



**Money, Macro & Markets Monitor**

*Insight & Support for the Managers of Wealth*

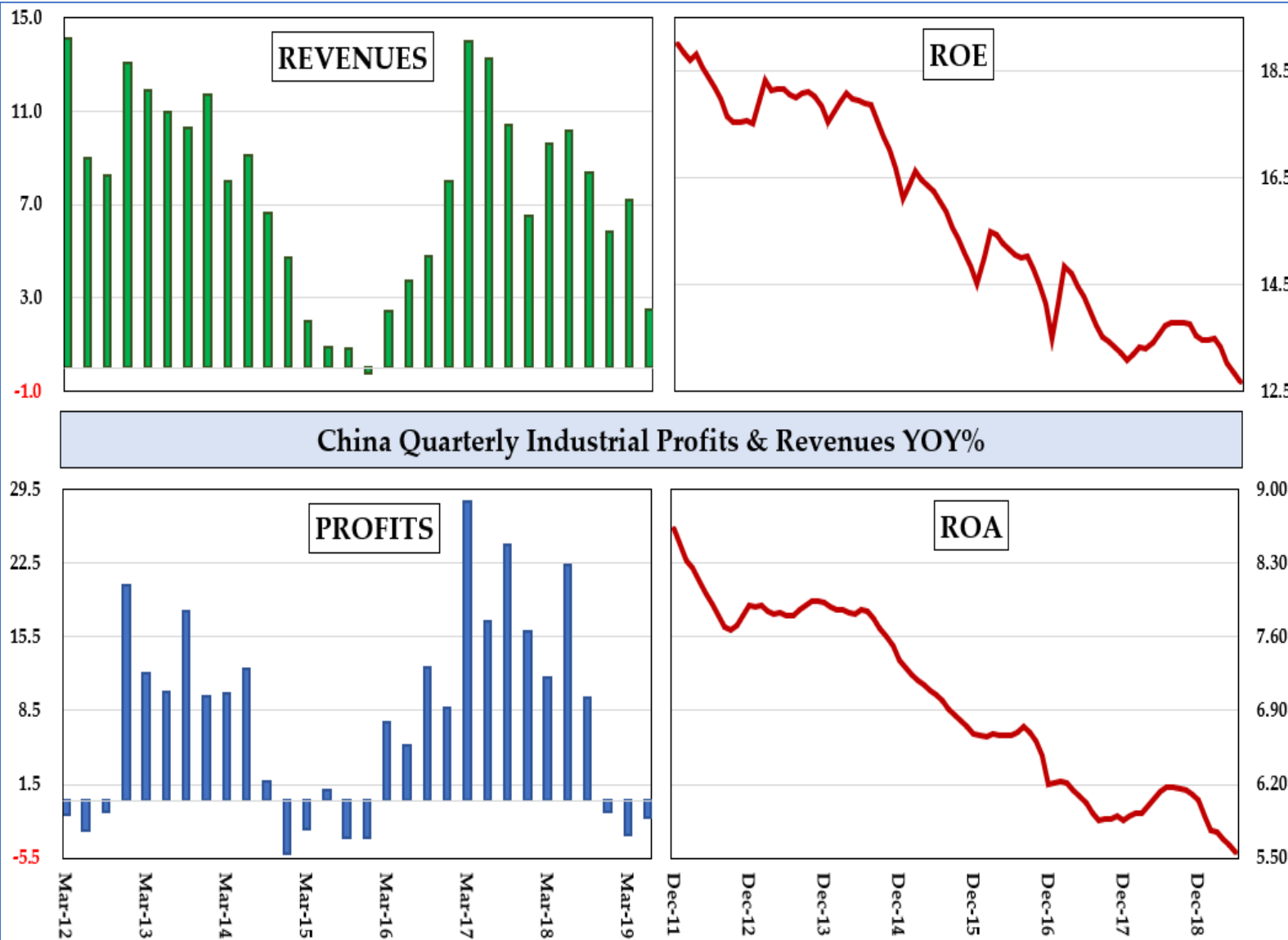
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Aug 19th, 2019

