THE **ASIA** ECONOMIC MONITOR

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Money growth is trending down, even taking into account the new penchant for NCD funding.

The official crackdown on shadow banking has yielded results and will impinge on GDP growth.

M1 growth is a solid leading indicator of GDP growth, and it slowed further in May.

Chinese Monetary Conditions Point to Slowing Growth into Next Year

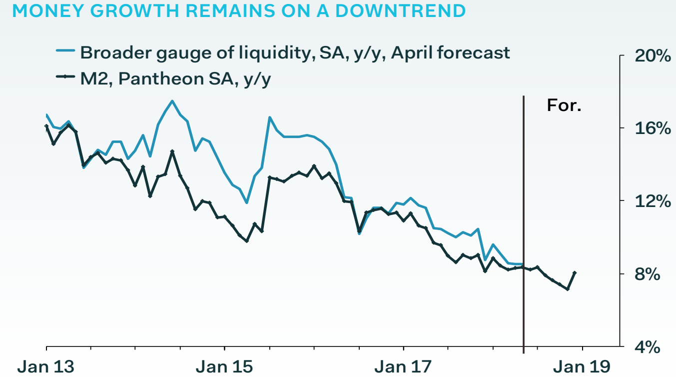
Chinese M2 growth was stable at 8.3% year-over-year in May, despite favorable base effects. Short-term measures of the trend now imply a further slowdown in the headline growth rate for the rest of this year. *This continued tightening of monetary conditions bodes ill for the trend in GDP growth.*

We calculate a broader gauge of liquidity than M2, aiming to take into account as much shadow banking activity as possible. *The problem with any such gauge is that shadow banking is constantly evolving.* That generally presents less of a problem when you are looking at the liabilities side of the banking/shadow banking balance sheet than wi the asset side. Banking entities are forever coming up with ingenious new forms of lending to get around the authorities, with much of this mislabelled on their balance sheets, or simply not appearing at all. Historically, many of these activities were funded through bank lending to non-bank financial institutions in the interbank market, creating money. As a result, we include this form of bank lending in our liquidity measure.

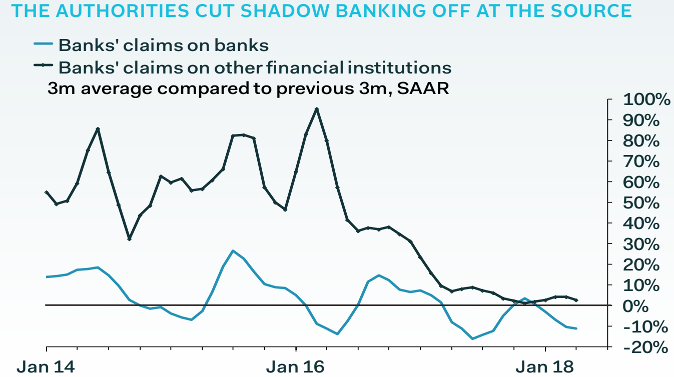
In recent years, the authorities have also realised that the best way of clamping down on shadow banking is not to rely solely on playing whack-a-mole with the various types of shadow banking instruments. Instead, officials have cut the funding off at the source, in the interbank market, capping interbank liabilities at no more than a third of each bank's total liabilities in May 2014. Initially, this worked, and is a substantial part of the reason for tightening monetary conditions. *But banks subsequently turned to Negotiable Certificates of Deposit as a source of funding, as these were not initially included in the funding ratio.*

In recent quarters, the authorities have also cracked down on the issuance of NCDs, with smaller banks now reportedly facing binding constraints. Big banks have not yet reached their regulatory limits, though, and issuance surged in Q1. We suspect that big banks somehow are taking advantage of their scope to issue NCDs, while small banks have hit the regulatory constraints. *Something fishy definitely seems to be going on with the distribution of issuance within the banking system.*

MONEY GROWTH REMAINS ON A DOWNTREND



THE AUTHORITIES CUT SHADOW BANKING OFF AT THE SOURCE



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Our broad liquidity gauge includes securities issued by the banking system, with NCDs as a subcategory. ***So at this stage we still think that our measure is picking up as much as possible of the money-creating shadow banking activities.*** On our metric, broad money growth has continued to slow, though it likely was stable in May, at 8.5%. Short-term trends point to a further slowdown later this year.

