Money, Macro &
Markets

Thursday, November 23rd

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CANTILLON CONSULTING

China: writing cheques the nation can’t cash

Money, Macro & Markets Monitor

Insight & Support for the Managers of Wealth

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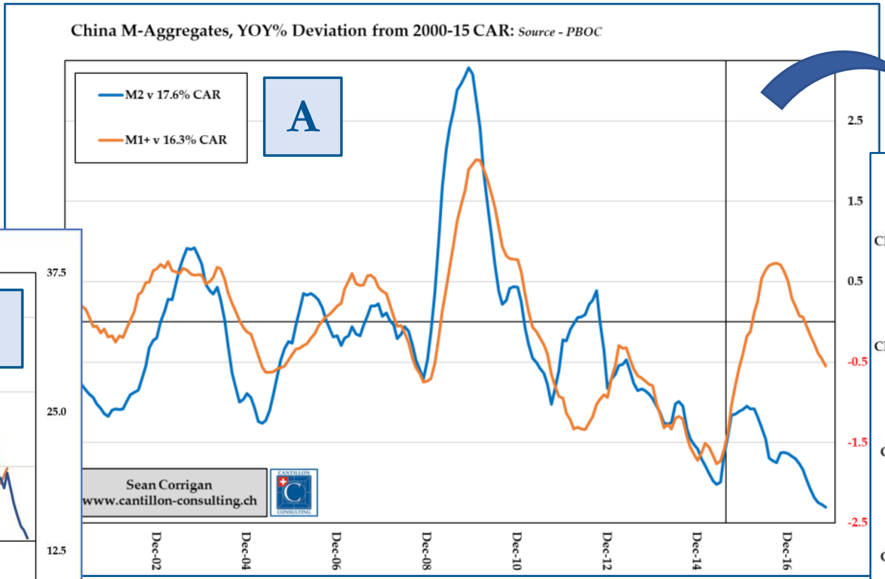
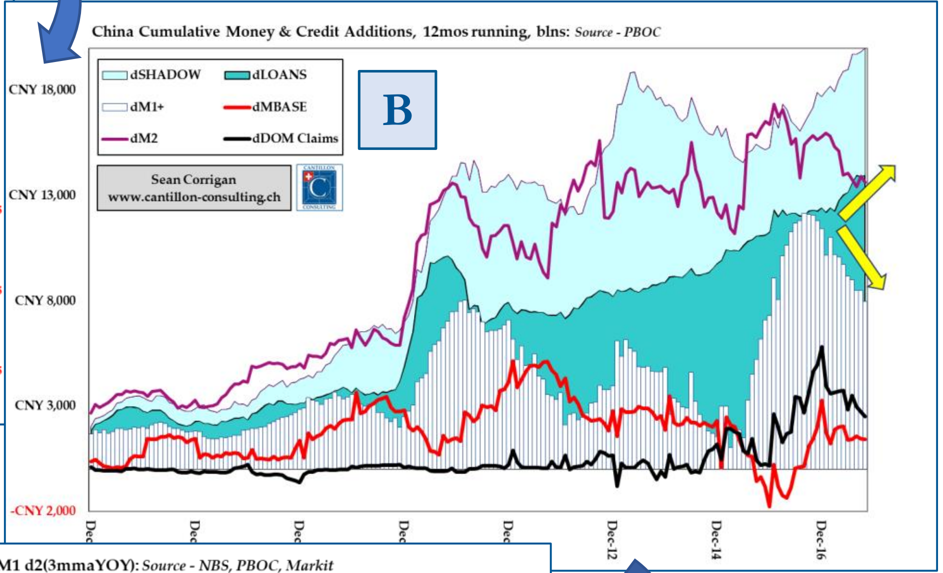
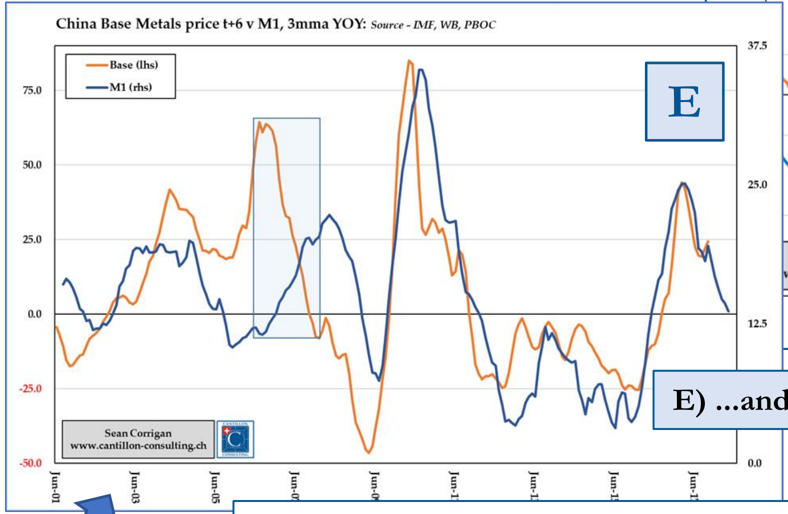
CHINA: A QUICK RECAP OF OUR THEME

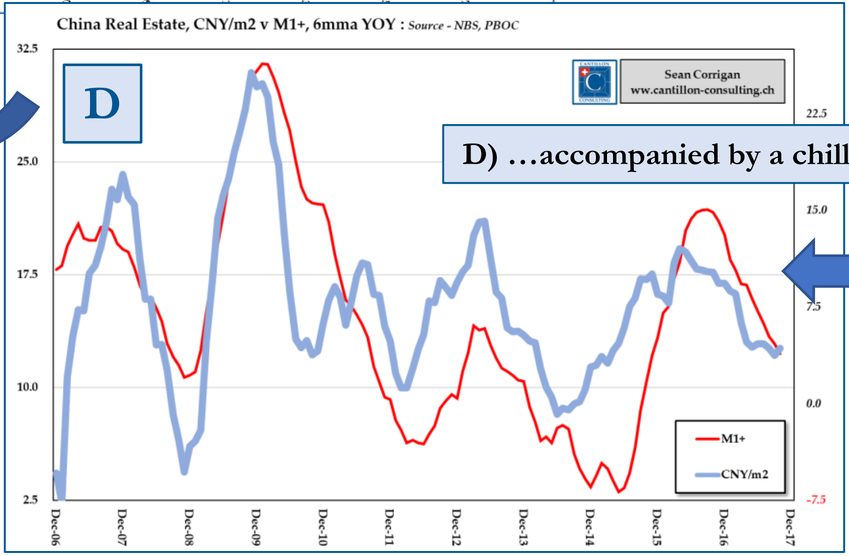
A) Rapidly decelerating money growth & a frozen bond market is (B) putting pressure on bank loan-deposit ratios



