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MACRO MORNING BRIEFING

September 19, 2024

China Macro Leverage Ratio on the Rise

The road to the stabilization of macro data is a long one in China. The latest August credit, activities and investment growth data remain sluggish. August aggregate financing (AF) eased to 8.1% y/y from 8.2% y/y. The breakdown of AF shows the bulk of the financing was done via the government bond issuance of CNY 1,620bn against overall AF monthly loan growth of CNY 3,031bn. Financial institution loan growth slowed to 8.5% y/y from 8.74% in July and 11% at the end of 2023. Medium- to long-term household loans, a proxy for mortgage activity, picked up a touch to CNY 117bn on the month. It is better than the near flat rate in July 2024, but well below the already depressed average loan pace of CNY 170bn between January and July 2024. Overall, domestic household loan growth rates hit a new historical low of 3.55% y/y vs. 6.9% at the end of December 2023.

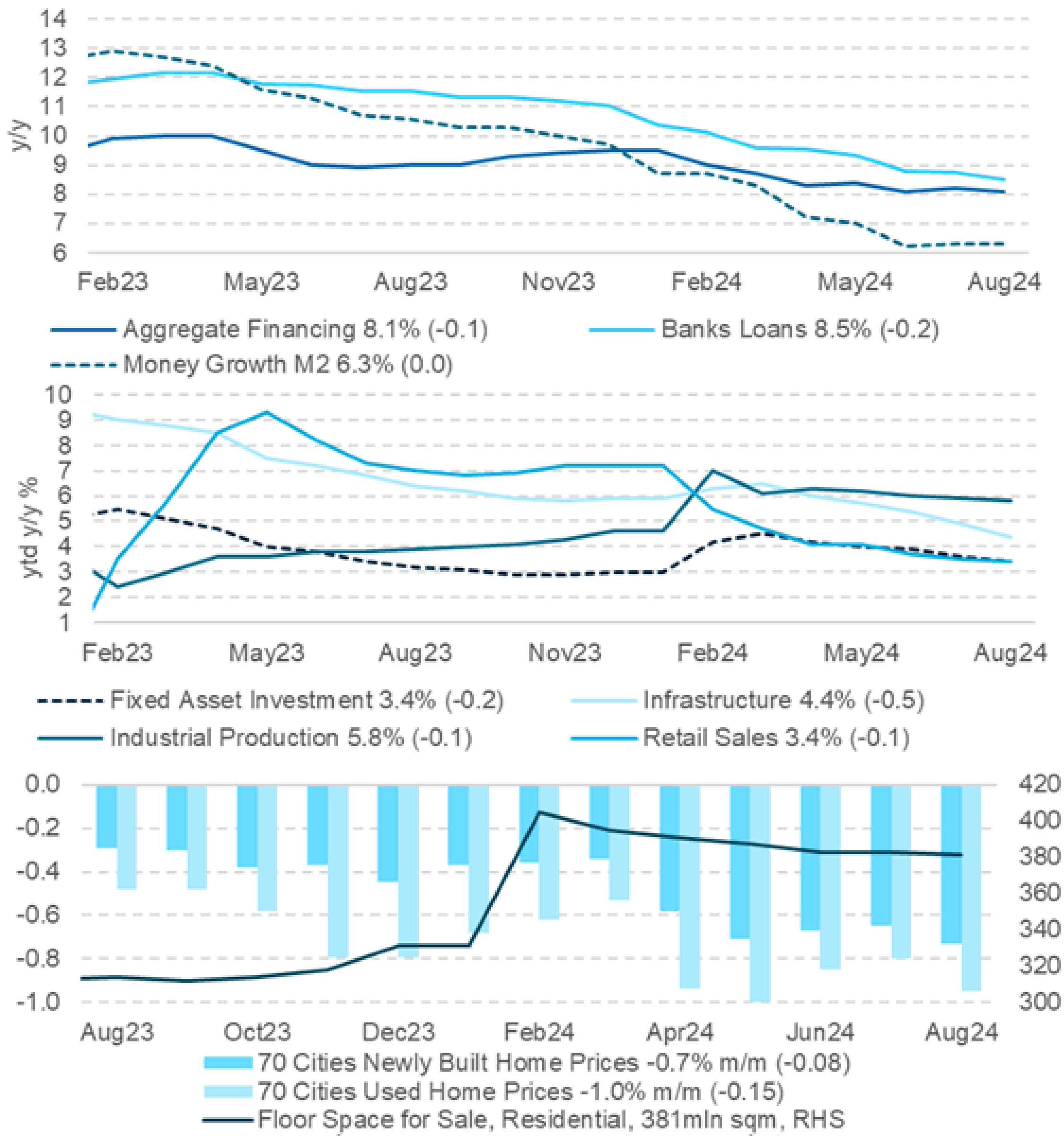
The lack of household demand reflects the continued low confidence in the housing market. The latest figures for August monthly new and used home prices saw accelerated declines at -0.73% m/m and -0.95% m/m, respectively. It was also the 16th straight monthly decline of used home prices. While housing prices remain low, we are encouraged by the improvement of sale and inventory data. Year-to-date, newly built residential floor space saw sales of 508mn sqm, or -20.4%, y/y as of August.

