Greater China — Week in Review

13 May 2024

Highlights: higher tolerance for weaker credit growth?

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Keung Ching (Cindy)
Greater China economist
cindyckeung@ocbc.com

We had a mixed data release from China last week. Total trade growth rebounded while inflation data were largely in line with expectations. However, China's April credit and monetary data have surprised to the downside.

This paints a worrying picture across three key indicators. Firstly, China's new aggregate social financing fell by 198.7 billion yuan in April, marking the first monthly decline since October 2005.

Secondly, M1, a measure of narrow money supply, experienced a 1.4% year-on-year decline in April, the second-lowest reading on record. Meanwhile, M2 growth decelerated to 7.2%, also marking a record low.

Thirdly, medium to long-term loans to households saw a significant decline of 166.6 billion yuan in April, representing the largest monthly drop on record. Despite easing property measures, China's household sector continues to deleverage, reflecting a cautious outlook on the property market.

Adding to the concern, there was a notable decline of 343.1 billion Yuan in the pledged supplementary lending (PSL) in April, marking the largest monthly decrease since the inception of the PSL. We believe the fall of PSL does not mean the rollbacks of property support measures by China. Instead, it was mainly the result of market force as the yield on 5-year bonds issued by China Development Bank has dipped below the PSL rate.

Nevertheless, the recent shift in demand for both central bank-engineered PSL and MLF, driven by relatively high funding costs compared to market-traded rates, underscores the dilemma facing the People's Bank of China (PBoC). In recent months, the PBoC's balance sheet has contracted from its peak, reflecting weak demand for MLF and redemptions for PSL, which could further hinder the expansion of the monetary base. Against a backdrop of increasing propensity for fixed deposits, the slowing creation of the monetary base may delay China's timeline for reflation.

The weak credit and money supply data, along with the recent reduction in the central bank's balance sheet, may indicate a potential requirement for the PBoC to further lower its policy rate.

However, the PBoC's first-quarter monetary policy report has poured the cold water. The PBoC argues that due to the ongoing transformation, upgrading, and pursuit of high-quality development within China's economy, the traditional relationship between credit growth and economic expansion is diminishing.

PBoC highlights the three reasons why the slowdown in China's total credit volume from double-digit to single-digit growth rates does not signify a weakening of financial support for the real economy.

The central bank also predicts that the revitalization of inefficiently utilized financial resources and the reduction of idle fund circulation may contribute to a slowdown in the growth rate of total credit. In addition to the possible deceleration of credit growth, the central bank also said that the deceleration in overall money supply growth doesn't necessarily indicate a decrease in the real economy's financial support intensity.

Overall, the report showed China's higher tolerance for lower credit growth and money supply. As such, this may reduce any hope for any imminent rate cut.

Meanwhile, PBoC also warned about chasing longer end government bond yields noting that in the first quarter, the trading volume of 20 to 30-year bonds in the interbank bond market surged to 8.9 trillion yuan, marking a nearly fivefold surge compared to the corresponding period last year. Rural financial institutions notably contributed to this trend, accounting for 24.8% of the interbank bond market's transaction volume—an increase of approximately 10.5 percentage points from the previous year. The central bank warned the potential losses from excessively short-term investment strategies.

There is a bright spot on the fiscal side. Fiscal deposits increased by only 98.1 billion yuan in April, significantly lower than the increase of 502.8 billion yuan observed in April 2023. Moreover, **fiscal deposits have actually fallen by 187.4 billion yuan in the first four months of 2024, a trend reminiscent of the decline seen in 2020 during the onset of the Covid-19 outbreak.** This decline in fiscal deposits indicates that fiscal policy remains proactive, despite the challenging economic environment.

In Hong Kong, Hang Seng Index rose further to the year-to-date high last week, as market sentiment was buoyed by the news that mainland regulatory bodies was considering the proposal to waive dividend taxes for shares bought via Southbound Stock Connect. Upon the commencement of proposal, 20% of dividend tax would be lift for individual investors. This added to a slew of supportive measures which intend to bolster Hong Kong's equity market liquidity and revive the sluggish IPO market.