# Cantillon Effects

*Cracked China*

*Sean Corrigan @CantillonCH*

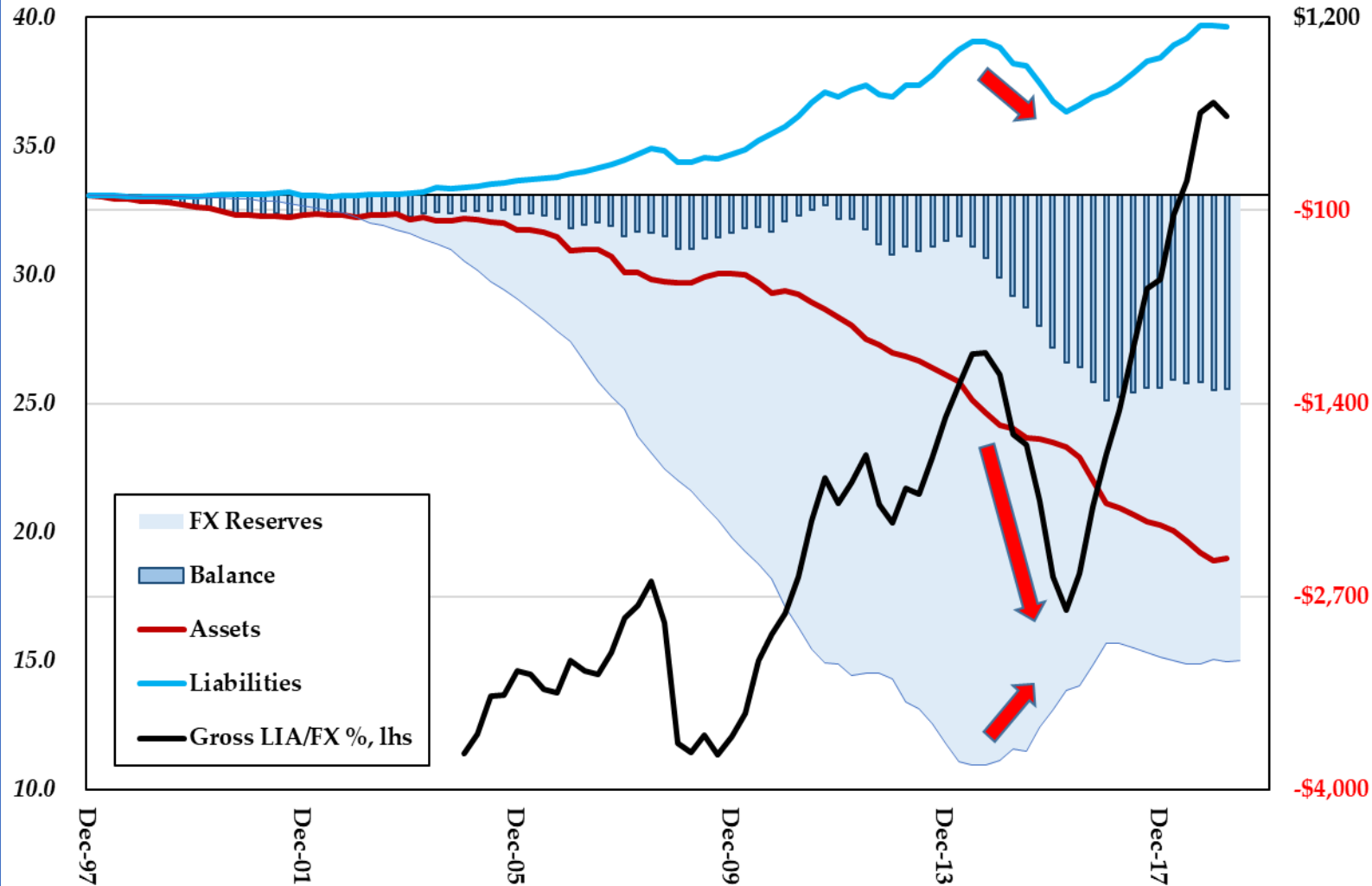


## No disguising the widespread pain in China

- Monthly company data have shown a sharp decline in recent quarters
- Revenues running at sub-3% hardly augur well for nominal, much less real, GDP (NB: Electricity use has also fallen to 2.3%YOY)
- Ostensible ROE has fallen by a third in 5 years
- High debt loads mean ROA is similarly depressed, suggesting actual ROIC is poor, too, and is probably below the cost of capital
- **MALINVESTMENT!**