In addition, growth on our gauge is now abnormally close to the M2 measure. This suggests that the authorities have been successful, overall, in slowing money creation in the shadow banking sector. On the asset side of the balance sheet, the data also suggest that the authorities have kept the screws tight on the shadow banking operations. The flow of trust loans and entrusted loans remained negative in May, while the flow of undiscounted bankers' acceptance bills dropped below zero again, after rising in April.

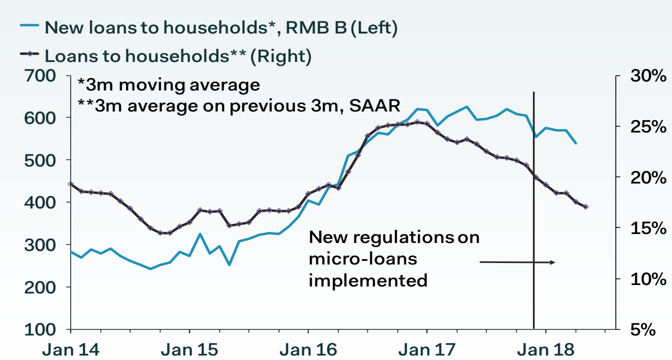
Conventional bank credit conditions also have tightened. In May, though, new loans were little changed, seasonally adjusted. Household borrowing growth continued to slow, but new loans to households remain elevated, though lower than last year. That results partly from the lagged effect of higher interest rates, a headwind which now is starting to wane. The authorities also have cracked down on micro-lending, by restricting the access of lenders to funding, starting in December last year.

The jury is still out on the results of curbs on household borrowing. ***Officials in lower tier cities still appear to be worrying about speculative investment financed by borrowing.*** As a result, they recently have imposed new regulations locking buyers in for longer, making it more difficult to flip houses. The trends in residential property prices are much more disparate across the country in this cycle than previously, though, as the engines of growth switch between cities. Residential prices in top tier cities continue to soften.

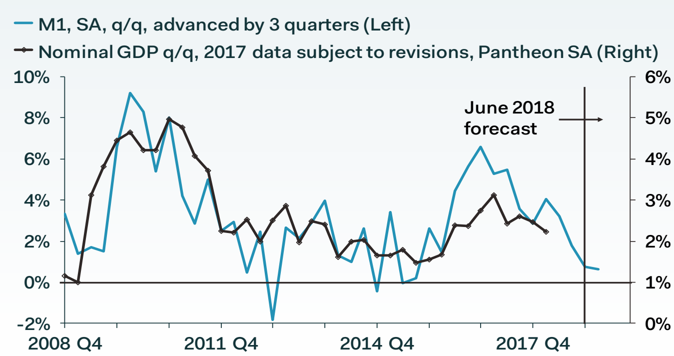
The data released yesterday also cast doubt on the durability of the nascent recovery in bond financing. The unadjusted flow of net corporate bonds has turned negative again, after a brief period of positive flow. Our seasonally adjusted measure dipped too. The prior uptick had given us the impression that the authorities were responding to the spurt of offshore issuance in the past 18 months by loosening restrictions in the onshore market. But the May data throw cold water on that, though the downshift isn't *necessarily* because of official action. The weakening of bond financing likely is largely due to widening credit spreads and greater investor wariness of the market, in the wake of a spurt of defaults.

Finally, M1 growth is a better gauge of short-term trends in economic activity than M2, and the slowdown to 6.0% in May, from 7.2% in April, paints a bleak picture of GDP growth early next year. *Overall, these data suggest that monetary and credit conditions have continued to tighten, giving a strong signal that GDP growth will trend down substantially into next year.*

HOUSEHOLD BORROWING GROWTH HAS SLOWED



M1 GROWTH POINTS TO SLOWING GDP INTO NEXT YEAR



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THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

Monday, June 11

• **Japan: Monetary Stock M2 (5) 08:50 JST**

Money growth likely was unchanged at **3.3%** y/y in May. The BoJ stealth taper seems to have dampened M2 growth, but the drag should now diminish. **Consensus: 3.3%.**

Tuesday, June 12

• **Japan: Tertiary Index (4) 08:50 JST**

The index *shot up* by **1.0%** m/m in April, after *falling* 0.3% in March, above the consensus for a 0.6% rise, boding well for a Q2 rebound in the services sector**.**

• **China: M2 (5)**

M2 growth was unchanged at **8.3%** y/y in May, below the consensus for an uptick to 8.5%, with the authorites keeping the screws on shadow banking activities.