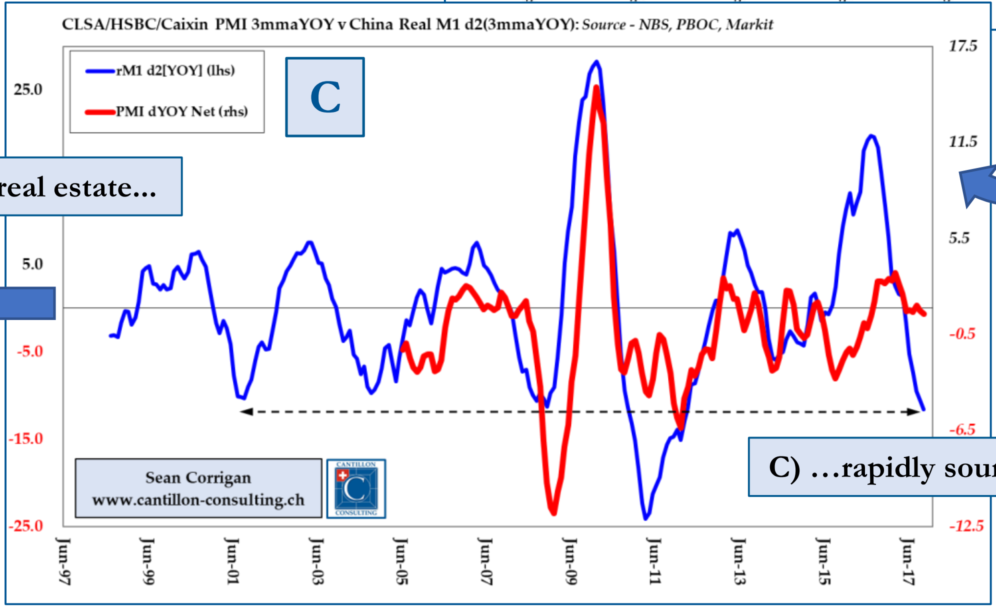




E) …and a potential knock-on in commodities



D) …accompanied by a chill in real estate…

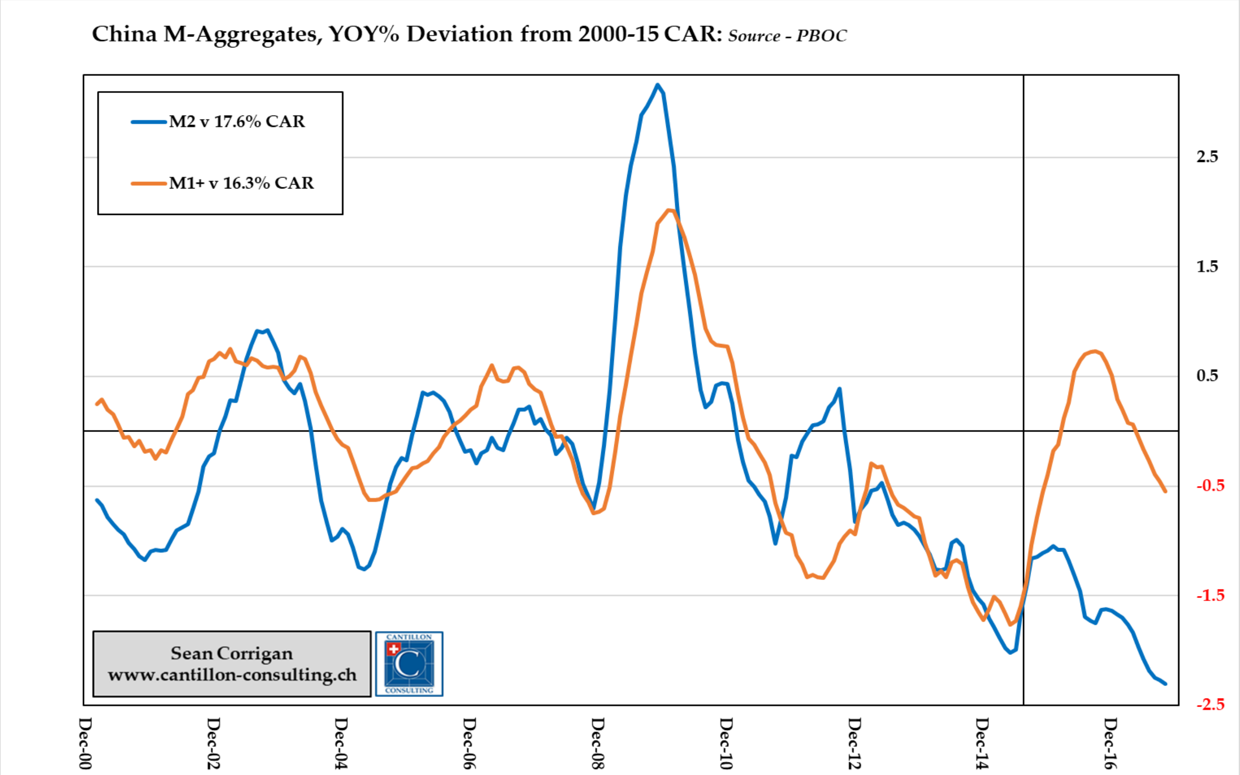


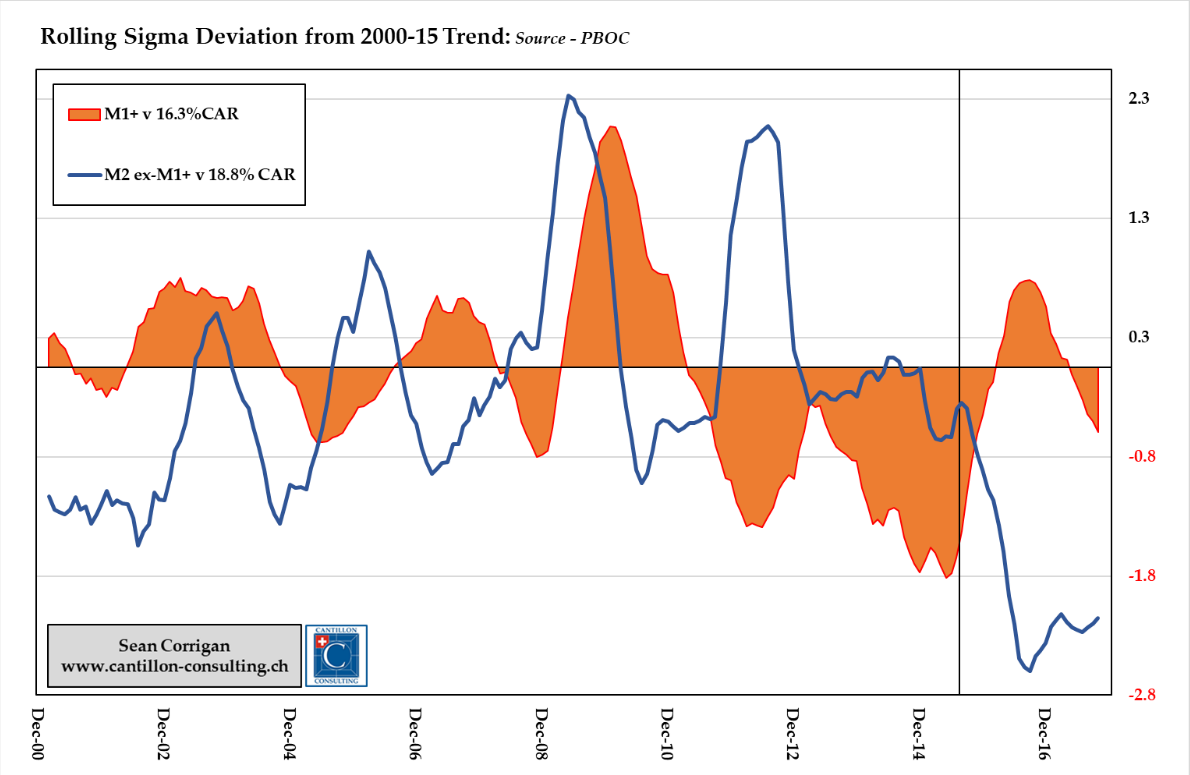
C) …rapidly souring business conditions…

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%.

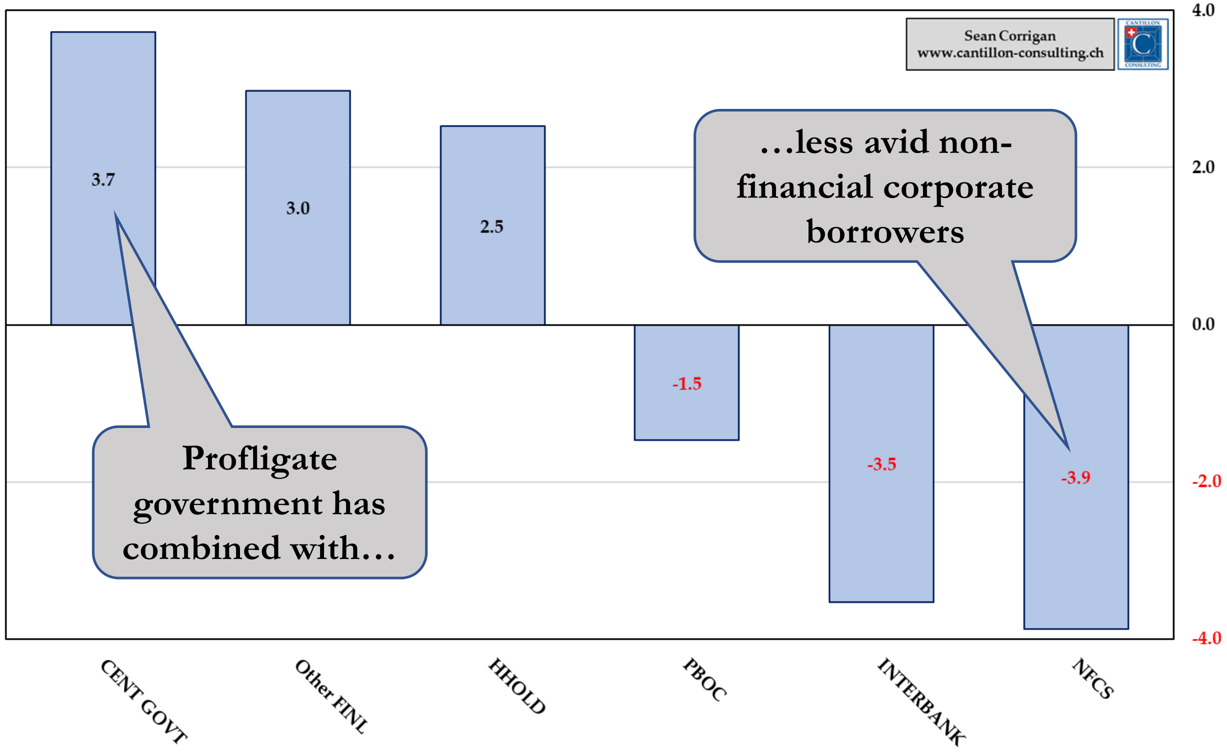
Talk is that higher-yielding WMPs, etc, are largely to blame with the spread of dedicated corporate finance arms further draining money away. The former could be the *REAL* reason for the crackdown on asset managers' guaranteed-return products. Among the estimated Y100+ trillion of these outstanding, 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; resrves 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?



