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Are China Stimulus Hopes Fading Already?

The price action in Chinese A-shares last night (-34bps on the heels of the hot TSF data released after Friday's close) is drawing some attention this morning. A Bloomberg story summed up the zeitgeist: "*China Stocks Fall as Better Data Dime Prospects of More Stimulus.*"

Contradictions regarding the China stimulus story are coming into focus:

1) Xi Jinping put his personal stamp on the deleveraging campaign and the adage that "houses are for living in, not speculation."

   So, either the deleveraging policy is credible, in which case we should expect any credit stimulus to be unwound as soon as it gains traction, or the economic agenda of the all-powerful leader will be exposed as unworkable.

2) To maintain credibility on "deleveraging" the Q1 stimulus has been presented as a frontloading of annual credit quotas rather than a resort to a new round of "flood-like stimulus." The goal is to shore things up so as to improve negotiating leverage on trade.

   So, either China gets a trade deal and the policy pressure subsides, or China does not get a trade deal in which case re-leveraging will be exposed as short-sighted and desperate.

There is no scenario in which China solves its trade problems, maintains the credibility of its economic policies, *and* engages in the degree of stimulus that market participants have come to expect.

PBoC today reaffirmed its aversion to "flood-like stimulus," reiterating Premier's Li's similar commitment at the March NPC meetings. From Bloomberg:

> *The People's Bank of China said it'll keep good control of the money supply "floodgate," while reaffirming a commitment to sufficient liquidity. The bank commented in a statement released Monday after the first-quarter meeting of the monetary policy committee, an advisory body chaired by Governor Yi Gang*
>
> *The phrases on controlling the monetary floodgate and not "flooding" the economy with excessive liquidity reappeared in the statement, after being dropped in the previous edition, signaling an emphasis on restrained liquidity management as the economy shows further signs of recovery.*
>
> *China's "economy has shown healthy development and economic growth is resilient," the statement said. The PBOC said it'll continue to take counter-cyclical measures and improve coordination with fiscal and other policies.*

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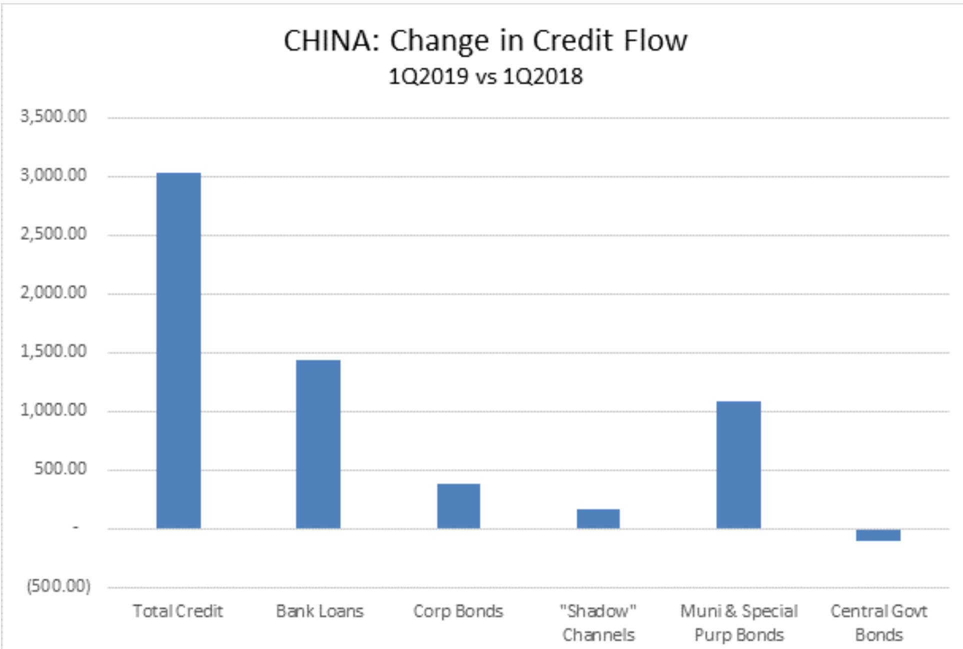
China's stimulus to this point has all the look of the typical "front-loading" in times of stress.