Wednesday, June 13

• **China: PBoC**

The PBoC likely will shift the key rates in its policy corridor higher by 5bp, after the Fed hike. The authorities also are likely to cut the RRR, in the imminent future.

Thursday, June 14

• **China: Retail sales (5) 10:00 CST**

Retail sales growth likely was unchanged at **9.4%** y/y in May. The headline is spookily stable, however, and probably doesn't reflect reality. **Consensus: 9.6%.**

• **China: Industrial Production (5) 10:00 CST**

The rise in industrial production likely slowed m/m, dragging the y/y growth rate down to **6.5%** in May, after the jump to 7.0% in April. **Consensus: 7.0%.**

• **China: FAI ex Rural (5) 10:00 CST**

FAI growth should slow to **6.5%** YTD y/y in May, from 7.0% in April, as the headline continues to converge back to the underlying data. **Consensus: 7.0%.**

Friday, June 15

• **Korea: Unemployment Rate (5) 08:00 KST**

The jobless rate should be unchanged at **3.8%** in May, but should edge down to 3.7% soon after. While this should assuage any fears that the minimum wage hike has seriously damaged hiring. But the unemployment rate is due to head higher later in the year,as a result of economic weakness. **Consensus: N/A.**

• **Japan: BoJ decision**

The policy balance rate likely will be unchanged at **-0.1%**, with the 10-year yield target also unchanged at **0.0%.** But we are getting closer to an "adjustment" especially if a fourth dot emerges in Fed predictions in September. **Consensus: N/A.**

CHINA ECONOMIC FORECASTS

	q/q			y/y	
GDP	Official	PM est.		Official	PM est.
Q1 2017	*1.5%*	*1.8%*	*2015*	*6.8%*	*5.0%*
Q2 2017	1.8%	1.2%	*2016*	*6.8%*	*5.8%*
Q3 2017	1.8%	1.5%	*2017*	*6.8%*	6.8%
Q4 2017	1.6%	1.4%	*2018*	6.4%	4.5%
Q1 2018	1.4%	1.5%			

	CPI, y/y		PPI, y/y
	Headline	Non-food	Headline
Mar-18	2.1%	1.8%	3.1%
Jun-18	2.0%	1.6%	4.2%
Sep-18	1.0%	1.5%	1.9%
Dec-18	0.8%	1.3%	2.0%

JAPAN ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core*
Q3 2017	0.5%	*Mar-17*	1.1%	0.3%
Q4 2017	0.3%	*Jun-18*	0.9%	0.5%
Q1 2018	-0.2%	*Sep-18*	1.1%	0.6%
Q2 2018	0.5%	*Dec-18*	0.5%	0.7%

*Excluding food and energy

KOREA ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core
Q3 2017	1.5%	*Mar-17*	1.3%	1.5%
Q4 2017	-0.2%	*Jun-18*	1.9%	1.5%
Q1 2018	1.1%	*Sep-18*	1.6%	1.5%
Q2 2018	0.8%	*Dec-18*	1.7%	1.5%

ASIAN YIELDS

		Mar	Jun	Sep	Dec
10-year, %	China	3.75	3.75	3.80	3.80
	Japan	0.05	0.00	0.20	0.20
	Korea	2.65	2.75	2.90	2.90

ASIAN MONETARY POLICY FORECASTS

China	Mini-hikes to interest rate corridor around Fed hikes, combined with RRR cuts
Japan	Policy balance rate to 0.0% before Q4, from -0.1%; 10-year target to 0.2% from 0.0%
Korea	7-day repo rate to 1.75% in July from 1.50%.

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