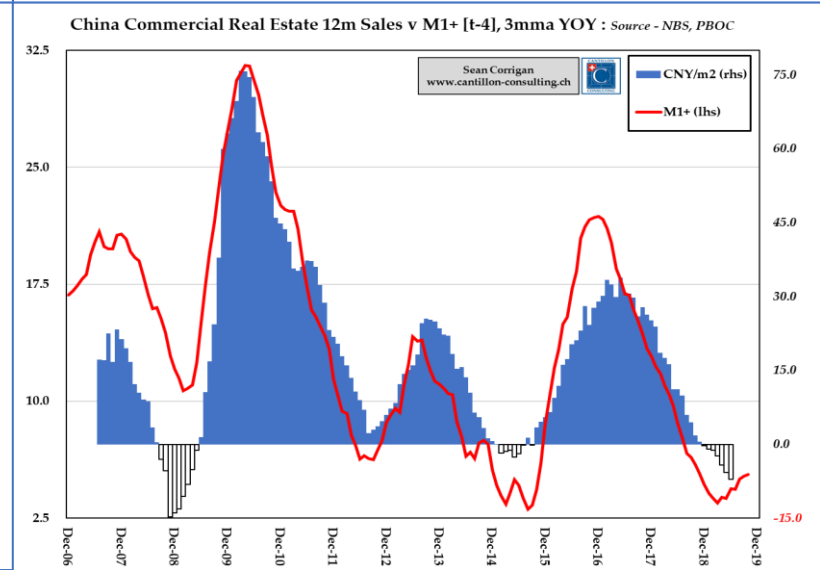
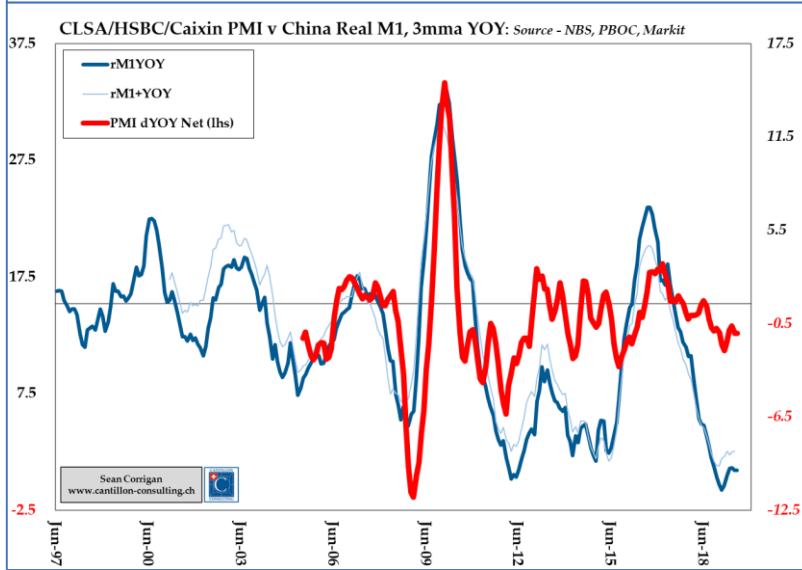
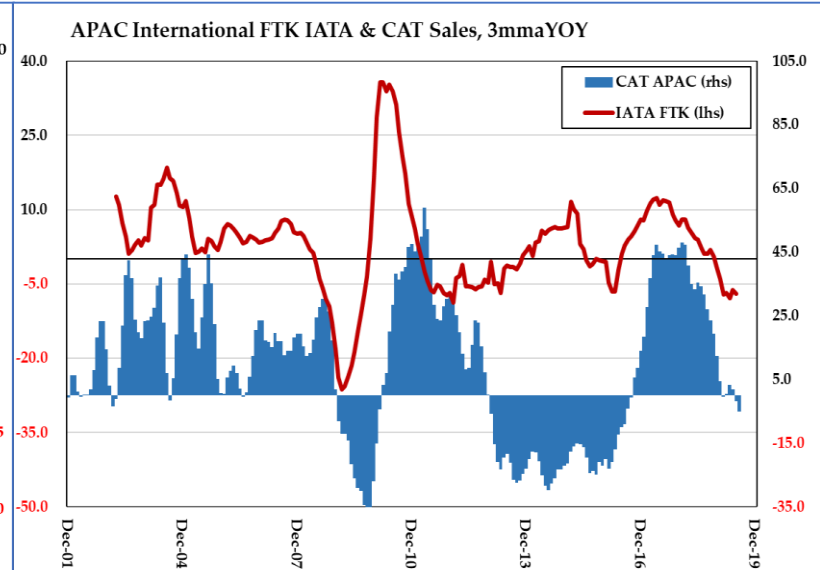
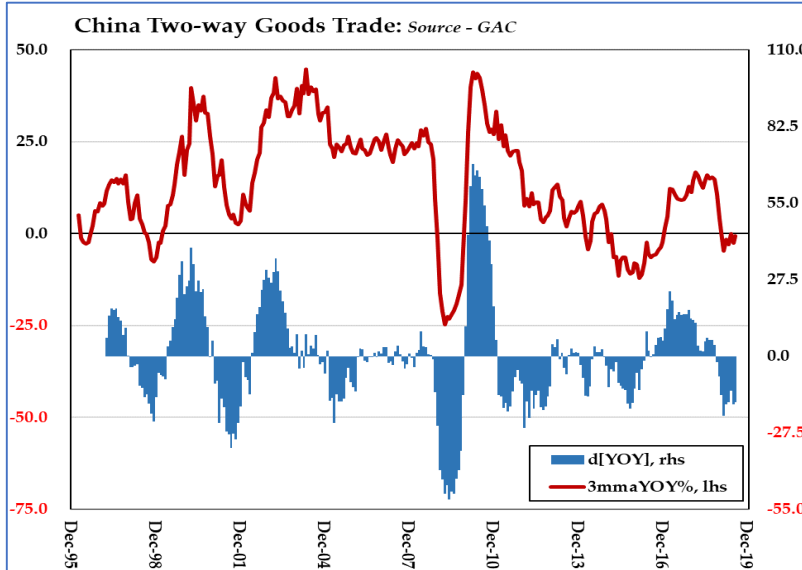
[NB: caveats apply to multi-year comparisons, not least due to selection bias of minimum business size]

