



China: what you need to worry about

February 2017



What not to worry about:

The renminbi and capital outflows



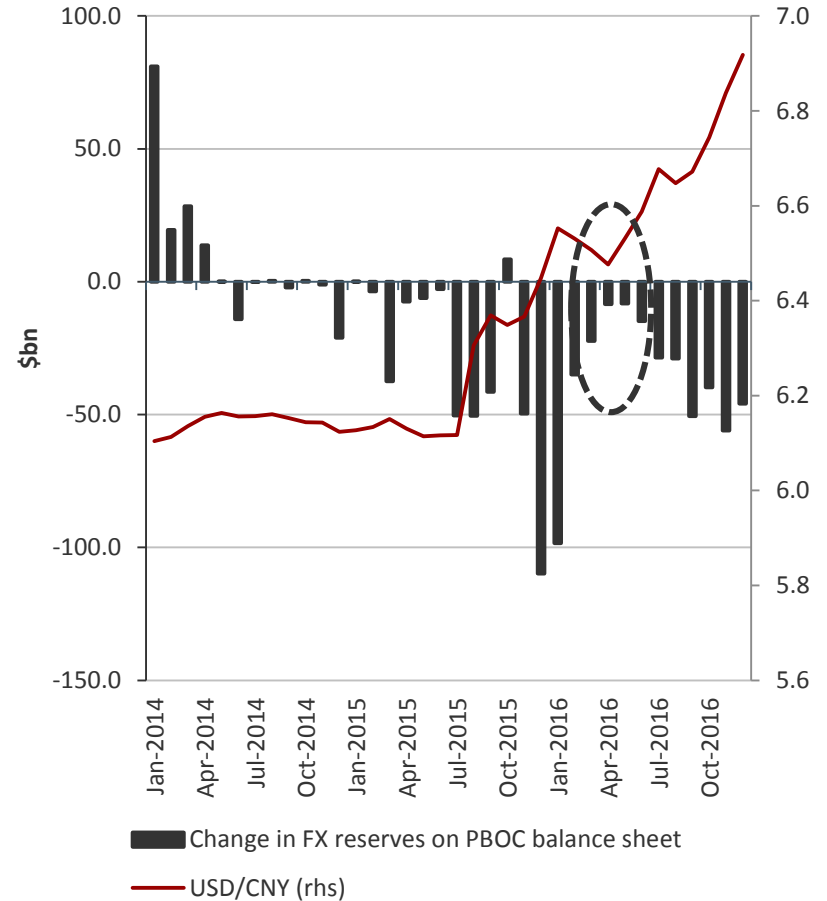
Weaker renminbi is function of dollar strength

