

China: writing cheques the nation can't cash

Bank balance sheets under pressure

Bond markets in turmoil

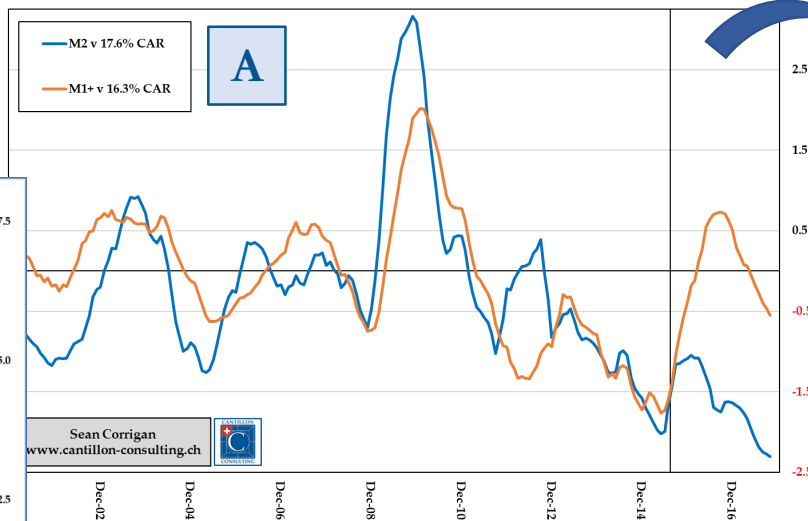
Multi-pronged regulatory crackdown

Stocks struggling (especially small-caps)

Can the real economy withstand the pressure?

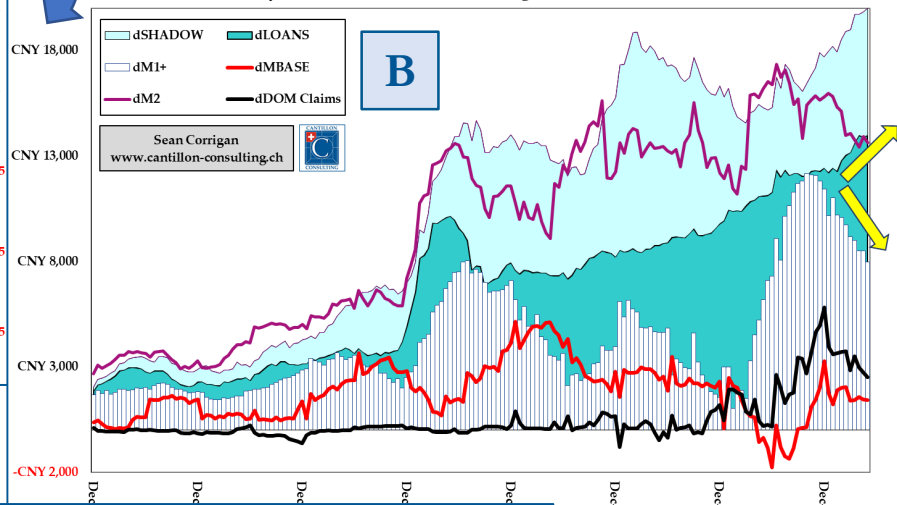
CHINA: A QUICK RECAP OF OUR THEME

China M-Aggregates, YOY% Deviation from 2000-15 CAR: Source - PBOC



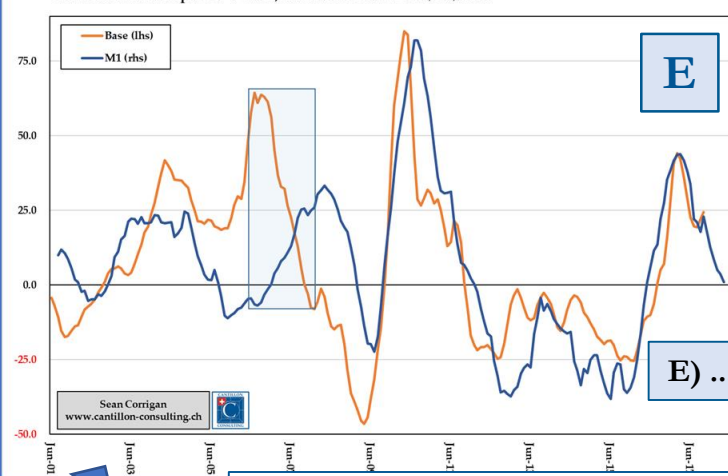
A) Rapidly decelerating money growth & a frozen bond market is (B) putting pressure on bank loan-deposit ratios

China Cumulative Money & Credit Additions, 12mos running, blns: Source - PBOC



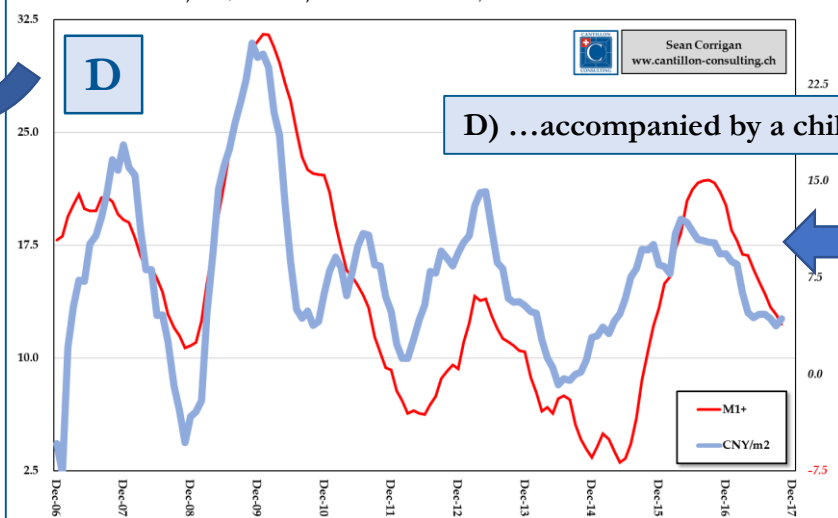
E) ...and a potential knock-on in commodities

China Base Metals price t+6 v M1, 3mma YOY: Source - IMF, WB, PBOC

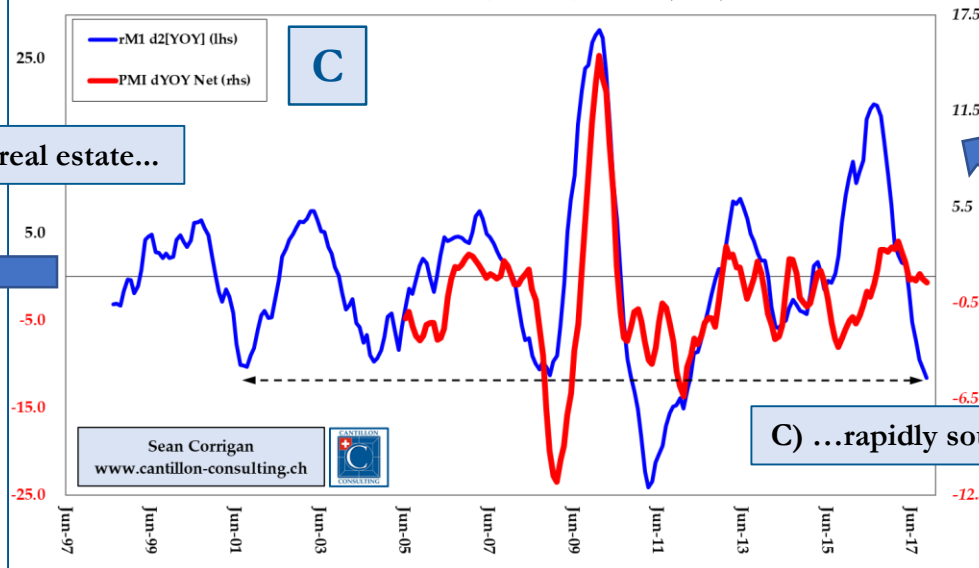


D) ...accompanied by a chill in real estate...

China Real Estate, CNY/m2 v M1+, 6mma YOY: Source - NBS, PBOC



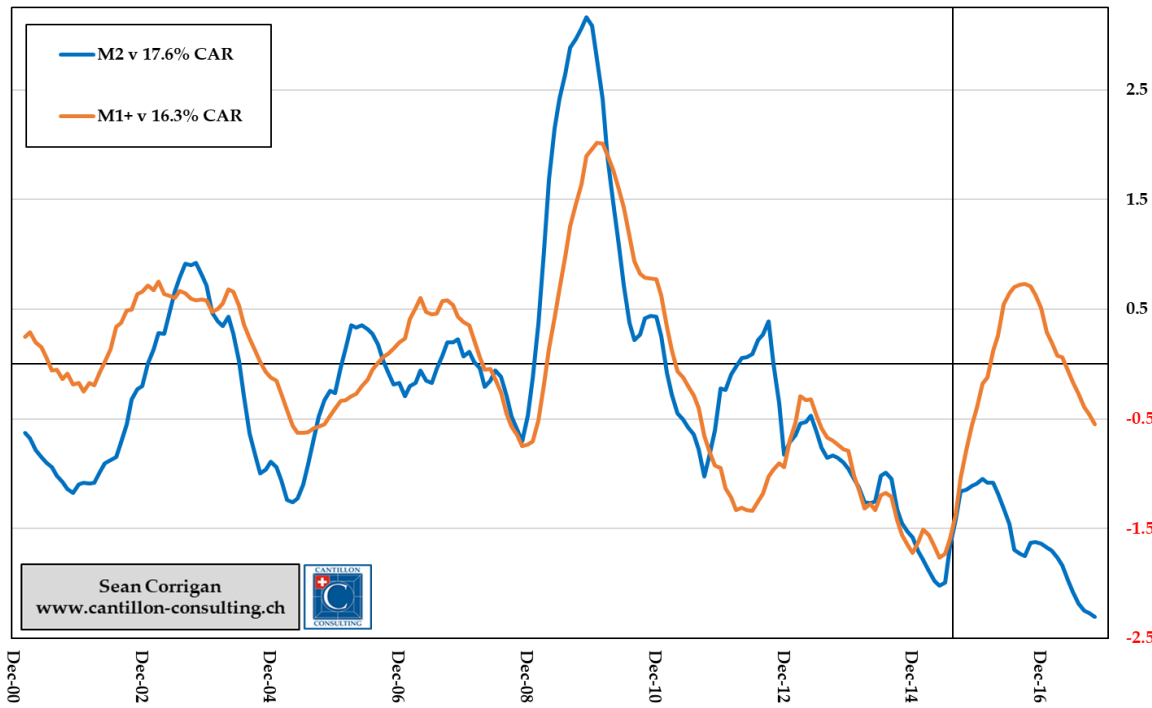
CLSA/HSBC/Caixin PMI 3mmaYOY v China Real M1 d2(3mmaYOY): Source - NBS, PBOC, Markit



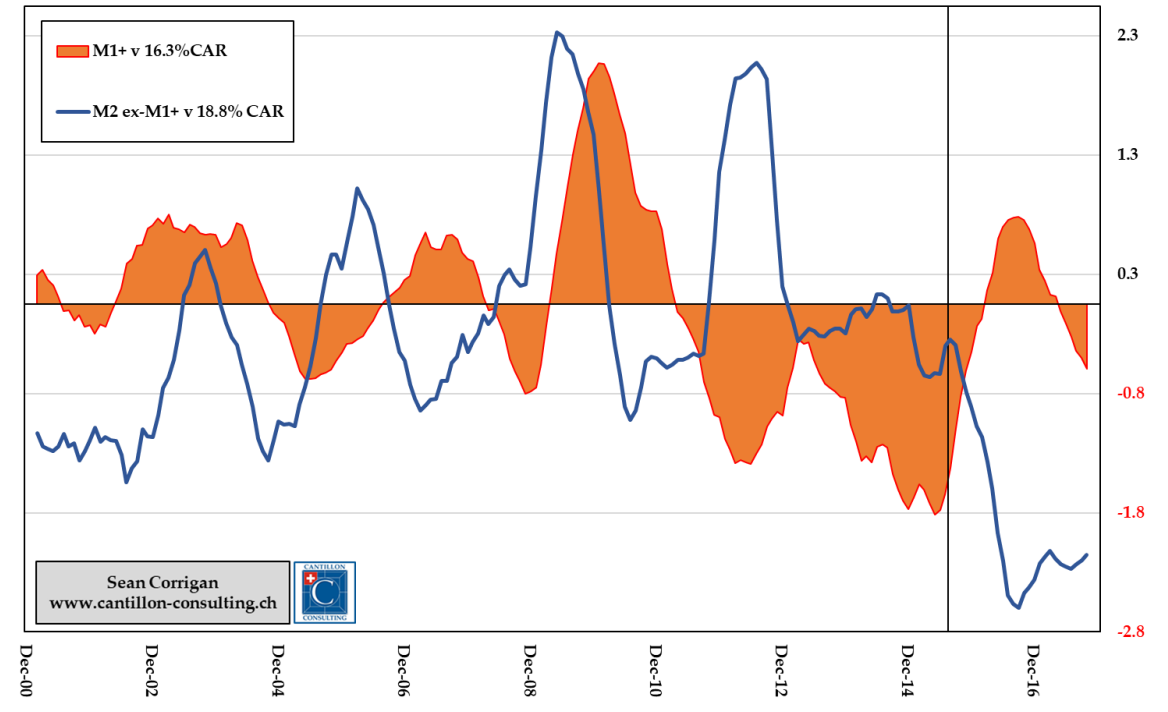
C) ...rapidly souring business conditions...