China External Portfolio & Other Debt, (BOP convention), blns: SAFE



**On the external front, we don't know nearly enough, but what we *do* know is bad**

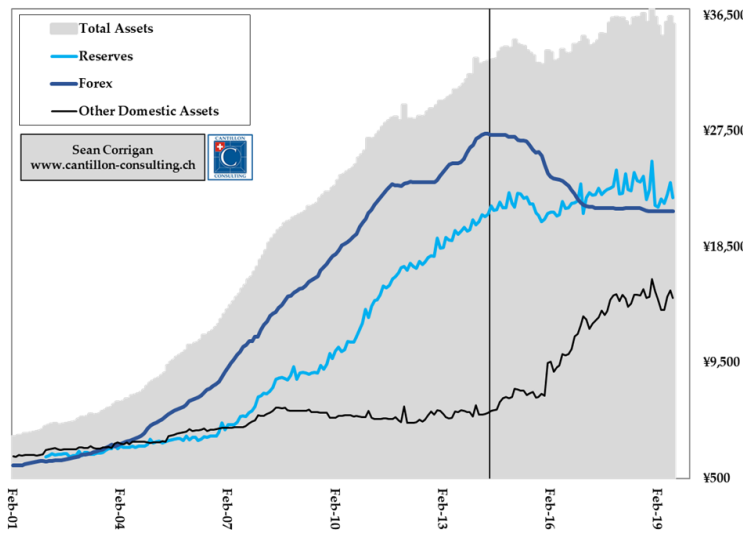
- As noted previously, over the past 5 years, China's cumulative current account surplus reached \$1 trillion – a figure almost exactly matched by the term '*Errors & Omissions*' in its BOP accounts!
- Debt is also likely to be misreported, too, but what we *are* told shows that external lending has been neatly matched by external borrowing for over 2 years, thus increasing leverage.
- We can also see that gross external debt has jumped to a significant new high as a fraction of reported reserves. Not pretty!



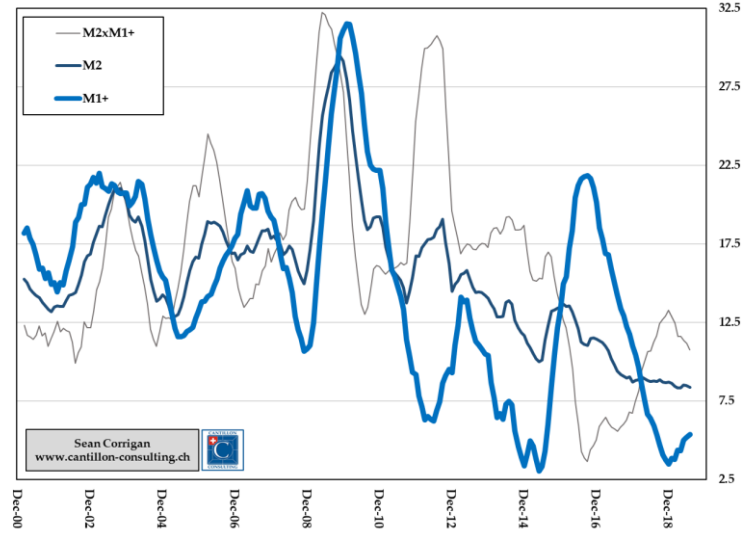
**Yes, trade has suffered, but domestic problems abound**