CFETS basket: renminbi vs trade-weighted basket of currencies



Source: Wind, NSBO China

FX reserves vs dollar/renminbi rate

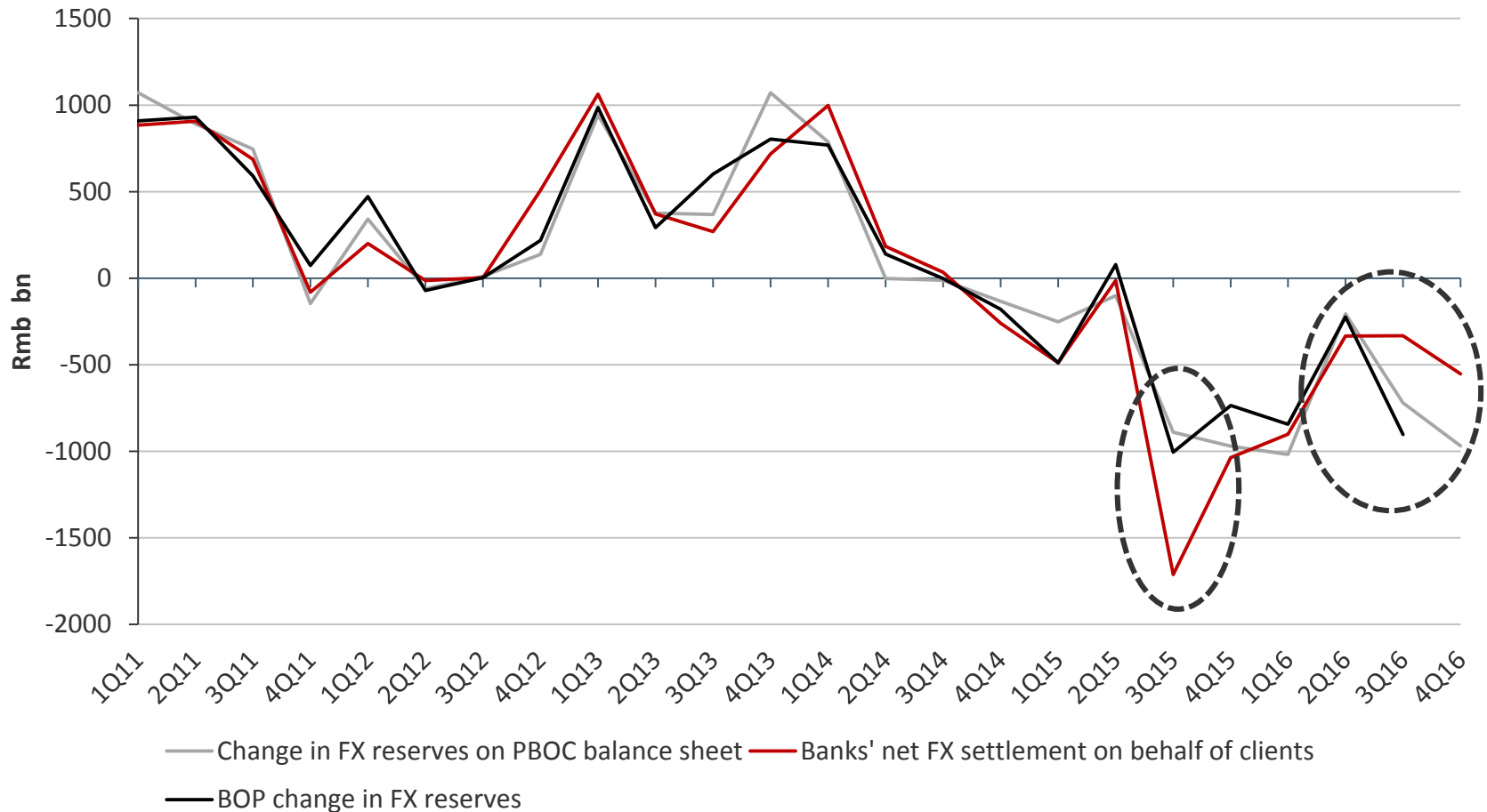


Source: Wind, SAFE, NSBO China



FX reserves are falling at a slower pace than they appear to be

Alternative measures of change in China's FX reserves

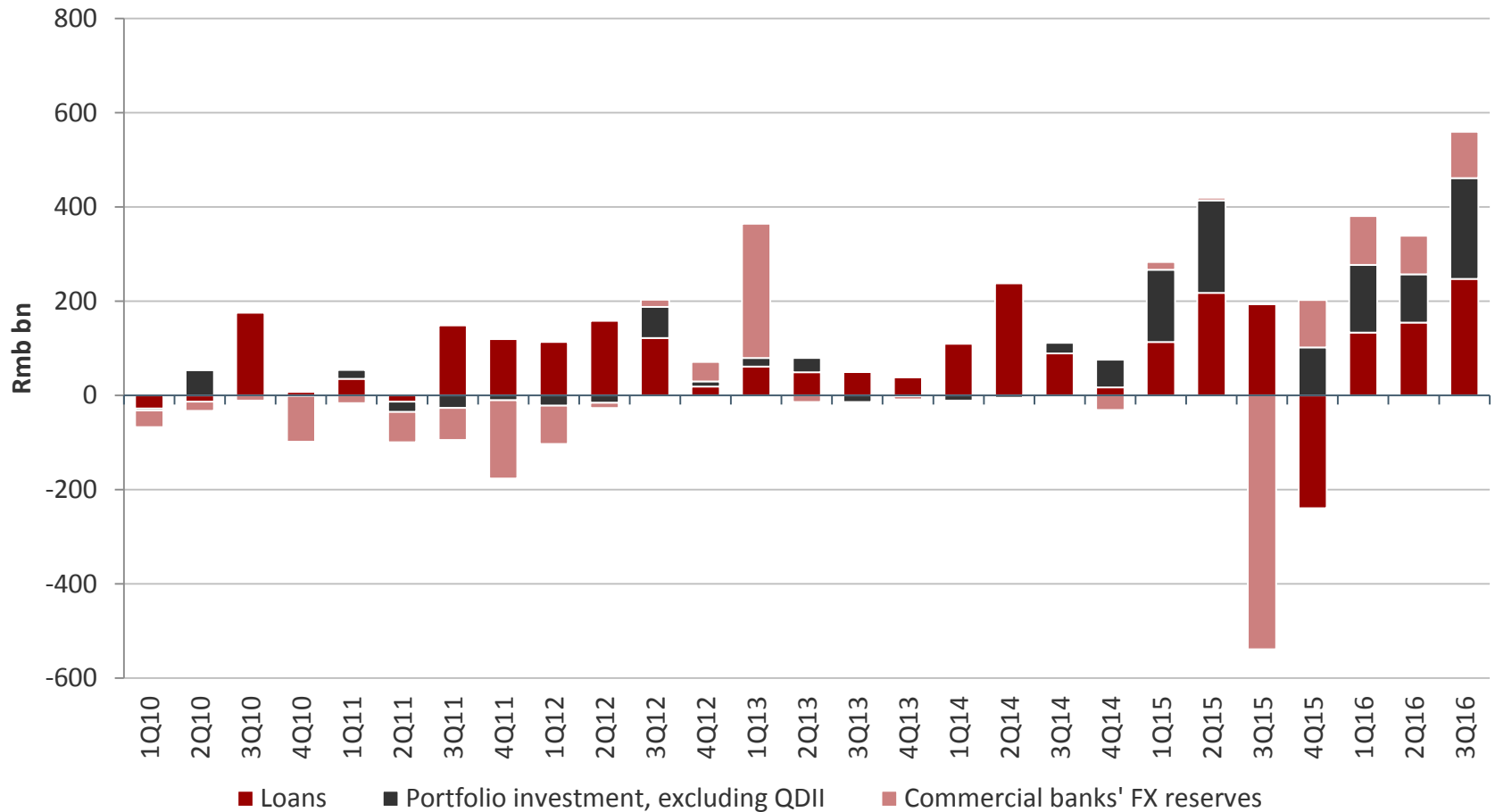


Source: PBOC, SAFE, NSBO China



Part of recent reserves drawdown has been due to state build-up of foreign assets

