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China Economics Update: Credit growth eases in July as PPI remains elevated

中国经济评论: 信贷增速放缓，工业品通胀仍然强劲

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7 月信贷数据低于预期：社会融资（TSF）在前两月回稳之后 7 月再次放缓，同比增速 10.7%。房屋贷款和政府债券是此次信贷增速走弱的主要驱动因素。影子银行信贷也继续收缩。

PPI 保持高位，CPI 通胀温和：7 月 PPI 保持高位。近几个月国内保供稳价政策对金属价格产生一定影响，然而全球复苏势头依然强劲，供应持续受限，因此 PPI 仍将承受上行压力。核心 CPI 因季节原因温和加速，整体来看 CPI 通胀由于食品价格下降仍保持温和。

央行致力于保持货币政策的稳定。在最新的季度报告中，央行表示政策前景稳定。Delta 病毒变体的传播是近期一个关键的风险点，宽松政策也因此可能会持续更长时间。但如果疫情情况显着恶化，财政支持可能会增加。我们认为长期利率的下行空间有限。

July credit data below expectation reflecting slower housing market and government borrowing. China's total social financing (TSF) growth rose 10.7% in July, down slightly after stabilizing at 11% for the prior two months. The easing in mortgage borrowing and government bond issuance were the main drivers of the deceleration. Shadow banking credit also continued to contract.

PPI inflation stays high; muted CPI inflation. PPI remained elevated in July. In recent months, the domestic policy of ensuring supply helped to curb price increases, especially those of metals; however, solid global recovery momentum and persistent supply constraints continued to put pressure on PPI. Core CPI has picked up in part due to seasonal factors yet overall CPI pressure is muted due to falling food prices.

PBOC committed to a stable monetary policy. In the latest quarterly report, the PBOC indicated a stable policy outlook. The spread of the Delta COVID-19 variant is a key near-term risk that may see easier policies for longer, though fiscal support is likely to be ramped up if the pandemic situation worsens significantly. We see limited downside to the long-term interest rate.

TSF below expectation

Total social financing rose 10.7% YoY in July 2021, a slight decline after 11% growth for the past two months (Fig 1). New TSF increased by RMB1.06t, 37% less than the level in July 2020 and below market consensus for RMB1.5t (Fig 2). Overall, credit growth resumed the slowdown trend after temporarily stabilizing last month.

- New yuan **loans** increased by RMB1.08t, in line with the market expectation (consensus: RMB1.09t). Medium- and long-term loans increased by RMB891b, lower than previous month (RMB1.35t) and July 2020 (RMB1.2t). Household ML loans increased much less than they did in the same period last year; growth slowed down to 16.1% (vs 16.9%YoY in Jun) as a result of tighter property measures. On the other hand, corporate ML loan growth remained steady (13.8% YoY in Jul vs 13.7% YoY in Jun. New short-term loans including bills financing contracted by RMB72b.
- Outstanding **corporate bonds** grew 6.9% YoY, a 0.2 ppt increase from the prior month. Outstanding corporate bond growth has been easing steadily over the past 12 months, partly due to the base effect. Meanwhile, we saw successive rounds of policy measures designed to contain leverage, particularly in real estate. In the past two months, new corporate bond issuance appeared to have stabilized, though we do not expect the momentum to recover to what it was in 1H20 when monthly average net issuance eclipsed RMB500b.
- Total renminbi loans and corporate bonds, which represent credit to the private sector, eased 0.2ppt from the previous month to 11.6% YoY in July.
- **Government borrowing,** including outstanding CGB and LGB, grew 16.1% YoY, having gradually declined from Dec 2020 when government borrowing peaked at 22.6%. Despite the decline, government borrowing was still the fastest growing of the major TSF items

- **Shadow banking** items (entrusted + trust + bills) continued to decline, with the pace of the decline accelerating in July, offsetting relative steady borrowing by the private sector, causing total TSF growth to ease further.

M2 growth softened. M2 grew 8.3% YoY in June, somewhat slower than 8.6% YoY in June and lower than the market expectation (consensus: 8.7%). M1 growth eased 0.6 ppt to 4.9% YoY. The development of M2 was consistent with lower new loans in July and further easing in credit growth (Fig 3).

PPI accelerated again; CPI pressure contained

July PPI inflation accelerated again. PPI grew 9.0% YoY (consensus: 8.8% YoY), compared with 8.8% YoY in June. On a sequential basis, July PPI rose 0.5% MoM after easing to 0.3% MoM in June. The price of producer goods rose 0.6% MoM, an increase of 0.1 ppt from the previous month, driven by faster price increases in the mining sector, (up 5.2% MoM in July vs 3.9% MoM in June, and raw materials, up 0.8% MoM in July vs 0.2% MoM in June). Consumer goods prices remained contained, growing only 0.1% MoM, consistent with the average growth rate for 1H21.

