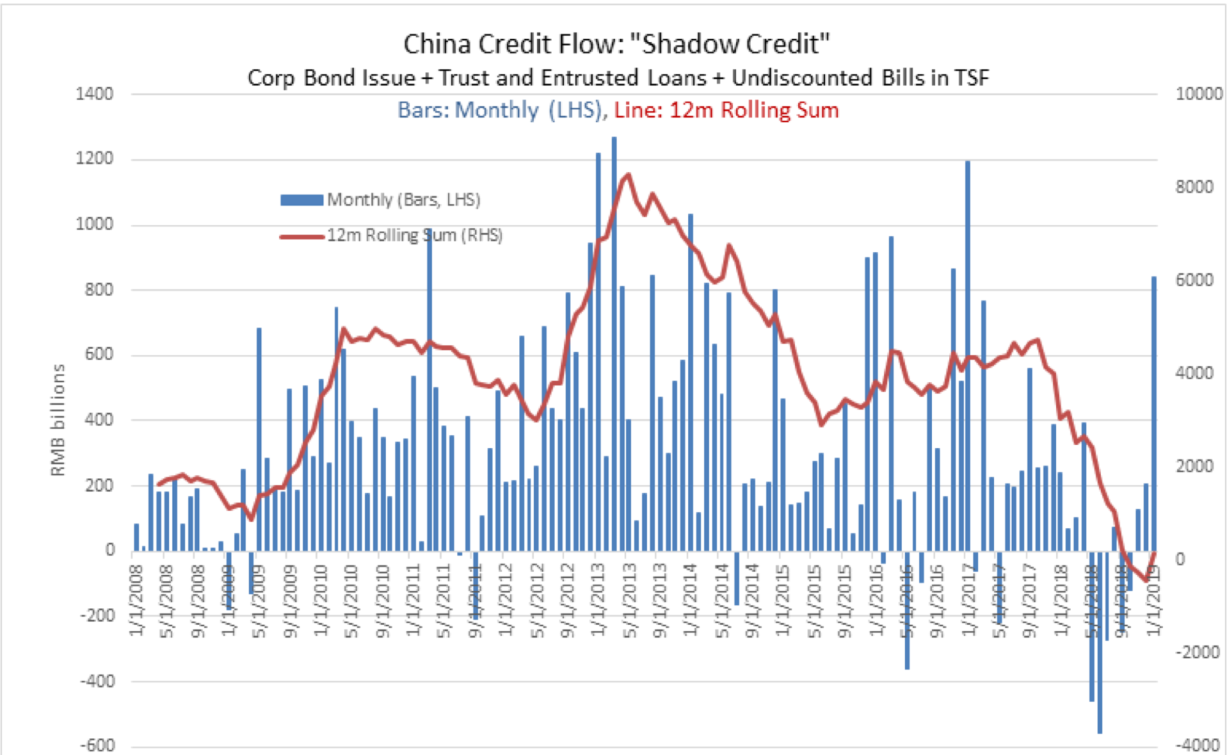
Shadow Stabilization

- "Shadow Credit" = Corporate Bond Issuance, Trust Loans, Entrusted Loans, and Undiscounted Bills



- Entrusted loans are bank-arranged off-balance sheet loans booked through trusts
- Undiscounted bankers acceptances (up Rmb 378bn in Jan) are IOU's that float around as an inter-corporate parallel currency
- Despite the big bounce in Jan, policymakers are likely to maintain the clamps on off-balance sheet activity