Change in state claims on foreign assets, excluding PBOC foreign reserves

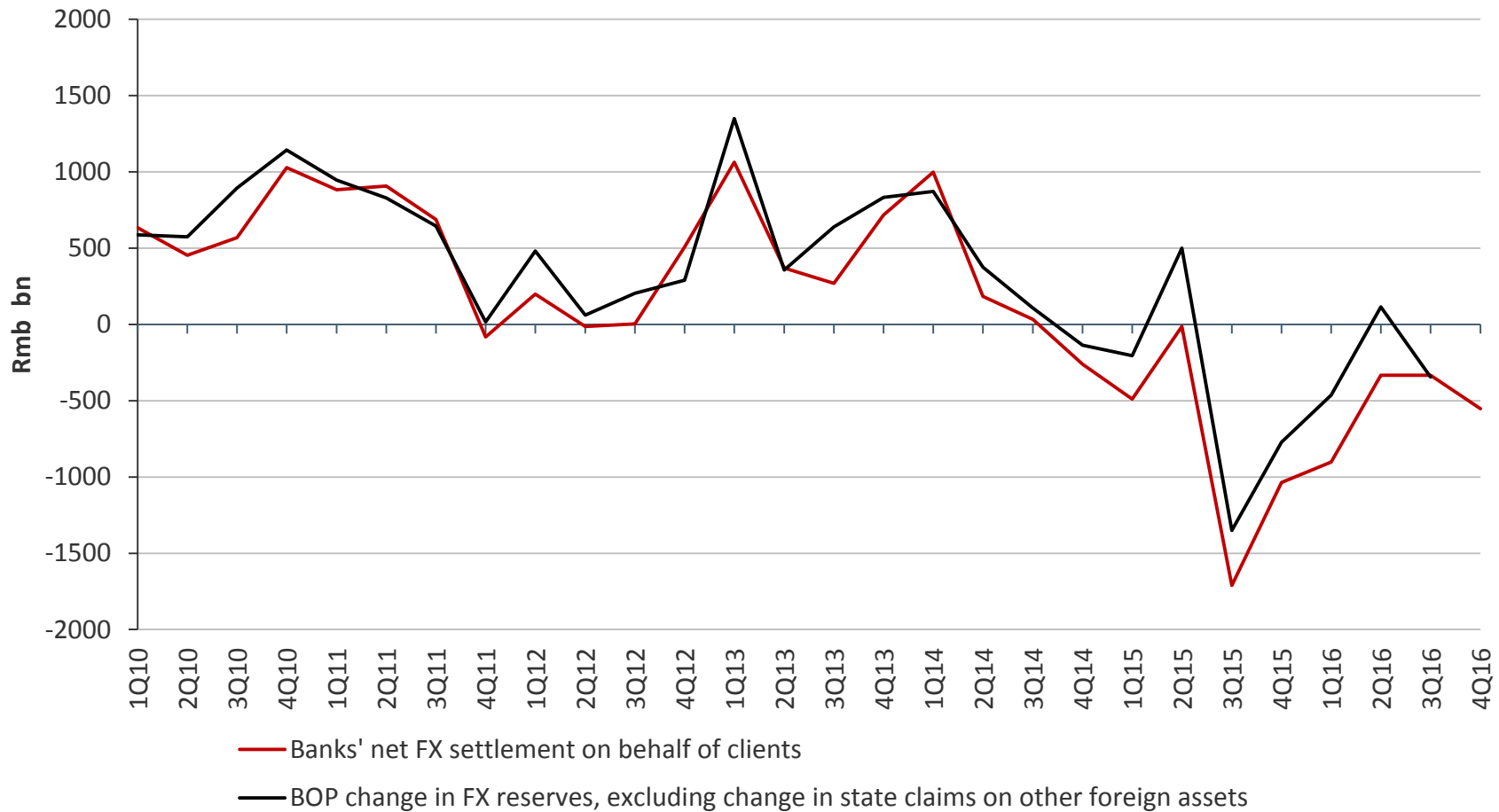


Source: SAFE, NSBO China



Non-state claims on foreign assets have risen by less

Adjusted alternative measures of change in China's FX reserves

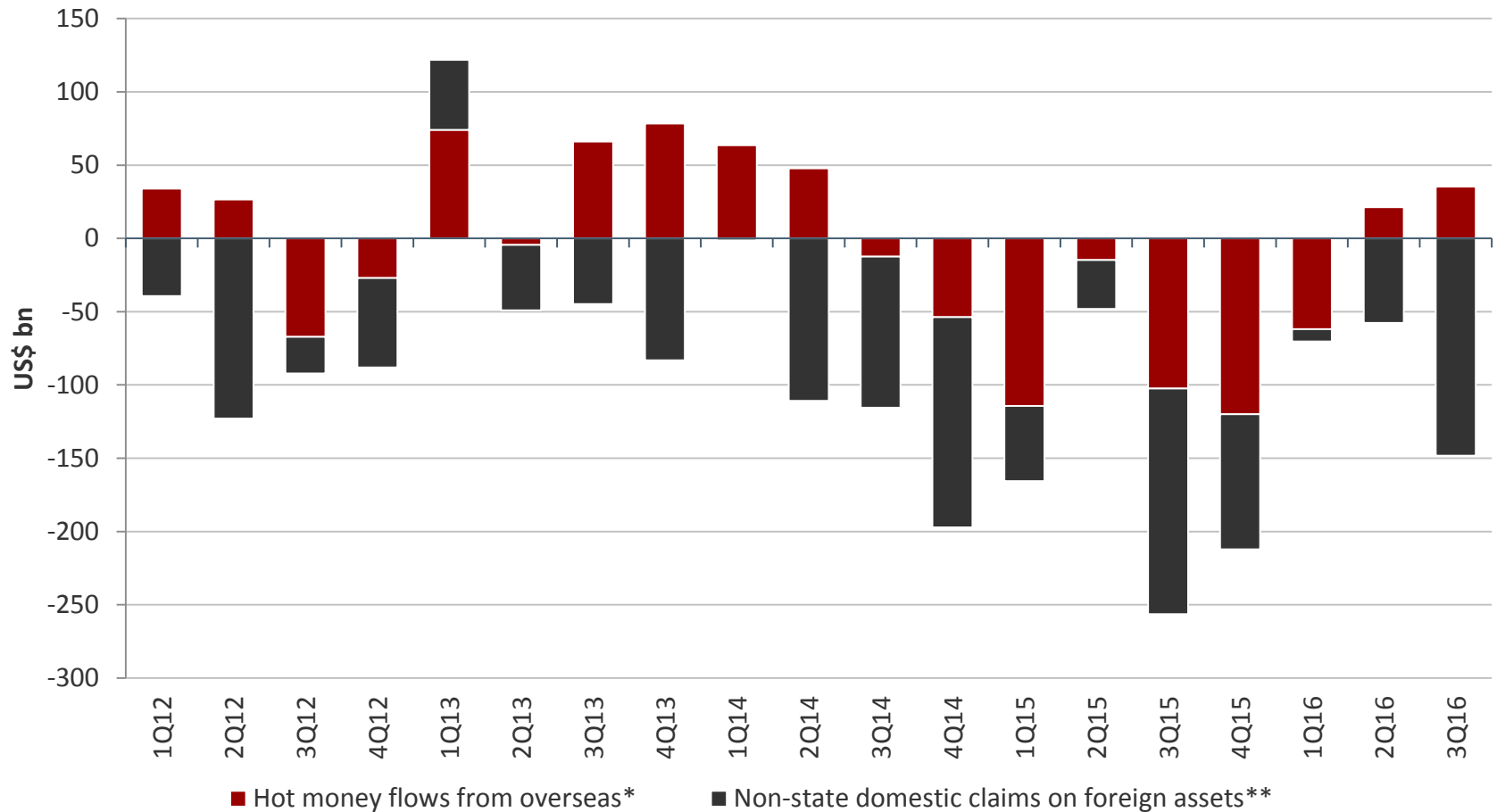


Source: PBOC, SAFE, NSBO China



Non-state capital outflows are now mainly via domestic entities

Capital outflows via non-state channels



Source: SAFE, NSBO China

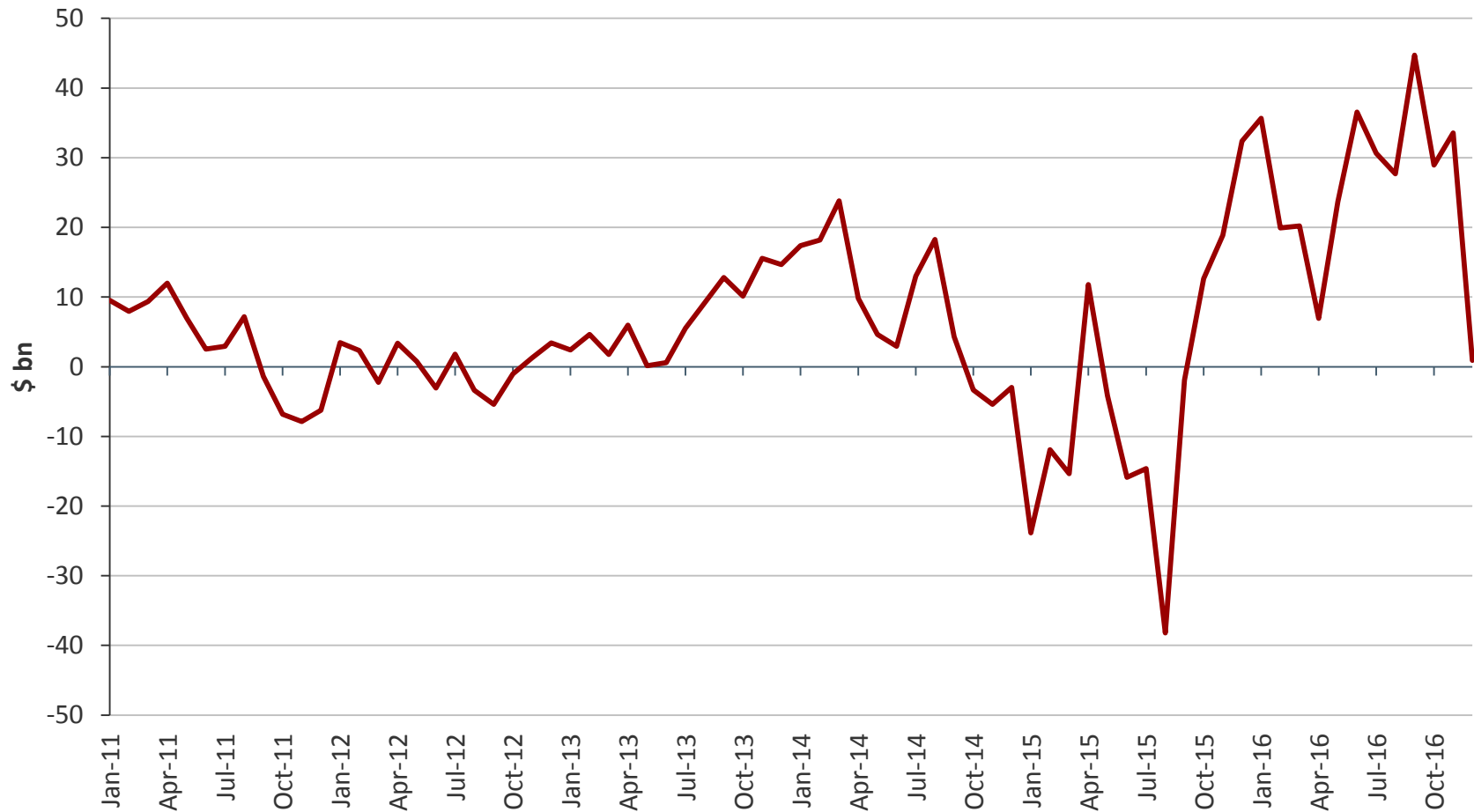
*net change in Chinese foreign debt and foreigners' deposits at onshore banks

**net errors and omissions, foreign deposits, overseas insurance and pensions, trade credit and QDII investment



Recent capital control measures have been successful

Net cross-border renminbi transactions



Source: SAFE, NSBO China



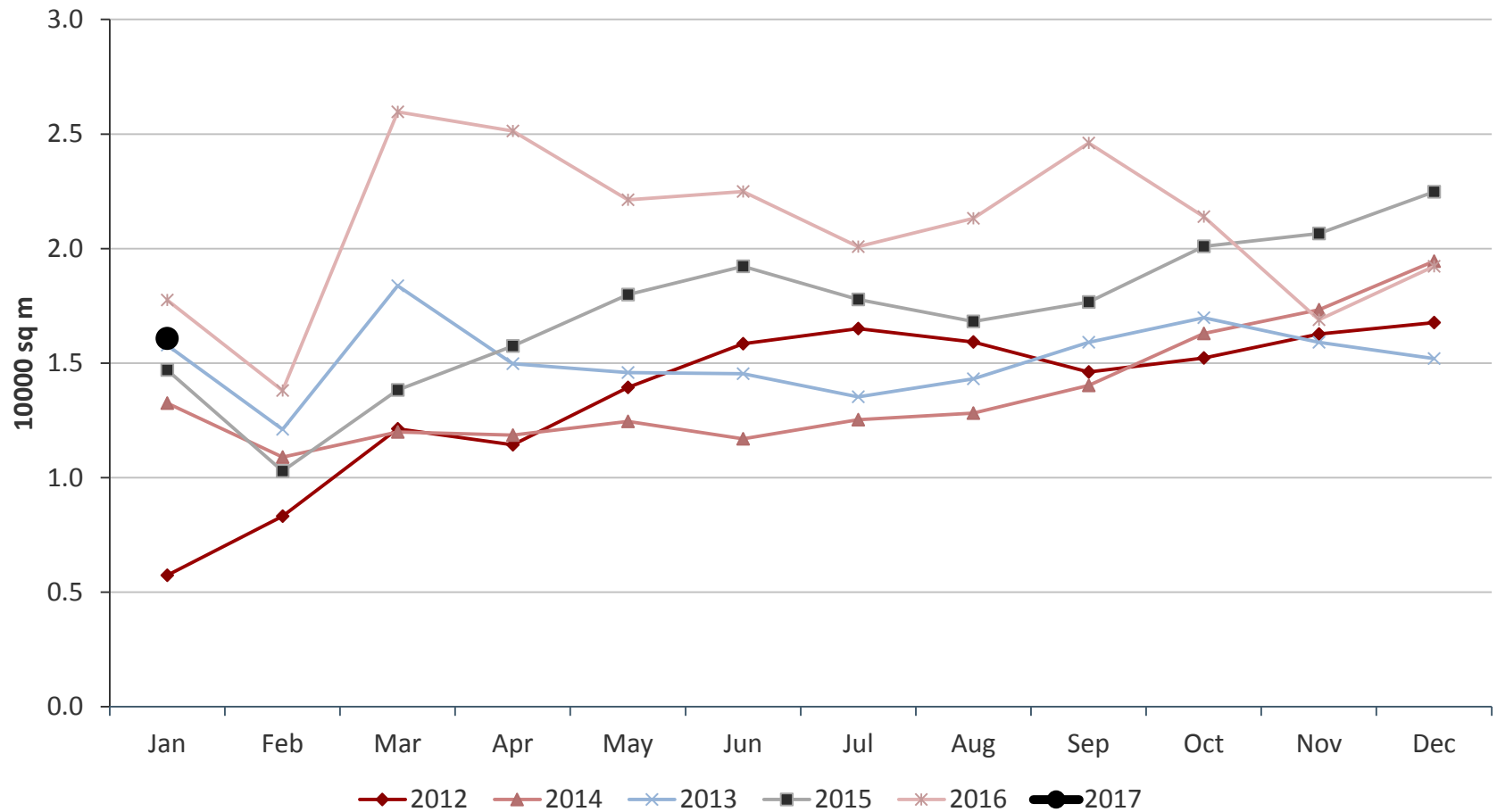
What to worry about:

