China: The powerful credit expansion in January marked a major turning point

The China/greater China sector has had a stellar 1Q, with China H-shares and A-shares rallying 12.4% and 28.7%, respectively. This outperformance follows a poor 2018 with full year losses of 10% and 23.6% respectively. The strong performance, against the backdrop of Fed dovishness and US/China trade deal progress, has led to investors wondering just how long the rally will last.

Read more on page 2 >

Market Performance

Global equities as measured by MSCI World Index gained 0.28% for the week.

US markets were higher, as the Dow Jones Industrial Average fell -0.05 on the week, the S&P 500 Index though was up 0.51% and the Nasdaq Composite added 0.57%.

European equities, as measured by the Stoxx Europe 600 Index, fell -0.18% for the week while in Japanese stocks rose, the Nikkei 225 rose 0.29% and the Topix fell -1.25%.

Emerging Markets, as measured by MSCI EM index gained 0.36%, led by MSCI Emerging Europe (2.25%), MSCI Middle East & Africa (2.1%) and Russia (2.25%) while MSCI Latin America fell (-2.58%). Within Asia, the China’s Shanghai Composite Index was down for the week (-1.78%) but Asia ex China gained (KOSPI up 1.08%, TAIX up 0.94% and S&P ASX 200 up 1.13%).
China: The powerful credit expansion in January marked a major turning point

The powerful credit expansion in January marked a major turning point: the China/greater China sector has had a stellar 1Q, with China H-shares and A-shares rallying 12.4% and 28.7%, respectively. This outperformance follows a poor 2018 with full year losses of 10% and 23.6% respectively. The strong performance, against the backdrop of Fed dovishness and US/China trade deal progress, has led to investors wondering just how long the rally will last. Citi analysts expect Chinese equities to be able to reclaim the levels reached in early 2018, which is still 15-20% above end of March 2019 levels for the MSCI China and CSI 300 indices. This is based on a trio of factors:

• **Domestic stimulus policies are in place:** The real game changer for financial markets may be the large credit expansion in China seen in January 2019, aimed at boosting the economy. The CNY4.6 trillion of new aggregate financing in January was spread out among mortgages, corporate bonds, both short- and long-term corporate loans, as well as off-balance sheet financing.

• The fact that bill financing and off-balance sheet credit are seeing a comeback after a deep freeze in the prior two years should serve as further evidence that authorities desire to ease credit conditions and signals a material change in the conservative targeted easing of 2018 to a more broad based and direct stimulus.

• Also note that this was followed by China announcing at the National People’s Congress in March that it will reduce taxes and fees totaling 2 trillion yuan, or around $298 billion this year. That’s almost twice as much fiscal stimulus than originally planned. Last year, China made 1.3 trillion yuan in tax cuts as the economy showed signs of slowing amidst trade tensions with the US.

• **Chinese earnings are still growing:** Consensus EPS growth estimate for 2019 is 12%, which may be slightly optimistic. But Citi analysts believe Chinese earnings growth is likely to reach 8-10% in 2019 with the two largest contributors coming from Technology and Financials.

• Technology earnings growth is likely to be stronger than 2018, as trade war and regulatory risks are much lower. Financials can benefit from the domestic stimulus aimed at the consumer, which will help with higher loan growth, greater trading volume and better investment returns.
China: The powerful credit expansion in January marked a major turning point (continued)

- **More capital inflows to support further gains**: Citi analysts estimate that the MSCI A Share reweighting and FTSE Russell index inclusion could bring US$100bn in equity inflows from passive and active investors and a further US$110-130bn bond inflows from the Bloomberg-Barclays Global Aggregate Index inclusion.

- This secular trend is likely to continue as long as the Chinese government’s commitment to open its financial services and capital markets for greater foreign participation remains credible. This then requires authorities to ease capital control measures that could lead to sizeable inflows, leading to RMB appreciation.

<table>
<thead>
<tr>
<th>MSCI China Sector weights and Earnings Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>15-Feb-19</td>
</tr>
<tr>
<td>--------------------------</td>
</tr>
<tr>
<td>MSCI China</td>
</tr>
<tr>
<td>Comm. Services</td>
</tr>
<tr>
<td>Financials</td>
</tr>
<tr>
<td>Consumer Disc.</td>
</tr>
<tr>
<td>Real Estate</td>
</tr>
<tr>
<td>Industrials</td>
</tr>
<tr>
<td>Energy</td>
</tr>
<tr>
<td>Health Care</td>
</tr>
<tr>
<td>Utilities</td>
</tr>
<tr>
<td>IT</td>
</tr>
<tr>
<td>Cons Staples</td>
</tr>
<tr>
<td>Materials</td>
</tr>
</tbody>
</table>

Source: CitiPrivateBank. As of 5 March 2019.