While the story for M1 is one of rapid deceleration from 2016's excesses (the rate of growth has since fallen in half), the remaining time & savings deposits which make up M2 are - by Chinese standards - barely edging ahead, with the household kind running at 7.3% YOY & the corporate kind at a paltry 3.8%. Talk is that higher-yielding WMPs, etc, are largely to blame with the spread of dedicated corporate finance arms further draining money away. The former could be the *REAL* reason for the crackdown on asset managers' guaranteed-return products. Among the estimated Y100+ trillion of these outstanding, WMPS have grown tenfold in the past 7 years to reach Y29 trillion. 'Pooling' of capital - something with the potential to allow a Ponzi mechanism to operate - has been banned; leverage ratios have been capped; reserves must be built out of fee income; and the pledging of asset companies' own shares as collateral has also been outlawed. Will this prove sufficient to force lenders to park their surplus monies once more at the bank? Or will it simply prove disruptive as these schemes are at least partially wound down?

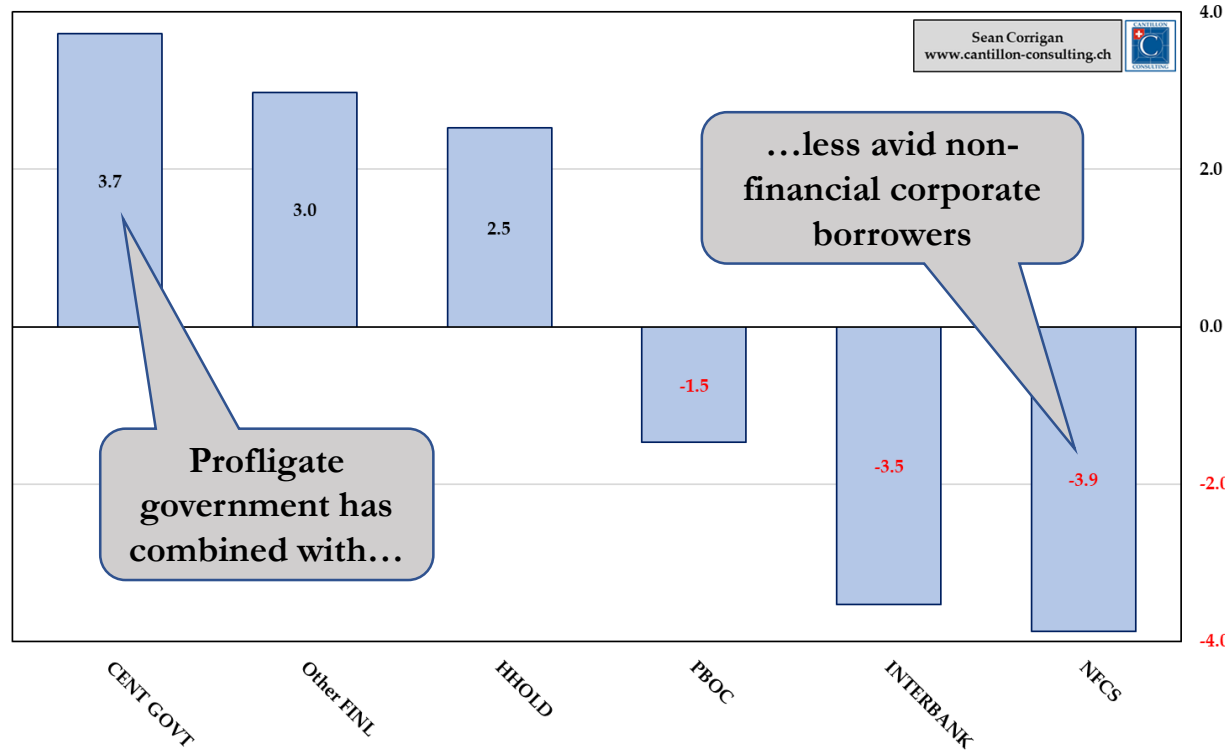
China M-Aggregates, YOY% Deviation from 2000-15 CAR: Source - PBOC



Rolling Sigma Deviation from 2000-15 Trend: Source - PBOC



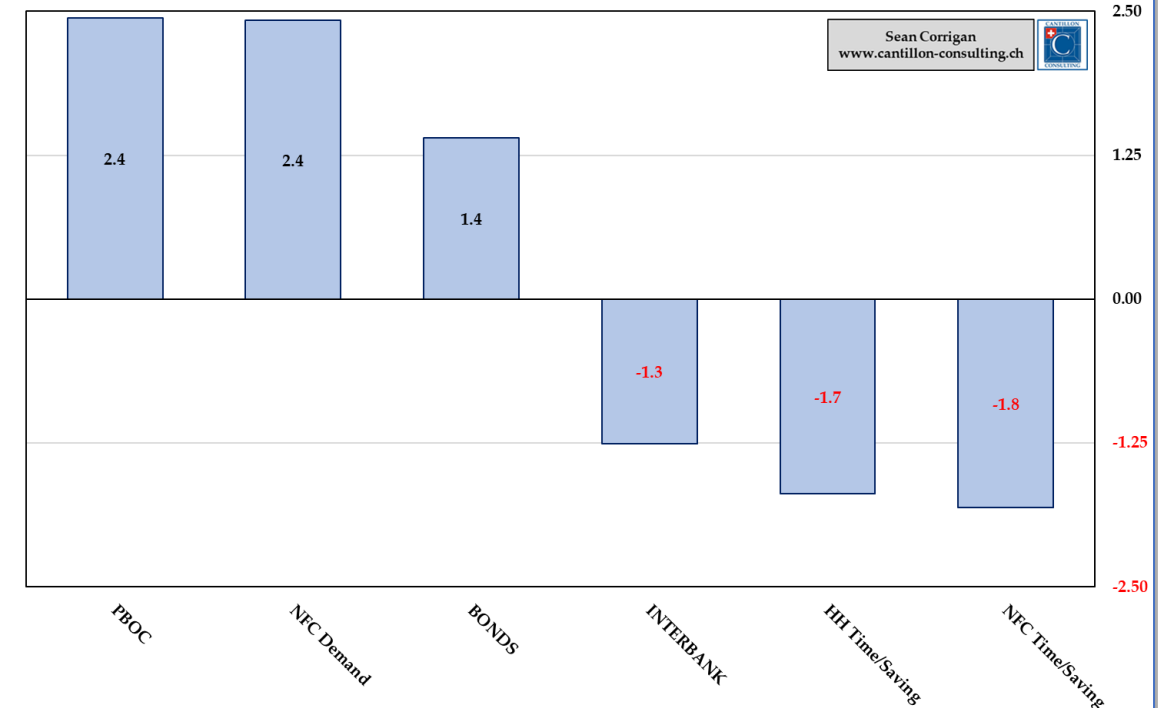
2-Year %Change in Share of Chinese Bank Total Assets: Source - PBOC



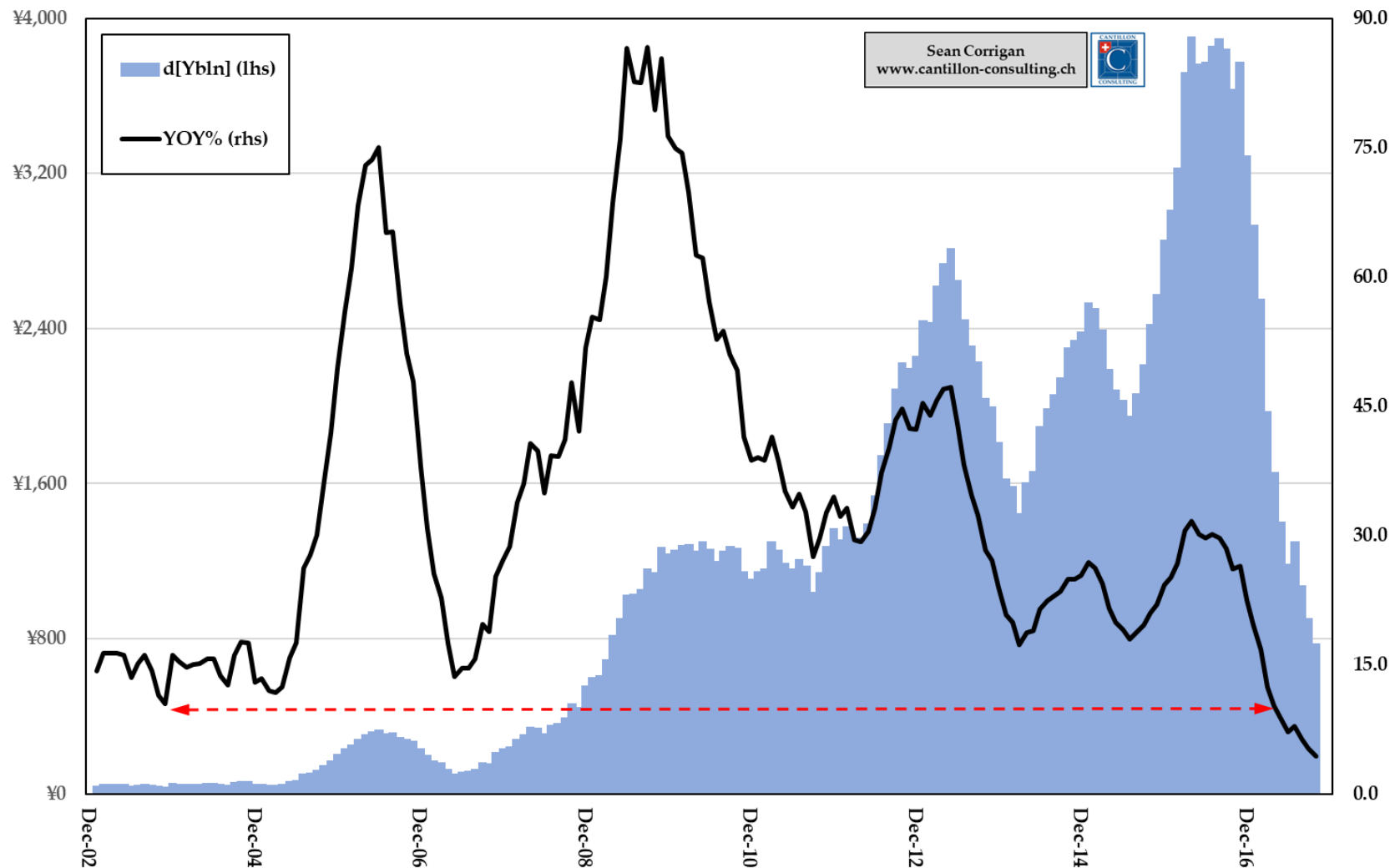
2) Banks have been reliant on PBoC special lending programs, as well as on bond sales (to WMPS!?), to plug the gaps in their balance sheets. The collapse in overall issuance and the dramatic spike in yields will not be exactly welcomed, therefore.