China has already shifted from stimulus to tightening



Home sales are falling on the back of policy tightening

Average daily home sales in 52 cities

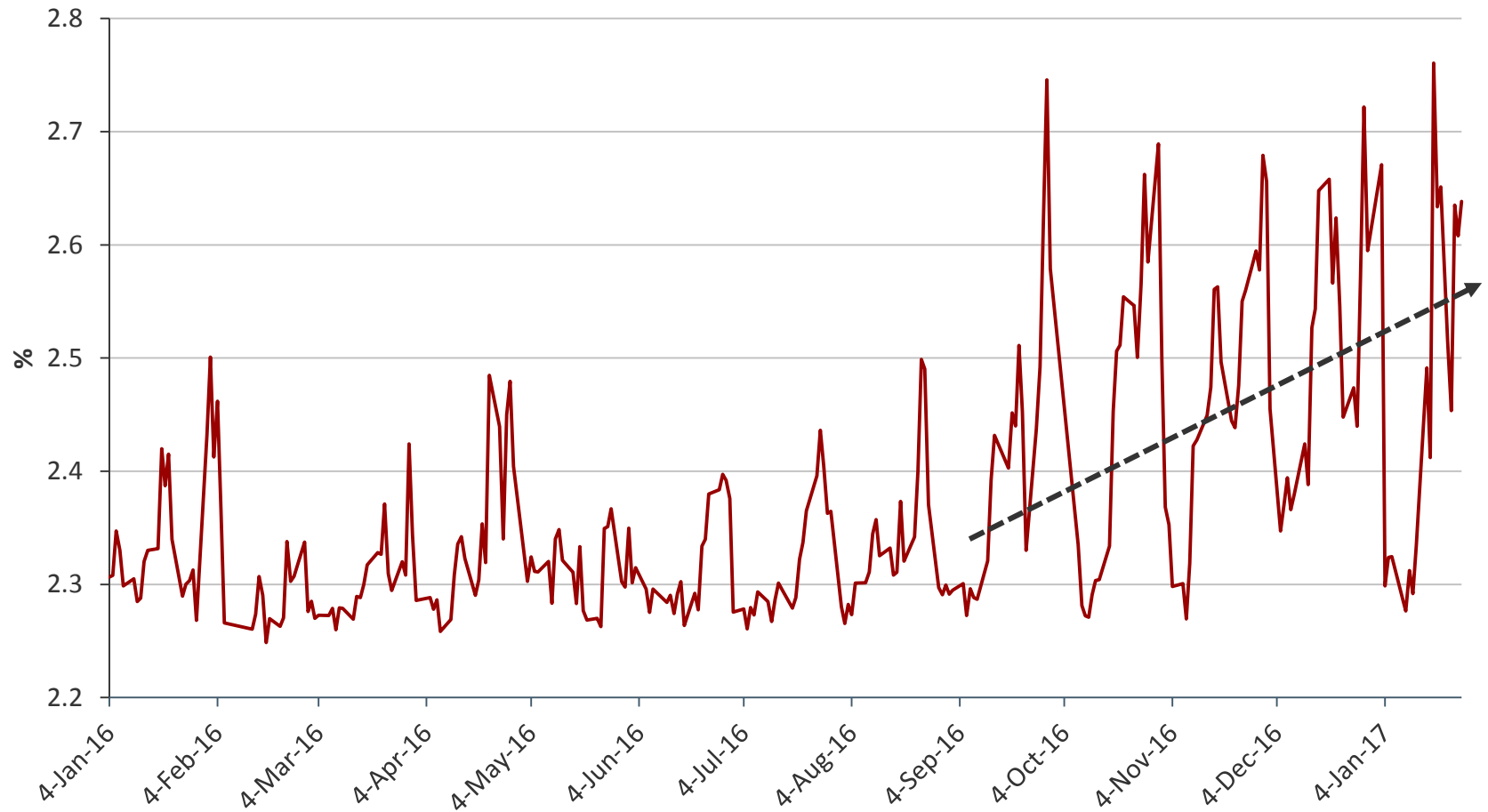


Source: Wind, CEIC, NSBO China



Monetary policy is being tightened

7 day interbank repo rate (weighted average)

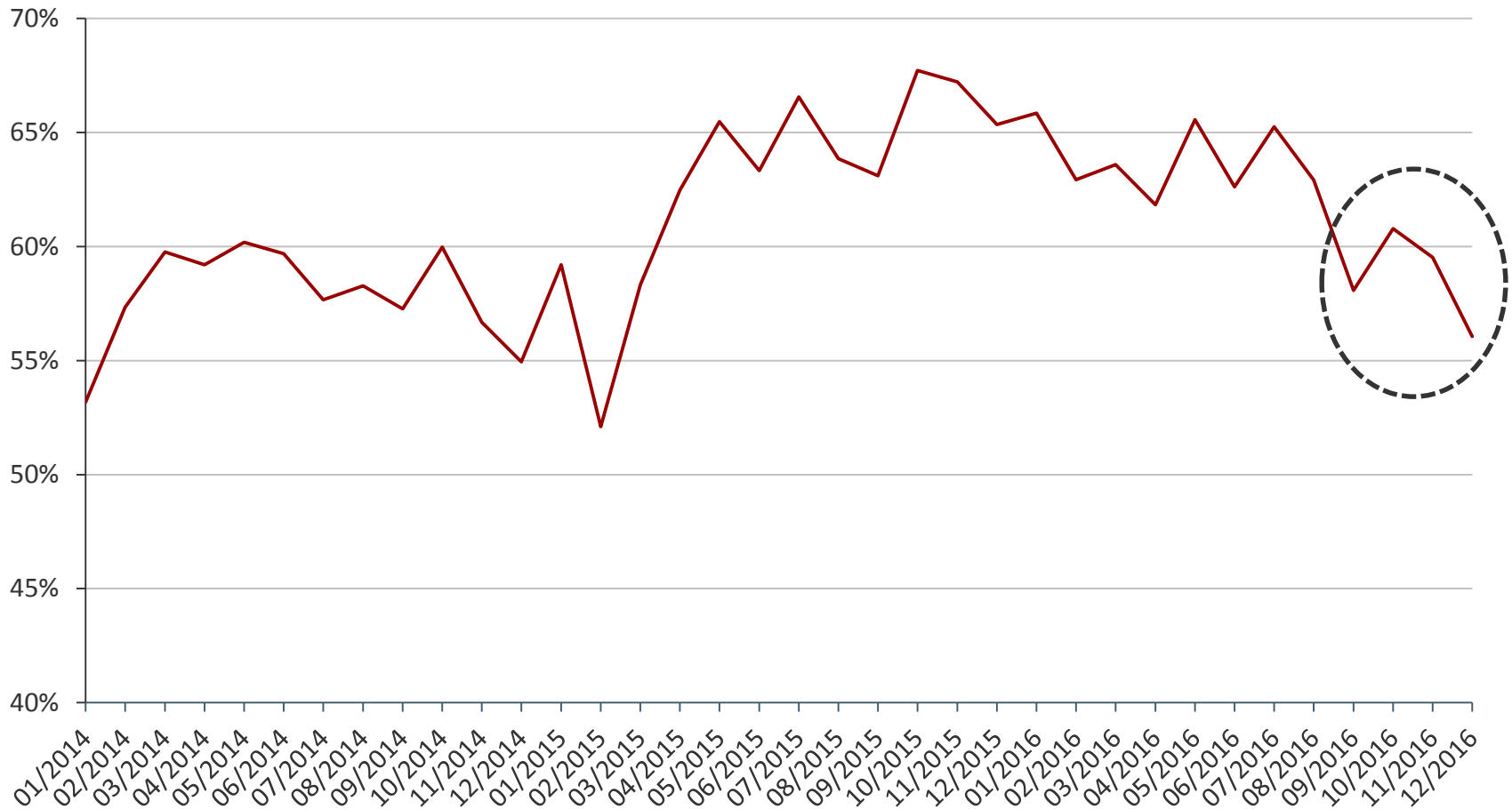


Source: Wind, NSBO China



PBOC tightening initially focused on the interbank market...