Source: PBoC

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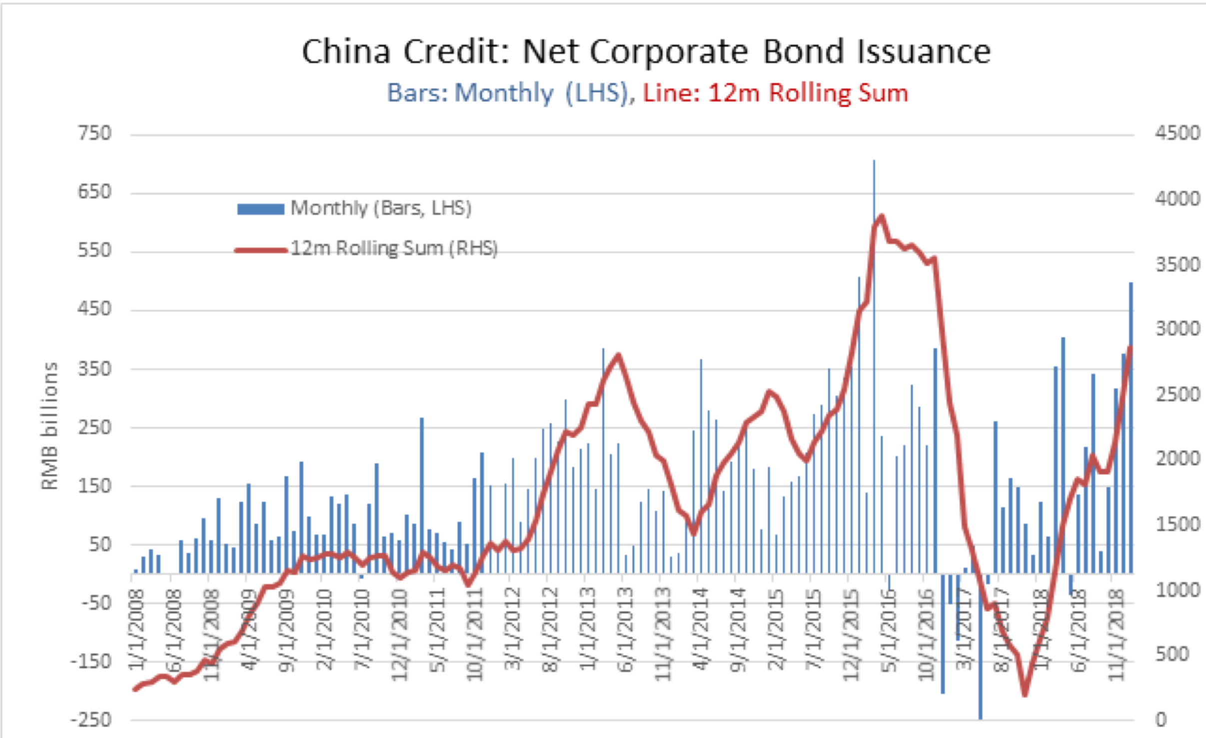
Corporate Bonds



- The corporate bond market has revived in recent months but most issuance has been by SOE's

Source: PBoC

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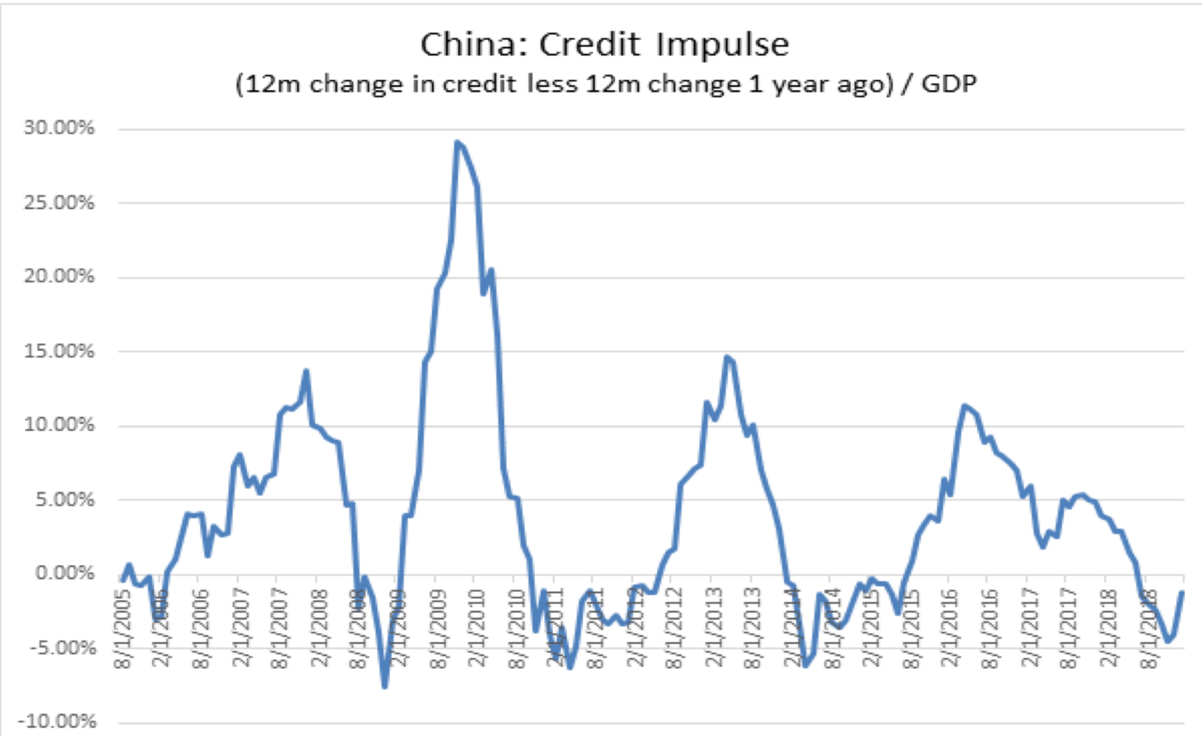
Credit Impulse Remains a Drag