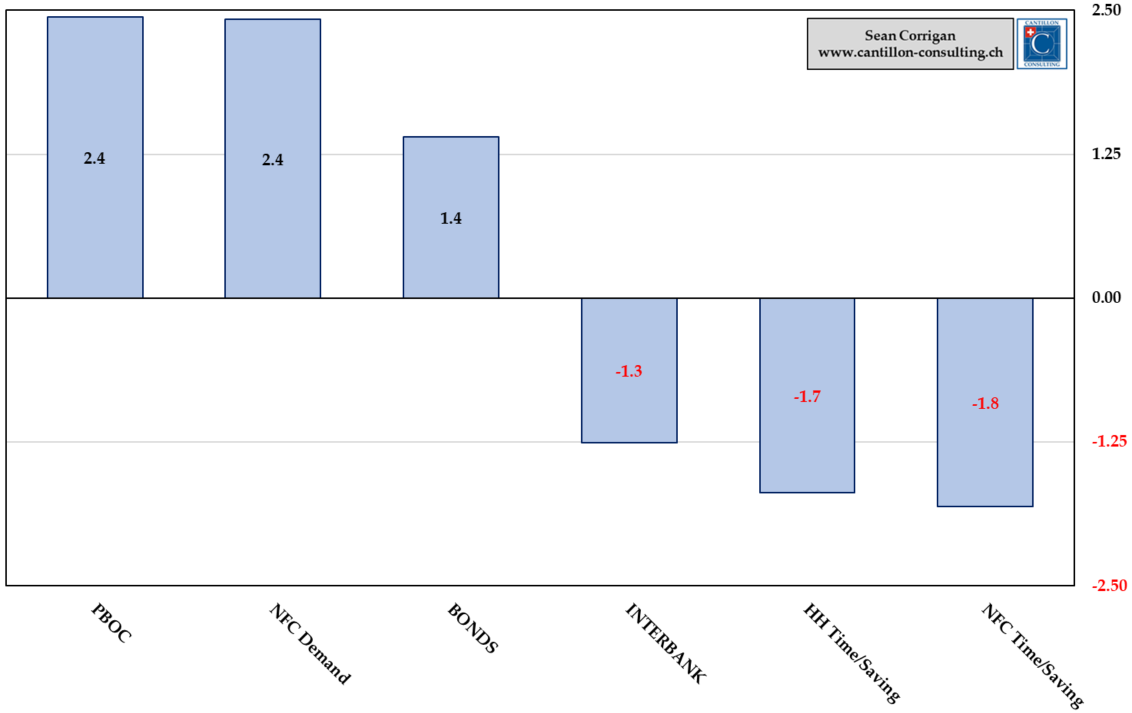


2-Year %Change in Share of Chinese Bank Total Assets: *Source - PBOC*

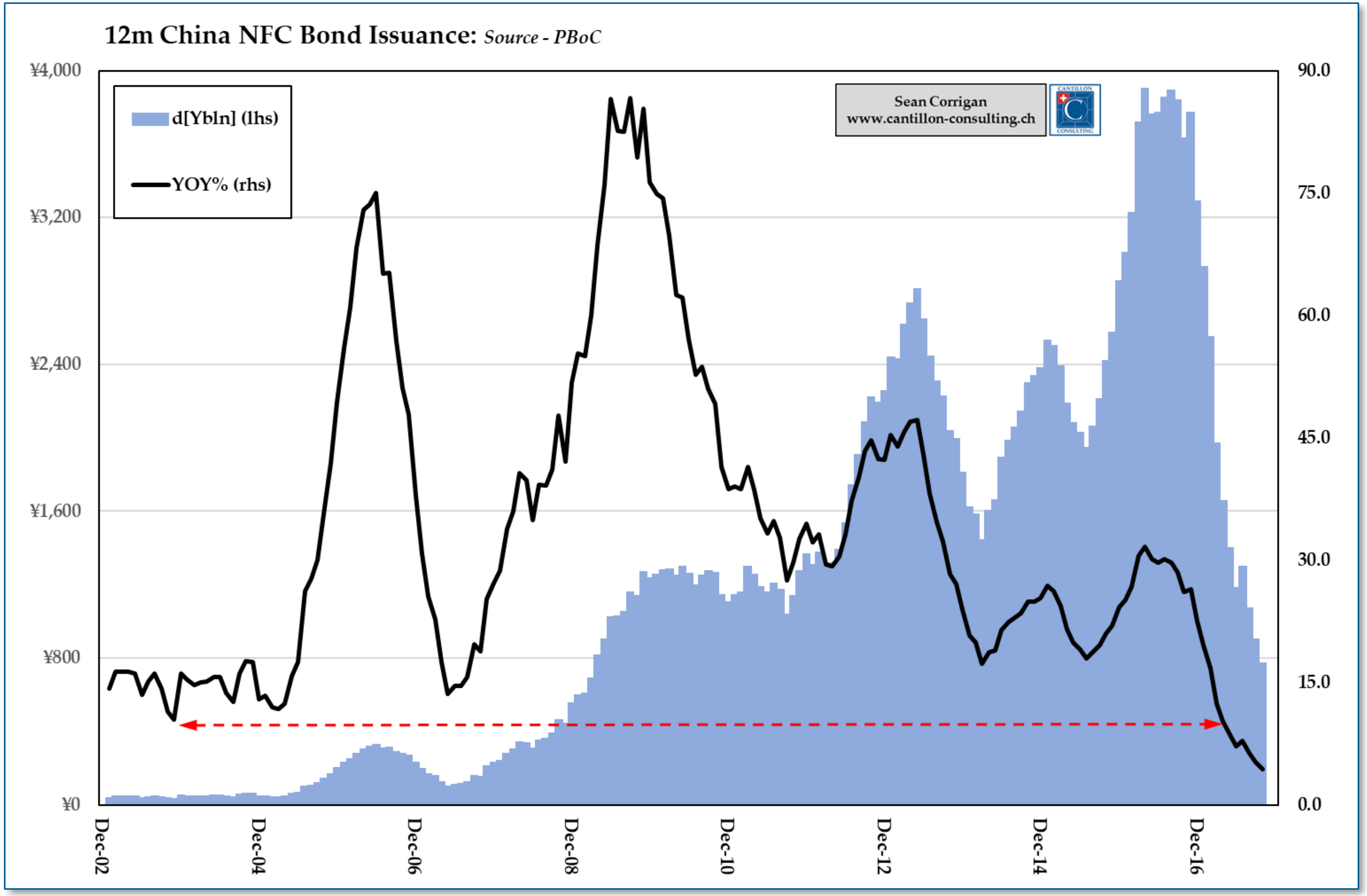


1) The simultaneous crack-down on the ~200 micro-loan P2P lenders might also be aimed as much at driving business back to the banks as at lessening burgeoning risks. On the latter count, consumer credit has certainly been roaring away of late. The reporting category which includes mortgage lending is 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 (Y1.6 trillion) so far in 2017 as in the whole of 2016.

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



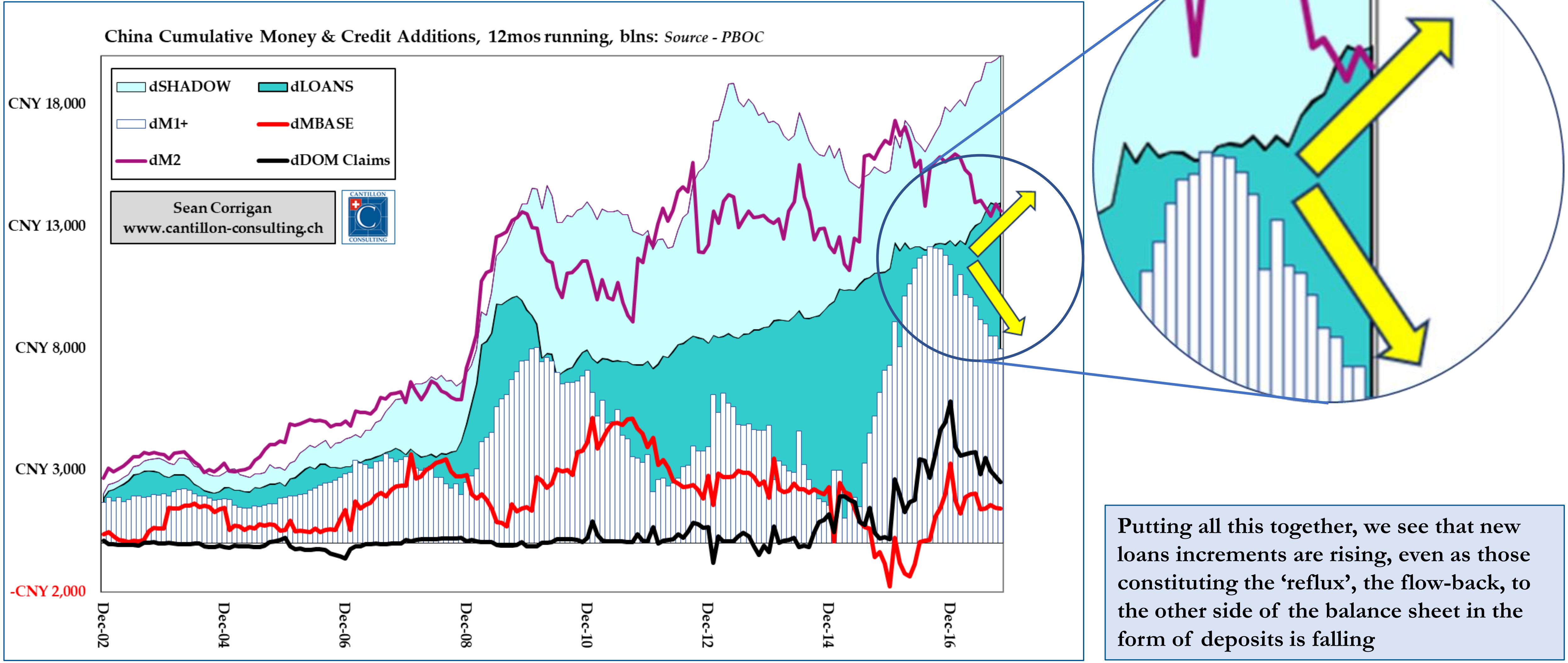
2) Banks have been reliant on PBoC special lending programs, as well as on bond sales (to WMPS!?), to plug the gaps in their balance sheets. The collapse in overall issuance and the dramatic spike in yields will not be exactly welcomed, therefore.



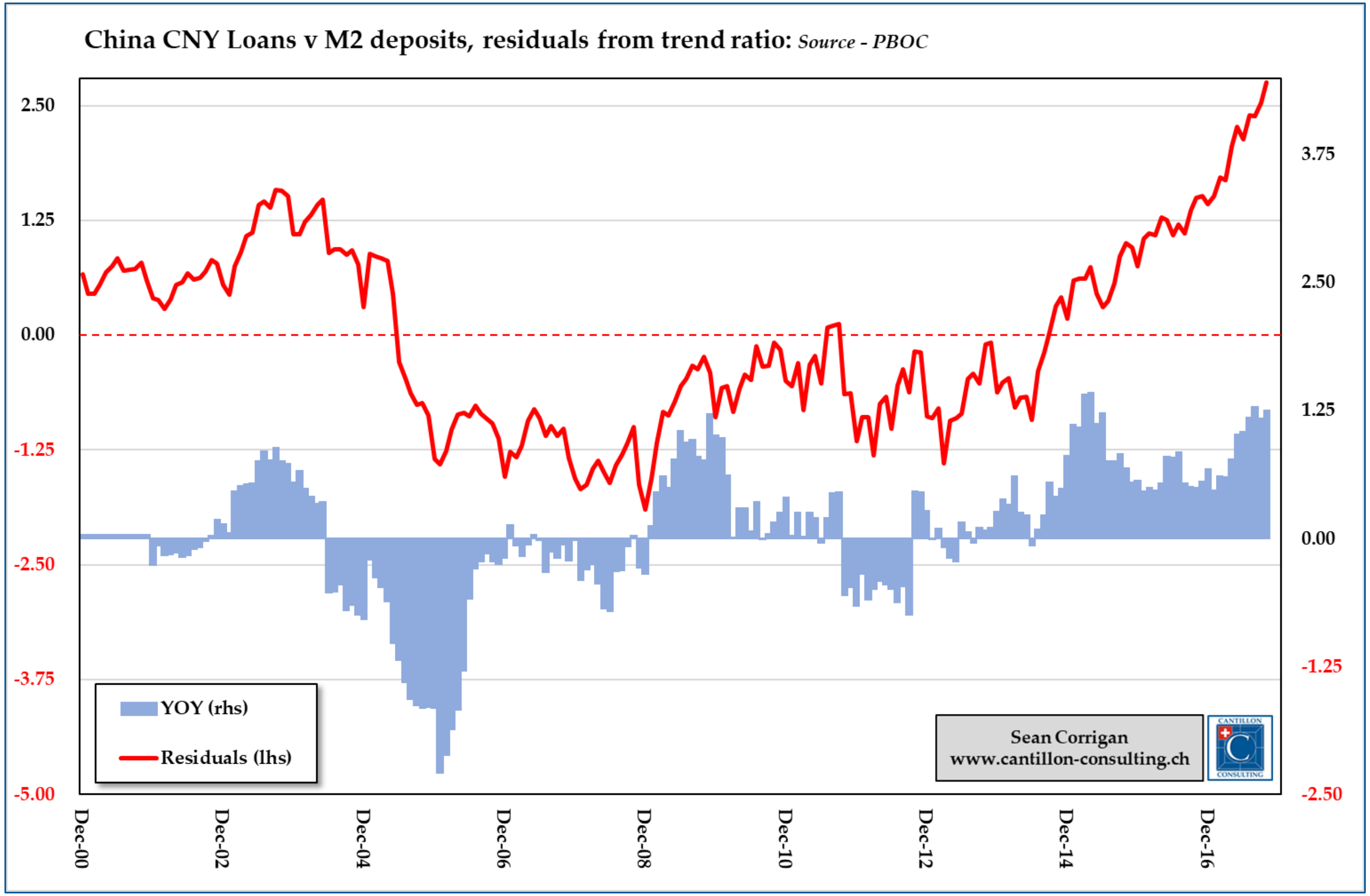
The bond market's travails in one picture – and this even before the recent, spectacular 40bp run up in yield to 3-year highs.

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.