Chinese activities and investments slowed across the measured spectrum in August. Fixed asset investments slowed to 3.4% ytd y/y (July: 3.6%), with infrastructure investments easing at a faster pace to 4.4% ytd y/y (July: 4.9%). Industrial production, at 4.5% y/y (5.1%) or 5.8% ytd y/y (5.9%), was dragged by production of cement (-12% y/y, -10.7% ytd y/y) and crude steel (-10.4%y/y, -3.3% ytd y/y). That said, growth in high-tech sectors was solid, with newenergy vehicles growing at 30.5% y/y, 31.3% ytd y/y, service robots 20% y/y, 9.9% ytd y/y, and integrated circuits at 17.8% y/y, 26.6% ytd y/y, respectively.

Finally, consumption growth slowed significantly to 2.1% y/y, 3.4% ytd from 2.7% y/y, 3.5% ytd y/y.

Slowing macro conditions continue to call for further policy easing, but the biggest question is what the best and most effective strategy is to revive market sentiment. After all, the reaction to a series of policy and regulatory easing measures over the past few months has not been effective.

Exhibit #1: Chinese Credit, Activities and Investment Growth Remain Sluggish



Source: BNY, Bloomberg L.P.

Further policy easing in China is almost a certainty in the coming month. The market consensus and official guidance suggest that a further reduction in the reserve requirement ratio (RRR) is imminent, as well as a potential reduction in interest rates (medium-term lending facilities (MLF), the loan prime rate (LPR) or the 7-day reverse repo reference rate). Note that the RRR ratio for major banks is currently 10%, while the average RRR is 3% lower at 7%, the 1-year MLF is 2.3% (ytd -20bp), the 5-year LPR is 3.85% (ytd -25bp) and the 7-day reverse repo is 1.7% (ytd -10bp).

The overall lack of a response to government policies is a concern and we have wondered about government reluctant to engage in more forceful fiscal stimulus to bring Chinese growth recovery momentum back on track. One of the reasons, in our view, could be the overall rising and accelerating macro leverage ratio trend.

According to the latest available data from the National Institution for Finance & Development (NIFD), total non-financial sector debt as a percentage of GDP, or the macro leverage ratio, stood at 294.8% as of Q1 2024, 6.8ppt higher than Q4 2023 or +48.2ppt compared with Q4 2019, when it was 246.6% of GDP.