- "Credit impulse" is the second derivative of credit outstanding
- It is the increase in NEW credit that provides the impulse to GDP growth



Source: PBoC

<u>Conceptualizing the "Credit Impulse"</u>

- Outstanding credit funded past GDP
- New credit will fund this year's GDP
- *More new credit than last year* will fund ***GDP growth***

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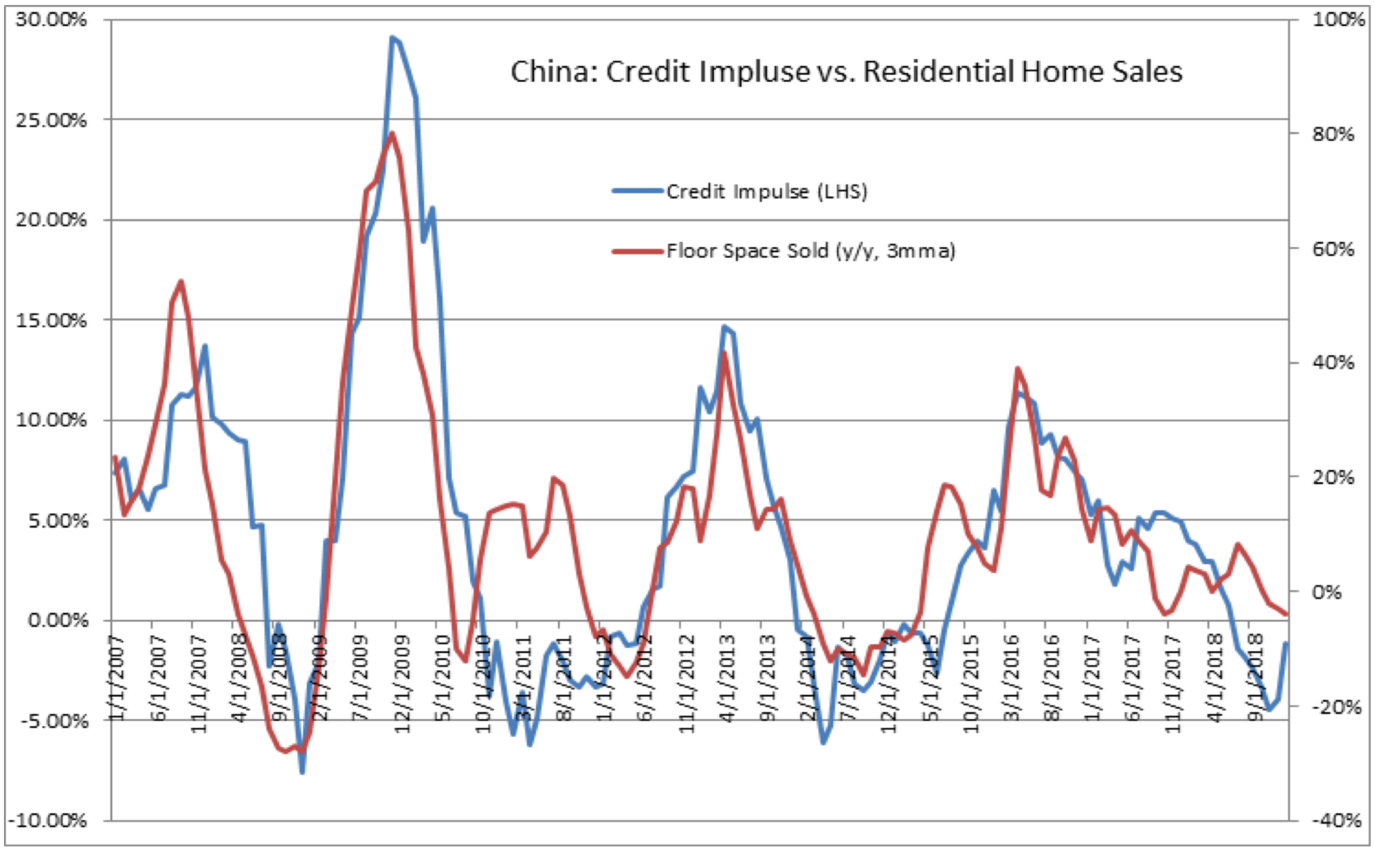
The Housing Bubble Feeds on Credit

- Sales activity in the Chinese Real Estate market has been driven by the credit impulse