1) The simultaneous crack-down on the ~200 micro-loan P2P lenders might also be aimed as much at driving business back to the banks as at lessening burgeoning risks. On the latter count, consumer credit has certainly been roaring away of late. The reporting category which includes mortgage lending is up 70% in the past two years, while short-term consumer loans (the kind with whom those P2P sharks are competing) have already enjoyed twice as big an increment (¥1.6 trillion) so far in 2017 as in the whole of 2016.

2-Year %Change in Share of Chinese Bank Total Liabilities: Source - PBOC



12m China NFC Bond Issuance: Source - PBoC

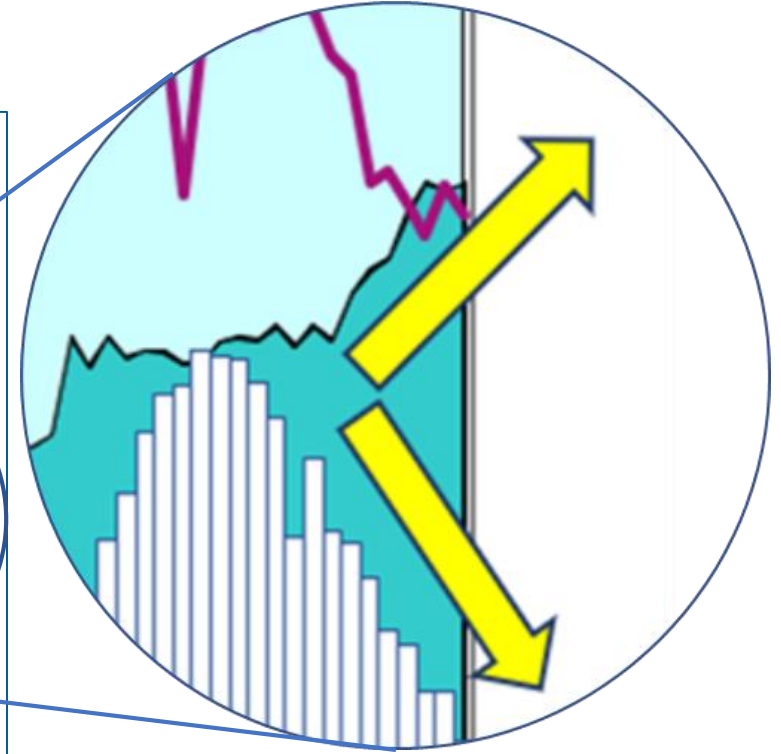
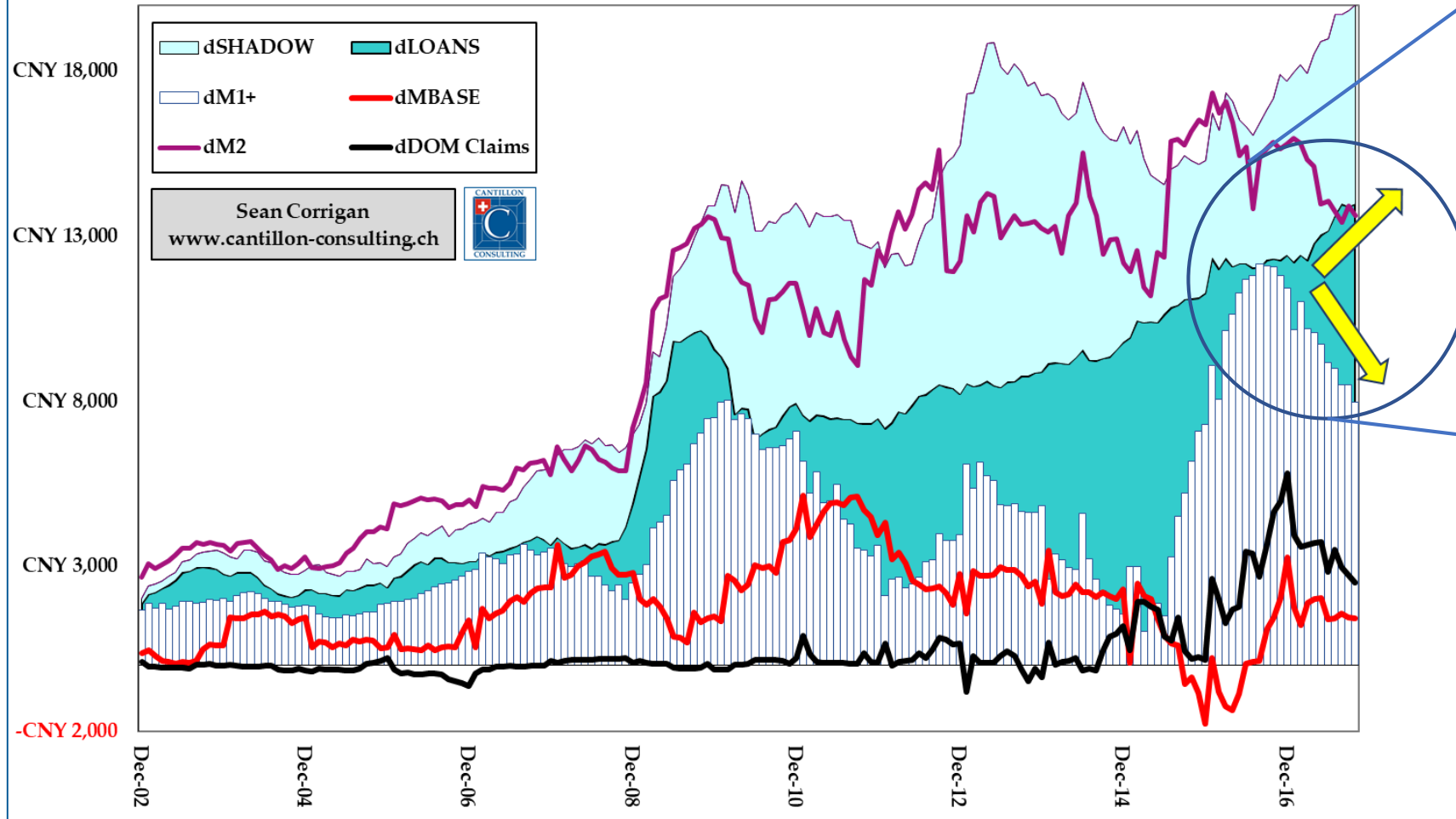


The bond market's travails in one picture – and this even before the recent, spectacular 40bp run up in yield to 3-year highs.

As few bonds have been issued to non-financial concerns as has been the case since the dark days succeeding the Lehman crash and the brief 'Snowball Earth' episode which followed it.

Some of the slack has been taken up by the issue of Trust loans - WMPs again – though the post-equity bubble crack down on the use of Entrusted (i.e., pass-through) loans has meanwhile closed off another main alternative source of finance.

China Cumulative Money & Credit Additions, 12mos running, blns: Source - PBOC



Putting all this together, we see that new loans increments are rising, even as those constituting the 'reflux', the flow-back, to the other side of the balance sheet in the form of deposits is falling



About Us

The fruits of a lengthy exercise of full intellectual independence, trading in, commenting upon, and analysing markets, placed fully at your disposal to help enhance your investment process.

Dedicated personal interaction, as well as written assessments, to enliven the debate and to mitigate risks by broadening the circle of opinion.

Detailed macro/market research with the possibility of undertaking special commissions upon request.

Ideas and arguments to incorporate into your existing framework of client communication either as 'white-labelled' material or, as you wish, to present as the stand-alone opinion of one of your firm's expert counsellors.

Assistance with content for reporting, proposals, marketing, etc.

Education and training.

Public speaking to entertain and inform you and your invited guests.

'Silver alone is the True Sinews of the Circulation' - Essai sur la Nature du Commerce en général



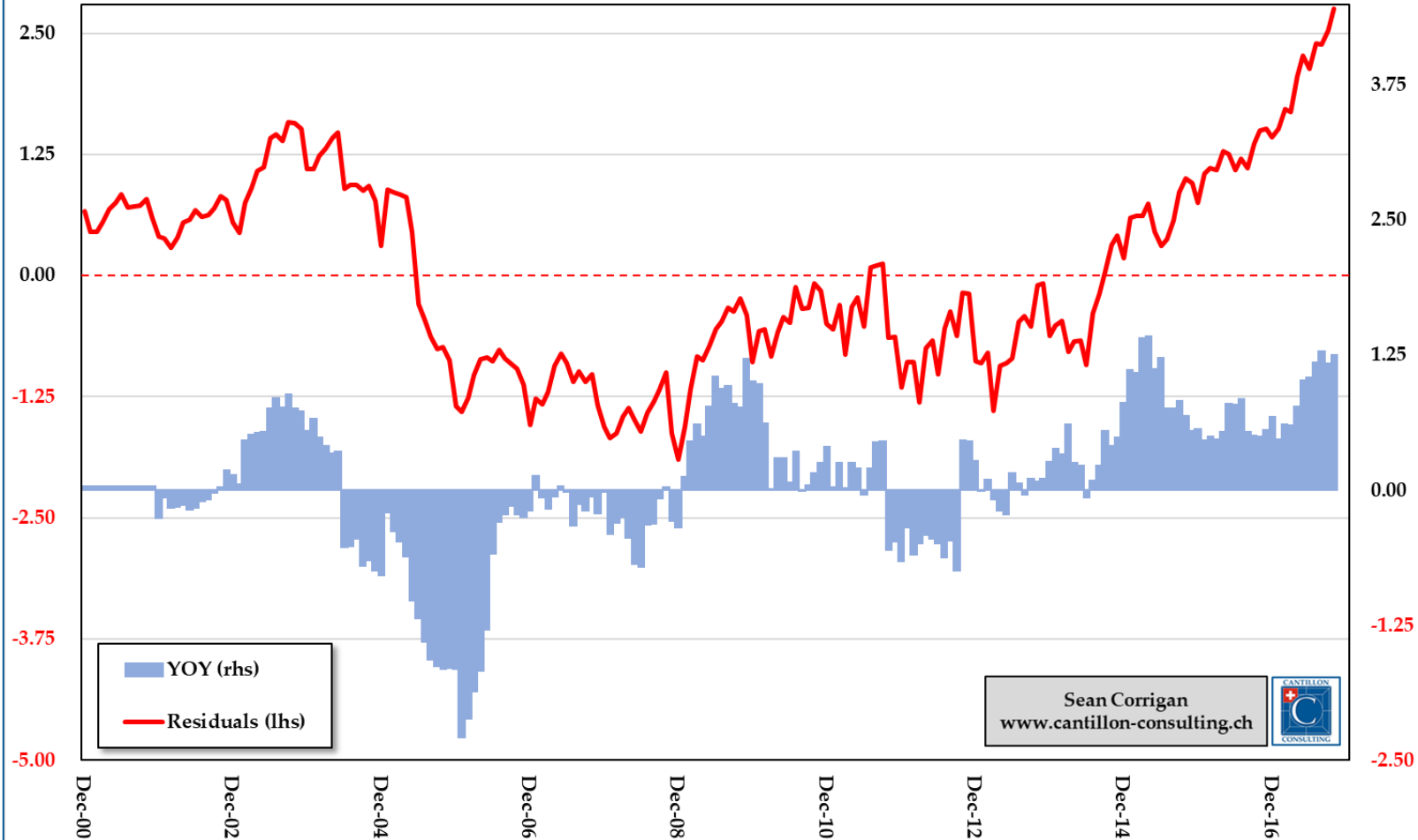
For much more, please visit the blog: www.truesinews.com