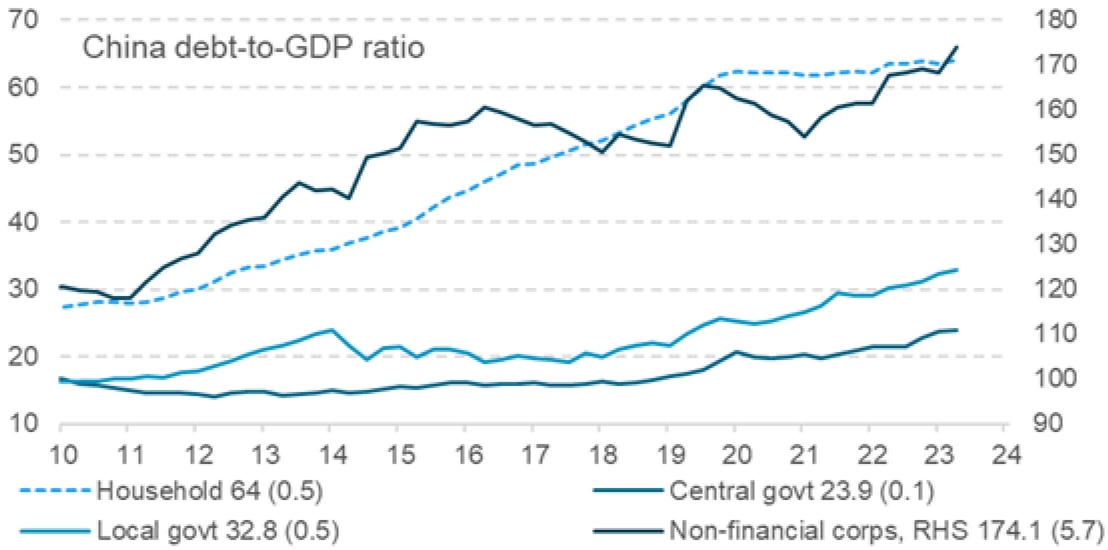
The bulk of the increase is from non-financial corporations, which account for the largest share at 174% of GDP (+5.7ppt vs. 168.4% in Q4 2023), followed by steady gains in central government (23.9%) and local government (32.8%) debt. As for household conditions, the improvement observed in Q4 2023 was short-lived as household debt (as a % of GDP) reached a new high of 64% as of Q1 2024.

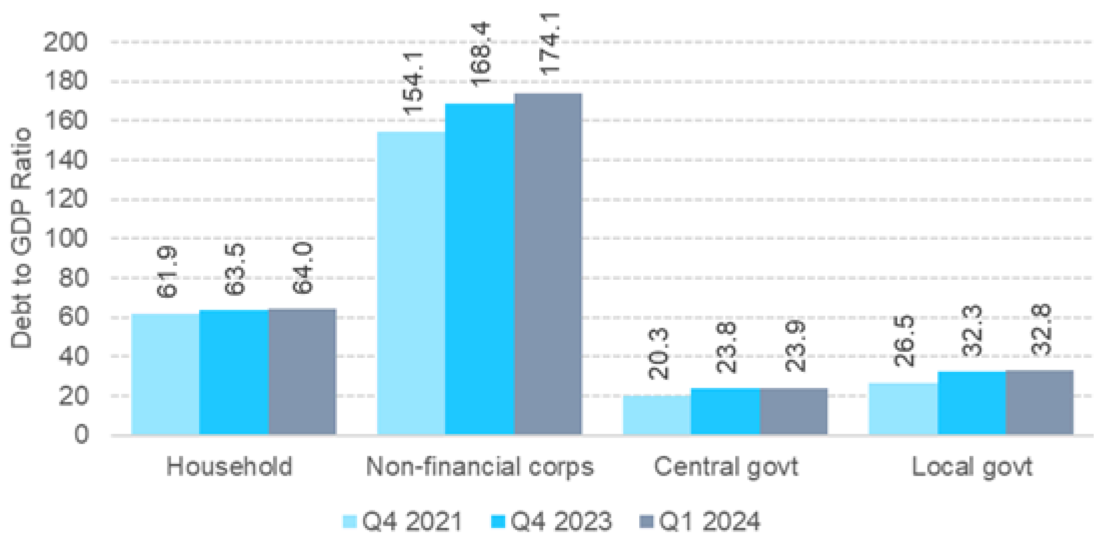
On another measure, China's total debt service ratio is at the highest level since 1999, at 10.5% as of 2022 vs. 5.9% in 2021.

The government fiscal stance has relaxed over the years with the introduction of special government bonds with specific and targeted sectors, but the central government's leverage ratio remains low in absolute terms. Financial stability is firmly in focus. The fast-paced expansion of local governments is not without risks of weakening fiscal and tax revenue.

We will be monitoring the evolution of debt and financial stability closely.