Source: China NBS, PBoC, Macrolens calculations

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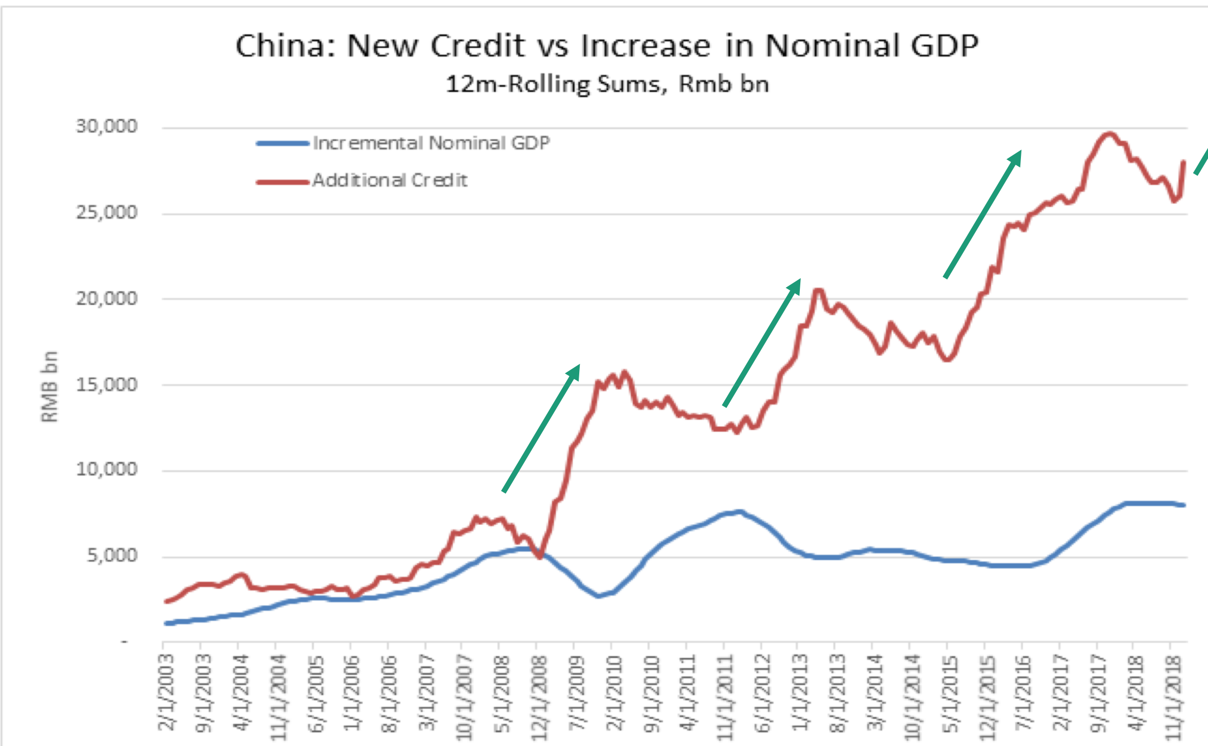
Declining Credit Efficiency

- The credit flow necessary to sustain a steady flow of GDP expansion continues to increase



- ***Again?***
- Next iteration could see $5T in annual credit expansion

Source: China NBS, PBoC, Macrolens calculations

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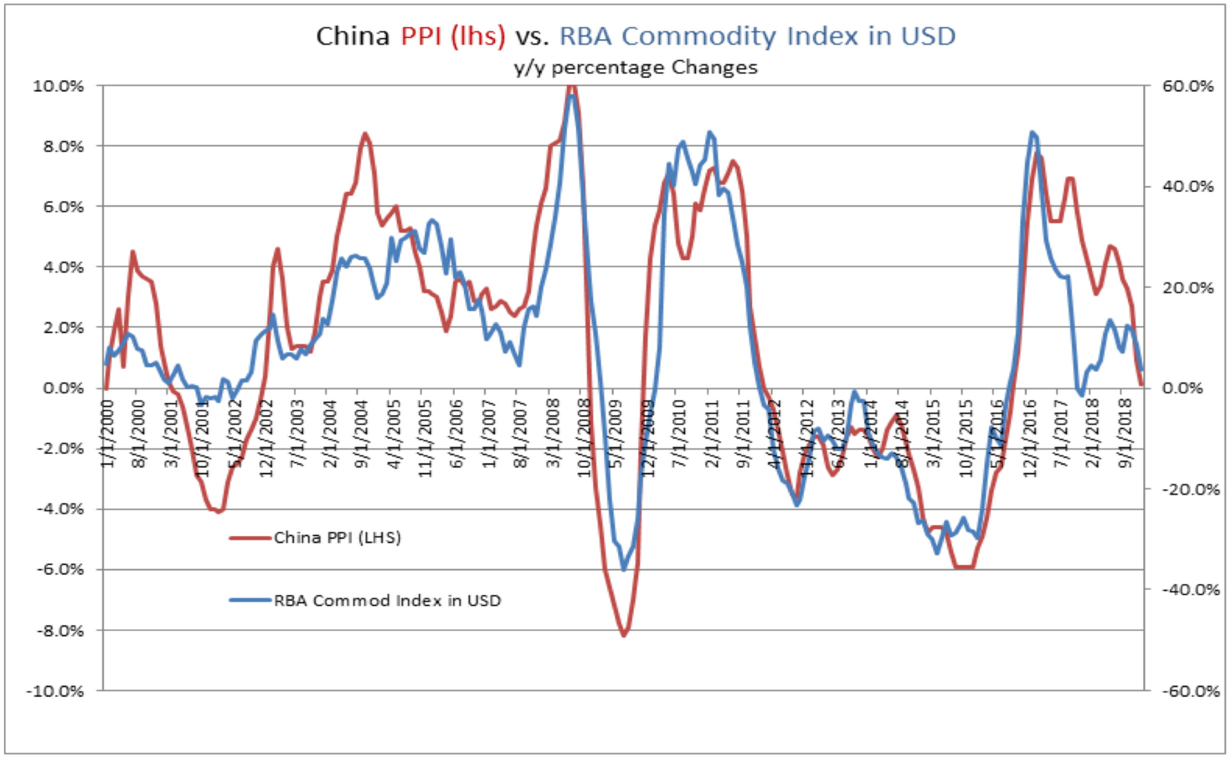
Stimulus Headwinds: China Has a Dollar Problem