For further details, please contact:
info[at]cantillon-consulting.ch

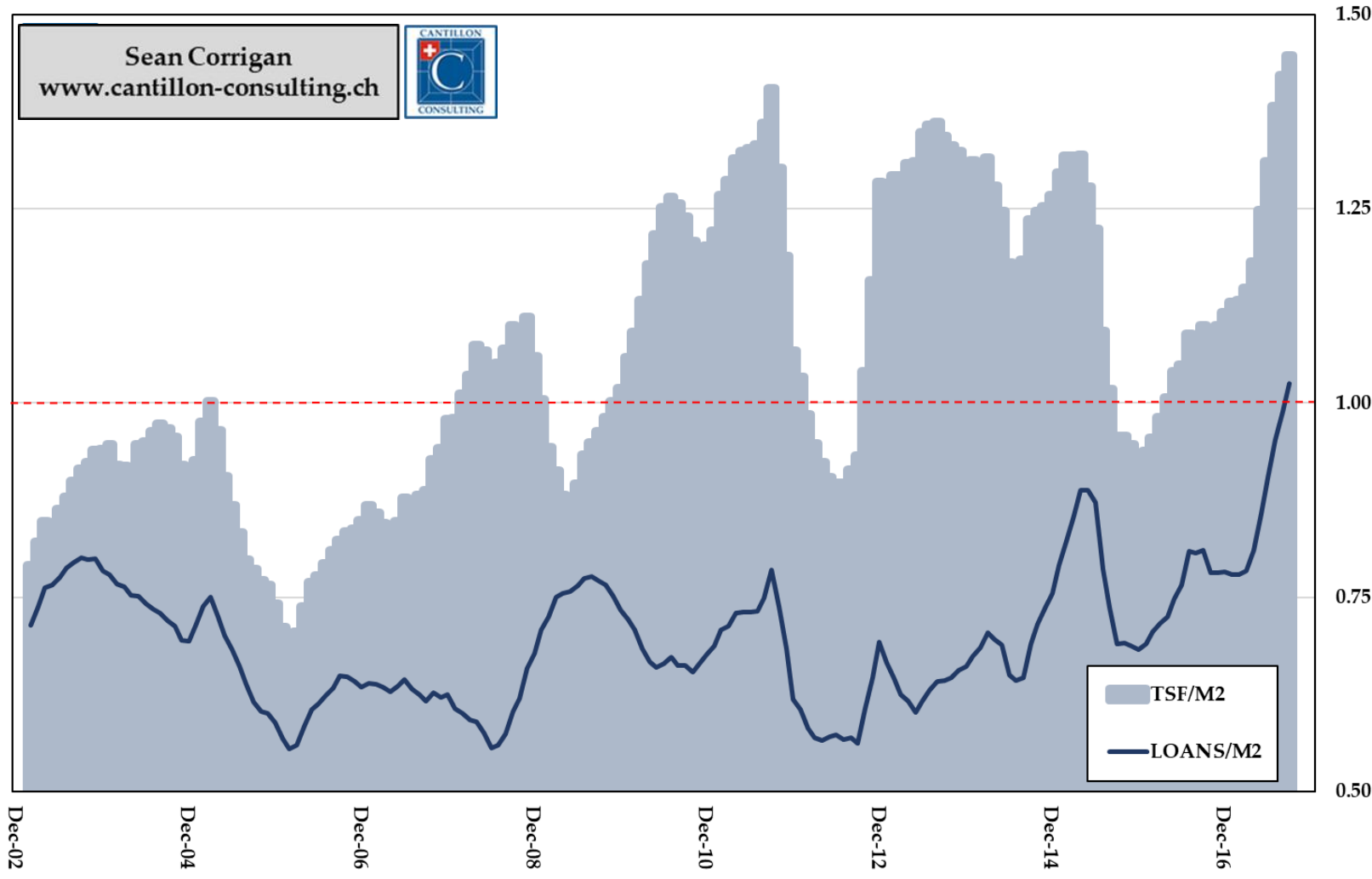
Copyright ©2017 Cantillon Consulting Sàrl

China CNY Loans v M2 deposits, residuals from trend ratio: *Source - PBOC*



A different way of visualizing the mismatch: deviations from the trend between two obviously closely correlated variables.

China TSF & Loans v M2 12-mos marginal ratio: *Source - PBOC*

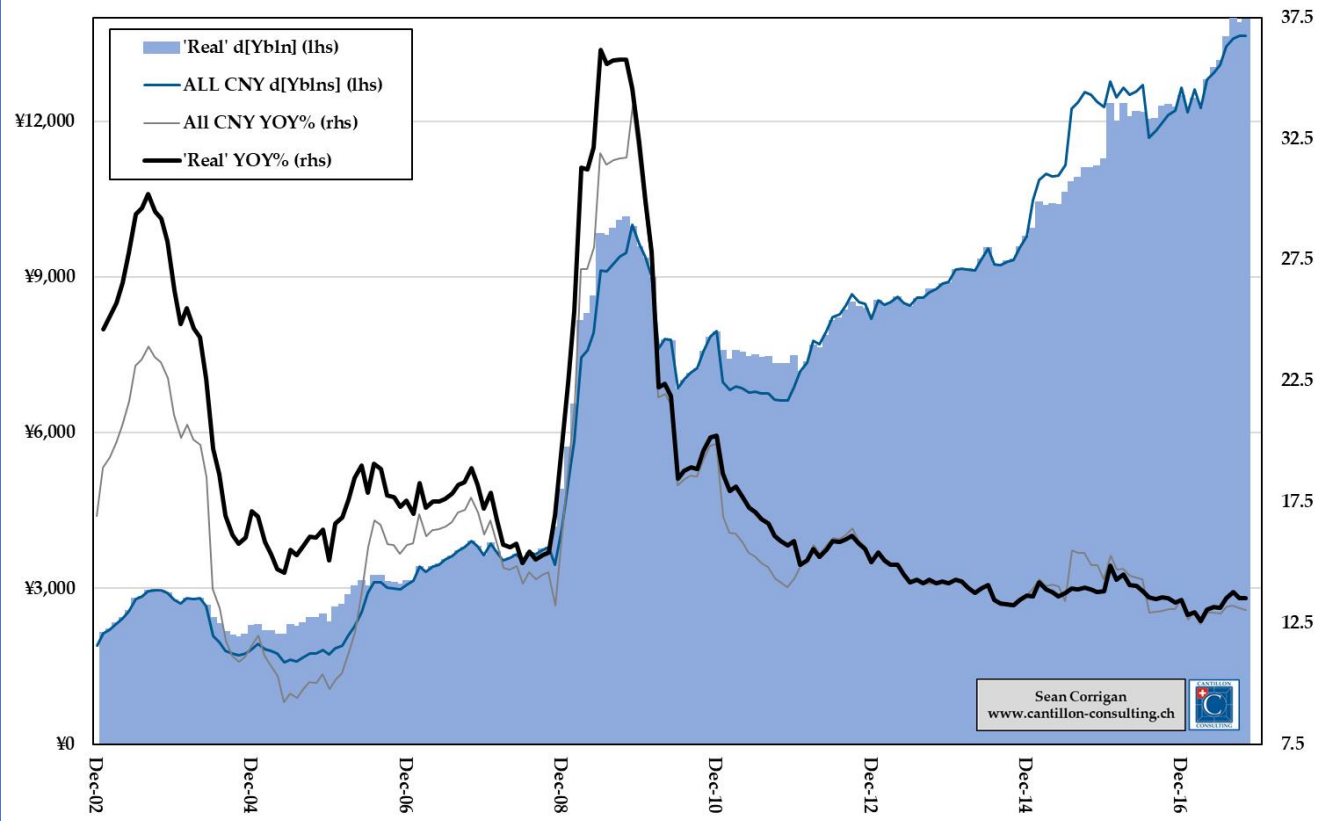


What all this means is that the marginal loan increment is now in excess of 100% of that of deposits, driving the ratio for the overall stock perilously close to the PBoC's 75% guidelines – a situation which cannot continue without some dangerously accommodative shift on the part of the regulators.

Never say never when it comes to China's stop-start attempts at regulation and reform, but the giving of such a signal would seem to run counter to everything being talked about, at present.

Also shown here is the unprecedented scale of 'aggregate' finance in relation to more money-type holdings. This also suggests the structure is becoming decidedly less liquid in its composition. The credit arteries are clogging up.

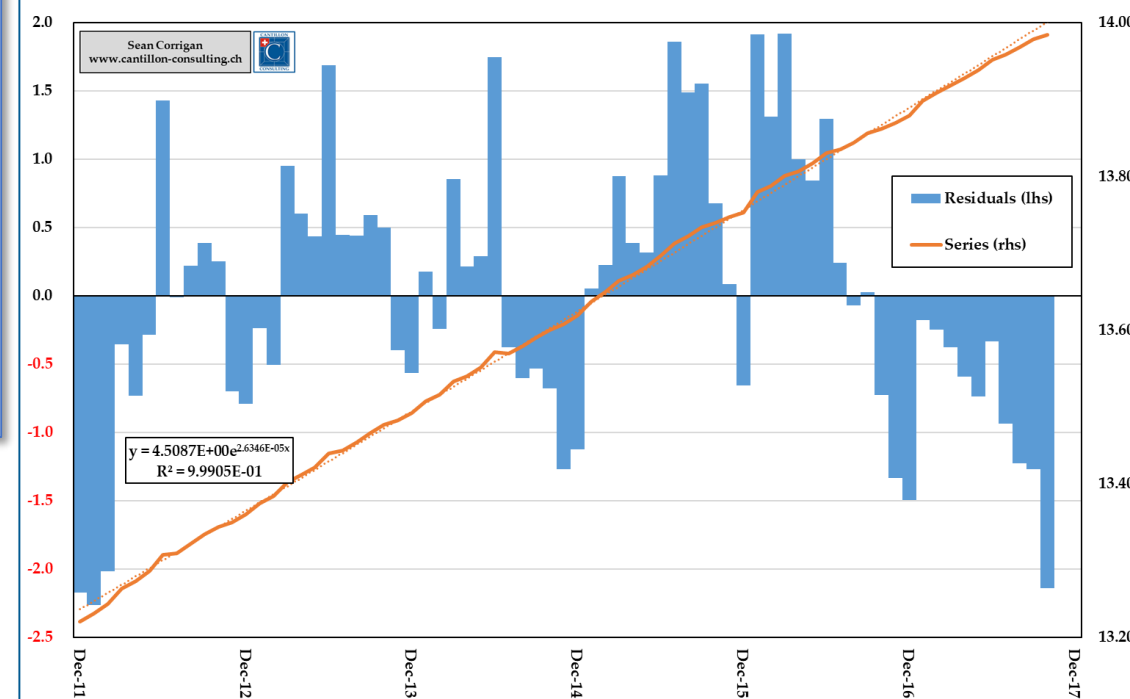
12m China 'Real Economy' Loan Issuance: Source - PBoC



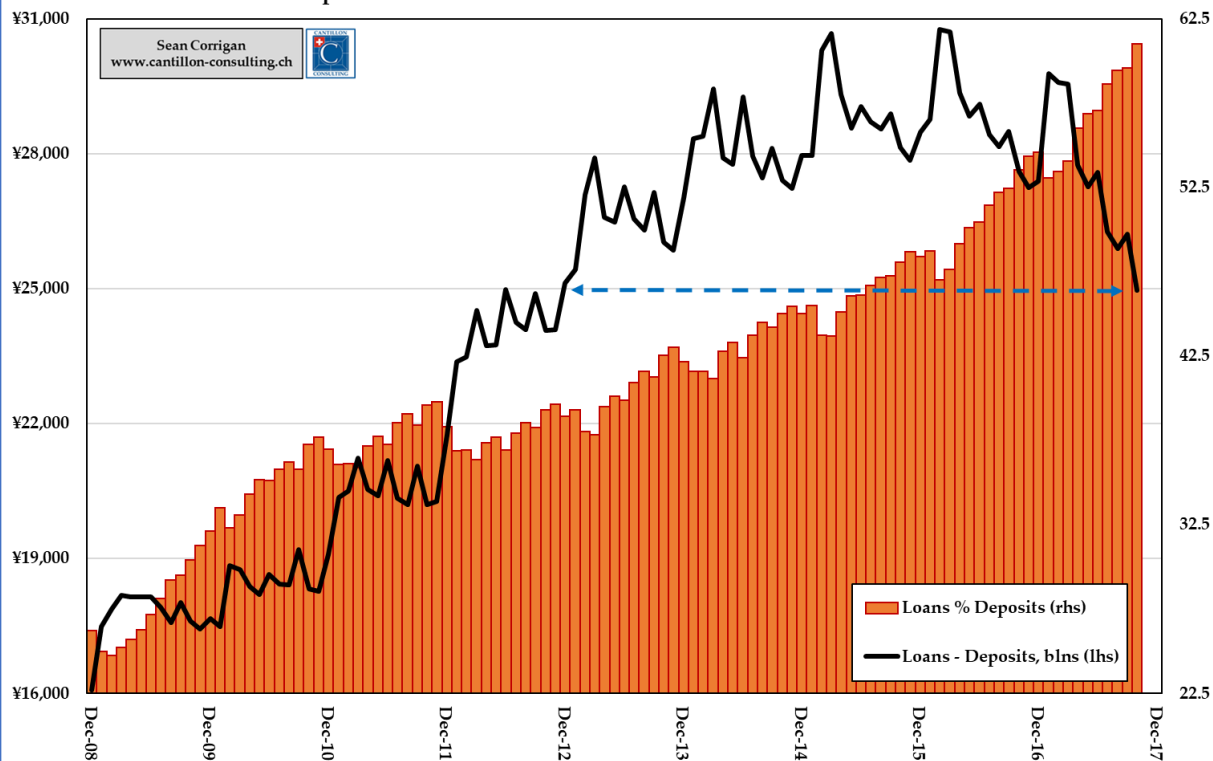
Despite all of the foregoing, note that – partly, it is true, due to the law of large numbers – the actual percentage growth of loans is relatively tardy at present, having dropped notably below even the past six-years' slower, post-panic reflation trend.

