China: Credit growth limited by deleveraging reform

Although China's aggregate finance grew at a slower pace than last year, yuan loan growth was faster than a year ago, showing that shadow banking has continued to shrink. Together with deleveraging reform, this suggests that financial market risks are under control. We expect no change in monetary policy for 2021

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Credit data matches deleveraging reform on real estate developers

China's total credit grew by CNY3.34 trillion in March and CNY10.24 trillion in 1Q21, down CNY873 billion from 1Q20. But yuan loans grew by CNY7.91 trillion in 1Q21, which was an increase of CNY659 billion from 1Q20.

The difference comes from a fall in shadow banking activities, including trust loans, entrusted loans, and less funding raising from corporate bonds and stocks.

This shows that China is in the midst of deleveraging reform, and will not expand credit in 2021.

Smaller shadow banking together with deleveraging reform suggests that financial market risks are under control.

The deleveraging reform started with real estate property developers in early 2021, and there have been added regulations on how banks lend to these developers. Together with moves to shrink shadow banking businesses, this deleveraging reform should help real estate property developers to reduce debt. This is also important to the health of the financial sector in China because real estate property developers have borrowed heavily in the past.

> *"Smaller shadow banking together with deleveraging reform suggests that financial market risks are under control."*

Liquidity was tight, but returned to normal after the Two Sessions

The increase in undiscounted bills of CNY325 billion in 1Q21 shows that liquidity in 1Q21 was tight as undiscounted bills have a function similar to cheques between corporates. The increase in undiscounted bills reflected higher demand for cash like credit. The tightness mainly came in January and ended in early March. The tone set by the Two Sessions in early March of a balanced monetary policy stance should have an impact on the central bank's daily liquidity management.

We believe that the People's Bank of China will continue to use 7D repo rate as a gauge of liquidity. We expect the 7D to hover around 2.2%, which is the 7D policy interest rate.

We expect no change in monetary policy

Before the government completes its deleveraging reform, we expect there to be no change in the PBoC's monetary policy, from the Reserve Requirement Ratio to 1Y and 5Y Loan Prime Rate, to the 7D reverse repo policy rate.

The chance of having a targeted RRR cut is also small. The economy is in recovery mode and there is no significant natural disaster, which would require such a cut. A targeted RRR cut could be justified for the agricultural sector, however, if it is affected by climate change.

Our USD/CNY forecast is 6.30 by end of the year as we expect a weaker dollar in the second half of the year.