- Global commodity prices drive China's PPI Inflation



- 88% correlation

Sources: China NBS, Reserve Bank of Australia

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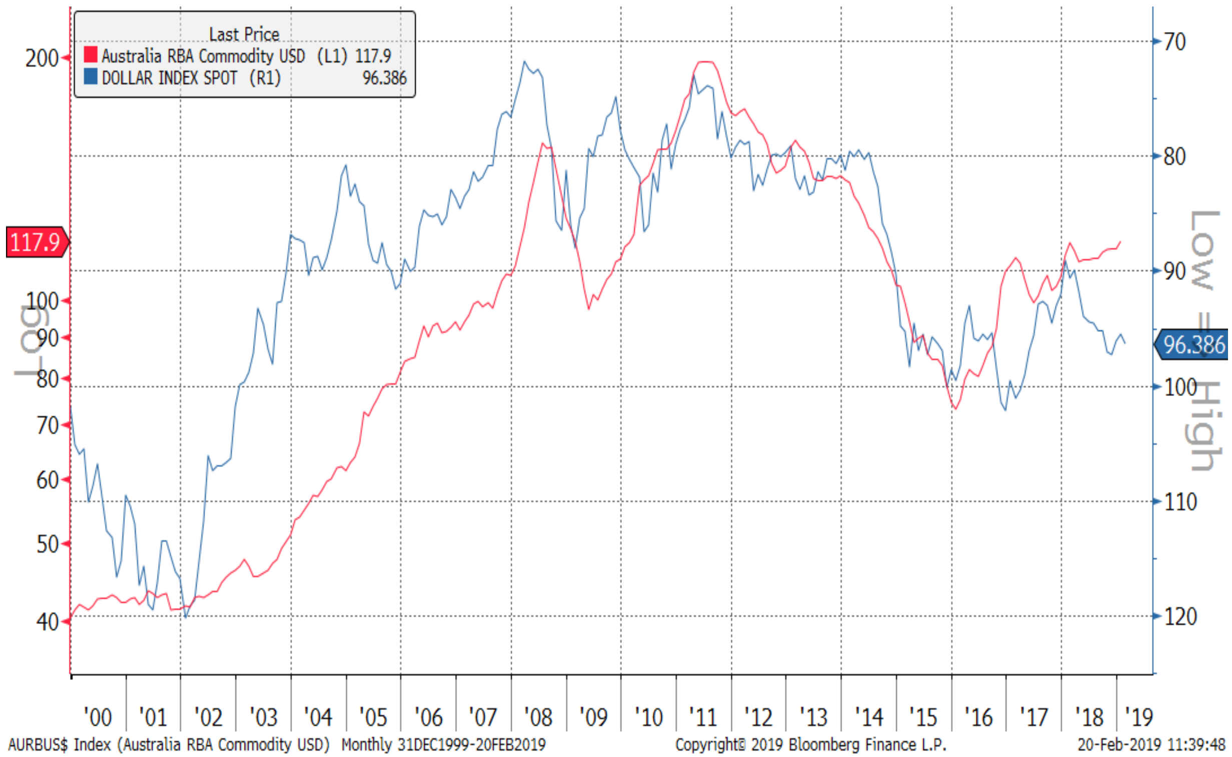
The Dollar Drives Global Commodity Prices, not China

- Yes, there is some reflexivity between Chinese stimulus and global commodity prices
- “China demand” may effect individual commodities at times *but the value of a broad basket will ultimately be driven by movements in the currency in which is it denominated*.