Exhibit #2: Chinese Macro Leverage Ratio on the Rise





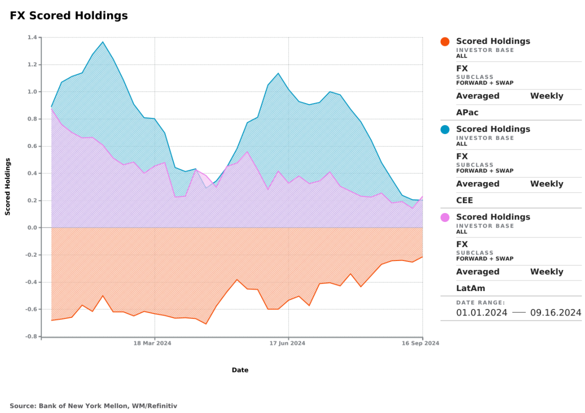
Source: BNY, Bloomberg L.P., http://www.nifd.cn/home/index

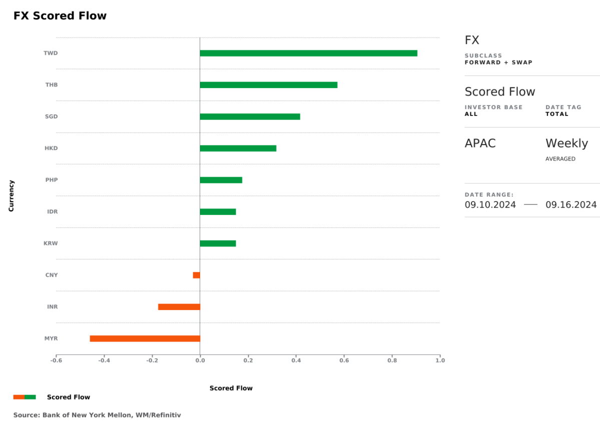
Over the past week, global FX posted broad inflows, along with USD outflow pressure. The rebalancing trend continues with further trimming of overheld and profitable CEE currencies while covering underheld and unprofitable APAC currencies. Since the beginning of July, scored holdings for CEE currencies have declined from a weekly average of 0.90 to 0.20, while scored holdings for APAC currencies increased from -0.57 to -0.21. As for LatAm, the pace of trimming of overheld conditions was slower, with a decline of 0.39 to 0.28 over the same period.

Within APAC, MYR, INR and CNY were sold last week against broad inflows in all other APAC currencies. Investors remain cautious and concerned about China's slowdown risks as currencies and all asset classes were sold. CNY posted light outflows last week while the selling trend in equities and sovereign bonds continued. THB, SGD and TWD received the most inflows over the past week.

In term of assets, equity flows diverged with continued outflow pressure in tech-related Taiwan and South Korean equities, but broad demand for other APAC countries, especially Malaysia and Philippines. As for bonds, both sovereign and corporate bond flows were biased to the sell side. Chinese sovereign bonds (CGB) were sold for the sixth consecutive week as the 10yr CGB yield fell to a new low of around 2%. Elsewhere, noteworthy flows included the sizable selling in Thailand and Indonesia’s corporate bond space.

Exhibit #3: APAC FX Narrowing Underheld Trend, with Most Inflows in TWD and THB





Source: BNY, Bloomberg L.P.

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Please direct questions or comments to: iFlow@BNY.com

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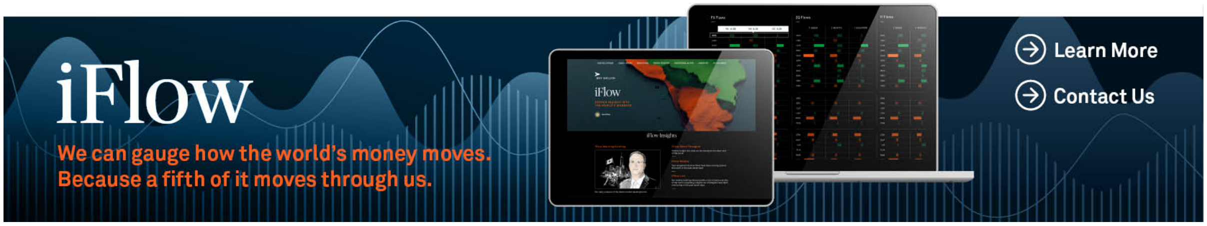

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