It seems constraints are starting to be felt.

CNY Loans v 2012-17 trend: Source - PBOC



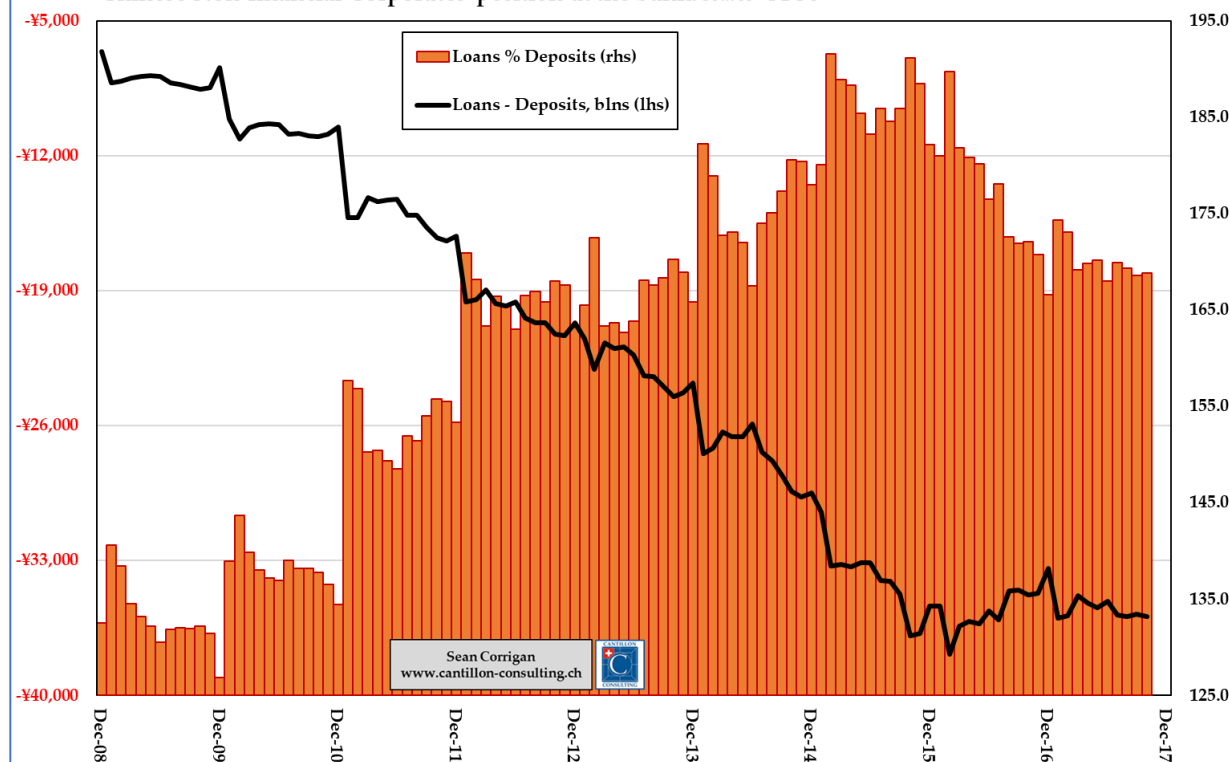
Chinese Households' position at the bank: Source - PBOC



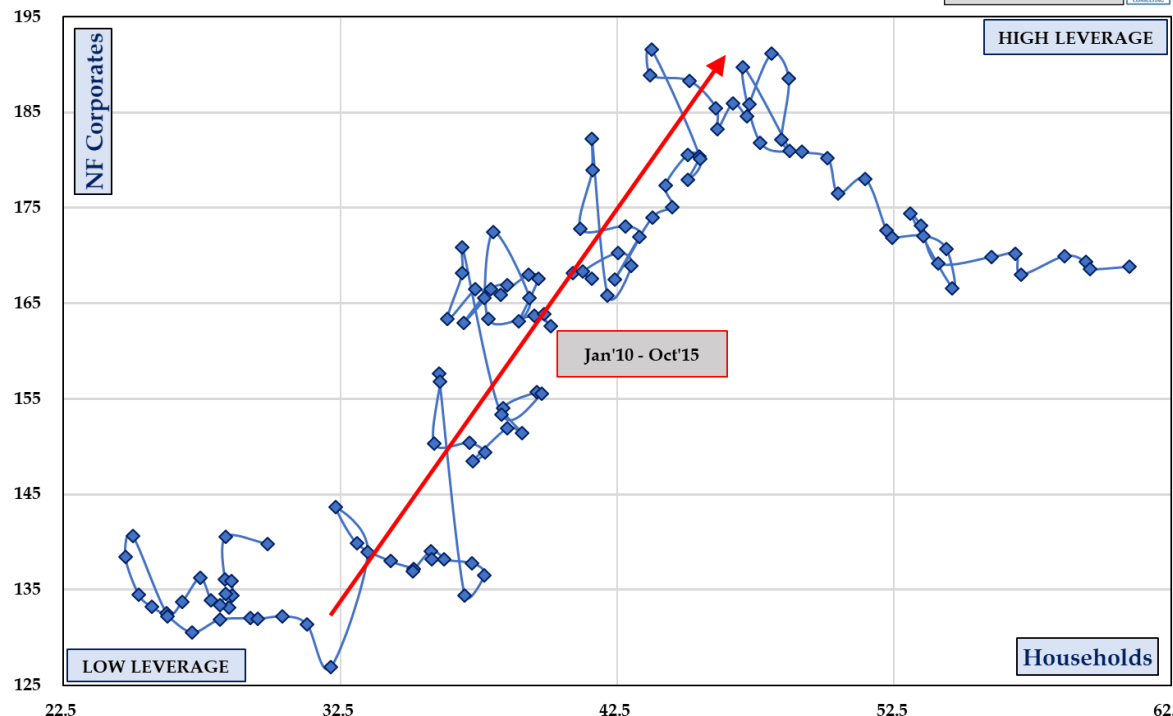
2) Non-financial corporates, meanwhile, have at last begun to show some signs of moderation. With the deficit having steadied, the ongoing increase in both numerator and denominator (loans and deposits, respectively) means their ratio has fallen appreciably in the past two years.

1) Replicating a measure we have long used for the Eurozone, we can see that household's standing at the bank has deteriorated markedly. They may or may not be saving outside the formal system but they have decidedly NOT given up borrowing from within it, especially for mortgages, as noted above. Their net deposit-loan balance has dropped over \$400 billion in just the past year to touch its lowest level in five years

Chinese Non-financial Corporates' position at the bank: Source - PBOC



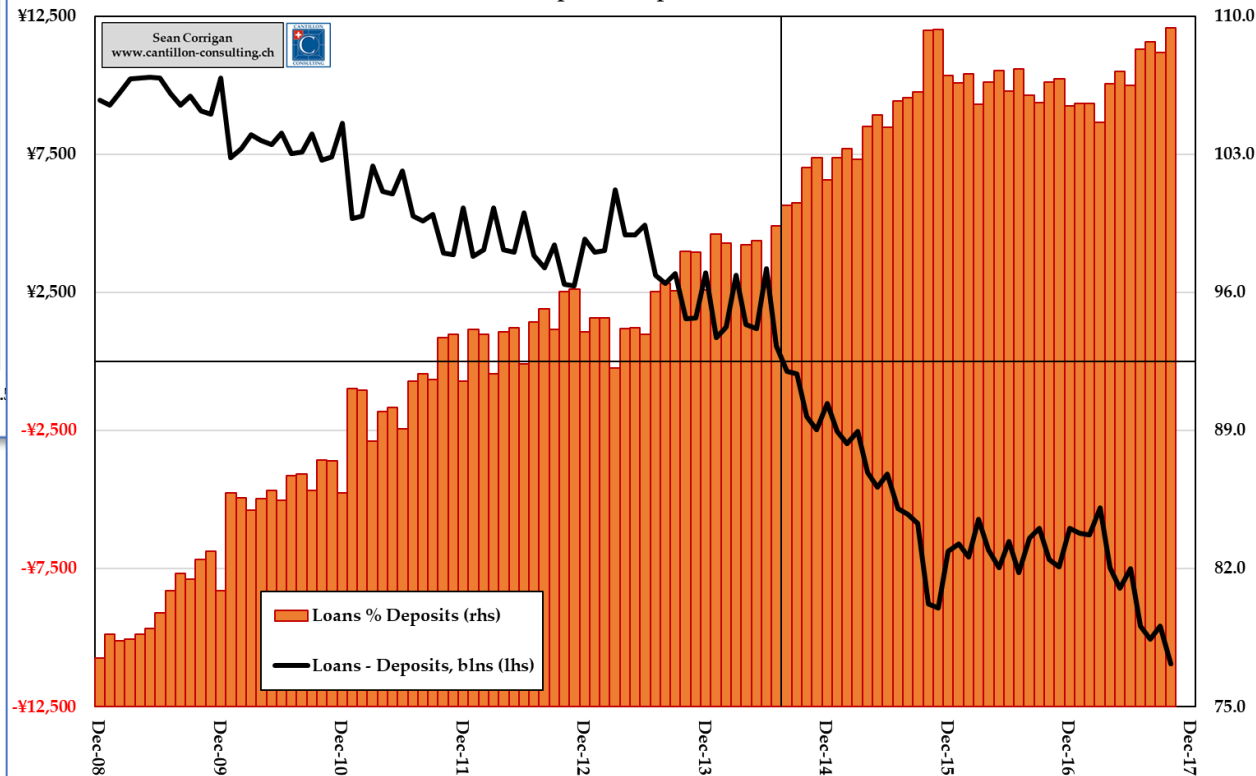
China Bank Claims as % of Deposits, 2008-to date: Source - PBOC

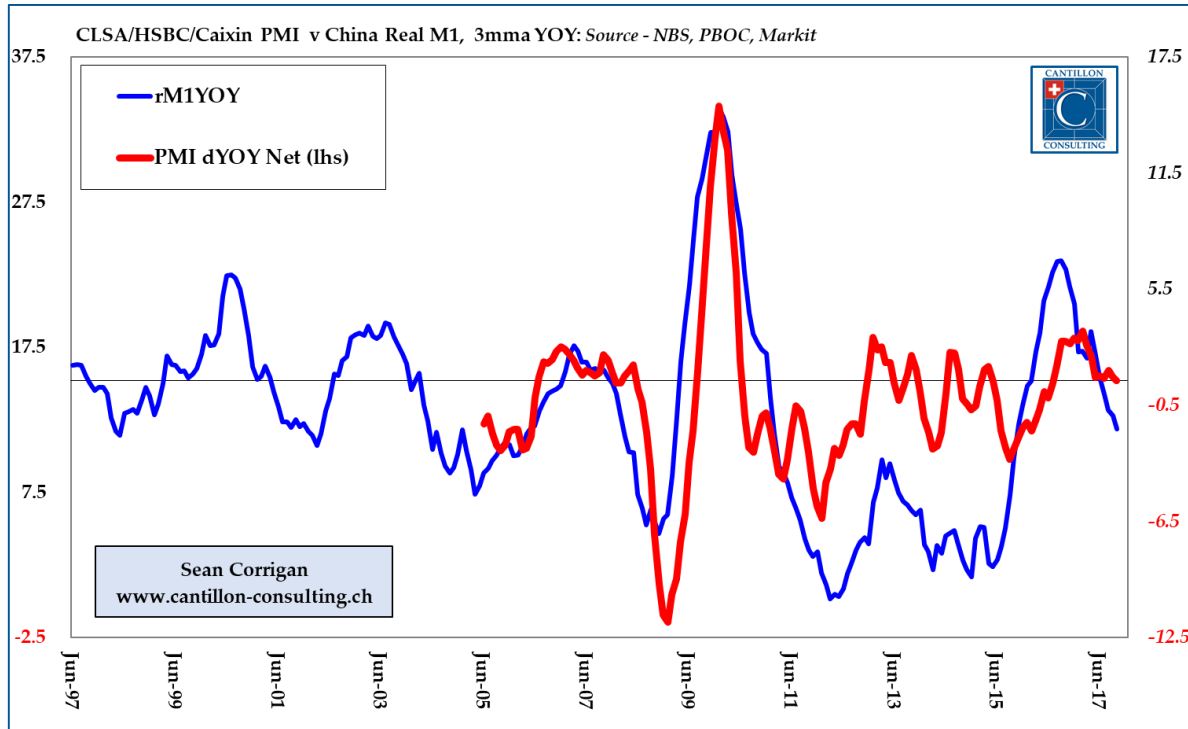


Notwithstanding that improvement, if we put the two sectors together, what also becomes apparent is that, for the past three years, net household *bank* savings have not been enough to fund net corporate bank borrowing, despite the relative lack of appetite of the latter. With claims on the government also up by two-fifths in the past two years, we can see, once again that things are becoming stretched.