The Hong Kong equity market managed to sustain recent rally, bouncing by more than 25% from the trough seen in January, amid growing economic optimism in mainland China, cheap valuation and global investors scaling back underweight of Chinese and Hong Kong equities, as well as a slew of positive developments in terms of regulatory setting and corporate actions (including share buyback, increased dividend payout). We are seeing real money flow into the local equity market, while market players are largely upbeat on the near-term outlook. That said, moving into May and June, seasonality factor is playing against the market.

Walking through the recent policy announcements, including expansion of stock connect and encouraging leading enterprise to list in Hong Kong, it is not hard to come to a conclusion that top management in China intends to reinstate Hong

Kong's role as an IPO hub and boost market liquidity. The latest dividend tax waiver proposal is believed to further bolster the southbound turnover. At the same time, the AH premium also continued to shrink, to the lowest since mid-2023.

Macau released the housing market data in March, when major property cooling measures were yet to be removed. Data showed that correction in the housing market continued with no sign of abating, as price index declined further, and trading activities turned even quieter.

In the first quarter this year, the overall residential property price index was down by 3.2% quarter-on-quarter and 9.0% year-on-year respectively. The housing price was on a broad downtrend in the past seven quarters, in the face of rising mortgage rate and negative spillovers from the sluggish property markets in mainland and Hong Kong. Comparing with the peak in 2018, the price index was down by a cumulative 16.3%. Meanwhile, trading volume of residential properties also fell further to 151 cases in March, the lowest in four months. While we believe the removal of property cooling measures in April help to support general sentiment, it however was insufficient to revive the market. We tip the range of change in housing price at -5% to 0% for 2024.

Key events	
Facts	**OCBC Opinions**
▪ Following a combined increase of 500 billion Yuan in the pledged supplementary lending (PSL) in December 2023 and January 2024, there was a notable decline of 343.1 billion Yuan in April, marking the largest monthly decrease since the inception of the PSL.	▪ This decline coincided with the April Politburo meeting, which saw a shift in emphasis away from the "three major projects," raising concerns about potential rollbacks of property support measures by China. ▪ However, the decrease in PSL may be attributed to strategic decisions made by policy banks. Notably, the yield on 5-year bonds issued by China Development Bank has dipped below the PSL rate. Furthermore, there has been a noteworthy surge in the issuance of policy financial bonds in April, suggesting that these bonds may be supplanting PSL as a preferred instrument. ▪ Nevertheless, the recent shift in demand for both central bank-engineered PSL and MLF, driven by relatively high funding costs compared to market-traded rates, underscores the dilemma facing the People's Bank of China (PBoC). In recent months, the PBoC's balance sheet has contracted from its peak, reflecting weak demand for MLF and redemptions for PSL, which could further hinder the expansion of the monetary base. Against a backdrop of increasing propensity for fixed deposits, the slowing creation of the monetary base may delay China's timeline for reflation. ▪ Given these circumstances, we believe there is a pressing need for the PBoC to lower its policy rate further. However, the decision to implement an outright rate cut may be constrained by concerns over RMB depreciation. The timing of the next rate cut remains uncertain and may hinge on the trajectory of the US dollar.
▪ In its 1Q monetary policy report, China's central bank deemphasized the importance of credit and money supply growth.	▪ With the ongoing transformation, upgrading, and pursuit of high-quality development within China's economy, the traditional correlation between credit growth and economic expansion is diminishing. The People's Bank of China (PBoC) has highlighted regional examples illustrating this trend. In 2023, one region experienced an average loan growth rate of 11.4%, yet its GDP only grew at an average rate of 5%. In contrast, another region saw an average loan growth rate of just 3.3%, while its GDP expanded at an average rate of 4.8%. ▪ The slowdown in China's total credit volume from double-digit to single-digit growth rates does not signify a weakening of financial support for the real economy, and several factors contribute to this. Firstly, China is actively undertaking structural adjustments, transformation, and upgrading efforts. These initiatives are aimed at moving away from an economic growth model heavily reliant on debt, especially given the challenges posed by dynamic changes in the property sector and local government debt. Simultaneously, there is a shift from traditional, credit-intensive heavy industries toward lighter, asset-light service industries, reflecting a broader economic evolution. ▪ Secondly, as the overall volume of credit within the economy reaches significant levels, the incremental impact of further credit expansion diminishes. This suggests that simply increasing credit issuance may not yield commensurate economic growth benefits. ▪ Lastly, the rise of direct financing offers a beneficial substitution effect for traditional credit channels. This implies that alternative forms of financing, such as equity financing and bond issuance, are increasingly complementing credit-based funding, thereby