Overnight repos as proportion of total interbank market turnover

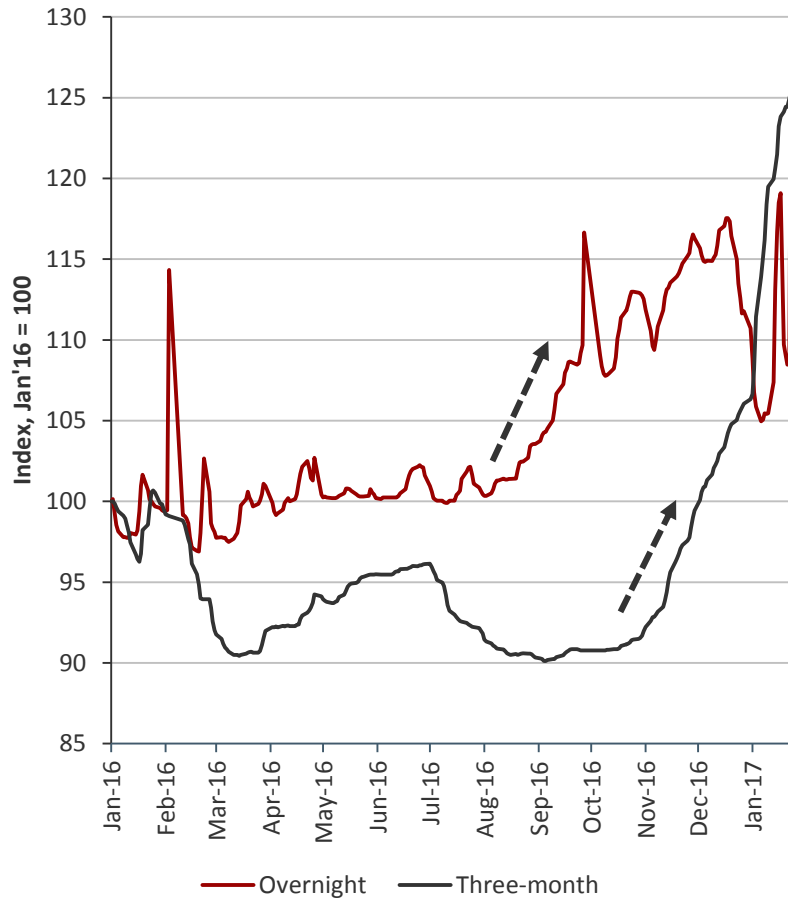


Source: Wind, NSBO China



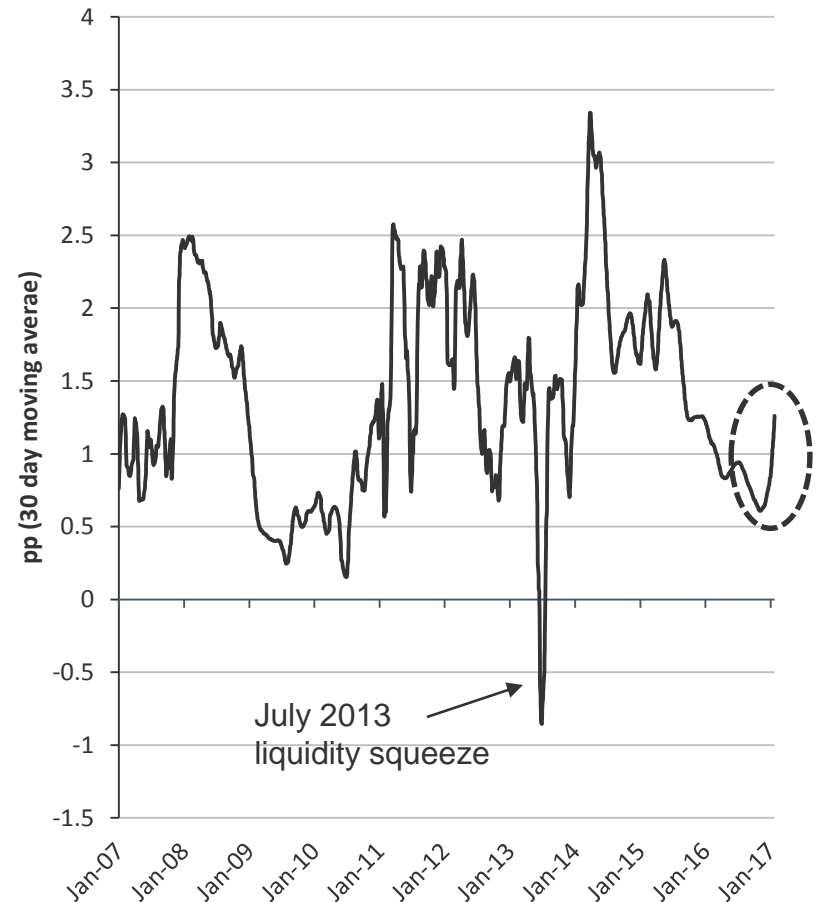
...but is now shifting to the real economy

Overnight vs three-month SHIBOR



Source: Wind, NSBO China

Spread between three-month and overnight SHIBOR

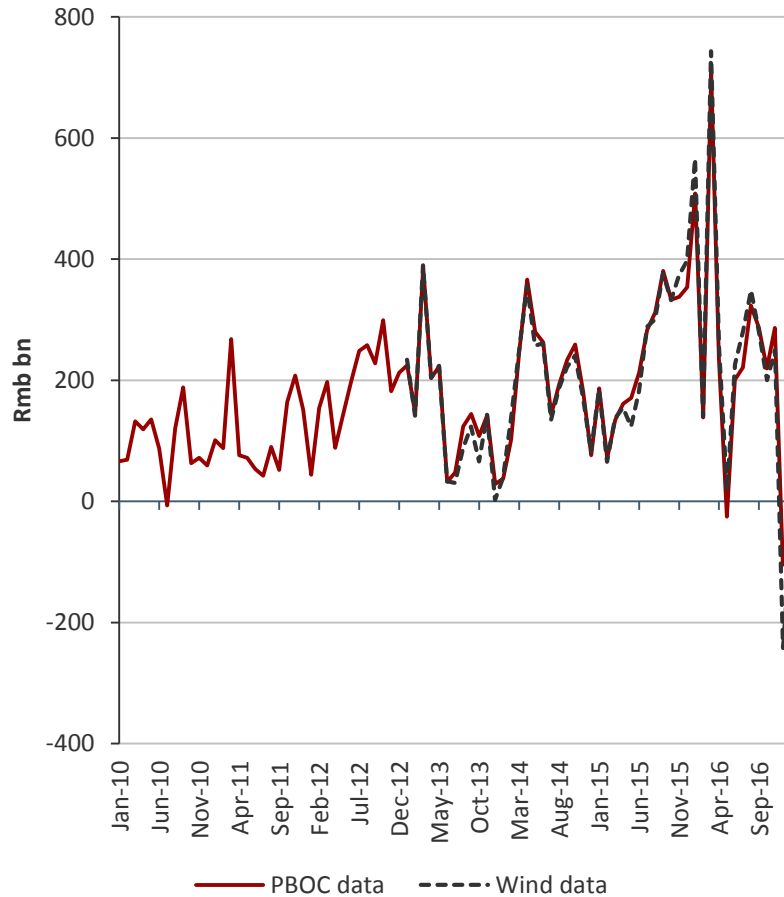


Source: Wind, NSBO China



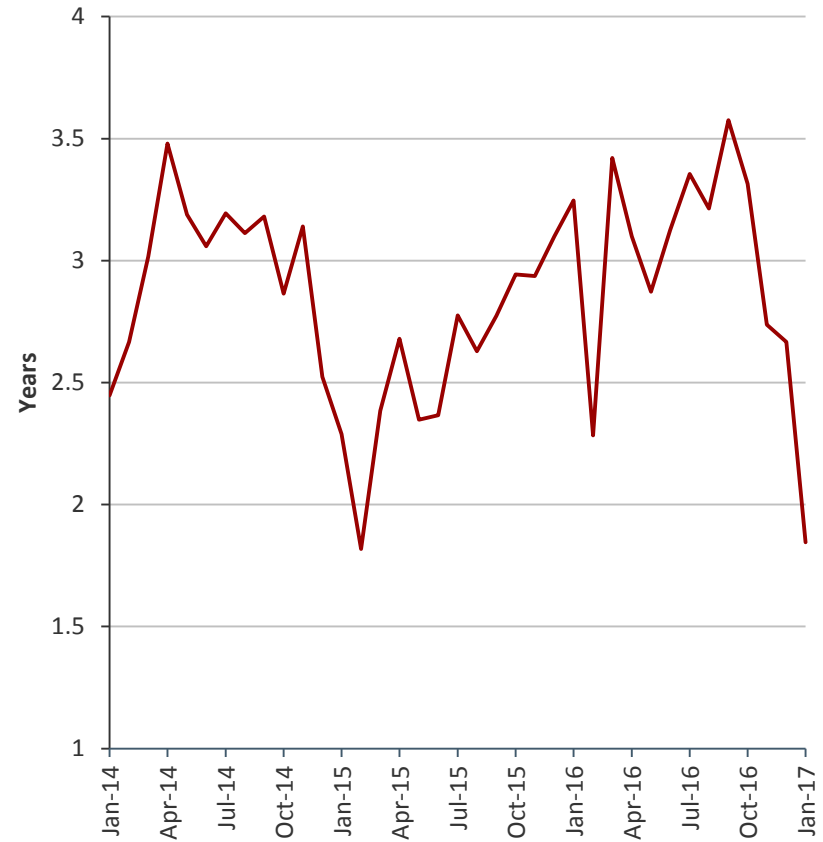
Corporate bond issuance is collapsing...