Never let it be said, but one might almost argue from this that the poisoned chalice of consumerism – that long-sought counter for what has been widely regarded as an over-proportionate level of investment – has already started to show the dreaded Occidental pathology of consuming, rather than, compounding one's capital. Given China's dubious generational/endowment arithmetic, its Millennials had better not get too Western, too soon...

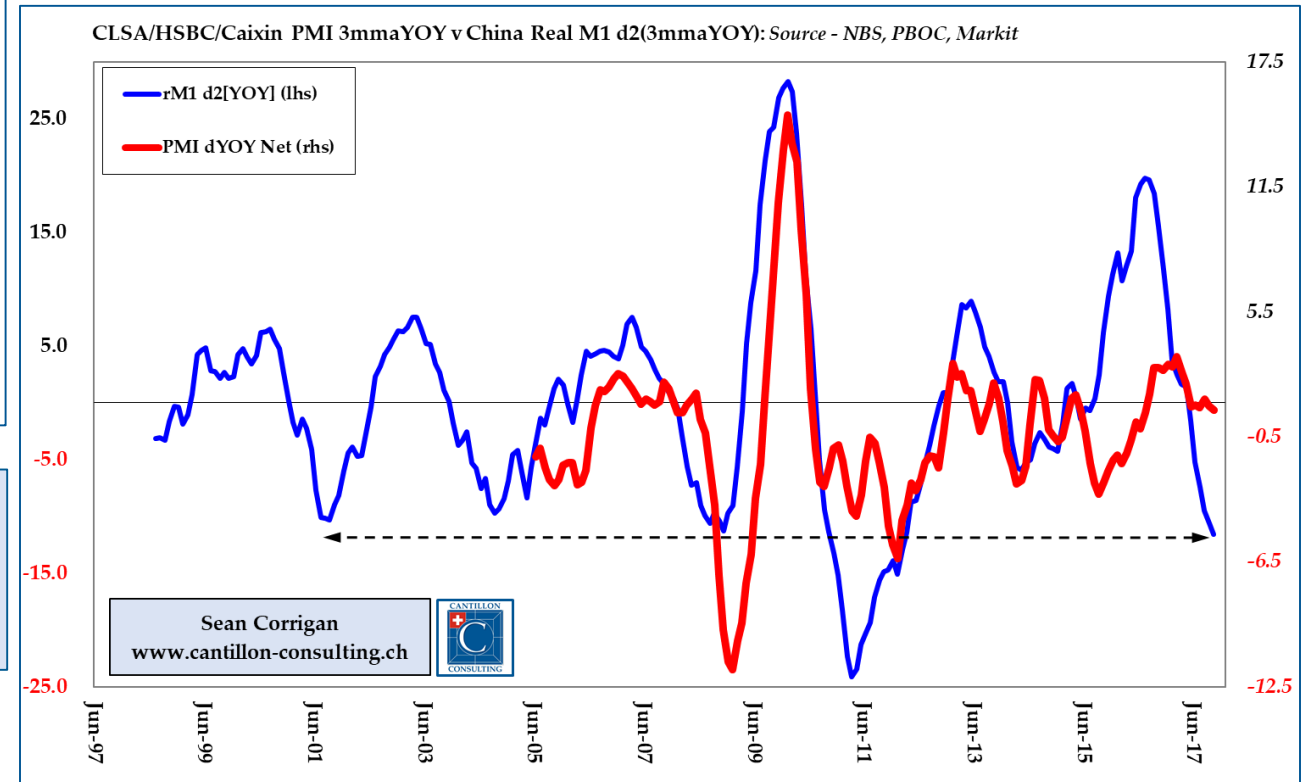
Chinese Households & Non-financial Corporates - position at the bank: Source - PBOC



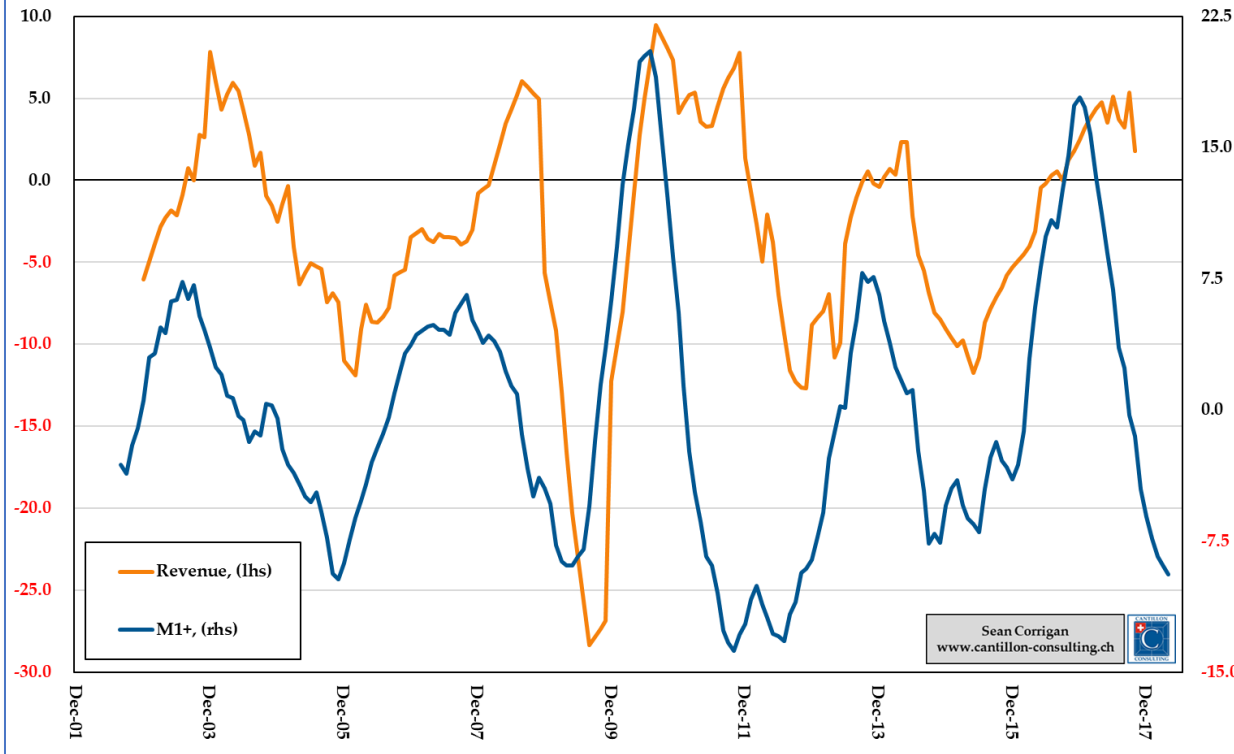


Suffice it only to say that, if the squeeze persists, it will have broad ramifications, not just for China, but around the world – primarily, though far from exclusively, for its North Asian industrial customers as well as for drillers and diggers everywhere.

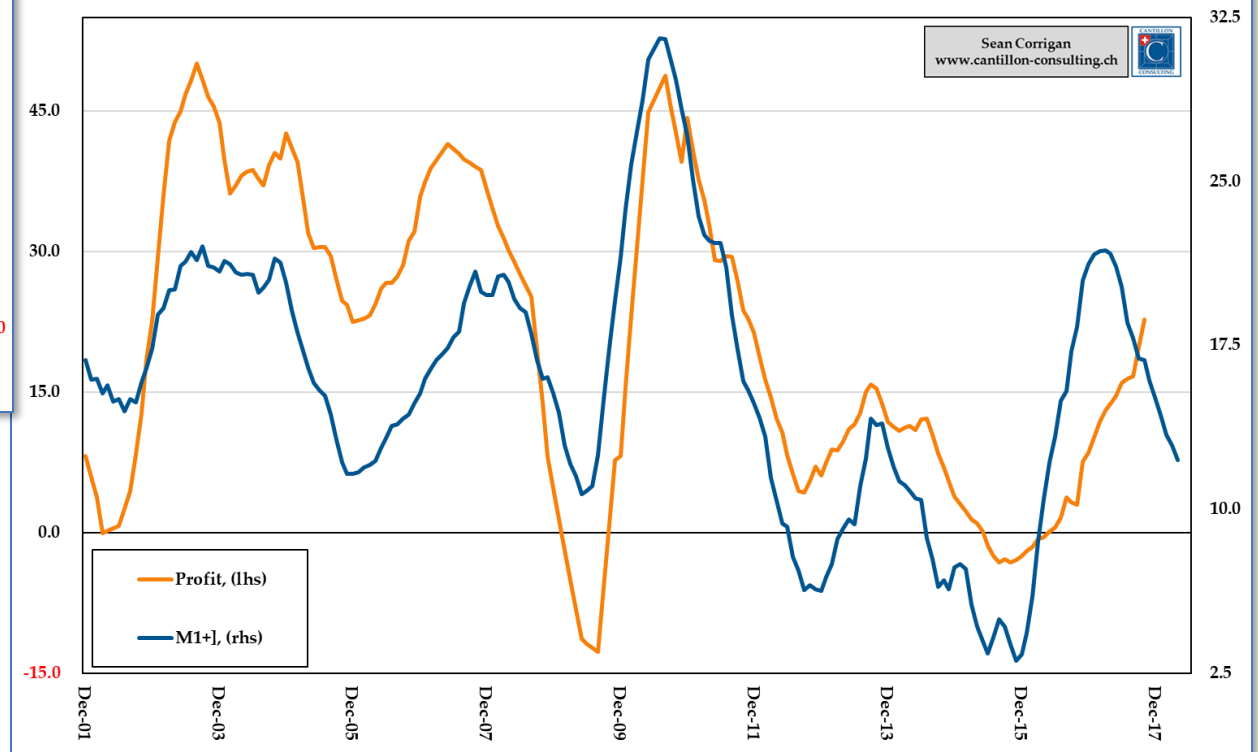
The remaining charts in this presentation need little further elaboration, they simply draw your attention to a feature of the Chinese economy – indeed, in some instances, of *all* economies – that we make much of in our analysis: *viz*, that money moves markets, markets make macro, and that macro, in turn, moulds money – or, to use our favourite motto: ‘*Silver is the True Sinews of the Circulation*’. NB: of late, they’ve been minting less of it!



