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iFlow

MACRO MORNING BRIEFING

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China: Faltering Credit Growth & Demand

The latest July inflation and credit data continue to suggest tepid and sluggish demand. China headline CPI for July rose more than expected to 0.5% y/y from 0.2% y/y in June, with a month-on-month increase of 0.5% after two monthly declines in May and June. Core inflation dipped to 0.4% y/y matching the lows of the year in January 2024. While further recovery of food (0% y/y) and pork (+20.4% y/y) prices would exert upward pressure in the near-term, disinflation risks remain unless we see a sustained pickup in services inflation. July consumable and services items inflation stood at 0.5% y/y and 0.6% y/y, respectively, compared with -1.1% y/y and 1.0% y/y at the end of 2023 (see Exhibit #1).

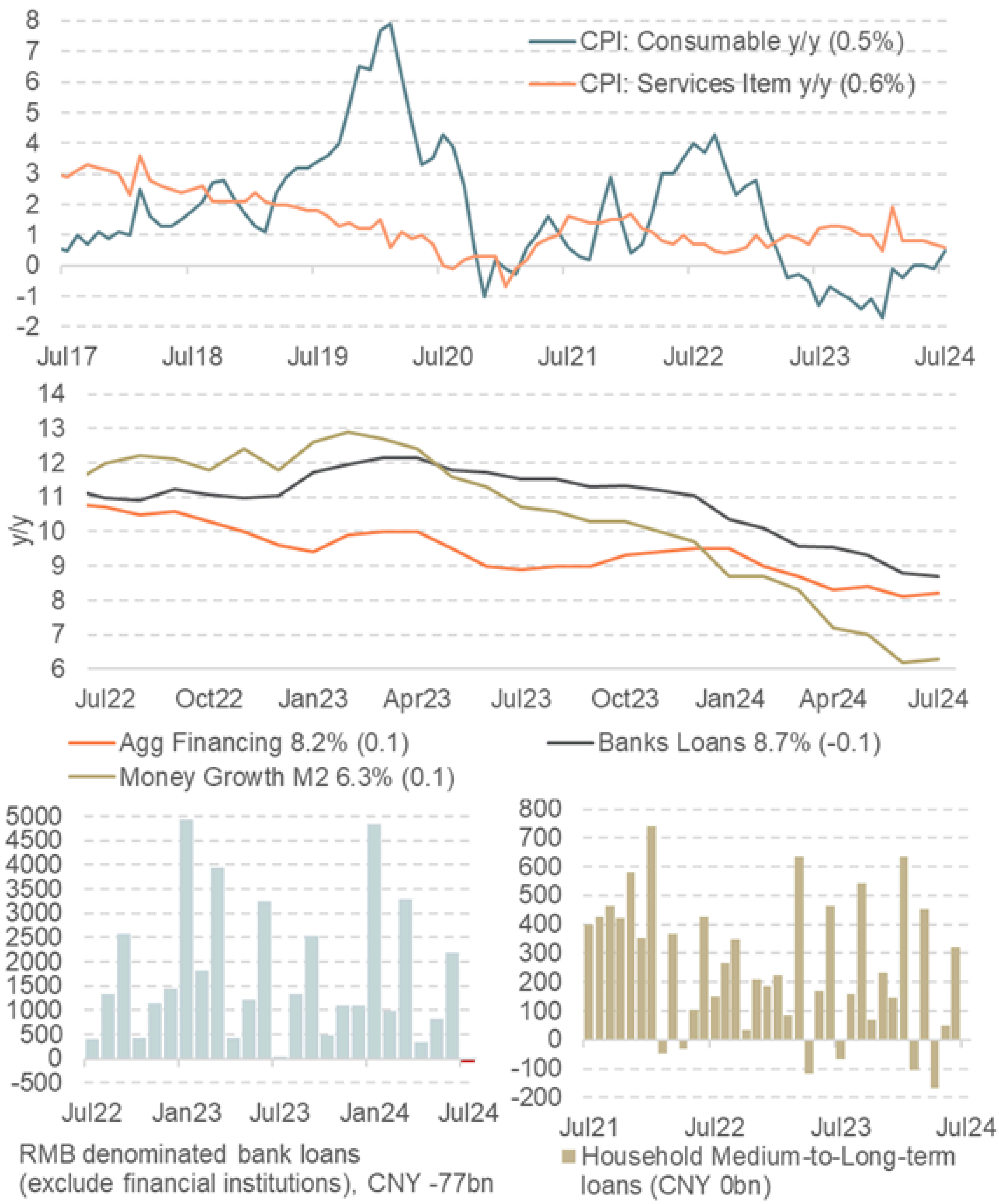
China July headline bank lending and broad credit growth rate exhibited some signs of stabilization, but the details are not promising. China's aggregate financing (AF) stood at CNY 1,8870bn year-to-date as of July 2024, up 8.2% y/y. It is primarily supported by local and national government and corporate bond issuance worth CNY 690bn and CNY 203bn, respectively. Within AF, yuan-denominated bank loans unexpectedly contract by CNY 77bn, the first time this has happened since July 2005 (CNY -31bn). There was only one other contraction month of bank loans in the available data, which was in July 2004 (CNY -1bn)