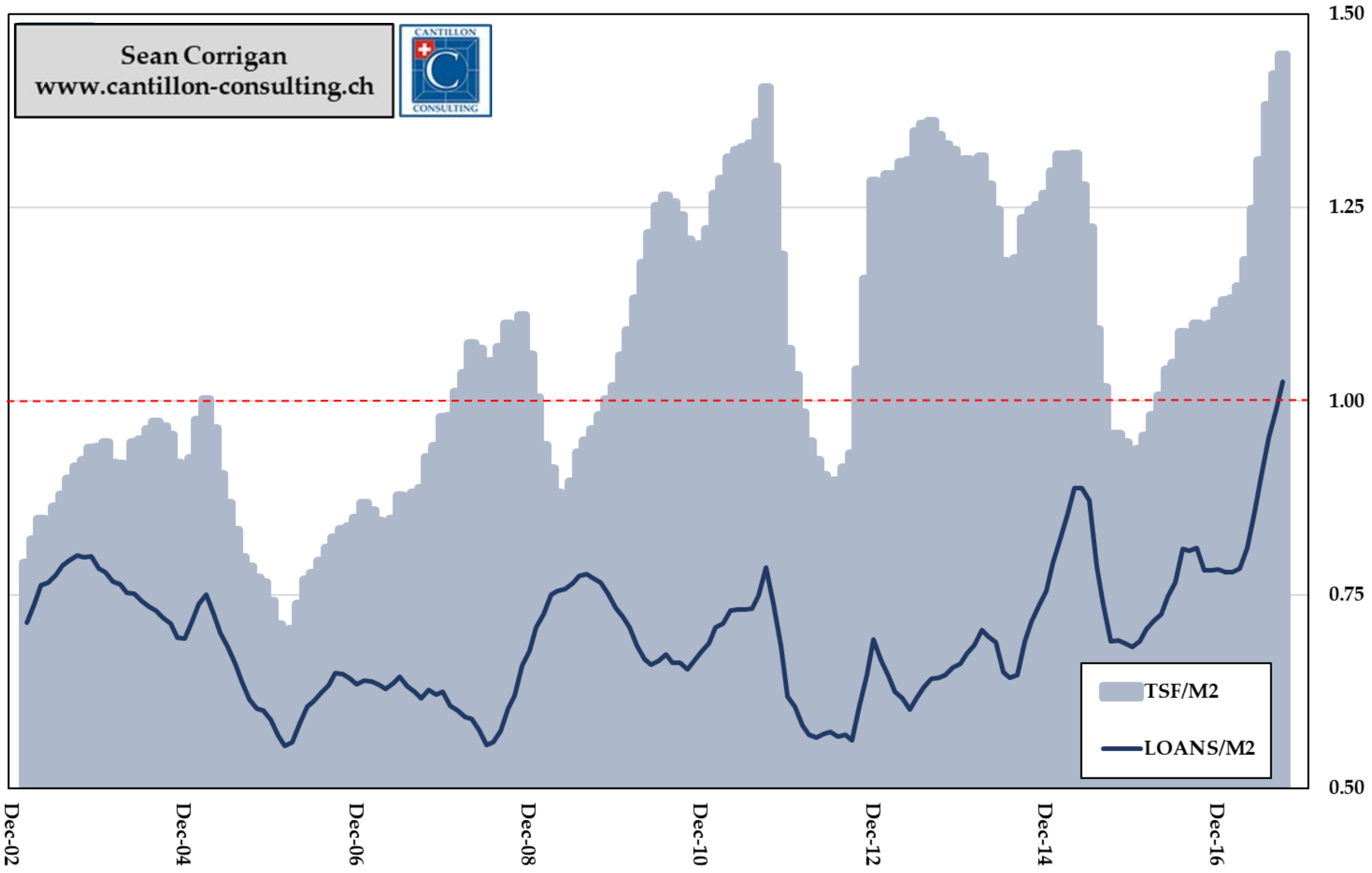


Putting all this together, we see that new loans increments are rising, even as those constituting the 'reflux', the flow-back, to the other side of the balance sheet in the form of deposits is falling



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

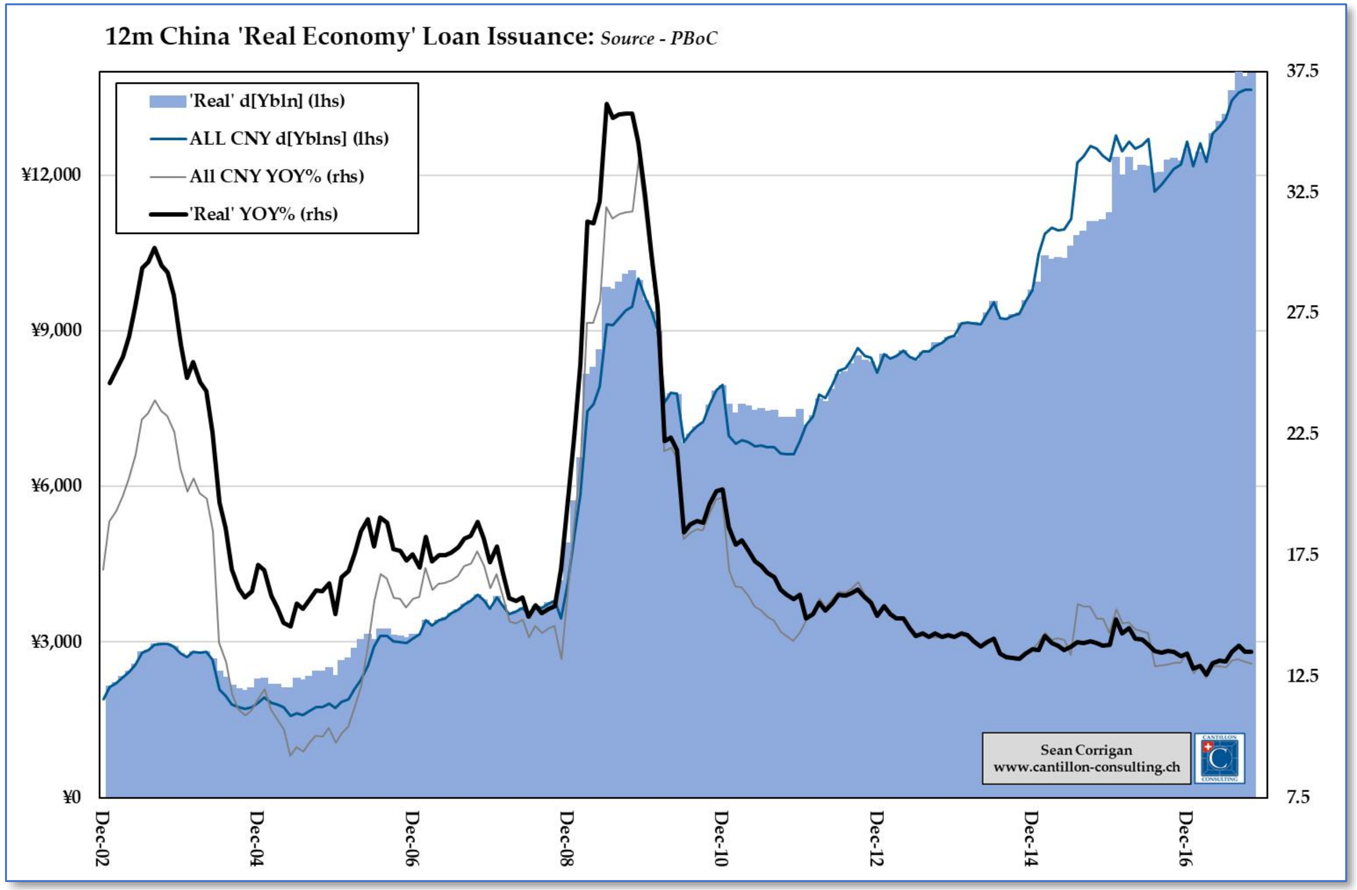
China TSF & Loans v M2 12-mos marginal ratio: *Source - PBOC*



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.

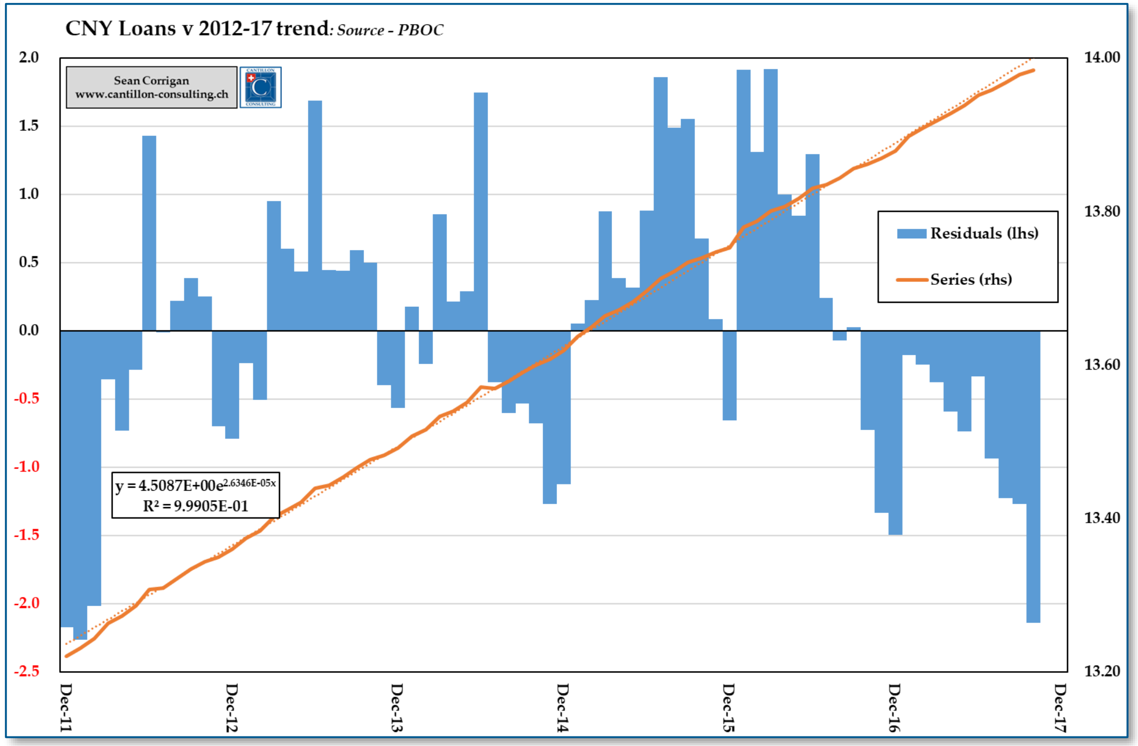
Never say never when it comes to China's stop-start attempts at regulation and reform, but the giving of such a signal would seem to run counter to everything being talked about, at present.