RBA Commodity Index in USD (log scale, lhs) vs The Dollar Index (inverted, rhs)



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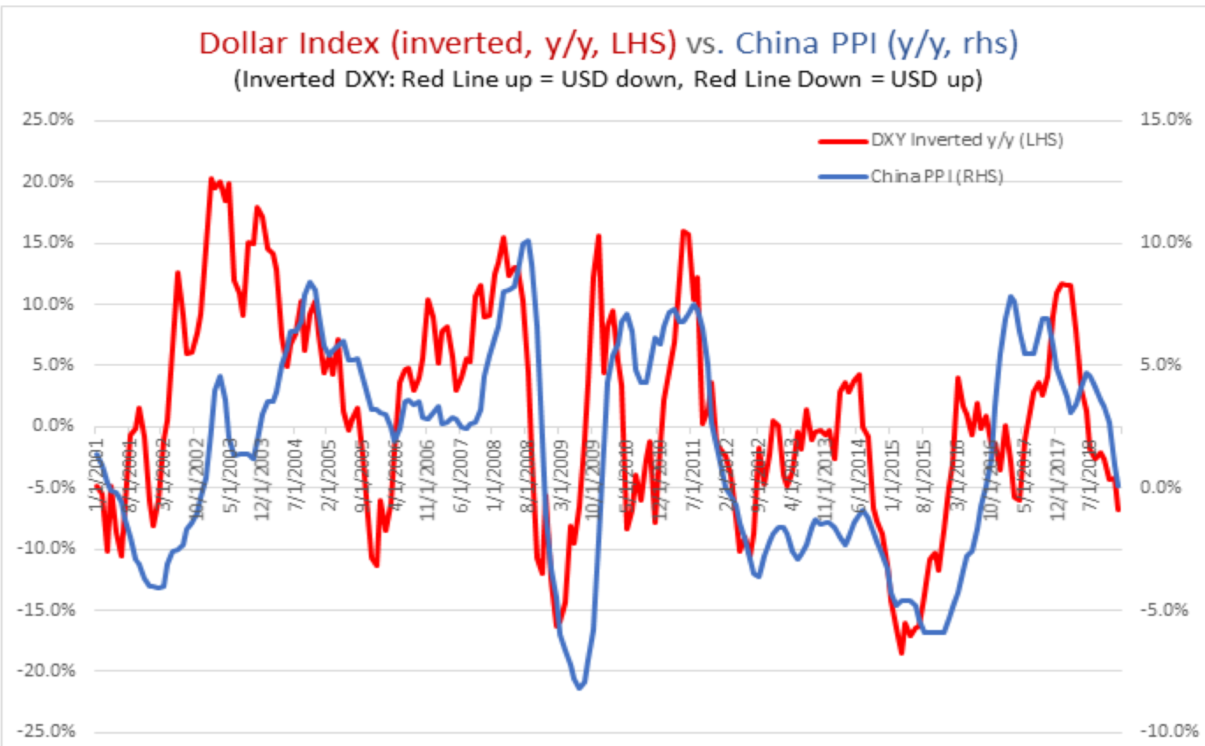
China Definitely Has a Dollar Problem

- The Dollar's influence on Chinese inflation is also directly visible
- This is perfectly consistent with economic theory regarding pegged / semi-pegged currencies



Sources: China NBS, Bloomberg

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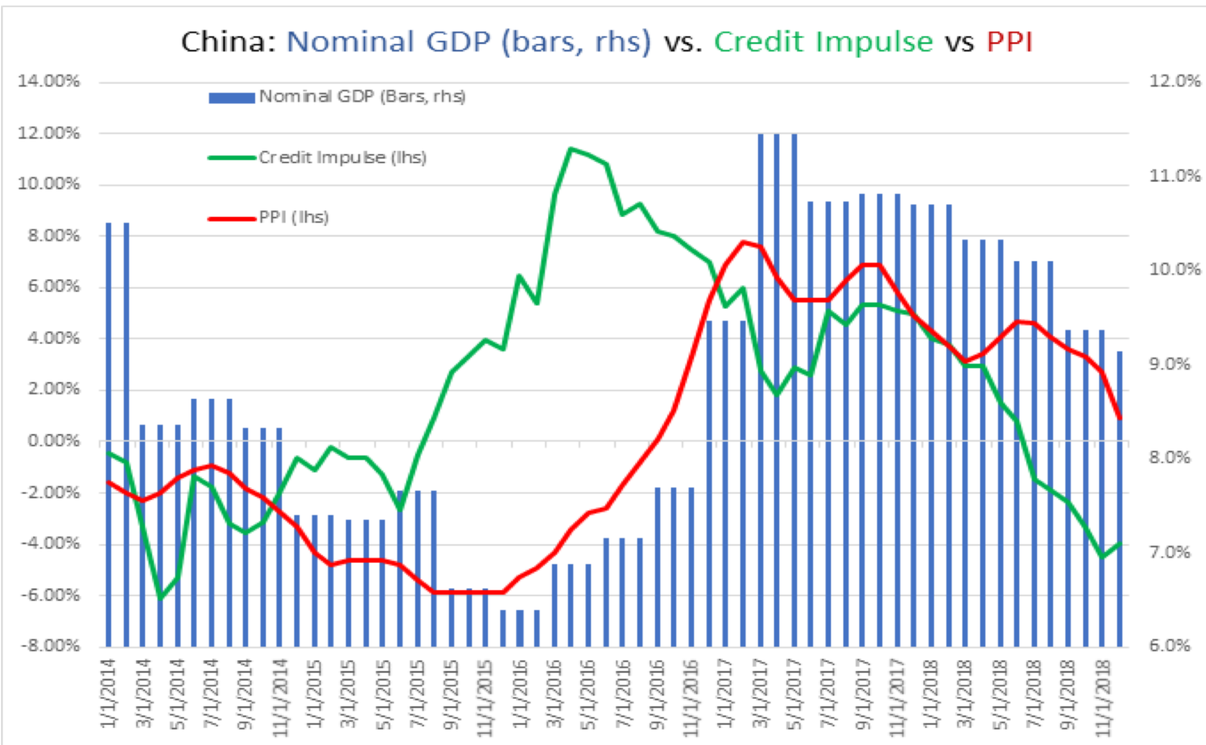
Stimulus Didn't Bail out China Last Time: *The Dollar Did*