- **Conclusion** - Combining valuation re-rating and earnings growth, Citi analysts expect Chinese equities to be able to reclaim the levels reached in early 2018, which is still around 15-20% above end of March 2019 levels for the MSCI China and CSI 300 indices.
China: Strong Credit Data to Reprice Easing Expectations

- **Money growth rebounded strongly** - M2 growth jumped by 0.6pp to 8.6%YoY in Mar, much higher than market expectations (Citi/Mkt: 8.2%YoY). The corporate demand for credit seemed to have improved and thereby facilitated the process of money expansion. Meanwhile, M1 growth passed the low point in Jan and continued to advance from 2.0% in Feb to 4.6% in Mar. The corporate sector’s cash flows have been recovering well after the CNY.

- **New RMB loans far exceeded expectations** - An RMB1.69trn increase in bank lending beat market expectations significantly (Citi/Mkt: RMB1.3/1.25trn). Corporate appetite for credit seems to be recovering. New bill financing almost halved to RMB97.8bn after the regulator moved to curb bill arbitrages earlier.

- **New TSF more than tripled as non-bank financing also improved** - New TSF posted RMB2.86trn in March vs RMB703bn in February, RMB1trn more than expected (Citi/Mkt: RMB1.8/1.85trn). Growth in outstanding TSF quickened by 0.5pp to 10.6%YoY in March. Adding local government bonds, adjusted TSF growth advanced by 0.6pp to 11.7%YoY.

- The broad credit impulse seemed to have sustained the recovery since January. Besides strong bank lending, total off-balance sheet lending increased by RMB82.4bn in March vs RMB364.9bn in February while corporate bond financing increased by RMB327.6bn vs RMB80.5bn in February. In the meantime, special local government bond issuance rose to RMB253.2bn vs RMB77.1bn in February.
China: Strong Credit Data to Reprice Easing Expectations (continued)

• The strong financial data with improved structure points to a recovery of credit demand and may lower the chance for near-term easing moves - The PBoC made a series of efforts to support growth in December and January, including the launch of TMLF and cuts to RRR. That broad credit growth has bottomed out strongly shows that the monetary apparatus is working. Meanwhile, financial conditions seem to have loosened substantially year to date due to strong equity performance.

• In the view of Citi analysts, the current priority for the PBoC is to enhance policy transmission and channel existing liquidity within the banking system to the real economy, especially SMEs and POEs, while outright easing efforts can be delayed. Citi analysts tend to think the PBoC will use other tools rather than a RRR cut to replenish liquidity when a sizable RMB367bn in MLF expires on Apr 17th.

• Over the medium term, the likelihood for more aggressive moves like interest rate cuts has also declined. Other than the steady economic growth, rising inflationary pressures may also constrain the policy room. No benchmark interest rate cuts have ever come during an upswing of CPI inflation.
Disclaimer

"Citi analysts" refers to investment professionals within Citi Research ("CR"), Citi Global Markets Inc. ("CGMI") and voting members of the Citi Global Investment Committee. CitiBank N.A. and its affiliates / subsidiaries provide no independent research or analysis in the substance or preparation of this document.

The information in this document has been obtained from reports issued by CGML. Such information is based on sources CGML believes to be reliable. CGML, however, does not guarantee its accuracy and it may be incomplete or condensed. All opinions and estimates constitute CGML's judgment as of the date of the report and are subject to change without notice. This document is for general information purposes only and is not intended as a recommendation or an offer or solicitation for the purchase or sale of any security or currency. No part of this document may be reproduced in any manner without the written consent of CitiBank N.A. Information in this document has been prepared without taking account of the objectives, financial situation, or needs of any particular investor. Any person considering an investment should consider the appropriateness of the investment having regard to their objectives, financial situation, or needs, and should seek independent advice on the suitability or otherwise of a particular investment. Investments are not deposits, are not obligations of, or guaranteed or insured by CitiBank N.A., CitiGroup Inc., or any of their affiliates or subsidiaries, or by any local government or insurance agency, and are subject to investment risk, including the possible loss of the principal amount invested. Investors investing in funds denominated in non-local currency should be aware of the risk of exchange rate fluctuations that may cause a loss of principal. Past performance is not indicative of future performance, prices can go up or down. Some investment products (including mutual funds) are not available to US persons and may not be available in all jurisdictions. Investors should be aware that it is their responsibility to seek legal and/or tax advice regarding the legal and tax consequences of their investment transactions. If an investor changes residence, citizenship, nationality, or place of work, it is their responsibility to understand how their investment transactions are affected by such change and comply with all applicable laws and regulations as and when such becomes applicable. CitiBank does not provide legal and/or tax advice and is not responsible for advising an investor on the laws pertaining to their transaction.

