CHINA Insights

OCBC Bank

What can we learn from those record numbers?

Wednesday, February 15, 2017

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Highlights:

- **China's credit continued to expand at a rapid pace in January despite China's prudent goal to contain financial risk in 2017.**
- **Five sets of data hit record high. Some of them are positive to support the recent economic recovery such as record high equity issuance and medium to long term loan to corporates while some of them may fuel concerns about asset bubbles such as record high off-balance sheet lending and medium to long term loan to household.**
- **The credit expansion in January has been out of policy maker's comfortable zone. This also justified PBoC's move to shift the money market funding curve higher around the Chinese New Year holiday season.**
- **The tug of war between PBoC to contain financial risk and commercial banks to meet their earning target is likely to continue. This may translate to higher volatility in both money and bond markets.**
- **Another encouraging data is the rebound of foreign currency loan. The returning demand for foreign currency liability shows that the concern about disorderly RMB depreciation has diminished.**

China's credit continued to expand at a rapid pace in January despite China's goal to contain financial risk in 2017. The credit expansion clearly supported the recent economic recovery; however, it also fuelled concerns about the asset bubbles. Looking at the breakdown, five sets of data hit the record including record high aggregate social financing at CNY3.74 trillion, record high off balance sheet lending at CNY1.24 trillion, record high equity financing at CNY159.9 billion, record high medium to long term loan to household at CNY629.3 billion and record high medium to long term loan to corporate at CNY1.53 trillion. Some of record numbers are positive while some of record numbers may be worrying.

Let's start with the positive

First, equity financing in January hit a record high of CNY159.9 billion thanks to stable equity market. It seems that China's reform in equity market has started to bear the fruits and the negative correlation between equity market performance and equity issuance has been broken. As such, we should expect equity financing to play an increasing role in China's total social financing.

Despite strong equity financing, the percentage of direct financing, which include both bond and equity financing, shrank to only 2.8% lowest since May 2007. This was mainly due to the decline of bond issuance and ballooning off-balance sheet lending. Bond issuance continued to shrink for the second month, down by CNY53.9 billion, probably due to rising volatility in the bond market. Should bond market volatility persist, the disruption to bond market as the funding platform may continue.

Second, medium to long term loan to corporate surged to a record high of CNY1.52 trillion. This is probably the result of booming infrastructure projects on the back of proactive fiscal policy. More than half of China's provincial governments have set the aggressive goal for fixed asset investment to boost their local economies. As such, this may continue to translate to stronger demand for credit.

Now here are two major concerns

First, off-balance sheet lending spiked to CNY1.24 trillion, highest in record. In particular, trust loan increased by CNY317.5 billion, highest since March 2013. The rebound of shadow banking activity was probably due to tightening property measures as well as window guidance on bank lending, which diverted the funding demand from on-balance sheet lending to off-balance sheet lending.

Second, housing loan remained strong in January despite tightening measures with medium to long term loan to household increased by a record high of CNY629.3 billion. This may again flag the risk in property market.

Overall speaking, the credit expansion in January has been out of policy maker's comfortable zone. This also justified PBoC's move to shift the money market funding curve higher to contain leverage around the Chinese New Year holiday season. The tug of war between PBoC to contain financial risk and commercial banks to meet their earning target is likely to continue. We expect PBoC to continue to use its window guidance as well as possible interest rate tool to keep the pace of credit expansion in check in the first quarter. Meanwhile, we also expect volatility in both money market and bond market to remain as a result of tight bias monetary policy.

Last but not least, here is another set of data worth mentioning. foreign currency loan increased by CNY12.6 billion, first positive growth in five months, highest since June 2015. The returning demand for foreign currency liability shows that the concern about disorderly RMB depreciation has diminished and Chinese corporates are more rational on RMB volatility.

Co.Reg.no.:193200032W