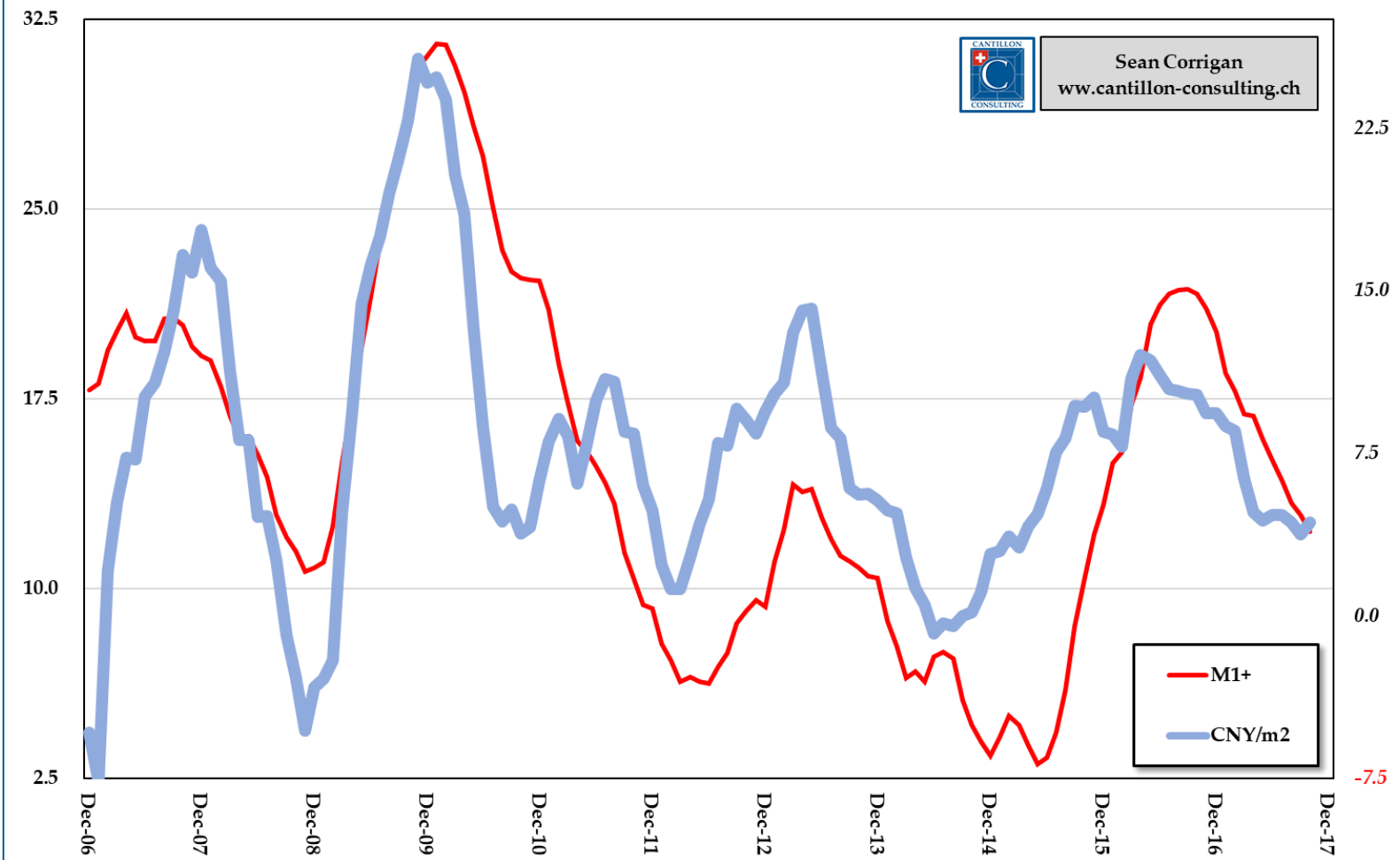
China Private Sector Industrial Revenues, d2(12m sum), t+6, v d2[M1+]: Source - NBS, PBOC



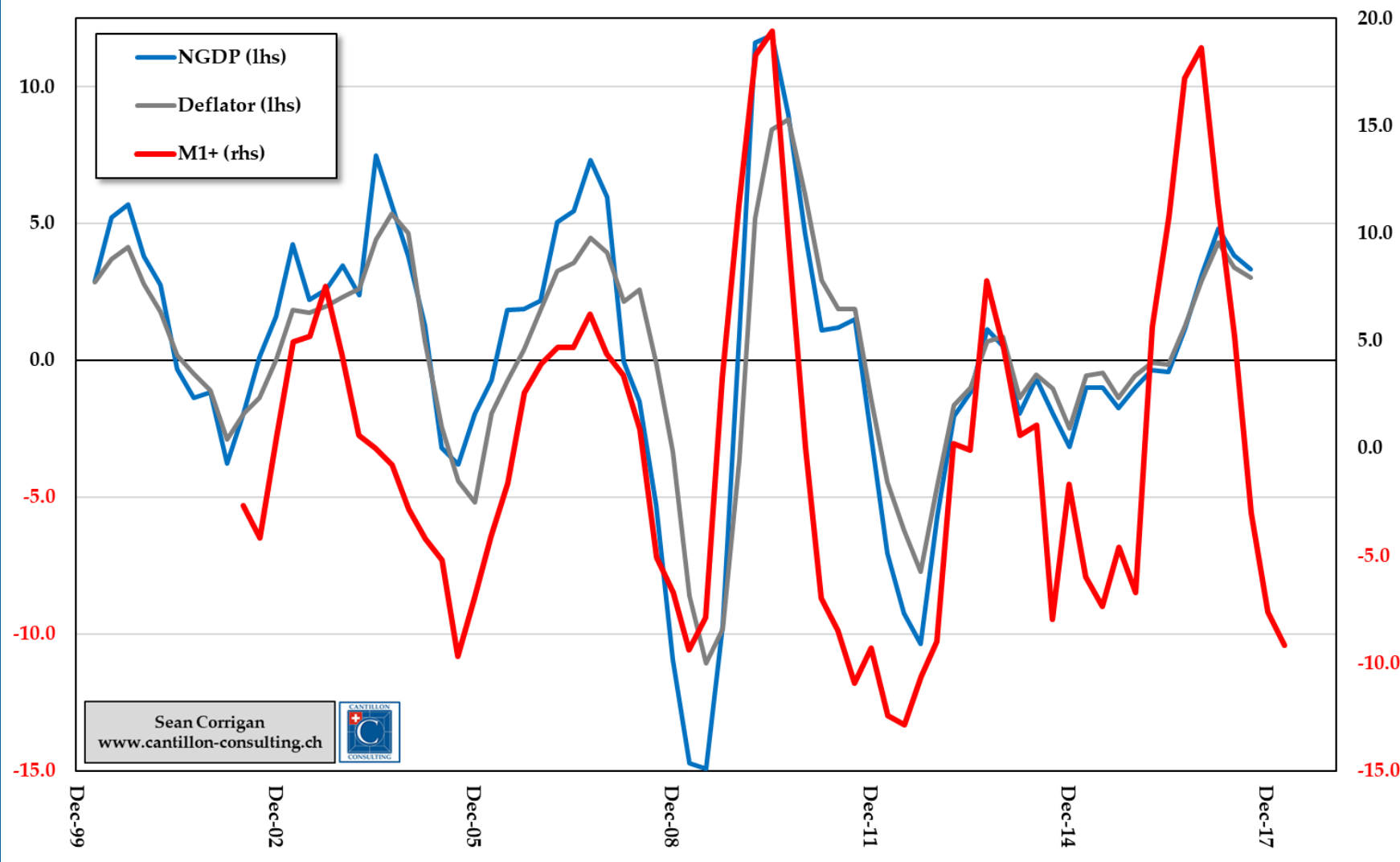
China Industrial Profits 12m sum YOY, t+6, v M1+ YOY: Source - NBS, PBOC



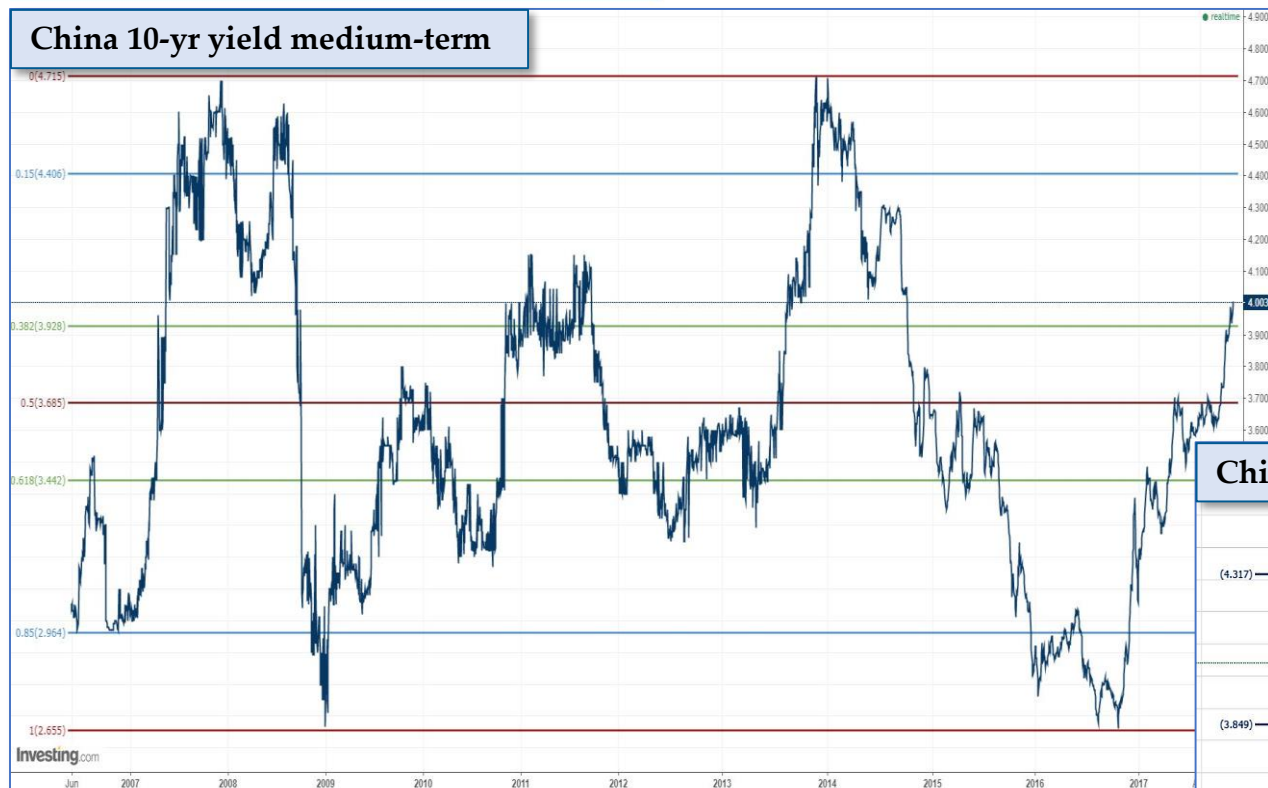
China Real Estate, CNY/m2 v M1+, 6mma YOY : Source - NBS, PBOC