Net new bond issuance by non-financial corporates



Source: PBOC, Wind, NSBO China

Weighted average maturity of newly issued bonds

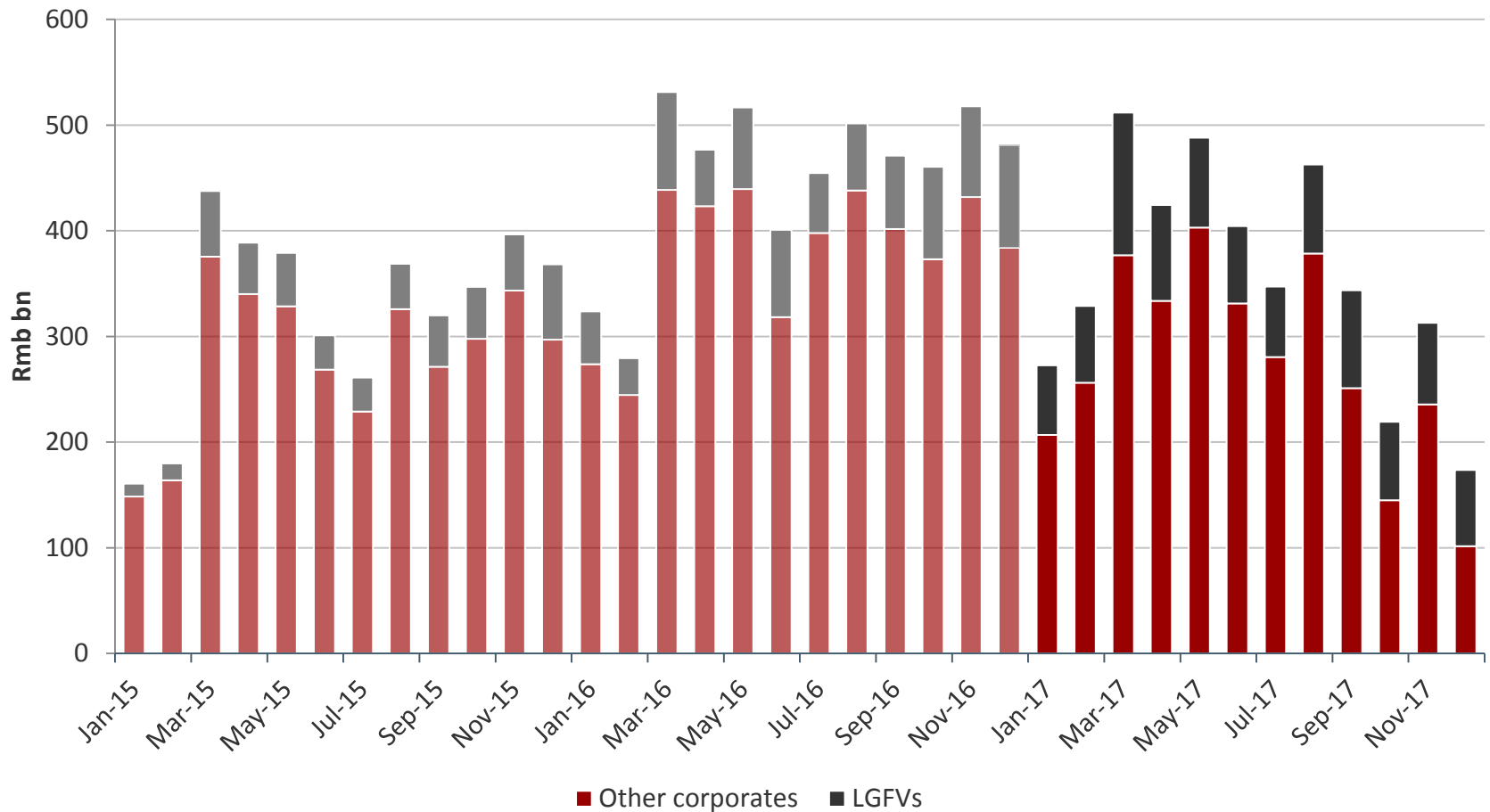


Source: Wind, NSBO China



...raising default risks

Maturing bonds of non-financial corporates

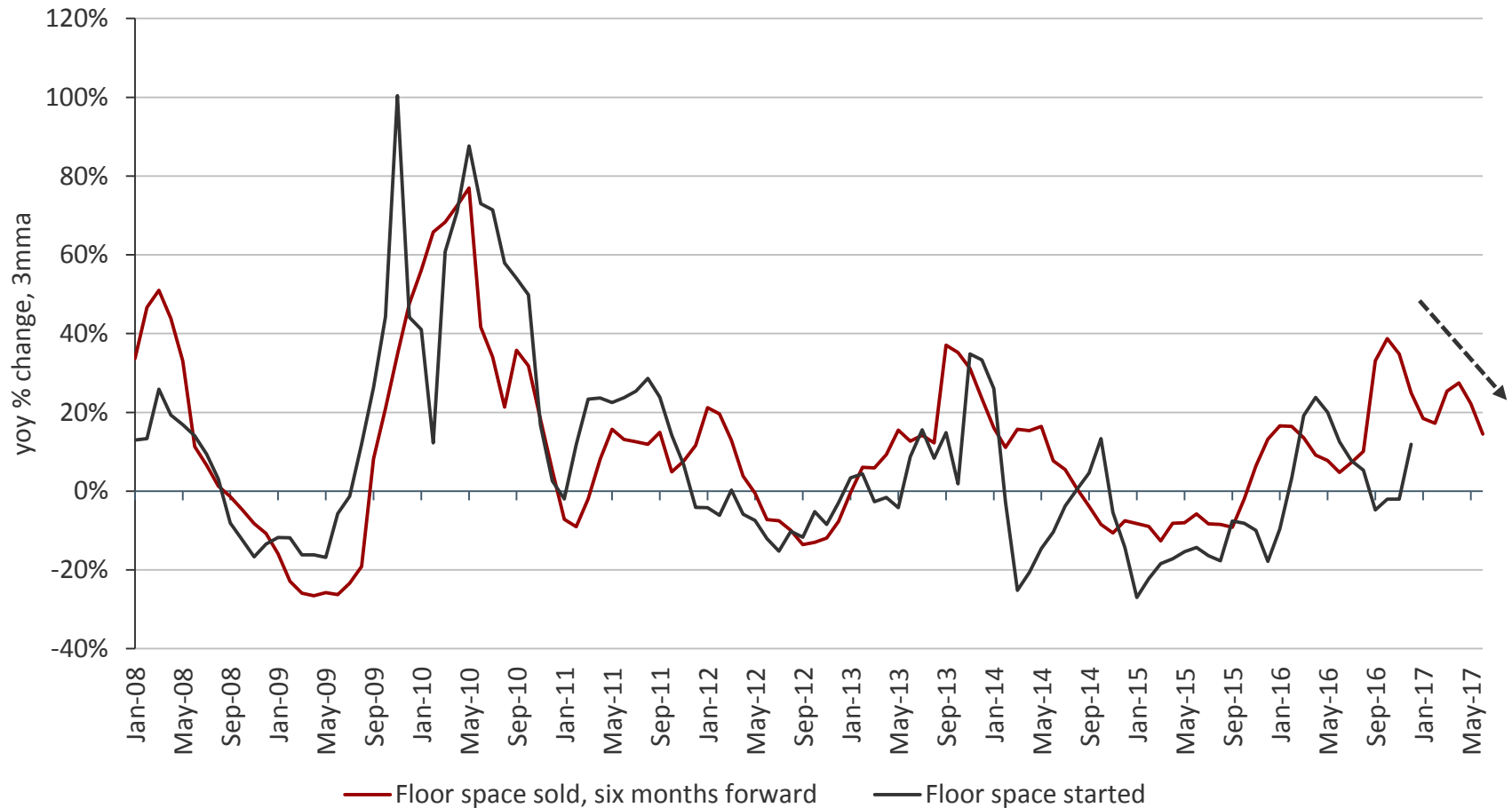


Source: Wind, NSBO China



Construction sector recovery will roll off as home sales slow

Home sales vs new construction starts

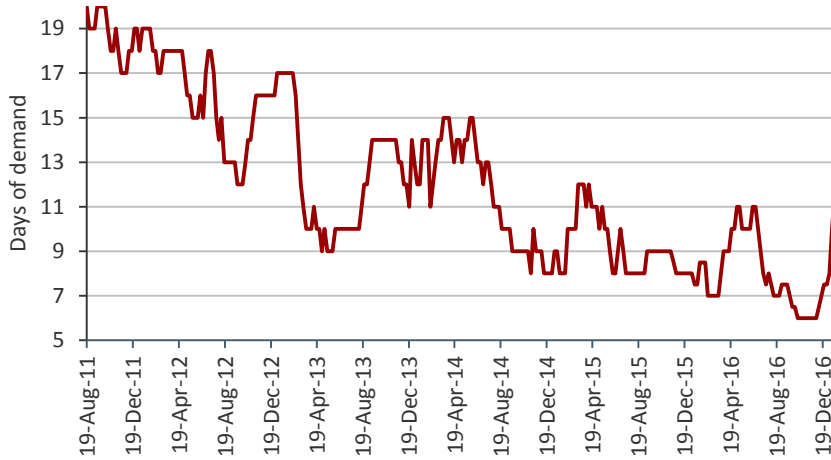


Source: NBS, NSBO China