Disaggregating the credit flows shows that the total RMB 3T *increased credit extension* relative to 2018 was concentrated in bank lending and local bond issuance.



Its likely that the increased flow of bank and muni bond credit is the result of front-loading of 2019 credit quotas which will be end up little changed from 2018 when all is said and done.

With regard to muni bonds, we know this to be the case because they announced in December the unusual step of allowing Q1 issuance of local government bonds:

> *The Standing Committee of the National People's Congress (NPC), China's top legislature, passed a bill last week allowing local governments to issue 1.39 trillion yuan ($202 billion) worth of bonds before the legislature officially approves a 2019 quota in March*

Local bond issuance in Q1 was in fact RMB 1.4T some 1.1T more than in 1q2018. Given market expectations for an overall muni bond quota increase of ~1T for 2019, *the entire impetus from increased local government bond issuance this year is likely now behind us*.

Ditto for bank loans. There is no explicit announcement of bank lending quotas, so there could be additional flexibility here if needs be. But the strong rhetorical commitment to avoiding "flood-like stimulus" suggests that increased bank lending year-to-date is also the result of aggressive front-loading rather than a sharp increase in annual loan quotes.

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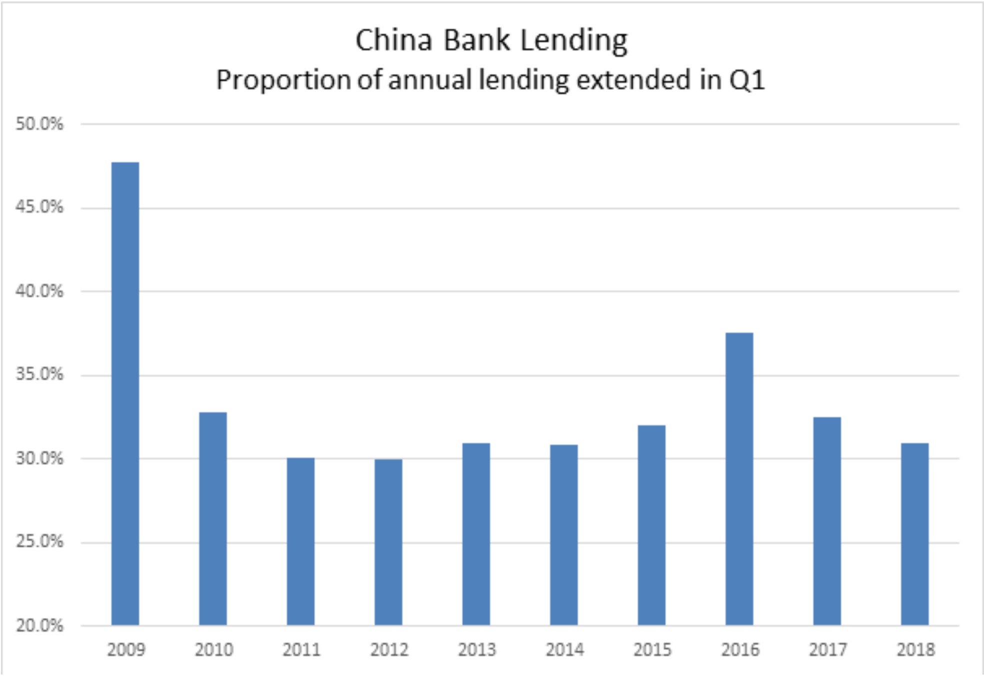
We've seen this before at times of stress. In both 2009 and 2016 the proportion of annual bank lending extended in Q1 rose notably above the 30-32% norm.



Bottom line

The RMB 3T in additional credit extension in 1q2019 vs 1q2018 is likely to account for the bulk of additional credit extension in calendar 2019.

A total of RMB 3T in expanded credit flow for all of 2019 would put year-end credit growth at around 12% - the outer limit of adherence to the policy commitment of maintain a "basically stable" macro leverage ratio.

Thus, the bulk of "credit stimulus" is probably already behind us.

It's perhaps too early to short Chinese shares on "stimulus over-optimism," but I'm watching this one like the proverbial cyclops with a monocle.