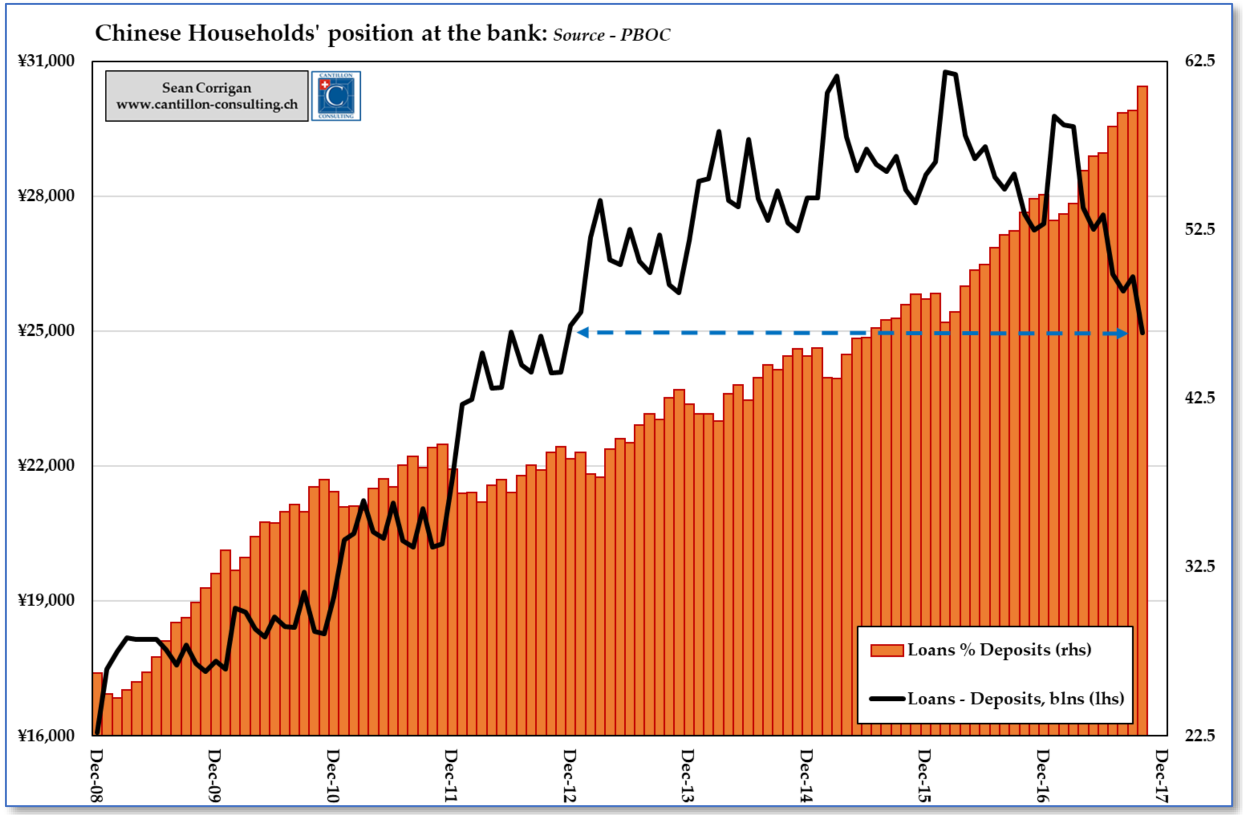
Also shown here is the unprecedented scale of 'aggregate' finance in relation to more money-type holdings. This also suggests the structure is becoming decidedly less liquid in its composition. The credit arteries are clogging up.



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.

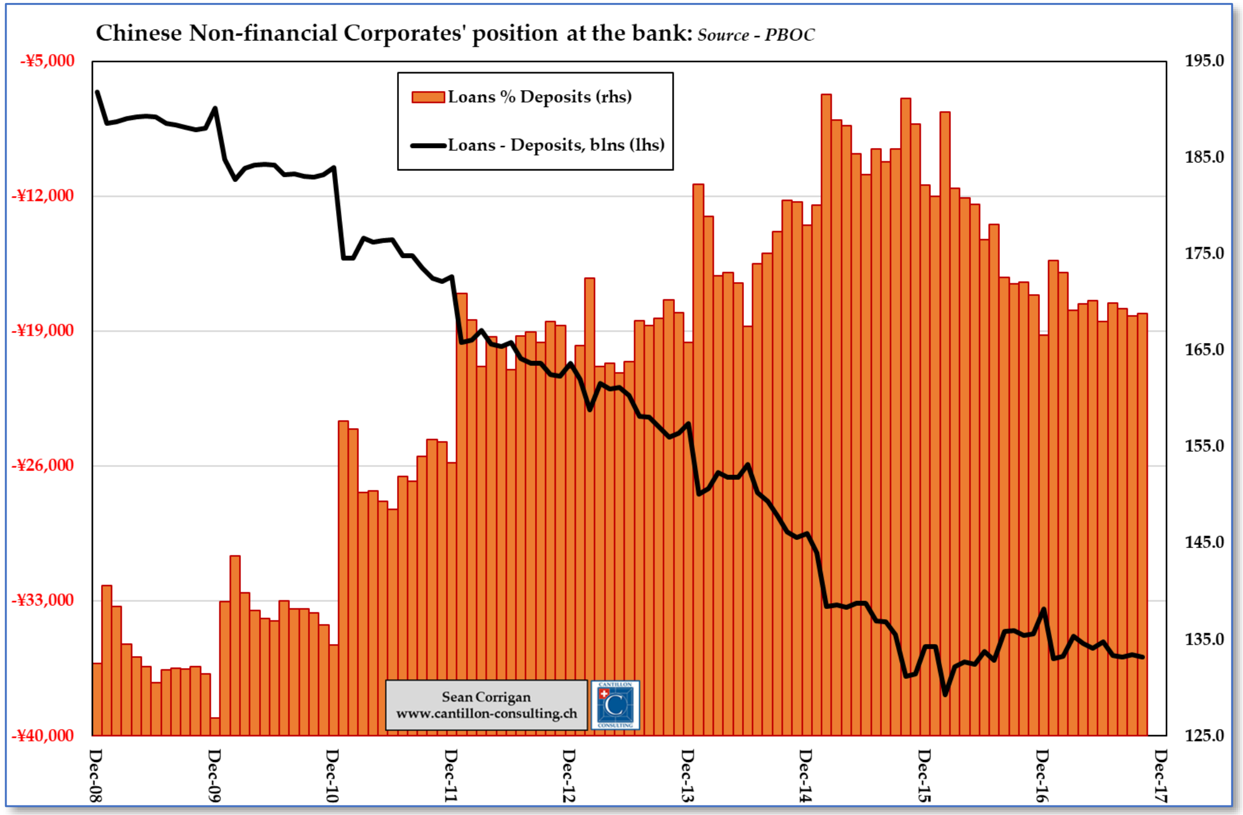
It seems constraints are starting to be felt.

