CHINA RAPID RESPONSE

Bank Lending & Broad Credit (Jul.)

Downturn deepens as borrowers hold back

- **China's bank loan growth fell to its lowest in seven months in July, while broad credit growth dropped to a record low. We expect further policy rate cuts and a spike in government bond issuance in the coming months, but unless there is a wider improvement in business and household sentiment, this probably won't lift credit growth much.**

- China's banks extended RMB346bn in new local currency loans in July on a net basis, much lower than expected (the Bloomberg median was RMB750bn and our forecast was RMB1,300bn). Aggregate financing (AFRE), the PBOC's measure of broad credit, was also well below expectations, rising by RMB528bn (Bloomberg RMB1,120bn, CE RMB600bn).

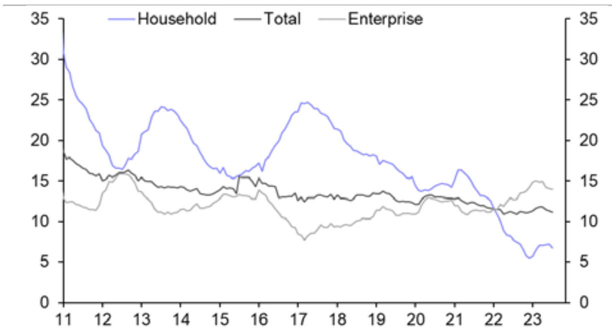
- The simplest way to cut through the seasonality of the net increase numbers is to look at y/y growth in outstanding credit. On this basis, **bank loan growth fell from 11.3% y/y to 11.1%, its lowest since the start of the year.** (See Chart 1.) This was driven by a slower expansion in both lending to corporates and households, with the latter reflecting weak mortgage demand – new home sales have reached the lowest level in more than a decade after a brief recovery at the start of the year. Although lending rates were lowered in June, the decline was too tiny to have much impact on private sector demand for bank loans.

- Turning to non-bank borrowing, growth in both government and corporate bond issuance remained unchanged, while shadow credit accelerated. **But this was not enough to offset the slowdown in bank lending.** All told, broad credit growth slowed from 9.0% y/y to 8.9%, its lowest on record. (See Chart 2.)

- The PBOC promised further rate cuts at a press conference following the dovish Politburo meeting late last month, and we expect one as soon as next Tuesday. But with the PBOC moving in increments of just 10bps, we doubt this will have much effect. Unlike in the past, when policymakers could reliably pump-up credit simply by relaxing quantitative controls on bank lending, the constraint now is weak credit demand. **Reviving demand would require much larger rate cuts than the PBOC is accustomed to, or for regulatory measures to succeed in restoring confidence in the housing market.**

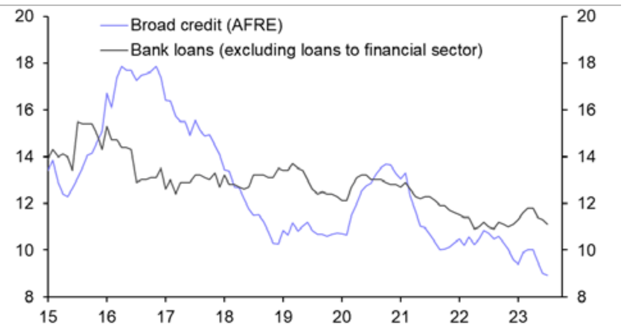
- **In the near-term, the biggest prop to credit growth will come from government borrowing.** Local officials have been told to fully utilize their annual quotas for special bonds by the end of next month, which implies a short-run spike in issuance. But unless policymakers roll out more substantial support, the resulting uptick in credit growth is likely to be modest and short-lived.

Chart 1: Growth of Outstanding Bank Loans (% y/y)



Sources: CEIC, Capital Economics

Chart 2: Growth of Outstanding Credit (% y/y)



Sources: CEIC, Capital Economics

Julian Evans-Pritchard, Head of China Economics, julian.evans-pritchard@capitaleconomics.com
Zichun Huang, China Economist, zichun.huang@capitaleconomics.com

TORONTO NEW YORK LONDON SINGAPORE

Email **sales@capitaleconomics.com** Visit **www.capitaleconomics.com**