- Tariff war effects are real, but are also masking underlying, domestic difficulties
- Residential RE has seen turnover dwindle (with rising prices hinting this is biased towards the lower end)
- Commercial RE is already in a slump amid multiple business failures and widespread reports of soaring vacancy rates in key centres
- As ever, money & credit lie at the root of the problem

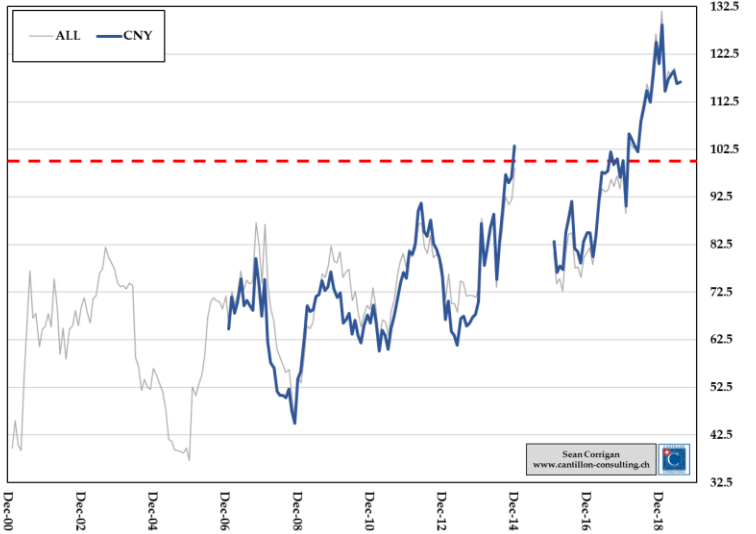
PBOC Balance sheet (billions): Source - PBOC



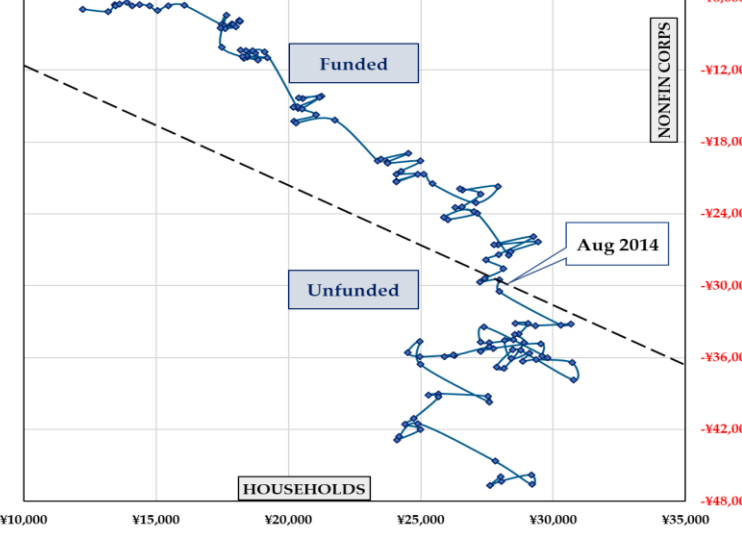
China Money Supply, 3mmaYOY%: Source - PBOC