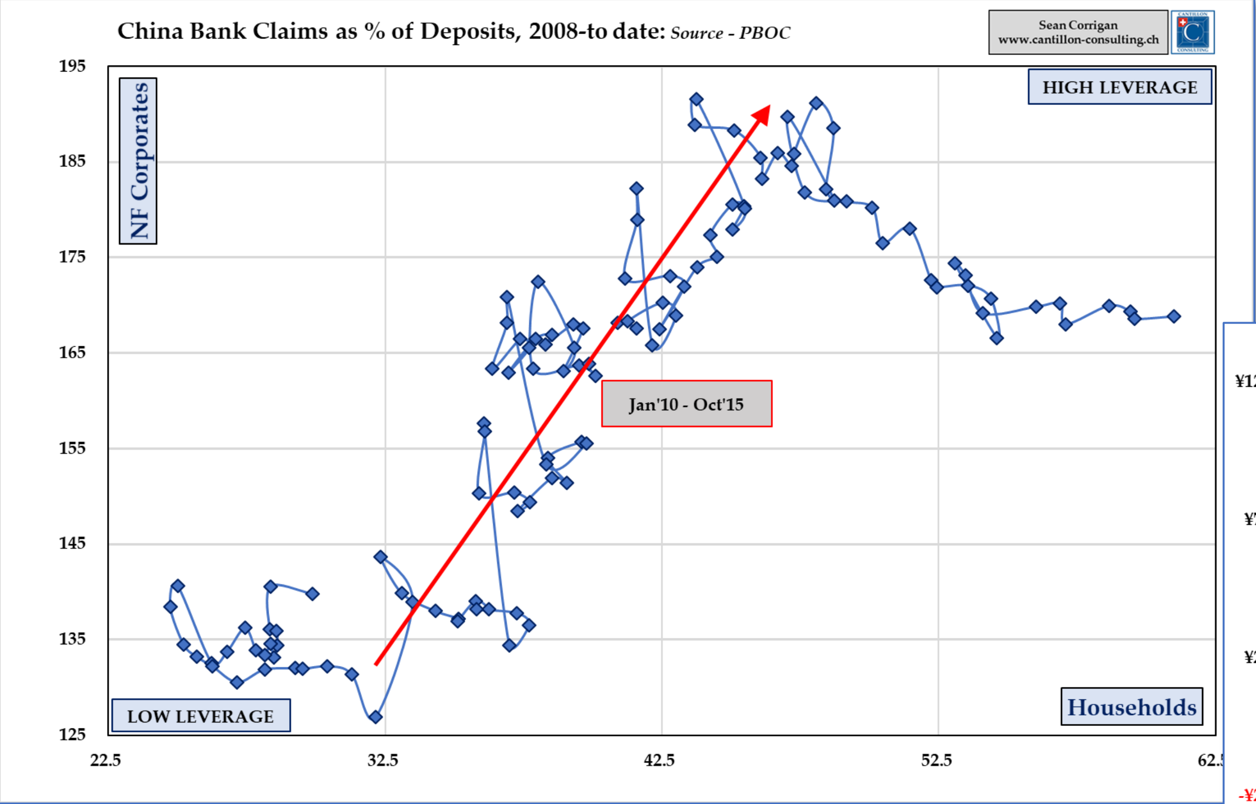




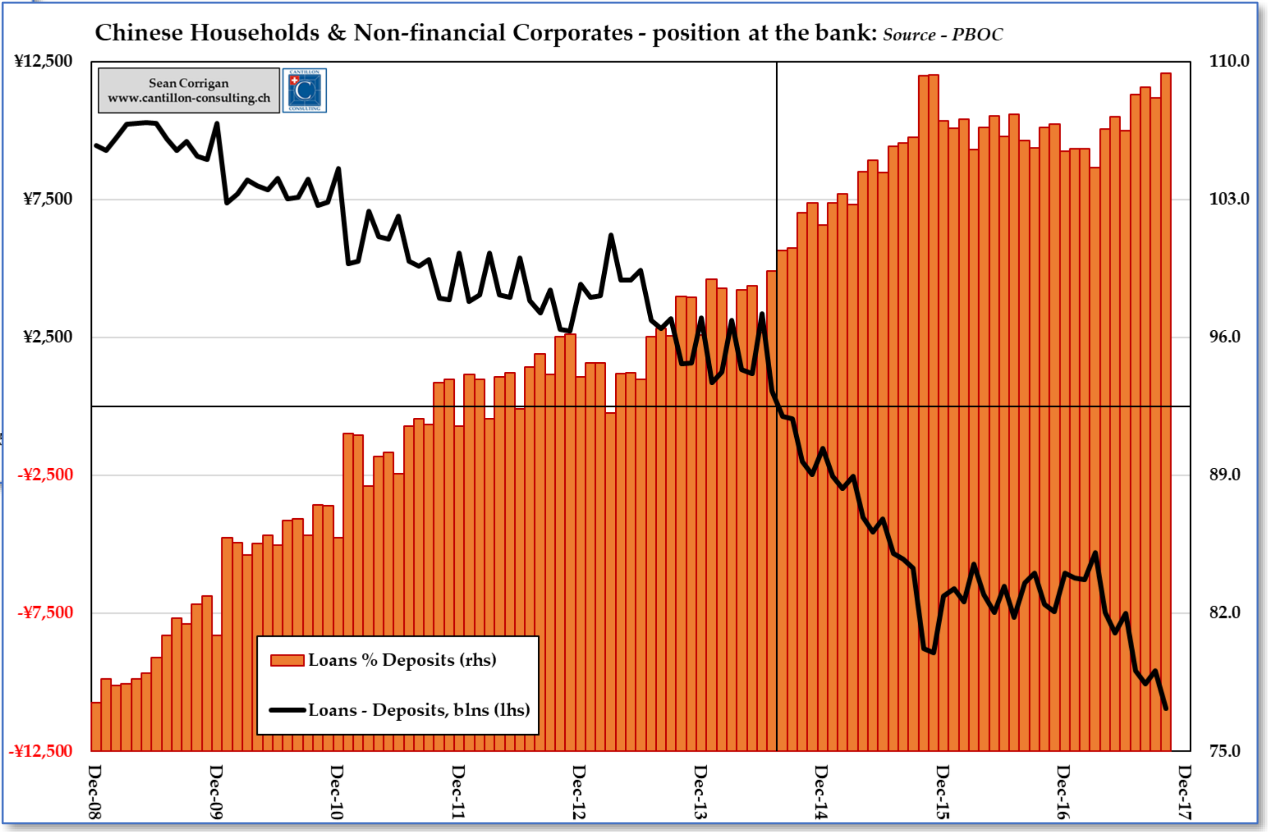
1) Replicating a measure we have long used for the Eurozone, we can see that household's standing at the bank has deteriorated markedly. They may or may not be saving outside the formal system but they have decidedly NOT given up borrowing from within it, especially for mortgages, as noted above. Their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

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.

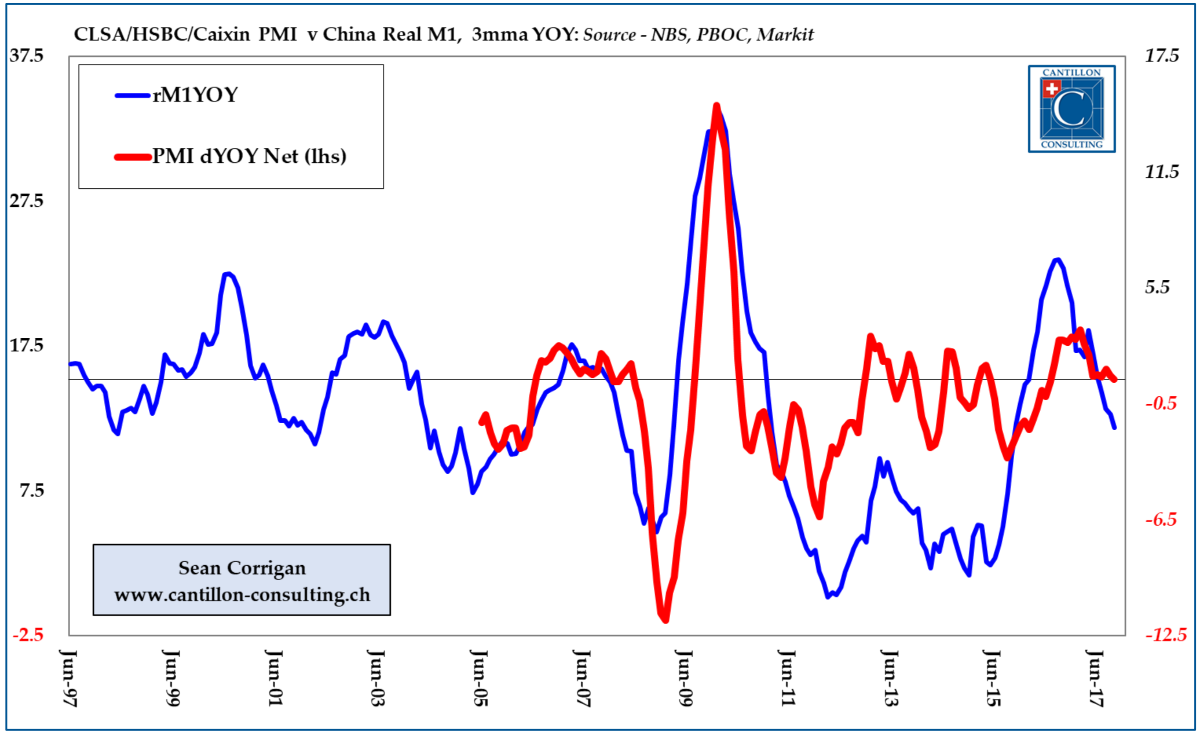




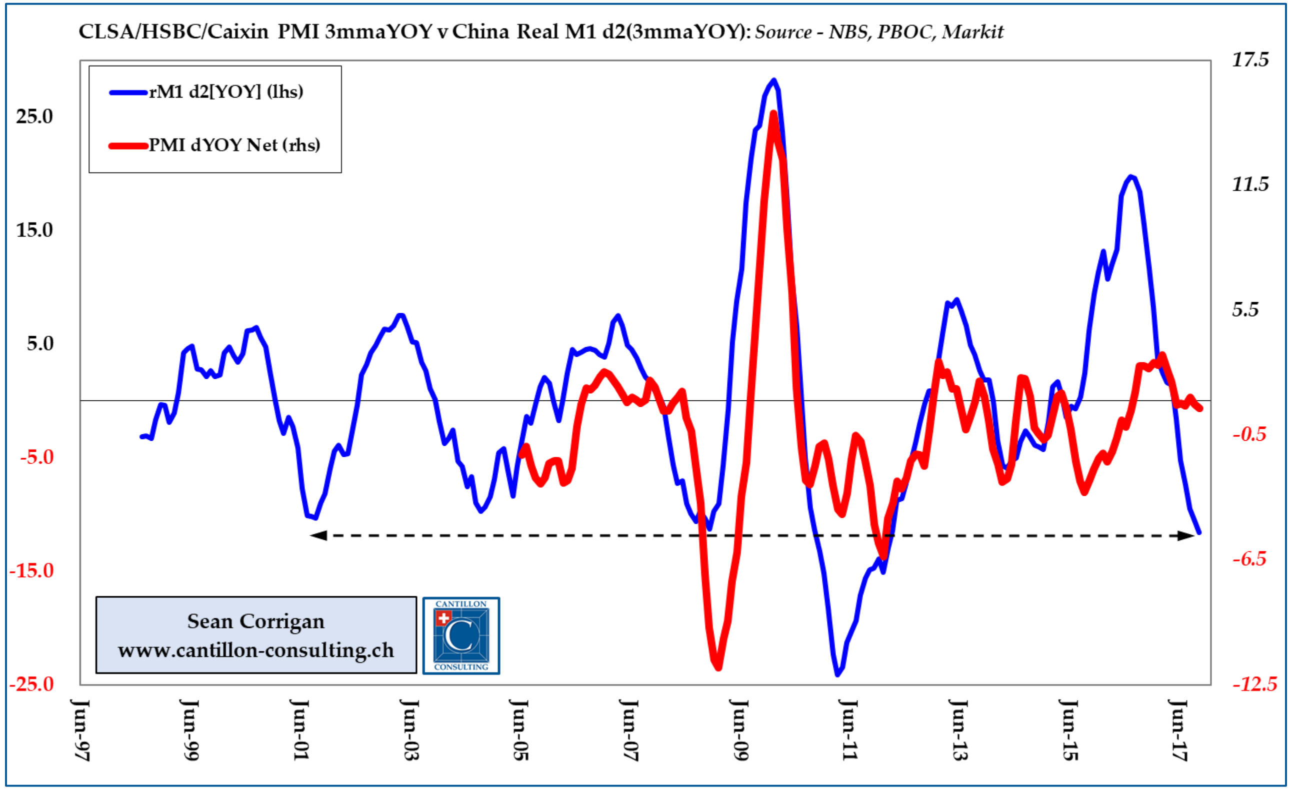
If we put the two sectors together, what also becomes apparent is that, for the past three years, net household *bank* savings have not been enough to fund net corporate bank borrowing, despite the relative lack of appetite of the latter. Noting that claims on the government are up by two-fifths in the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



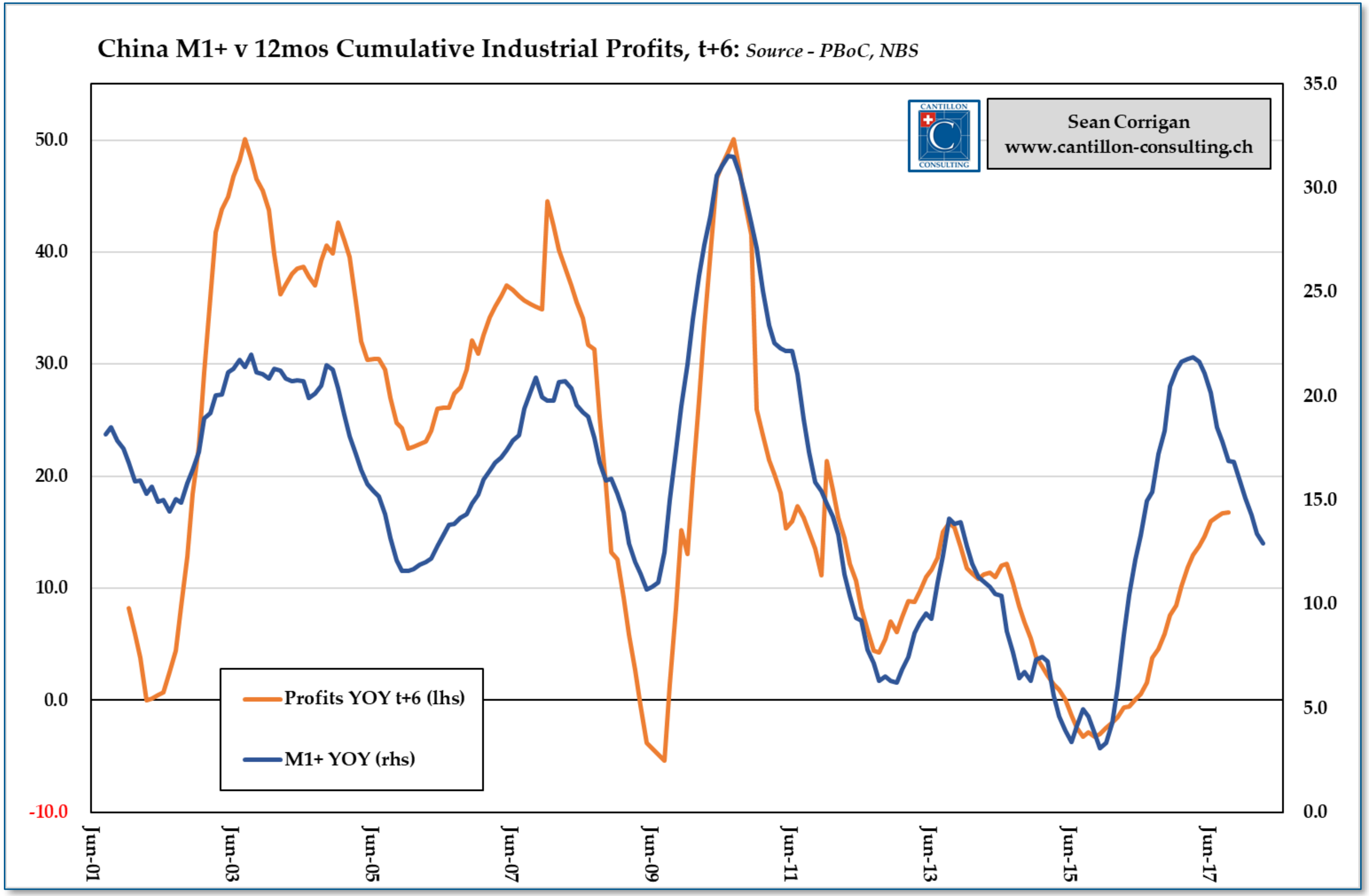
Never let it be said, but one might almost argue from this that the poisoned chalice of consumerism – that long-sought counter for what has been widely regarded as an over-proportionate level of investment – has already started to show the dreaded Occidental pathology of consuming, rather than, compounding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