As for loans by financial institutions, July new yuan loans were CNY 268bn, or CNY 1,3530bn year-to-date. The loan growth rate eased to 8.7% y/y from 8.79% in June. Medium- to long-term household loans, a proxy for mortgage activities, were flat at zero after reaching CNY 323bn in June and CNY 51bn in May. In the context of a series of real estate sector-specific support measures, this is a clear vote of no confidence. That said, we warn against being too bearish on the sector as destocking of housing inventories is a multi-year process. As of June

2024, total residential and office floor space available for sale was 739million square meters, near 2016 highs.

The overall lack of a response to government policies is a concern. The credit transmission mechanism is broken and needs to be addressed. Supportive monetary and credit policies and ample banking system liquidity has thus far failed to stimulate credit growth or boost sentiment.

Exhibit #1: China July Inflation and Credit Profile



Source: BNY, Bloomberg L.P.

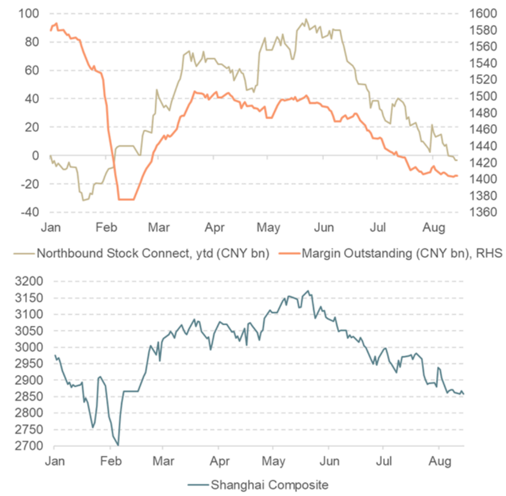
Markets and investors had been on the sideline after multiple false hopes. The long-awaited stabilization of macroeconomic data had yet to be seen, and the domestic equities market continues to lag and underperform relative to the region. For example, the recent news of the Shenzhen Public Housing Group buying unsold residential properties to turn into affordable rentals only managed to spark a brief one-day rally of the CSI 300 real estate index before dropping back to the lower end of the range.

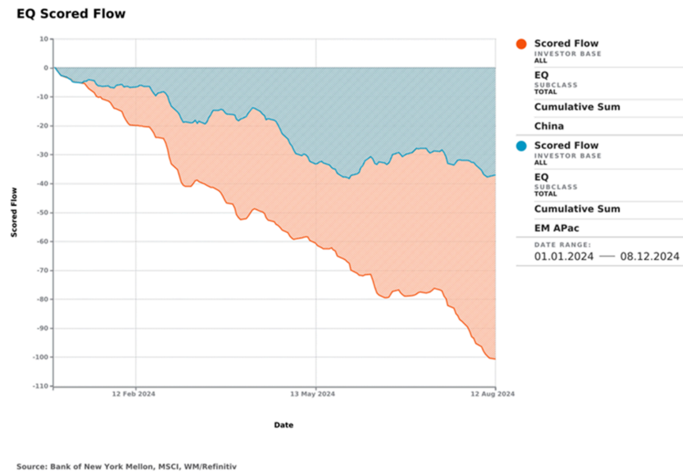
Recent interest rate reductions to both the 7d reverse repo benchmark rate to 1.70% (-10bp) and the 1yr Medium-Term Lending Facility (MLF) to 2.30% (-20bp) sparked a surge in demand for sovereign bonds, but a lackluster reaction in the equities market. We are concerned about the negative feedback loop between market prices and investors sentiment.