Citi Research (CR) is a division of Citigroup Global Markets Inc. (the "Firm"), which does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. For more information, please refer to https://www.citivelocity.com/cvr/appUBLIC/citi_research_disclosures

Country Specific Disclosures

Australia
This document is distributed in Australia by Citigroup Pty Limited ABN 88 004 325 080, AFSL No. 238098, Australian credit licence 238098. Any advice is general advice only. It was prepared without taking into account your objectives, financial situation, or needs. Before acting on this advice you should consider if it is appropriate for your particular circumstances. You should also obtain and consider the relevant Product Disclosure Statement and terms and conditions before you make a decision about any financial product, and consider if it is suitable for your objectives, financial situation, or needs. Investors are advised to obtain independent legal, financial, and taxation advice prior to investing. Past performance is not an indicator of future performance. Investment products are not available to US people and may not be available in all jurisdictions.

Bahrain
This document is distributed in Bahrain by CitiBank N.A., Bahrain. CitiBank N.A., Bahrain is licensed by the Central Bank of Bahrain as a Conventional Retail and Wholesale Bank and is bound by the CBB's regulations and licensing conditions with regards to products and services provided by CitiBank N.A. Bahrain. These terms are governed by and shall be construed in accordance with the laws of the Kingdom of Bahrain. The Customer irrevocably agrees that the civil courts in the Bahrain shall have non-exclusive jurisdiction to hear and determine any suit, action or proceeding and to settle any disputes which may arise out of or in connection with these Terms and Conditions and for such purposes the Customer irrevocably submits to the jurisdiction of such courts. Investment products are not insured by government or governmental agencies. Investment and Treasury products are subject to investment risk, including possible loss of principal amount invested. Past performance is not indicative of future results: prices can go up or down. Investors investing in investments and/or treasury products denominated in foreign (non-local) currency should be aware of the risk of exchange rate fluctuations that may cause loss of principal when foreign currency is converted to the investors' home currency. Investment and Treasury products are not available to U.S. persons. All applications for investments and treasury products are subject to Terms and Conditions of the individual investment and Treasury products. Customer understands that it is his/her responsibility to seek legal and/or tax advice regarding the legal and tax consequences of his/her investment transactions. If customer changes residence, citizenship, nationality, or place of work, it is his/her responsibility to understand his/her investment transactions are affected by such change and comply with all applicable laws and regulations as and when such becomes applicable. Customer understands that CitiBank does not provide legal and/or tax advice and are not responsible for advising him/her on the laws pertaining to his/her transaction. CitiBank Bahrain does not provide continuous monitoring of existing customer holdings.

People's Republic of China
This document is distributed by Citibank (China) Co., Ltd in the People's Republic of China (excluding the Special Administrative Regions of Hong Kong and Macau, and Taiwan).

Hong Kong
This document is distributed in Hong Kong by CitiBank (Hong Kong) Limited ("CHKL"). Prices and availability of financial instruments can be subject to change without notice. Certain high-volatility investments can be subject to sudden and large falls in value that could equal the amount invested.

India
This document is distributed in India by Citibank N.A. Investment are subject to market risk including that of loss of principal amounts invested. Products so distributed are not obligations of, or guaranteed by, Citibank and are not bank deposits. Past performance does not guarantee future performance. Investment products cannot be offered to US and Canada Persons. Investors are advised to read and understand the Offer Documents carefully before investing.

Indonesia
This report is made available in Indonesia through Citibank N.A., Indonesia Branch. Citibank N.A., is a bank that is licensed, registered, and supervised by the Indonesia Financial Services Authority (OJK).
Country Specific Disclosures

Korea
This document is distributed in South Korea by Citibank Korea Inc. Investors should be aware that investment products are not guaranteed by the Korea Deposit Insurance Corporation and are subject to investment risk including the possible loss of the principal amount invested. Investment products are not available to US persons.