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!



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.


China M1+ v 12mos Cumulative Industrial Profits, t+6: *Source - PBoC, NBS*
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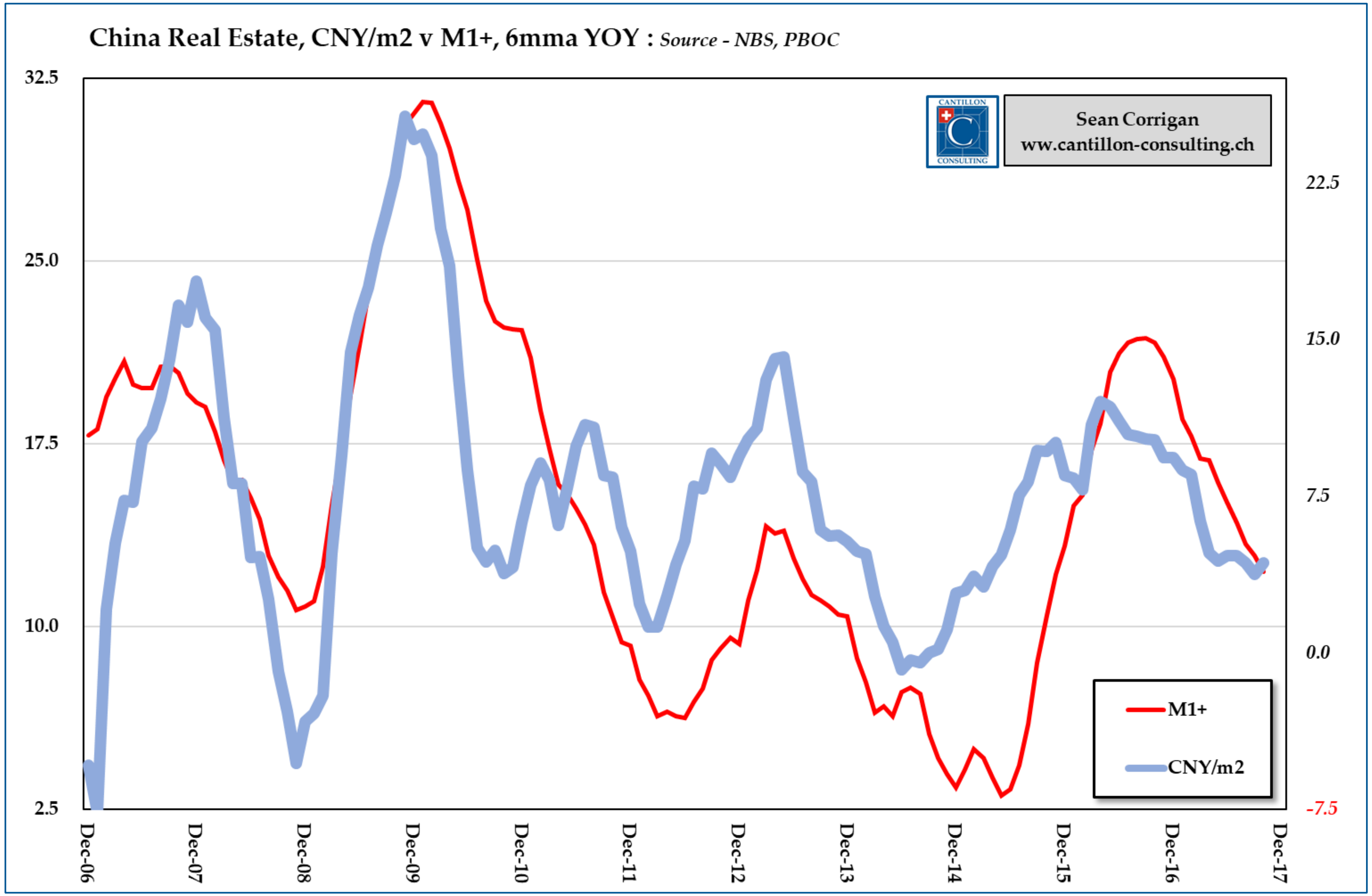
50.0
40.0
30.0
20.0
10.0
0.0
-10.0
35.0
30.0
25.0
20.0
15.0
10.0
5.0
0.0
Jun-01
Jun-03
Jun-05
Jun-07
Jun-09
Jun-11
Jun-13
Jun-15
Jun-17
Profits YOY t+6 (lhs)
M1+ YOY (rhs)


China Real Estate, CNY/m2 v M1+, 6mma YOY : Source - NBS, PBOC
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32.5
25.0
17.5
10.0
2.5
22.5
15.0
7.5
0.0
-7.5
Dec-06
Dec-07
Dec-08
Dec-09
Dec-10
Dec-11
Dec-12
Dec-13
Dec-14
Dec-15
Dec-16
Dec-17
M1+
CNY/m2

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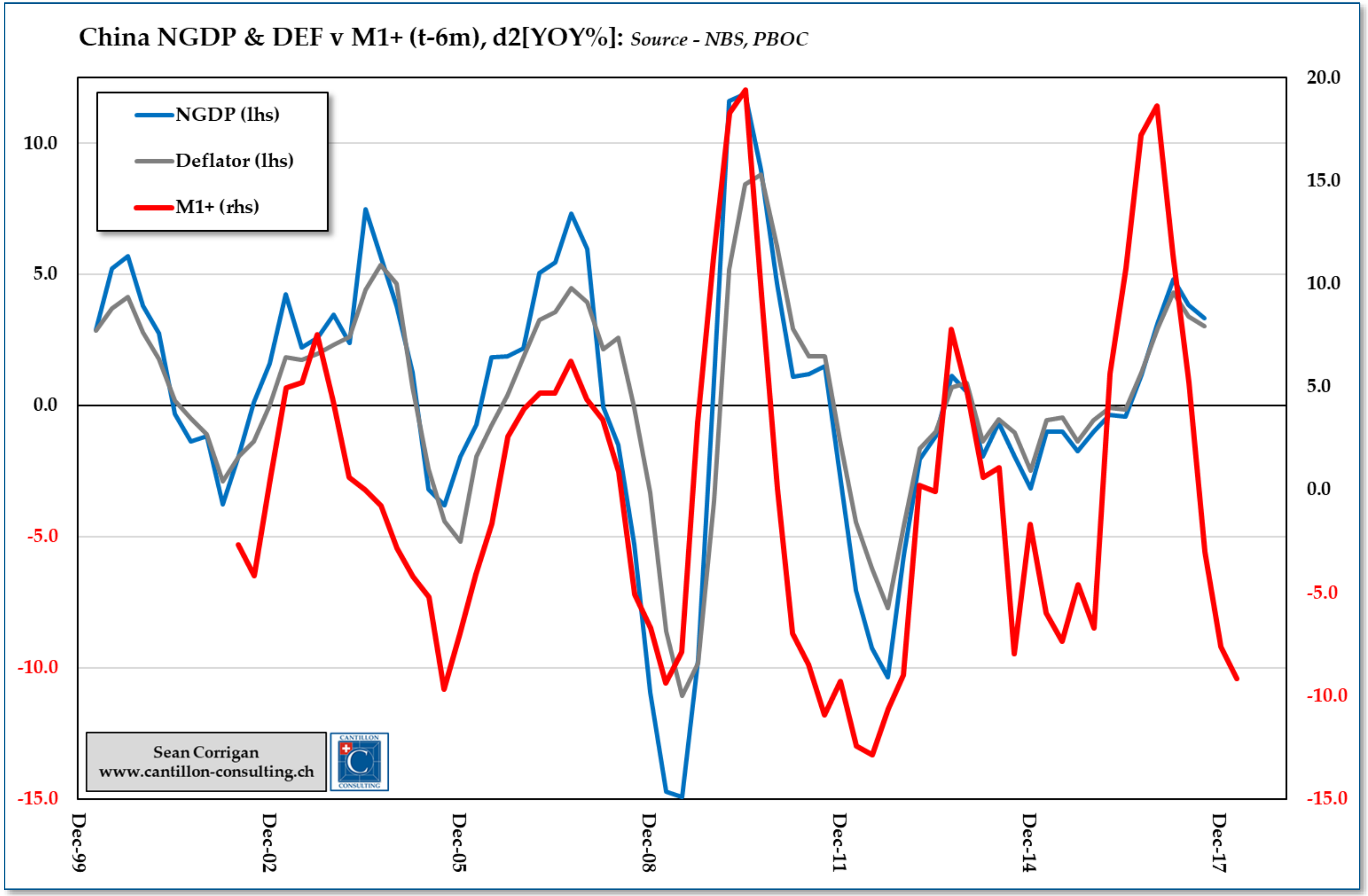
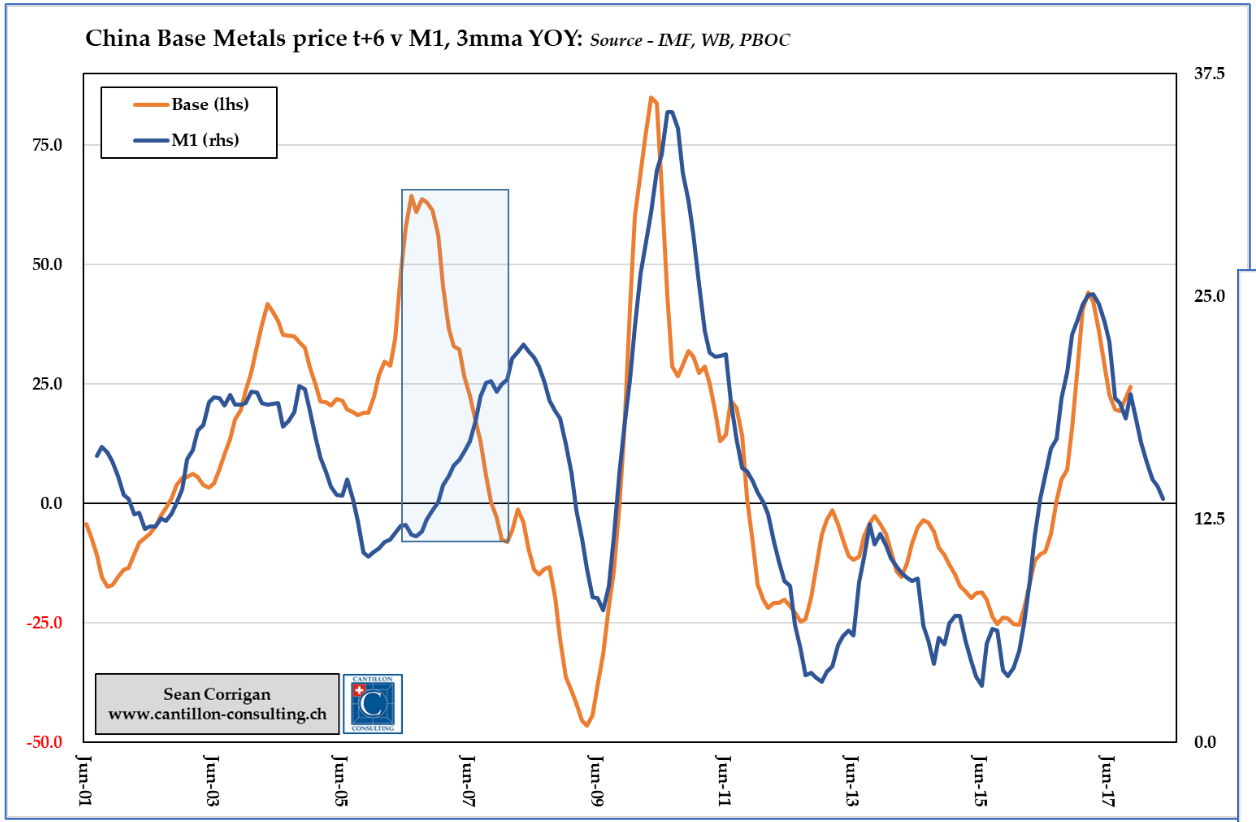