Foreign investors and domestic sentiment toward equities remains fragile. Northbound Stock Connect flows, a proxy for foreign investor demand, net sold CNY 25bn month-to-date to bring the cumulative year-to-date total back into negative territory. Northbound Stock Connect year-to-date flows were net sold as much as CNY 31bn at the beginning of the year. China stock exchange margin trading outstanding has shown a persistent unwinding since May, irrespective of equities performance. Lastly, BNY iFlow equities data show accelerated equity outflows in July despite overall steady flows within the EM APAC region. (see Exhibit #2).

The second half of the year will be challenging, with market and macro stabilization being the top priority. China, in the latest Q2 monetary policy implementation report, has made clear that further easing and reform are on the cards, including steadily lowering companies' financing and household credit costs and China government bond trading as part of PBOC's open market operations (OMO).

Exhibit #2: Foreign Investors and Domestic Flows in Chinese Equities





Source: BNY, Bloomberg L.P.

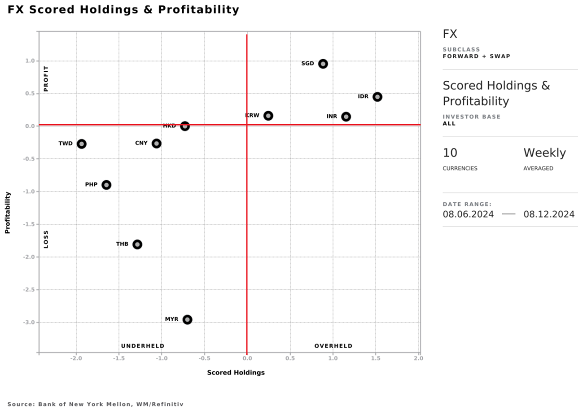
Despite heightened global market volatility over the past week, capital flows, as measures by iFlow, were relatively muted. iFlow data reveal mixed and moderate flow ranges from weekly average scored flows of +0.7 inflows in INR to -0.4 outflows in THB. Elsewhere, notable flows included accelerated inflows in IDR and KRW against outflows in MYR.

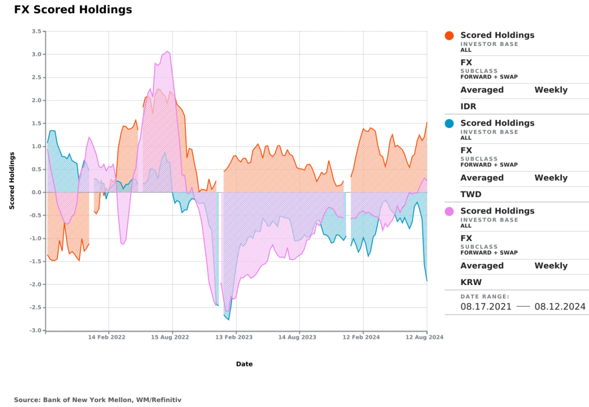
Scored holdings and profitability profiles showed a clear distribution into the overheld, profitable and underheld, unprofitable quadrants, suggesting the increasing USD as a dominant force. MYR is the most unprofitable currencies in APAC and within iFlow Universe on the back for substantial MYR rallies over the past week.

There are a few interesting observations. First, IDR scored holdings reached new 2024 highs despite ongoing market concern about Indonesia’s fiscal condition. Indeed, iFlow data have seen steady demand for equities but limited outflows in Indonesia bonds. KRW and TWD scored holdings diverged significantly. Strong KRW inflow momentum pushed KRW into overheld territory for the first time since October 2022. TWD, with a similar tech profile as KRW, suffered sharp outflows over the same period. TWD fell deeper into underheld territory, with its scored holdings at the lowest level since early 2023 (see Exhibit #3). Strong inflow momentum led INR scored holdings to reach multi-year highs, suggesting a low hedge ratio on the back of an Indian sovereign bond buying spree.

Elsewhere in China, flows suggest persistent outflows of equities, and investors became sellers of Chinese sovereign bonds for the first time in eight weeks.

Exhibit #3: Divergence within APAC Currencies Scored Holdings





Source: BNY, Bloomberg L.P.

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

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