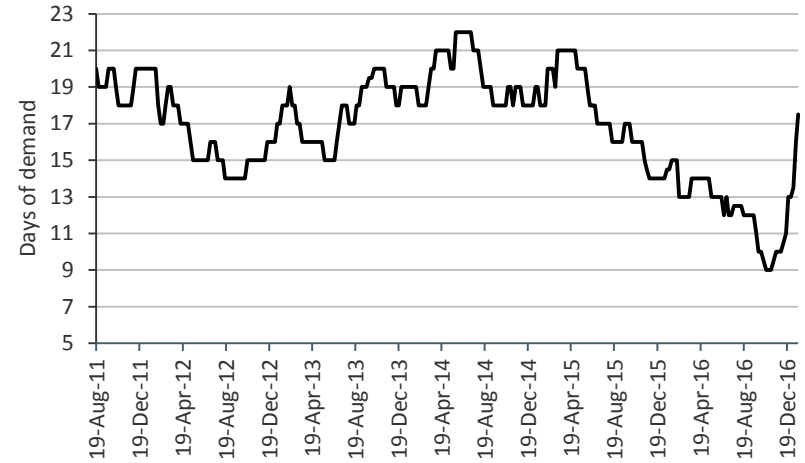


But industry thinks things are going to continue to get better

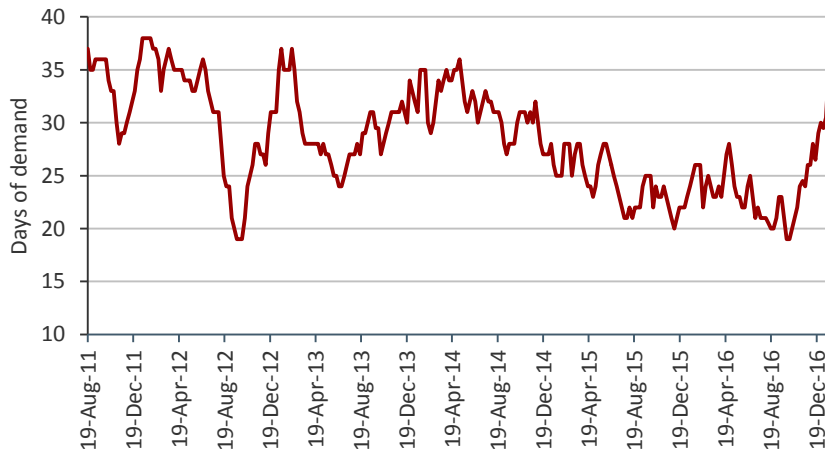
Coke inventories at surveyed steel mills



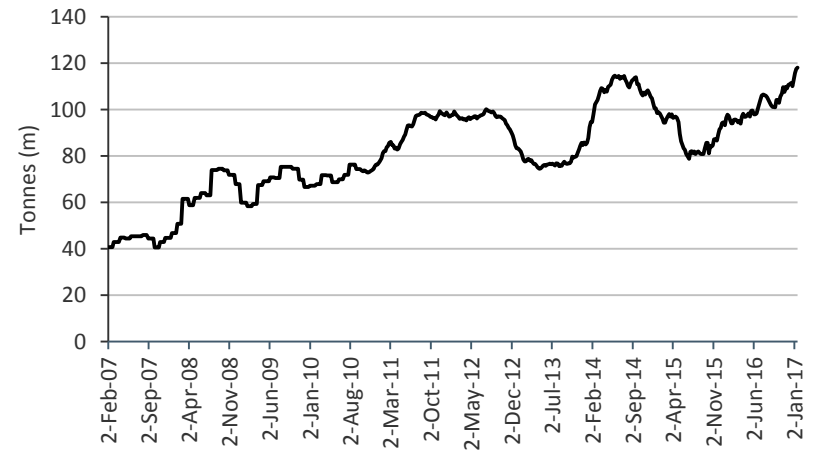
Coking coal inventories at surveyed steel mills



Imported iron ore inventories at surveyed steel mills



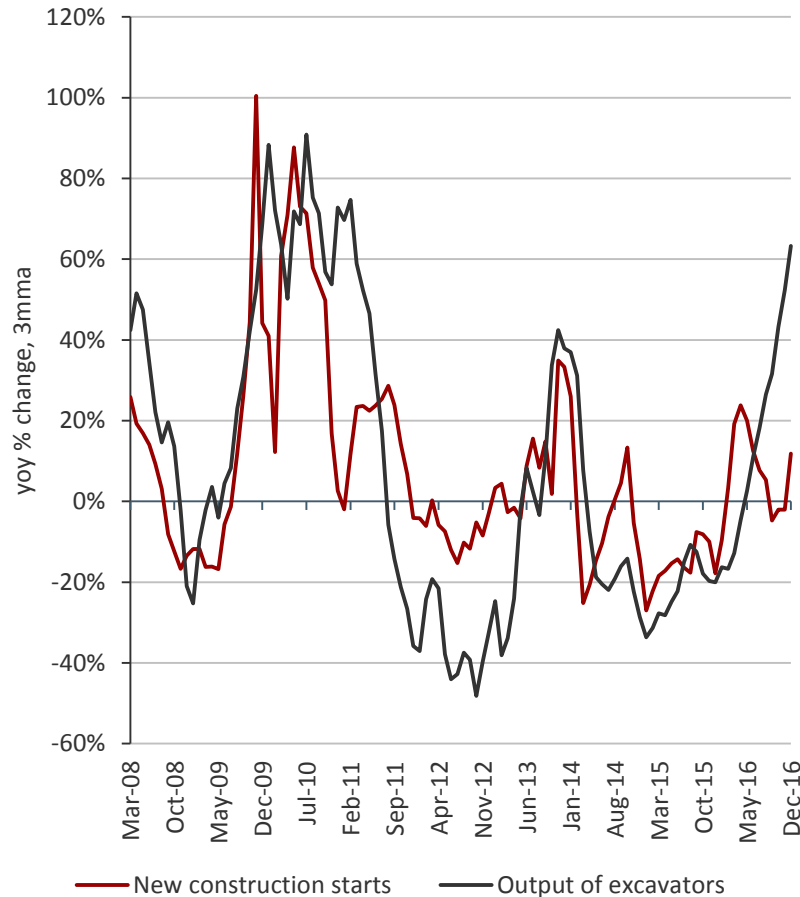
Imported iron ore inventories at ports





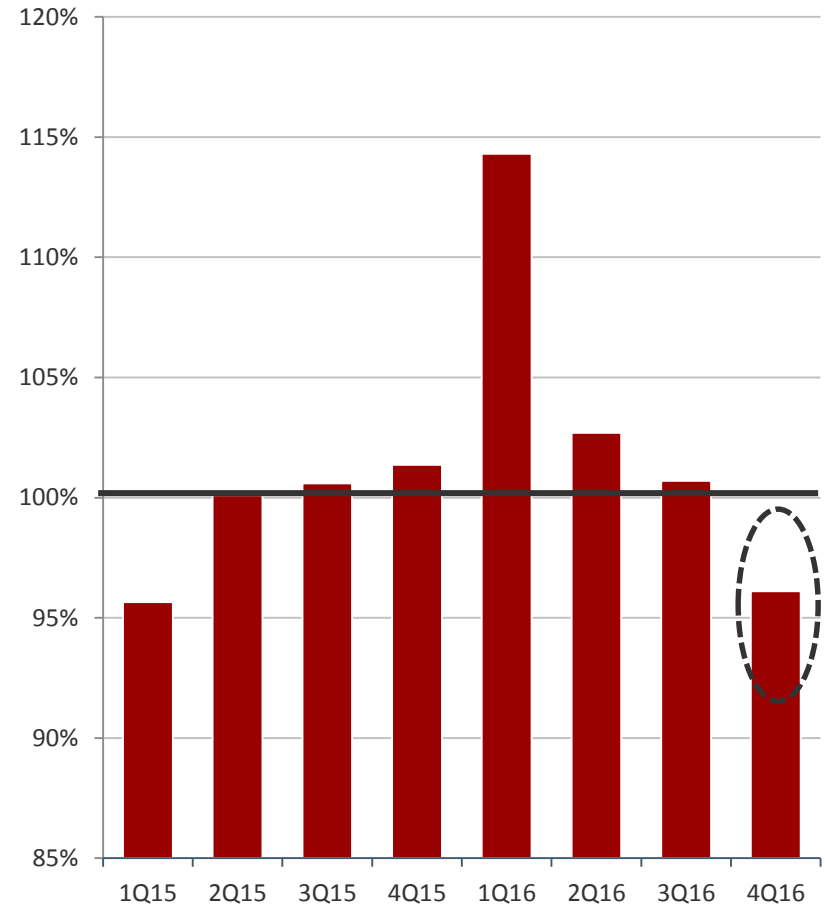
Industry over-optimism is not confined to the steel sector