With the domestic policy of ensuring supply while stabilizing prices, the growth rate of input prices in metal-related industries slowed in the last two months. Take, for instance, ferrous metal materials, which rose 1.1% MoM in July compared with a 1.7% MoM increase in June, and non-ferrous metals and electric wire, unchanged in July compared with a 0.7% MoM increase in June. However, under the combined effect of internal factors (carbon neutralization policies) and external factors (still elevated international commodity prices, particularly the oil price rebound in late July), PPI pressure remains elevated. While the base effect will gradually fade in 2H21, PPI is likely to stay resilient over the rest of the year, averaging around 9.0% for both 3Q and 4Q.

Core CPI inflation turns up again. July CPI rose 1.0% YoY, higher than the market expectation (consensus: 0.8% YoY). On a sequential basis, CPI inflation rose 0.3% MoM after contracting for four consecutive months. Food prices continued to contract with a decline of 0.4% MoM, though the pace was slower than it was in previous months. Non-food and service prices both increased at an accelerated pace: 0.4% MoM and 0.6% MoM, respectively. Core CPI inflation, excluding food and energy, picked up 0.3% MoM after contracting 0.1% MoM in the previous month.

By industry, prices for transportation and communication as well as education culture & entertainment rose relatively faster than others, by 1.5% MoM and 1.0% MoM, likely due to rising service demand over the summer holidays. Overall, China's CPI YoY price pressure remained limited thanks to falling food prices, but core CPI has continued to recover.

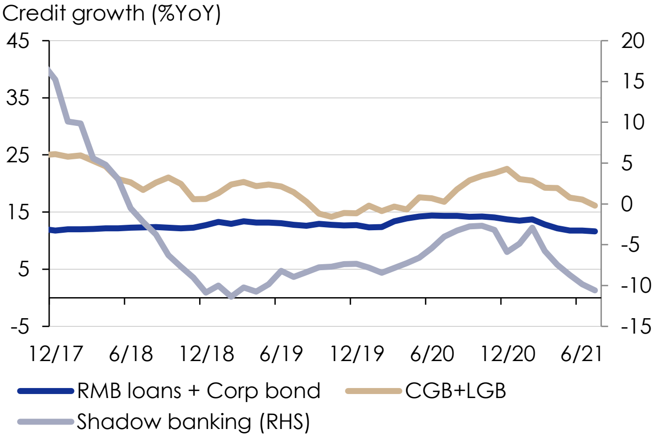
Our view

PPI inflation pressure to persist for the rest of the year while CPI inflation is kept under control. PPI pressure so far has concentrated on producer input and output prices for mining, raw materials, and upstream manufacturing goods. Pass-through to the downstream, including consumer products, has been limited. Elevated commodity prices led to a series of administrative measures from China's top authorities, helping to contain price increases since June. Nonetheless, with solid global recovery momentum and persistent supply constraints, it is likely that commodity prices will stay elevated, at least in the near-term, keeping pressure on PPI inflation for rest of the year.

On the CPI front, while headline inflation has so far benefited from declining food prices, core inflation is picking up, partly supported by seasonal patterns. While we expect manufacturing price pressure to stay strong, travel restrictions imposed in some of China's major provinces amid the spread of the Delta variant could jeopardize the recovery in services in the near term. We thus expect headline CPI inflation in the remainder of the year.

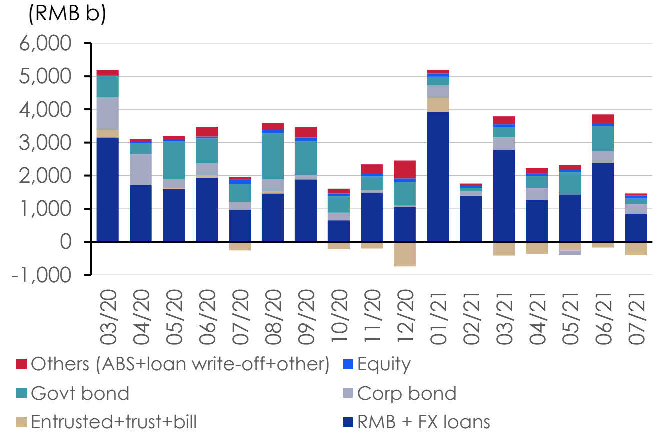
Central bank to keep monetary policy stable. In the quarterly report released this week, the PBOC stated it will maintain a stable monetary policy while making it more forward-looking and effective in order to render more support to the real economy while avoiding "flood-like" stimulus. The PBOC report indicates the intention of the central bank to pay more attention to inflation, and likely a preference for targeted policy support (For details on the impact of continued easing, see *The Big Picture: Stable policy signals; what's next for liquidity?*, 1 August 2021). A wider spread of the Delta pandemic variant represents a key near-term risk that could see more liquidity easing and additional RRR cuts in the coming months. However, fiscal support may be a more direct tool for providing targeted support, implying limited downside to long-term rates.