	diversifying and strengthening the financial ecosystem supporting economic development. ▪ Overall, the central bank predicts that the revitalization of inefficiently utilized financial resources and the reduction of idle fund circulation may contribute to a slowdown in the growth rate of total credit. Nevertheless, they argue that this shift can lead to more efficient allocation of funds, particularly benefiting efficient enterprises genuinely in need of financing. ▪ In addition to the possible deceleration of credit growth, the central bank also said that the deceleration in overall money supply growth doesn't necessarily indicate a decrease in the real economy's financial support intensity. With the expansion of bond issuance, including treasury and corporate bonds, traditional bank deposit and loan activities may see a decline, consequently impacting deposits, loans, and the money supply. Nonetheless, the ongoing advancement of direct financing is beneficial for optimizing resource allocation and enhancing fund utilization efficiency, thereby reducing the reliance on indirect financing methods. ▪ Overall, the report showed China's higher tolerance for lower credit growth and money supply. As such, this may reduce any hope for imminent rate cut.
▪ Hang Seng Index rose further to the year-to-date high last week, as market sentiment was buoyed by the news that mainland regulatory bodies was considering the proposal to waive dividend taxes for shares bought via Southbound Stock Connect. Upon the commencement of proposal, 20% of dividend tax would be lift for individual investors. This added to a slew of supportive measures which intend to bolster Hong Kong's equity market liquidity and revive the sluggish IPO market.	▪ The Hong Kong equity market managed to sustain recent rally, bouncing by more than 25% from the trough seen in January, amid growing economic optimism in mainland China, cheap valuation and global investors scaling back underweight of Chinese and Hong Kong equities, as well as a slew of positive developments in terms of regulatory setting and corporate actions (including share buyback, increased dividend payout). We are seeing real money flow into the local equity market, while market players are largely upbeat on the near-term outlook. That said, moving into May and June, seasonality factor is playing against the market. ▪ Walking through the recent policy announcements, including expansion of stock connect and encouraging leading enterprise to list in Hong Kong, it is not hard to come to a conclusion that top management in China intends to reinstate Hong Kong's role as an IPO hub and boost market liquidity. The latest dividend tax waiver proposal is believed to further bolster the southbound turnover. At the same time, the AH premium also continued to shrink, to the lowest since mid-2023.