- Credit stimulus in 2015 was necessary to combat weakness stemming from deeply negative PPI and a collapse in Nominal GDP
- While stimulus helped, *the economic upswing was driven by a 14 ppt swing in PPI which goosed nominal growth*



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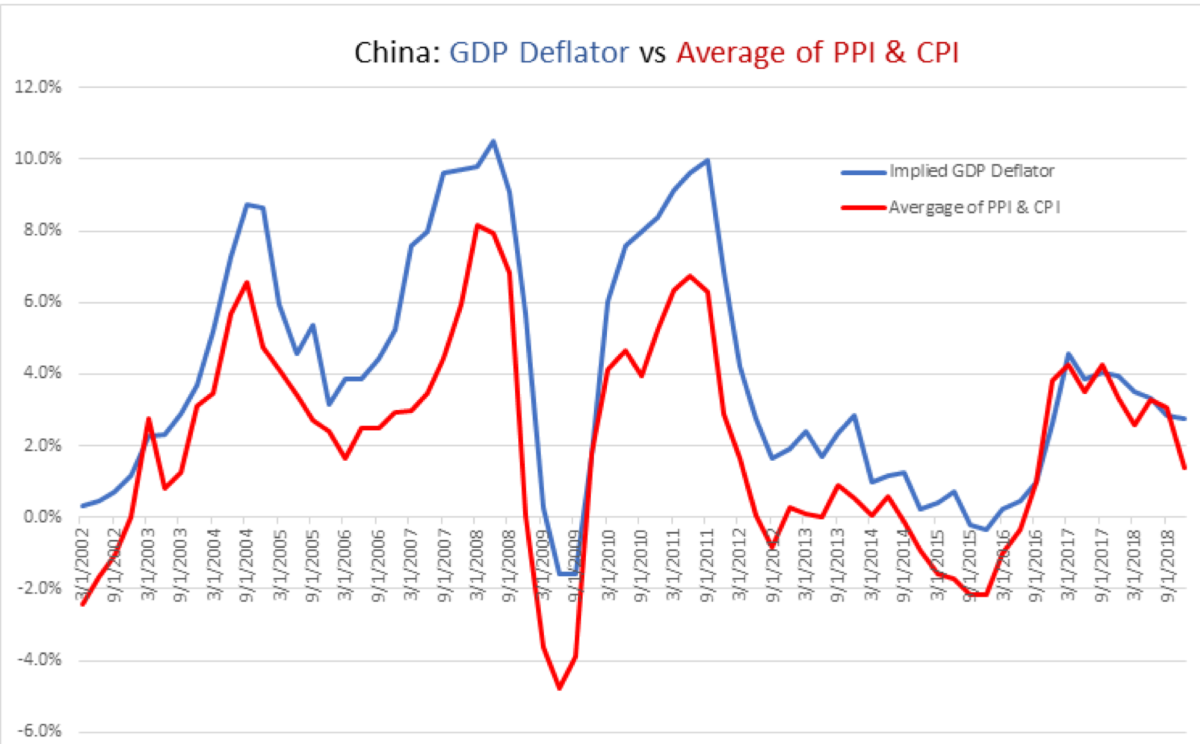
China's GDP Deflator = @AVG(PPI+CPI)

- Averaging CPI and PPI is a good back-of-the-envelope estimate of China's GDP deflator…