Fig 1: TSF growth eased again in July as lending to the private sector remained relatively stable



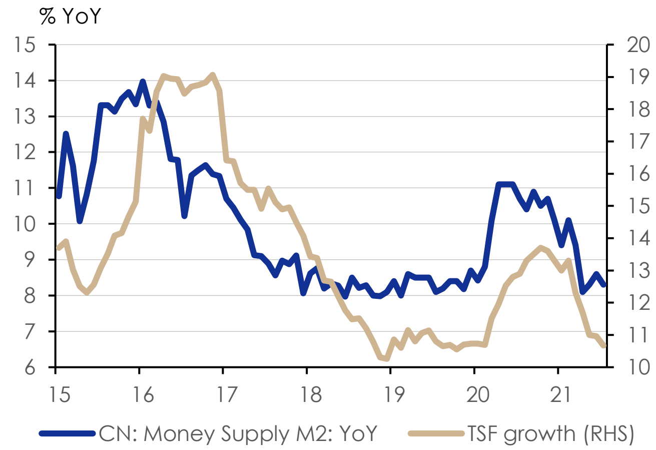
Source: CEIC, CCBI

Fig 2: New loans were below the level in the prior month and Jul 2020, despite the effects of seasonality



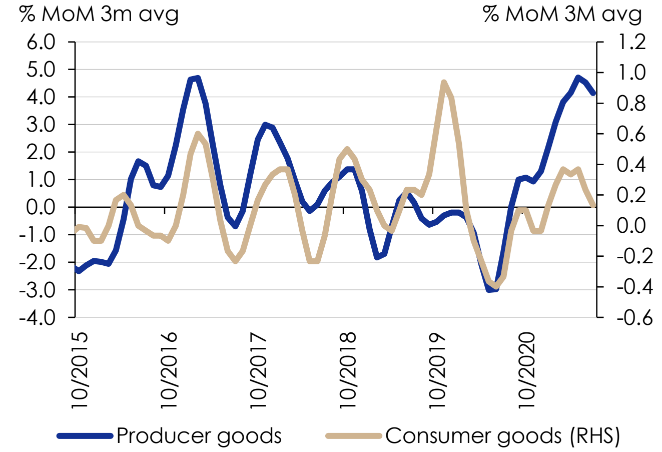
Source: CEIC, CCBI

Fig 3: M2 softened on lower-than-expected new loans and easing credit growth



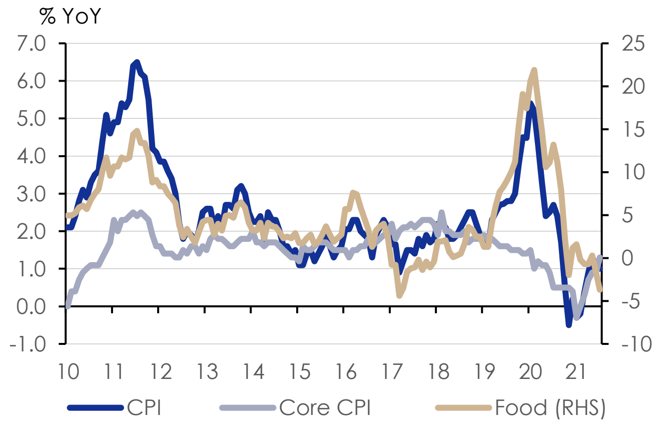
Source: CEIC, CCBI

Fig 4: PPI price pressure remained elevated for producer goods, with limited feedthrough to consumer goods



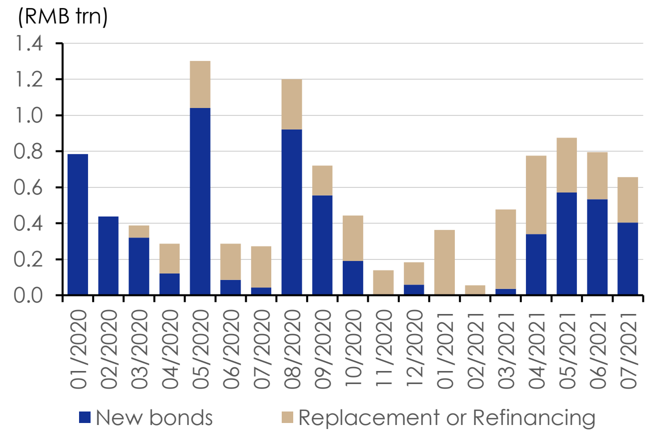
Source: CEIC, CCBI

Fig 6: Core CPI accelerated partly due to seasonal factors



Source: CEIC, CCBI

Fig 7: New LGB issuance fell short of annual quota; possibility of rising supply to support growth going forward



Source: CEIC, CCBI

Rating definitions:

Outperform (O) – expected return > 10% over the next twelve months
Neutral (N) – expected return between -10% and 10% over the next twelve months
Underperform (U) – expected return < -10% over the next twelve months

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