China Marginal 12-month CNY Loan: Deposit %: Source - PBOC



2008-18 China NFC & Households: (Deposits - Bank Loans), blns: Source - PBOC

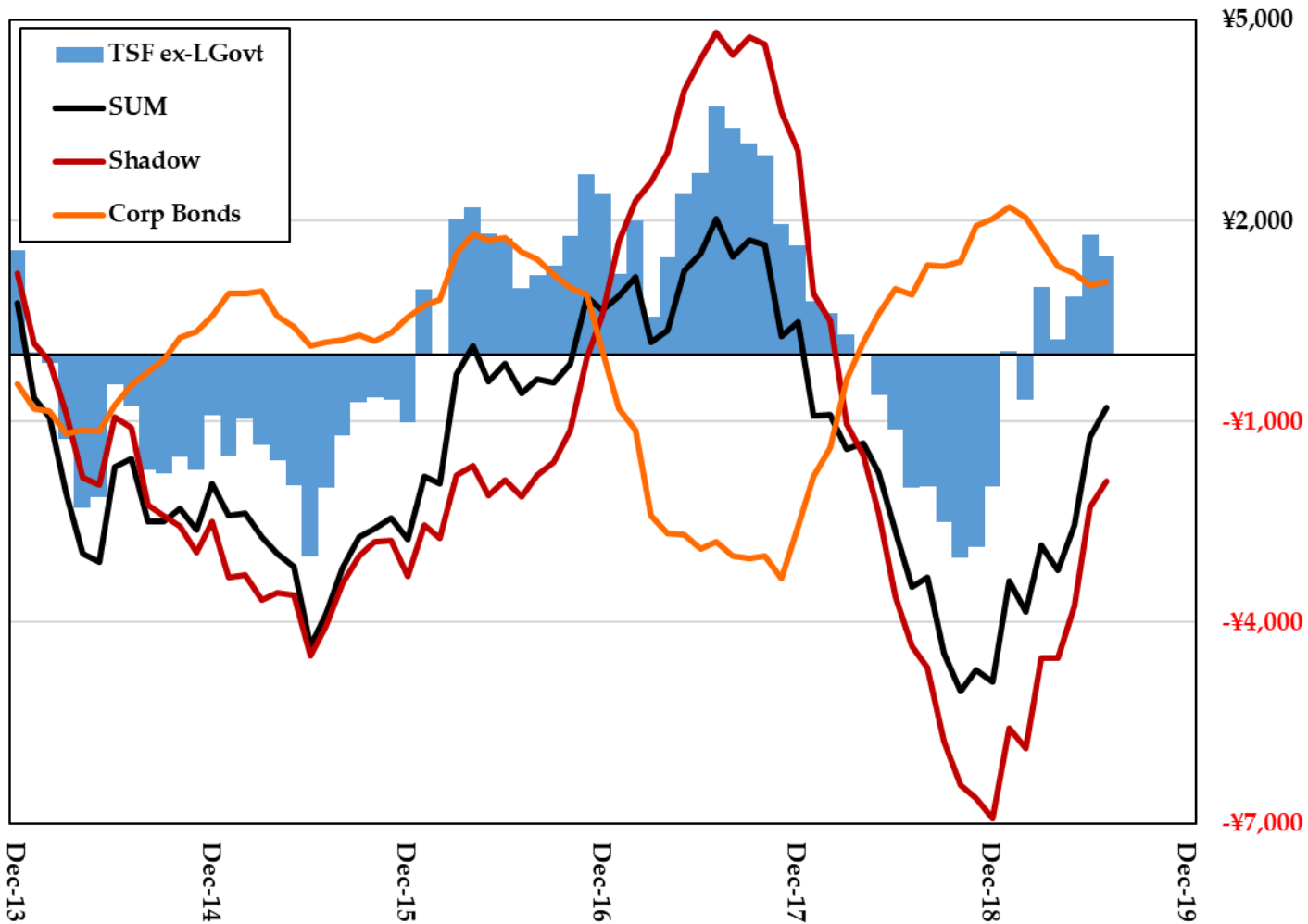


## The financial system is under strain

- PBOC has recently relied on RRR cuts & firefighting operations rather than massive balance sheet expansion
- Banks, however, face two different problems: the inability to attract deposits & a shortage of capital
- Slowing money growth reflects the former, as does a rapidly rising loan:deposit ratio
- With private-sector bank savings clearly insufficient to fund its own needs, and the state a heavy net borrower, non-bank finance becomes of added importance