Key Economic News	
Facts	**OCBC Opinions**
▪ In April, China's Consumer Price Index (CPI) accelerated to 0.3% year-on-year from 0.1% in March.	▪ On a sequential basis, the CPI rebounded by 0.1% month-on-month following a 1% contraction in March. Non-food prices increased by 0.3% month-on-month, while food prices saw a further softening of 1% month-on-month. The sequential rise in prices was partially driven by energy and commodity prices, influenced significantly by overseas input factors. The international surge in energy and gold prices collectively contributed to a month-on-month CPI increase of approximately 0.15 percentage points. However, core CPI rose by 0.2% month-on-month, equivalent to 0.7% year-on-year, indicating an improving price level. Looking ahead, with the drag from the base effect likely to ease further, we anticipate China's CPI to accelerate further towards 1% during the summer.
▪ China's total trade in dollar terms rebounded by 4.4% year-on-year in April after experiencing contractions in the previous two months.	▪ This recovery was primarily driven by stronger-than-expected growth in imports, which surged by 8.5% year-on-year, while exports also saw an uptick of 1.5% year-on-year. Improved demand from the US and EU markets contributed to this growth, alongside sustained strength in China's exports to ASEAN, which saw an impressive increase of 8.15% year-on-year. The share of exports to ASEAN continued to rise, reaching 15.8% in April, up from 15.7% in March. Furthermore, China's demand for key commodities such as crude oil and electronic integrated circuits experienced a notable rebound. Imports of crude oil by value surged by 14.12%, while imports of chips saw a significant increase of 15.77% in value terms.
▪ China's April credit and monetary data have surprised to the downside.	▪ This paints a worrying picture across three key indicators. Firstly, China's new aggregate social financing fell by 198.7 billion yuan in April, marking the first monthly decline since October 2005. This decline can be attributed to two primary factors: a contraction in off-balance sheet lending, particularly bill financing, and an unusual decrease in government bond financing due to the delayed issuance of long-term special bonds. Secondly, M1, a measure of narrow money supply, experienced a 1.4% year-on-year decline in April, the second-lowest reading on record. Meanwhile, M2 growth decelerated to 7.2%, also marking a record low. This weaker-than-expected money supply growth indicates subdued effective demand in the economy. Thirdly, medium to long-term loans to households saw a significant decline of 166.6 billion yuan in April, representing the largest monthly drop on record. Despite easing property measures, China's household sector continues to deleverage, reflecting a cautious outlook on the property market. ▪ However, there is a bright spot on the fiscal side. Fiscal deposits increased by only 98.1 billion yuan in April, significantly lower than the increase of 502.8 billion yuan observed in April 2023. Moreover, fiscal deposits have actually fallen by 187.4 billion yuan in the first four months of 2024, a trend reminiscent of the decline seen in 2020 during the onset of the Covid-19 outbreak. This decline in fiscal deposits indicates that fiscal policy remains proactive, despite the challenging economic environment.

▪ Hong Kong's PMI edged down to 50.6 in April, down from that of 50.9 in March, dragged by the decline in new orders and inventories sub-index. Overall sentiment remained subdued, though the level of pessimism eased during the month.	▪ External demand remained weaken in April as new business from abroad and mainland China eased. On price front, both input price and output price inflation moderated. In the meantime, private sector firms raised their employment level while cutting back on inventory. ▪ S&P commented that fall in new orders can be partly attributed to the strong HKD against other currencies, a factor which we believed hindered the domestic demand as well. Going forward, we suspect the strength of local economy will in large part depend on the level of resilience of external demand.
▪ Macau released the housing market data in March, when major property cooling measures were yet to be removed. Data showed that correction in the housing market continued with no sign of abating, as price index declined further, and trading activities turned even quieter.	▪ In the first quarter this year, the overall residential property price index was down by 3.2% quarter-on-quarter and 9.0% year-on-year respectively. The housing price was on a broad downtrend in the past seven quarters, in the face of rising mortgage rate and negative spillovers from the sluggish property markets in mainland and Hong Kong. Comparing with the peak in 2018, the price index was down by a cumulative 16.3%. Meanwhile, trading volume of residential properties also fell further to 151 cases in March, the lowest in four months. ▪ While we believe the removal of property cooling measures in April help to support general sentiment, it however was insufficient to revive the market. We tip the range of change in housing price at -5% to 0% for 2024.

GLOBAL MARKETS RESEARCH

Macro Research

Selena Ling
Head of Strategy & Research
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Keung Ching (Cindy)
Hong Kong & Macau
cindyckeung@ocbc.com

Herbert Wong
Hong Kong & Macau
herberthtwong@ocbc.com

Lavanya Venkateswaran
Senior ASEAN Economist
lavanyavenkateswaran@ocbc.com

Ahmad A Enver
ASEAN Economist
ahmad.enver@ocbc.com

Jonathan Ng
ASEAN Economist
JonathanNg4@ocbc.com

Ong Shu Yi
ESG
ShuyiOng1@ocbc.com

FX/Rates Strategy

Frances Cheung, CFA
Rates Strategist
FrancesCheung@ocbc.com

Christopher Wong
FX Strategist
christopherwong@ocbc.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Chin Meng Tee
Credit Research Analyst
MengTeeChin@ocbc.com

*Follow our podcasts by searching '**OCBC Research Insights**' on Telegram!*