

CHINA REACT: Shadow Lending Slump Shows Deleveraging Picking Up  
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(Bloomberg Economics) -- OUR TAKE: A surprisingly large slump in new credit in May suggests China's deleveraging agenda is gaining traction. The drop in shadow bank lending was particularly sharp. It's that area where we'd expect policy makers to focus their deleveraging efforts at first, as it's the most opaque and riskiest segment of credit. In contrast, bank loans were relatively stable. Overall, expansion in outstanding credit slowed further -- implying a slightly heavier drag on growth.

The economy has been surprising resilient this year, buoyed in part by solid global demand. Our view though, is that growth will slow in 2H, as headwinds from credit, slowing exports, and a cooling property sector become stronger. The push to curb credit growth even as risks from trade tensions with the U.S. rise suggests strong determination to deleverage the economy. We expect the People's Bank of China to further nudge up rates on its policy tools -- the reverse repo and medium-term lending facility -- to buffer the shock from Federal Reserve tightening and advance the deleverging effort.

#### New Total Social Finance and Growth

Total social finance, China's broadest gauge of new lending and equity finance, fell to 760.8 billion yuan from 1.56 trillion yuan in April. That was the smallest amount since July 2016. It was also far below the consensus estimate of 1.3 trillion yuan and 1.06 trillion yuan in May 2017. The 799.7 billion yuan decline in total social financing was about four times the size of the average drop of 189.7 billion yuan in the same month over the past five years.

#### Credit Growth, Local Government Bond Issuance

Looking at the increase in outstanding credit -- which has a stronger relationship with GDP growth -- the data suggest credit growth continues to slow. Outstanding credit to the private sector rose 10.3% year on year in May, down from 10.6% in April and a recent peak of 12.4% in the summer of 2017. Taking account of local government bond issuance, credit growth fell to 11.8% from 12.2%.

#### Total Social Financing by Category

Looking at the details, the composition of lending continued to shift toward on-balance-sheet lending from off-balance sheet:

\* New bank loans denominated in yuan totaled 1.14 trillion, up slightly from 1.1 trillion in April. The 41.3 billion yuan rise was slightly below the average increase of 98.1 billion yuan recorded in the same month over the past five years.

\* The stock of shadow bank lending -- entrusted loans, trust loans, and back acceptances -- dropped across the board. The total fell 421.5 billion yuan, the steepest monthly drop in data available back to 2016.

\* Net financing of corporate bonds contracted by 43.4 billion yuan, after an increase of 377.6 billion yuan in April. Rising defaults have hit sentiment in the bond market. Equity financing was more stable, falling moderately to 43.8 billion yuan from 53.3 billion yuan.

\* Recent policy moves have been tilted toward support for bank lending. In April, the PBOC cut the reserve requirement ratio for banks. In June, it broadened the types of collateral that could be used against central bank loans.

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