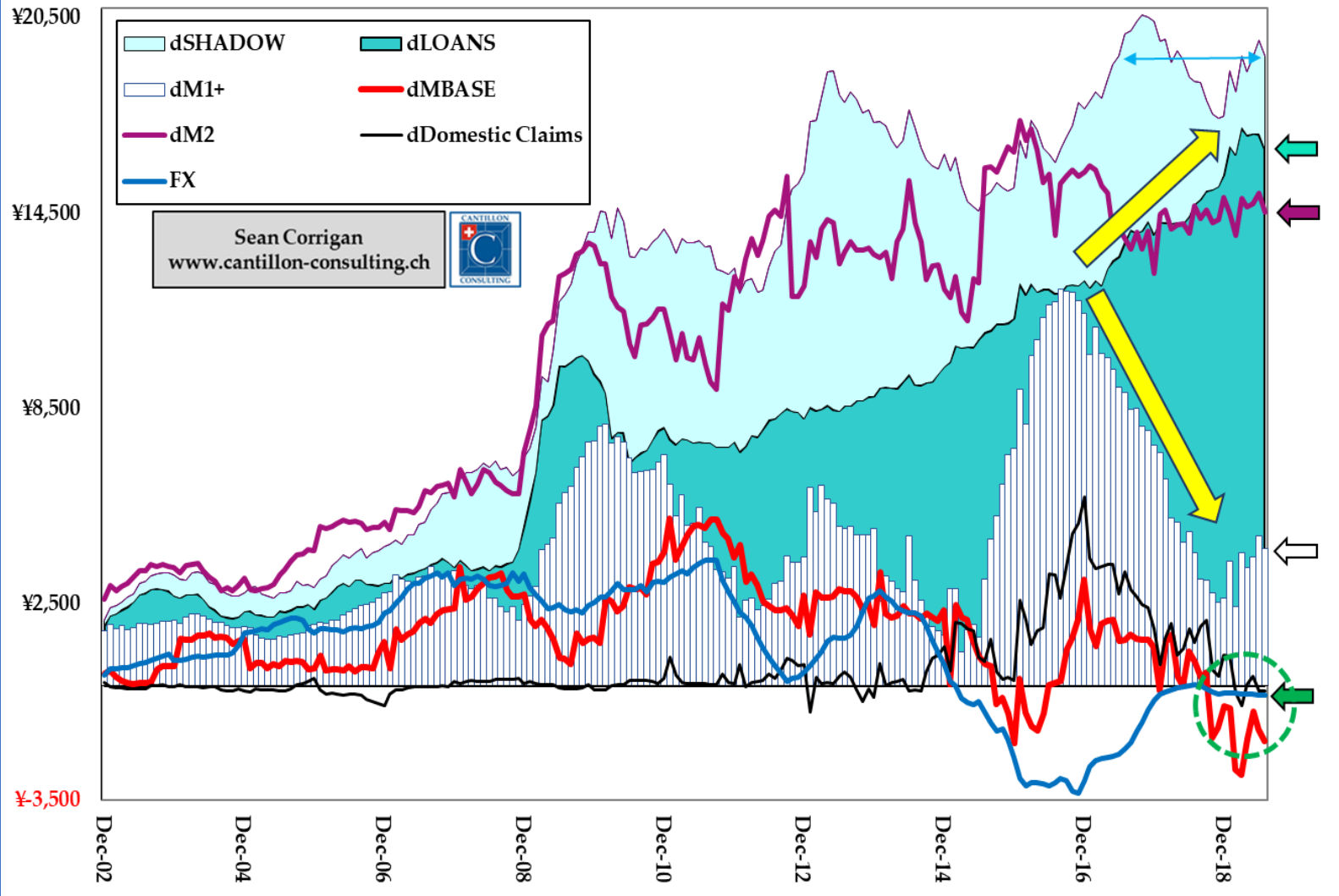
China financing, 12mos increments YOY, blns: *Source - PBOC*



## But, other forms of finance are a shadow of their former selves

- Unfortunate, then, that the authorities have led an assault on non-bank credit
- The magnitude of boom and bust (shown here by changes in 12-month additions of such funds) are truly remarkable. 'Stop - Go' hardly does them justice
- Though bond issuance moves counter to 'shadow' usage, it is of lesser magnitude, plus access to it is much more narrowly focused
- Weakness in autos and real estate, as well as spill-overs to other sectors have been worsened, as a result

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



## Last month's numbers were notably weak

- Not shown on this attempted synthesis of the previous arguments is the poor composition of last month's credit numbers
- Out of a TSF total of CNY1,011bln, no less than 43% was due to local government issuance, with almost all the rest going to households
- That left precious little to grease the wheels of productive activity.
- The economy is undeniably in dire straits.
- Corporate malfeasance, banking bail-outs, soaring food prices, a stalled property market, job losses, the HK protests: political knives will be sharpening



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