China NGDP & DEF v M1+ (t-6m), d2[YOY%]: Source - NBS, PBOC



China 10-yr yield medium-term



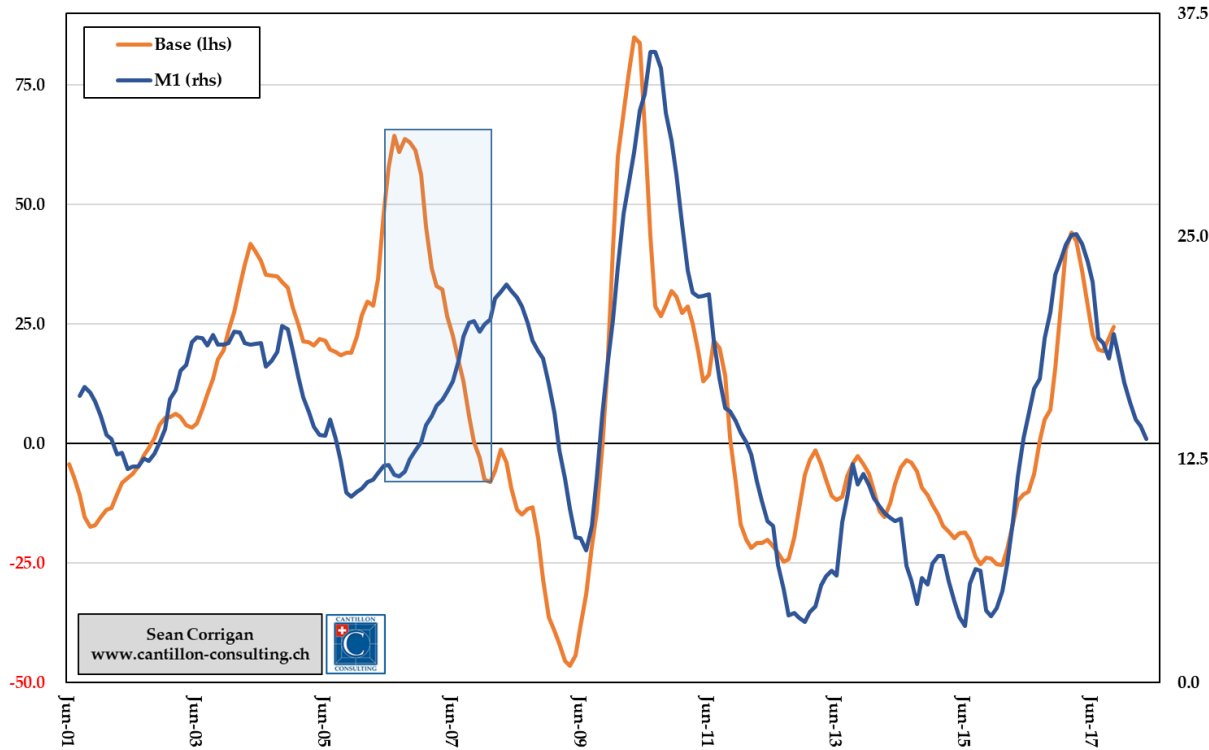
China 10-yr yield detail



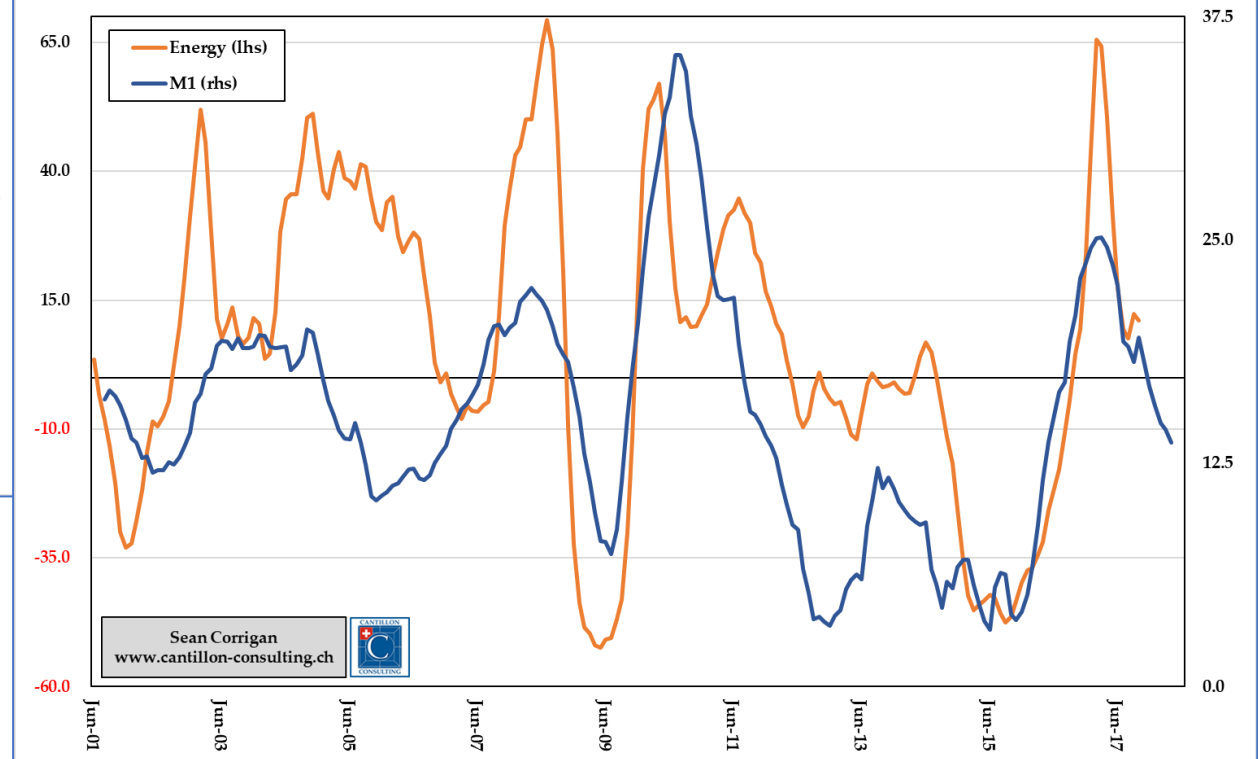


When it comes to stocks, it has been very much a case of 'the SMALLER they are, the harder they fall'!

China Base Metals price t+6 v M1, 3mma YOY: Source - IMF, WB, PBOC



China Energy price t+6 v M1, 3mma YOY: Source - IMF, WB, PBOC



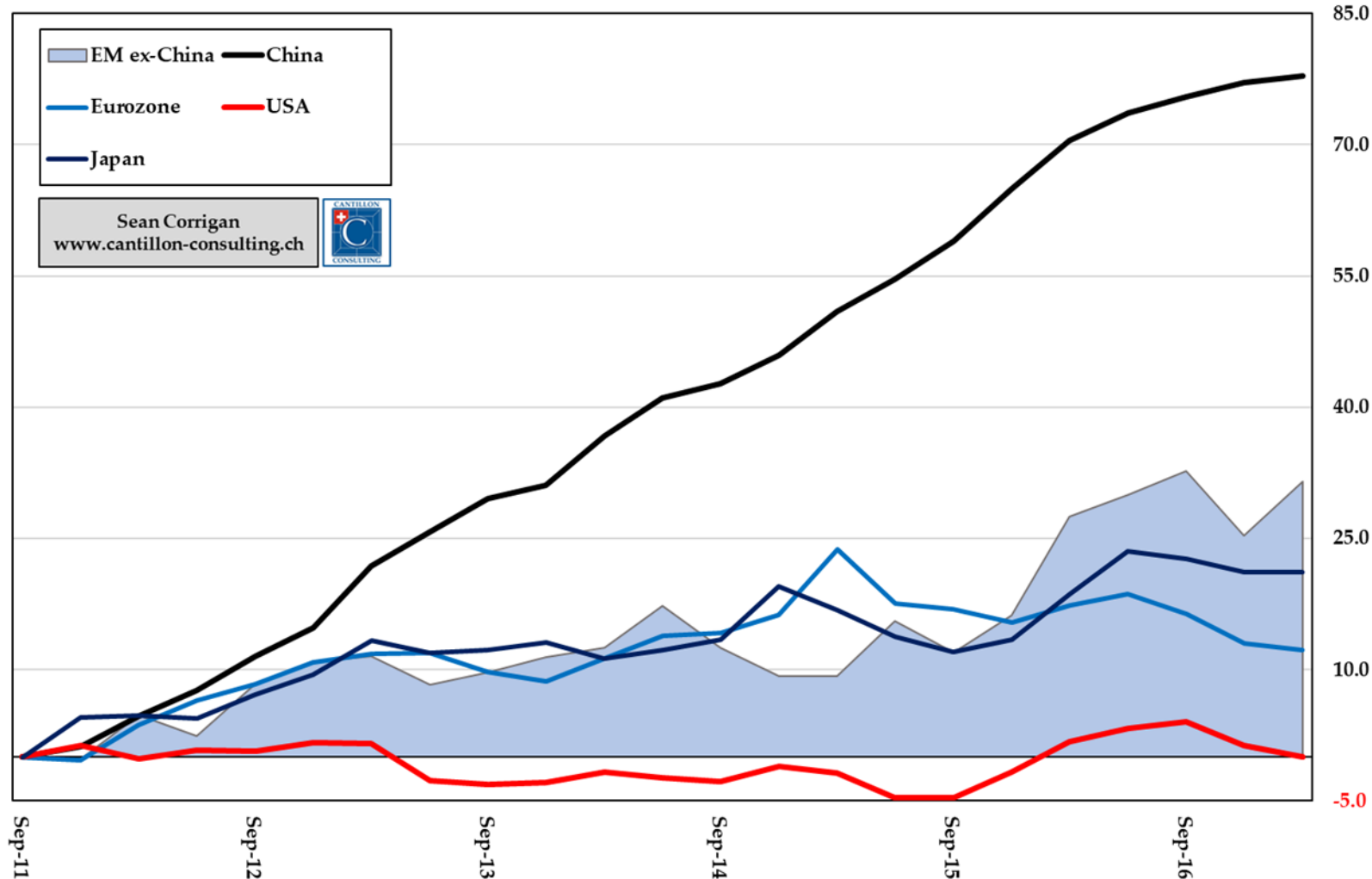
LME COPPER

O 6939.50 H 6958.50 L 6911.25 C 6928.00

So far, so good, but the evidence of the previous charts tells us that this move may well be on borrowed time



Change in Non-Financial Debt as % of GDP: Source - BIS



And just to close by giving the horses a fright, note that when it comes to the accumulation of non-financial debt, there has really only been one principal culprit these past several years.

No wonder Xi Jinping has sternly avowed that *'Financial security is an important part of national security'*, or that PBOC Chief Zhou has bewailed the fact that *'financial innovation has led to a series of bubbles in multiple markets'*.

The message coming out of the country thus far, since the end of Xi's apotheosis at the Party Congress, is that a determined attempt to put an end to all this chicanery is now underway.

Whether or not the intent will evaporate at the first sign of trouble, in time-honoured fashion, or whether a more steely resolve will this time hold sway, risks are undeniably on the rise since high leverage ALWAYS implies heightened non-linearity of a kind no central planner, no matter how ready to backtrack at the first sign of trouble, can ever fully anticipate.

Disclaimer

All content is intended to give general advice only. The investments and instruments mentioned therein are not necessarily suitable for every individual and you should use this information in conjunction with other advice and research to determine its suitability for your own circumstances and risk preferences. The value of all securities and investments, as well as the income derived from them, can fall as well as rise. Your investments may be subject to sudden, often substantial, declines in value which may not be recoverable; others may expire worthless after a specified period. You should not buy any of the securities or other investments mentioned with money you cannot afford to lose. In some cases there may be significant charges which may reduce the value of your investment. You run an extra risk of losing money when you buy shares in certain securities where there is a large difference or 'spread' between the buying price and the selling price, a circumstance which means that, should you sell them immediately, you may get back much less than you paid for them. In the case of investment trusts and certain other funds, these may use or propose to use the borrowing of money in order to increase the size of their exposures and/or invest in other securities with a similar strategy. As a result, movements in the price of the securities may be more volatile than the movements in the prices of those underlying investments. Some investments may involve a high degree of such borrowing (often referred to as 'gearing' or 'leverage') This means that a small movement in the price of the underlying asset may have a disproportionately large effect on that of your investment. Accordingly, a relatively small adverse movement in the price of the underlying asset can result in the loss of the entirety of your original investment. Changes in rates of exchange may have an adverse effect on the value or price of the investment and you should be aware that additional dealing, transaction, and custody charges for certain instruments may result when these are not traded in your home currency. Some investments may not be quoted on a recognised investment exchange and, as a result, you may find them to be 'illiquid'. You may not easily be able to trade your illiquid investments and, in certain circumstances, it may become difficult, if not impossible to sell the investment in a timely manner and/or at its indicative price. Investment in any of the assets mentioned may have tax consequences regarding which you should consult your tax adviser. All reasonable care has been taken to ensure that all statements of fact and opinion contained in the either written or spoken form are fair and accurate in all material respects. All data is from sources considered to be reliable but its accuracy cannot be guaranteed. Investors should seek appropriate professional advice if any points are unclear.

Copyright ©2017 Cantillon Consulting Sàrl. Any disclosure, copy, reproduction by any means, distribution, or other action which relies on the contents of such materials, made without the prior written consent of Cantillon Consulting, is strictly prohibited and could lead to legal action.