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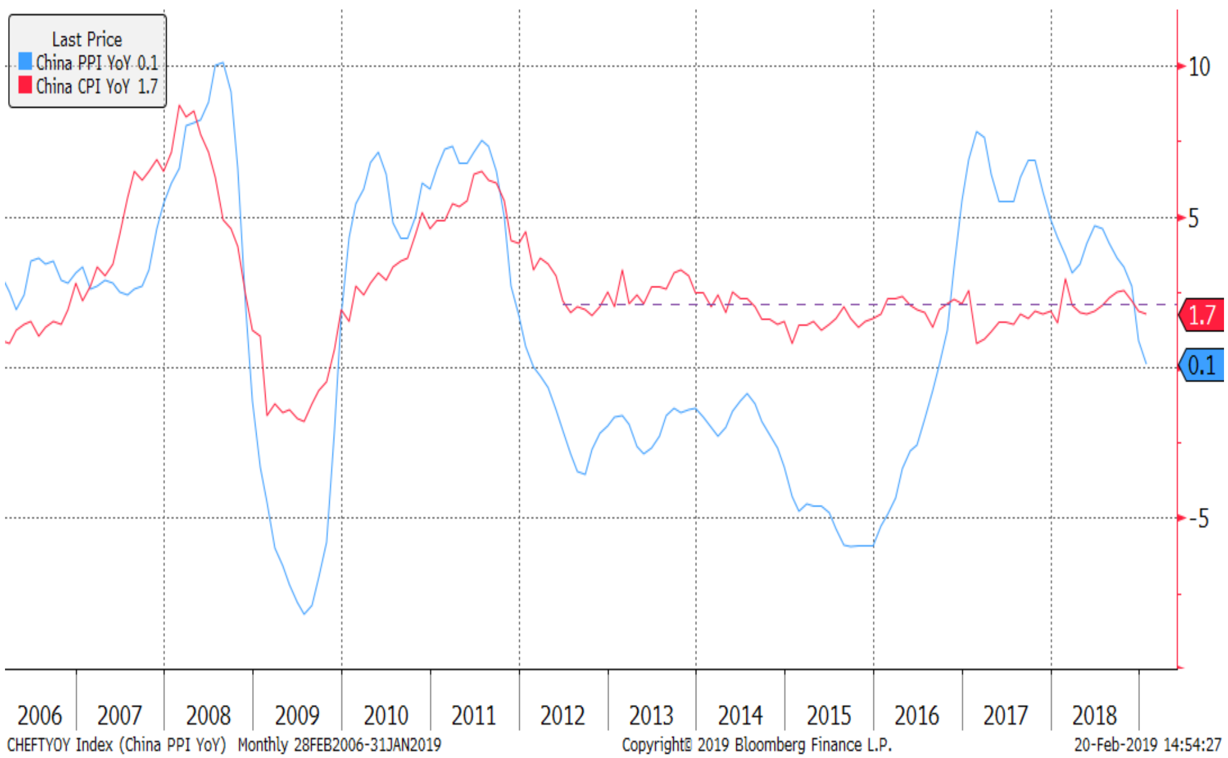
PPI is the swing variable for China's GDP Deflator

- Because CPI hasn't budged in 6 years…

China CPI vs China PPI



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Nominal Growth to Remain Under Pressure in 2019

- ***Unless the Dollar weakens significantly***, China's PPI is likely to hover around zero, suppressing nominal growth
- Back of the envelope forecast: 2% CPI + 0% PPI = 1% GDP Deflator
  6% real GDP + 1% deflator = 7% nominal GDP Growth

- 7% nGDP felt like a crisis in 2015
- Since the end of 2015, credit has *grown by an additional RMB 86T*
- 15% credit growth would merely fill the hole left by decelerating nominal growth
- ***There will be no 2016/17-style boom unless the Dollar weakens sharply***

Sources: China NBS

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China Growth Model is Badly Exposed

- **The Deleveraging Dream is dead**: China has proven incapable of sustaining single-digit credit growth
- The goal of ”moving up the value chain” is under grave threat from the U.S.
- There is no Plan B

- 7% nominal GDP growth
- + 15% credit growth
- will take the debt ratio to 286% in 2019

Xi’s “deleveraging campaign” is over in the blink of an eye

Sources: PBoC, China NBS, Macrolens calculations

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Conclusions

- “Fiscal Stimulus” is a myth
- “Credit Stimulus” is underway, subject to the restrictor plate of a possible RMB-stability pact
- The U.S. Dollar is the key to China’s outlook
- ”Credit stimulus” is necessary merely to fill the cash-flow hole left by declining nominal growth
- Forget the 2016-17 analog: China will remain a drag on global growth in 2019
- China’s growth model is exposed: the risk of a devastating break in domestic sentiment is ever-present