Malaysia
Investment products are not deposits and are not obligations of, not guaranteed by, and not insured by, Citibank Berhad, Citibank N.A., Citigroup Inc. or any of their affiliates or subsidiaries, or by any government or insurance agency. Investment products are subject to investment risks, including the possible loss of the principal amount invested. These are provided for general information only and are not intended as a recommendation or an offer or solicitation for the purchase or sale of any security or currency or other investment products. Citibank Berhad does not represent the information herein as accurate, true or complete, makes no warranty express or implied regarding it and no liability whatsoever will be accepted by Citibank Berhad, whether in contract, tort or otherwise, for the accuracy or completeness of such information including any error of fact or omission herein which may lead to any direct or consequential loss, damages, costs or expenses arising from any reliance upon or use of the information in the material.

Philippines
This document is made available in Philippines by Citicorp Financial Services and Insurance Brokerage Phils. Inc. and Citibank N.A. Philippine Branch. Investors should be aware that investment products are not insured by the Philippine Deposit Insurance Corporation or Federal Deposit Insurance Corporation or any other government entity.

Singapore
This report is distributed in Singapore by Citibank Singapore Limited (“CSL”). Investment products are not insured under the provisions of the Deposit Insurance and Policy Owners’ Protection Schemes Act of Singapore and are not eligible for deposit insurance coverage under the Deposit Insurance Scheme.

Thailand
This document contains general information and insights distributed in Thailand by Citigroup and is made available in English language only. Citigroup does not dictate or solicit investment in any specific securities and similar products. Investment contains certain risk, please study prospectus before investing. Not an obligation of, or guaranteed by, Citibank, Not bank deposits. Subject to investment risks, including possible loss of the principal amount invested. Subject to price fluctuation. Past performance does not guarantee future performance. Not offered to US persons.

UAE
This document is distributed in UAE by Citibank, N.A. UAE. This is not an official statement of Citigroup Inc. and may not reflect all of your investments with or made through Citibank. For an accurate record of your accounts and transactions, please consult your official statement. Before making any investment, each investor must obtain the investment offering materials, which include a description of the risks, fees and expenses and the performance history, if any, which may be considered in connection with making an investment decision. Each investor should carefully consider the risks associated with the investment and make a determination based upon the investor’s own particular circumstances, that the investment is consistent with the investor’s investment objectives. At any time, Citigroup companies may compensate affiliates and their representatives for providing products and services to clients.

Vietnam
This document is distributed in Vietnam by Citibank, N.A., - Ho Chi Minh City Branch and Citibank, N.A. - Hanoi Branch, licensed foreign bank’s branches regulated by the State Bank of Vietnam. Investment contains certain risk, please study product’s prospectus, relevant disclosures and disclaimers and the terms and conditions for details before investing. Investment products are not offered to US persons.

United Kingdom
This document is distributed in the U.K. by Citibank N.A., London Branch and Citibank Europe plc, UK Branch.

Citibank N.A., London Branch is authorised and regulated by the Office of the Comptroller of the Currency (USA) and authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Our firm reference number with our UK regulators is 124704. Citibank N.A., London Branch is registered as a branch in the UK at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB. Registered number BR00010B. Citibank N.A. is incorporated with limited liability in the USA, Head office: 399 Park Avenue, New York, NY 10043, USA.

Citibank Europe plc is authorised by the Central Bank of Ireland and by the Prudential Regulation Authority. It is subject to supervision by the Central Bank of Ireland, and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our authorisation and regulation by the Prudential Regulation Authority, and regulation by the Financial Conduct Authority are available from us on request. Citibank Europe plc, UK Branch is registered as a branch (registration number FC035763) in the register of companies for England and Wales. The registered address in the UK is Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB. Citibank Europe plc is registered in Ireland with number 132781 with its registered office at 1 North Wall Quay, Dublin 1. Citibank Europe plc is regulated by the Central Bank of Ireland. Ultimately owned by Citigroup Inc., New York, USA.

© Citibank N.A. 2019. CITI, CITI and Arc Design are registered service marks of Citigroup Inc.

Jersey
This document is distributed by Citibank N.A., Jersey Branch. Citibank N.A., Jersey Branch is regulated by the Jersey Financial Services Commission. Citi International Personal Bank is registered in Jersey as a business name of Citibank N.A. The address of Citibank N.A., Jersey Branch is P.O. Box 104, 38 Esplanade, St Helier, Jersey JE4 8QB. Citibank N.A. is incorporated with limited liability in the USA. Head office: 399 Park Avenue, New York, NY 10043, USA. © Citibank N.A., 2019. CITI, CITI and Arc Design are registered service marks of Citigroup Inc.