November 23rd 2017

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
Base (lhs)
M1 (rhs)
75.0
50.0
25.0
0.0
-25.0
-50.0
37.5
25.0
12.5
0.0
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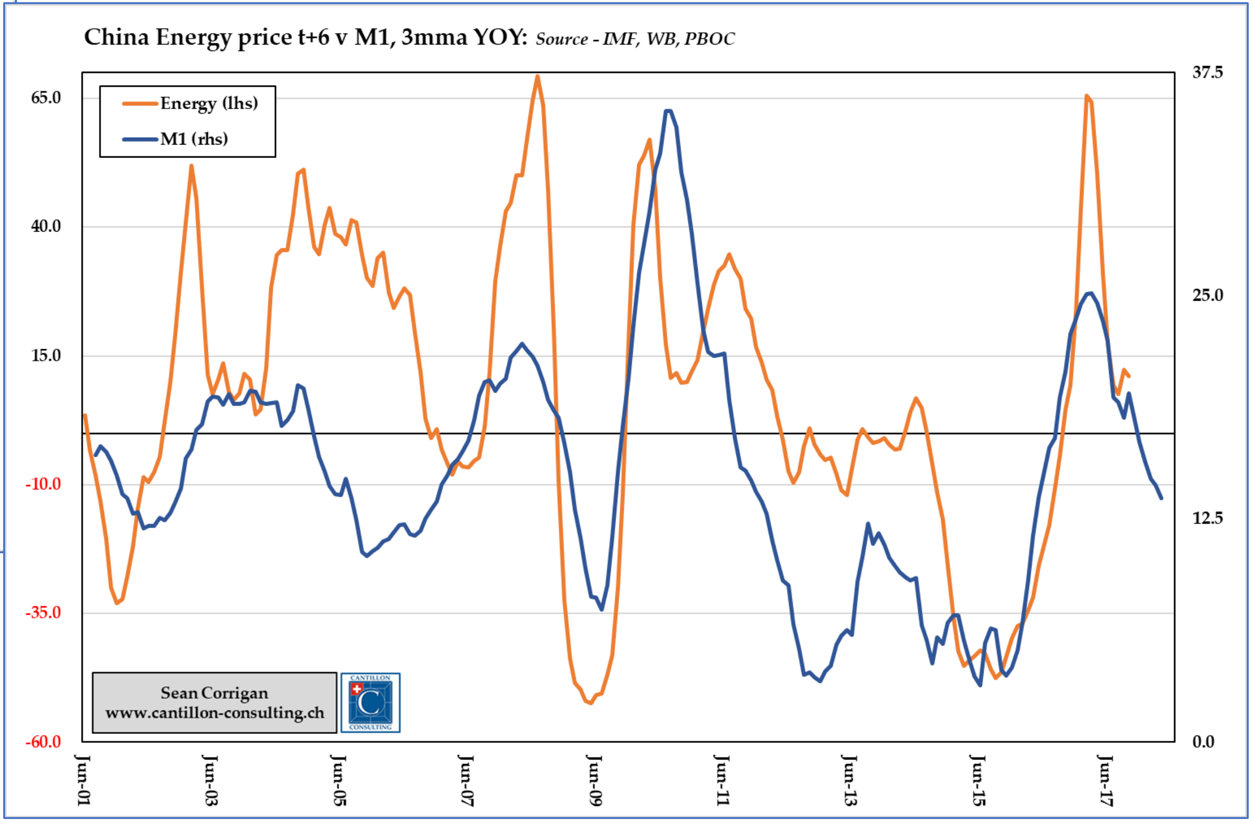
Jun-01
Jun-03
Jun-05
Jun-07
Jun-09
Jun-11
Jun-13
Jun-15
Jun-17


China Energy price t+6 v M1, 3mma YOY: Source - IMF, WB, PBOC
Energy (lhs)
M1 (rhs)
65.0
40.0
15.0
-10.0
-35.0
-60.0
37.5
25.0
12.5
0.0
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Jun-01
Jun-03
Jun-05
Jun-07
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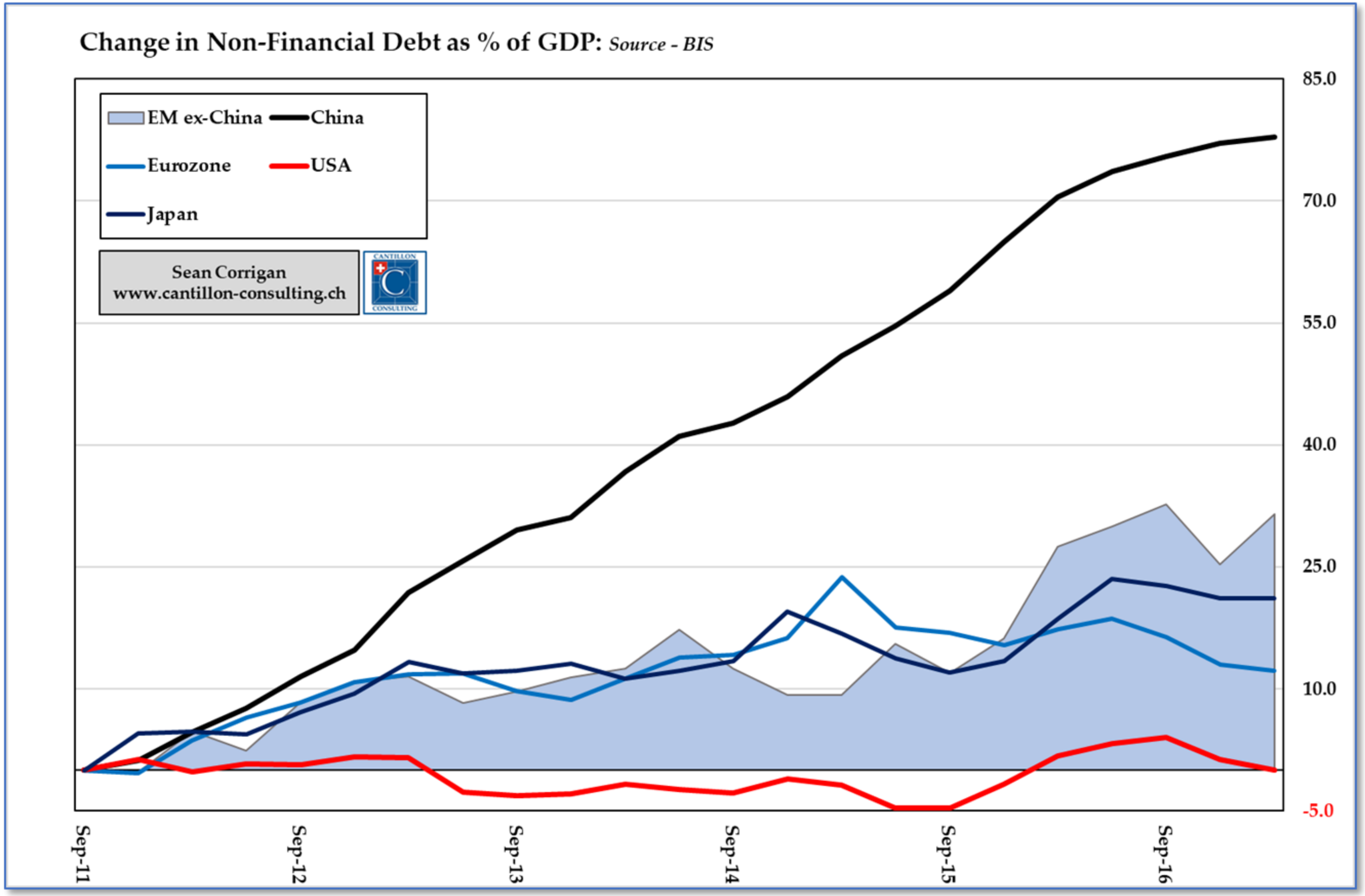
Jun-13
Jun-15
Jun-17

LME COPPER

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



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.

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