New construction starts vs output of excavators



Source: NBS, Wind, NSBO China

Proportion of excavators sold, YTD

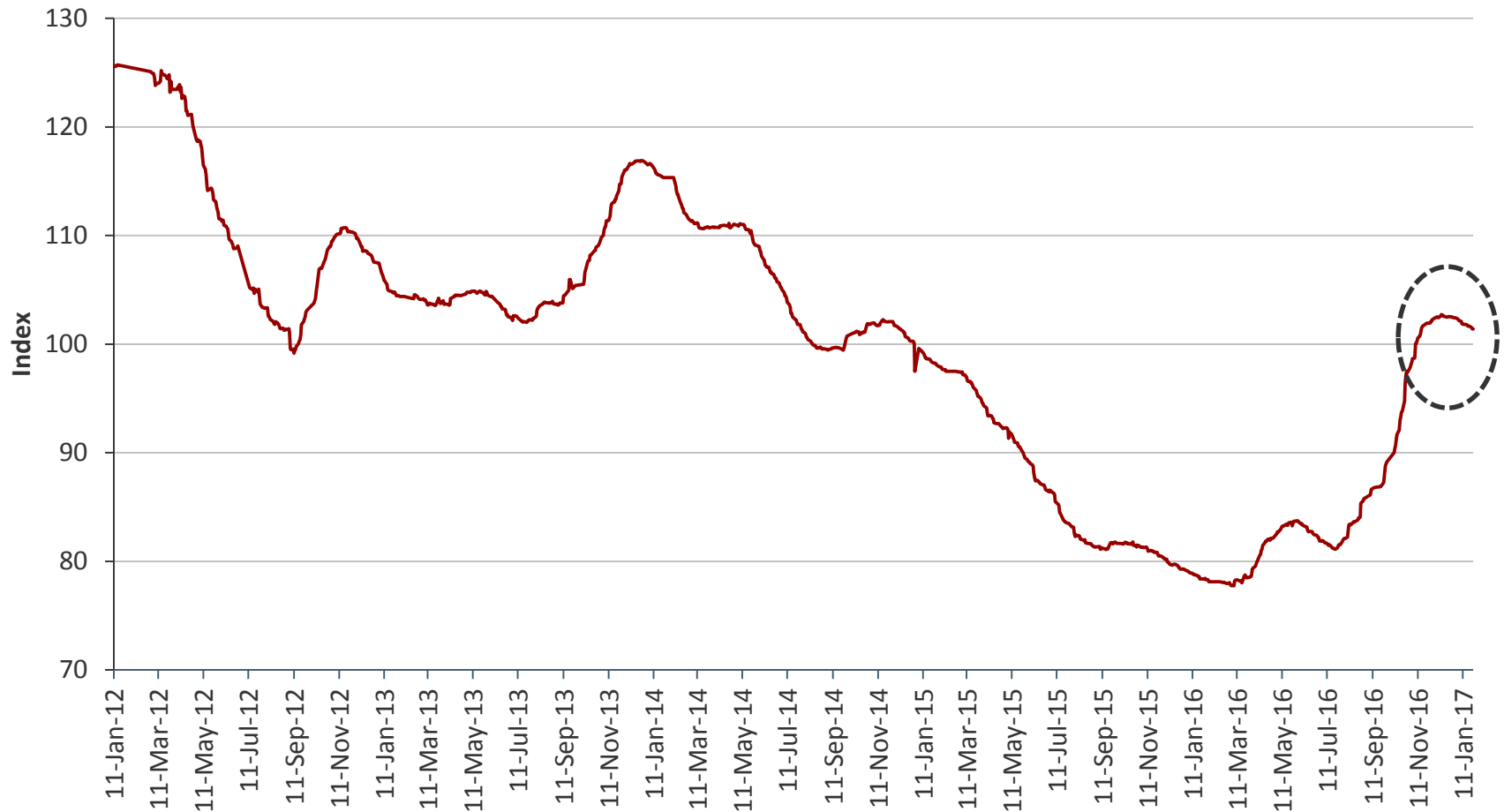


Source: Wind, NSBO China



Materials less prone to hoarding have seen less of a price rise

CC Cement.com national cement price index

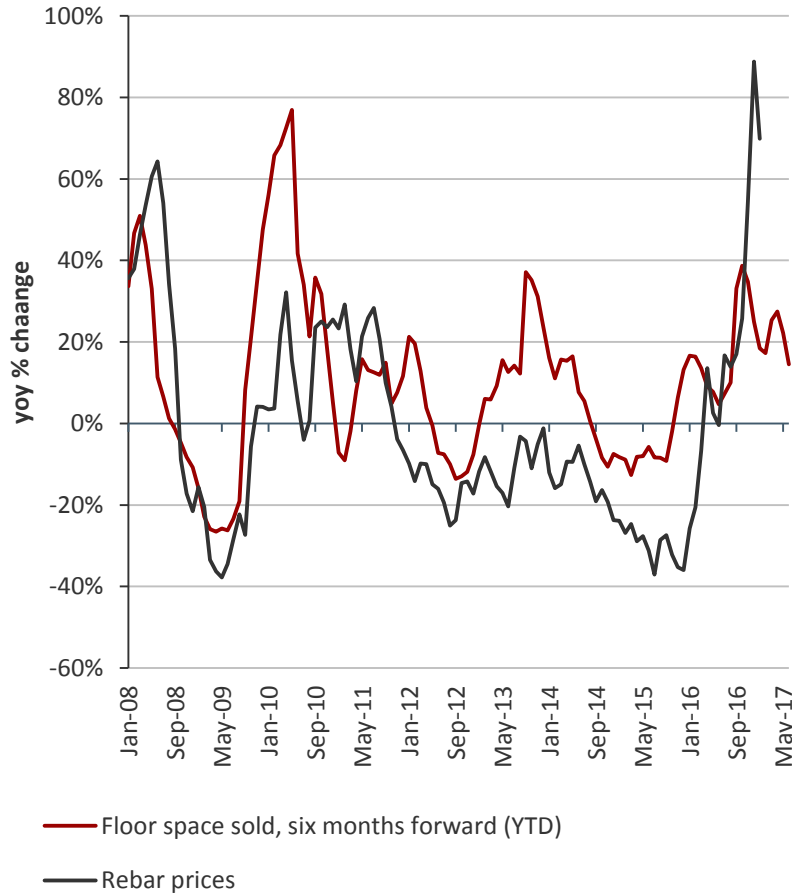


Source: Wind, NSBO China



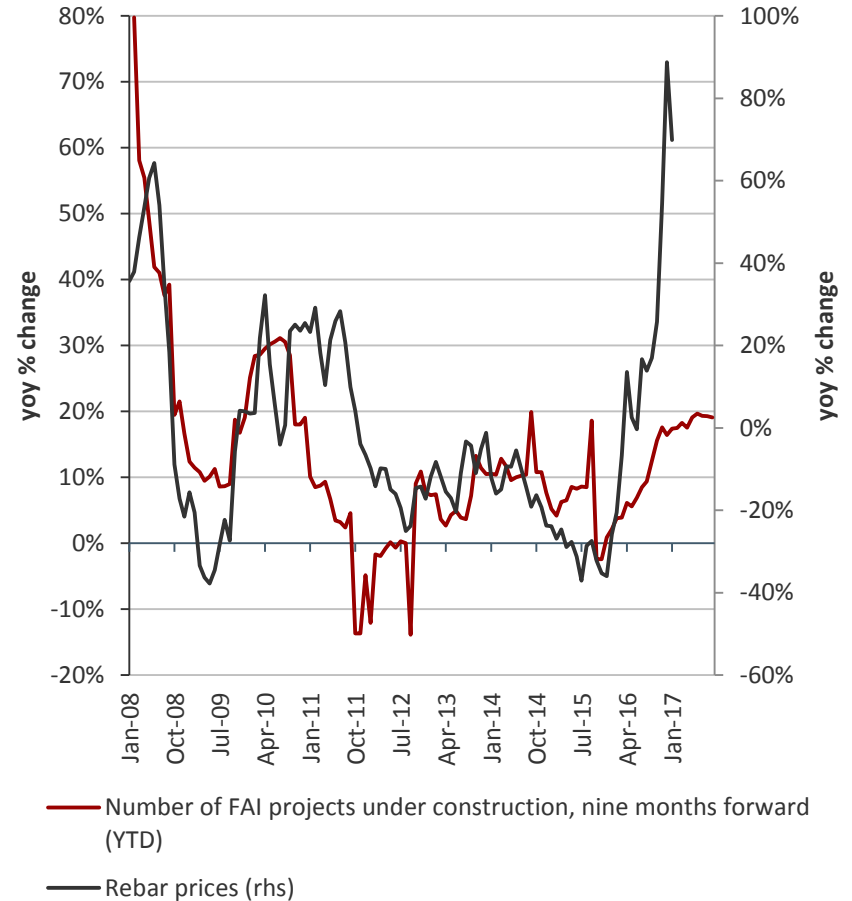
Market is not pricing in a slowdown as stimulus boost fades

Real estate sales vs steel prices



Source: NBS, Wind, NSBO China

FAI projects vs steel prices



Source: NBS, Wind, NSBO China



Beijing, China
B616, Nanxincang Business Tower,
A22 Dongsishitiao,
Beijing, 100007
People's Republic of China

Tel: +86 10 5218 5160
www.nsbo.com

中国,北京
中国,北京东四十条甲22号
南新仓商务大厦B616室,
邮编100007

London, United Kingdom
2nd Floor, 12 Groveland Court,
London, EC4M 9EH
United Kingdom

Tel: +44 (0)20 7024 4600,
Fax: +44 (0)20 7024 4699

Exclusive Global Distribution by North Square Blue Oak Limited

This presentation has been prepared by North Square Blue Oak Ltd. For the purpose of the UK Financial Services & Markets Act 2000 this publication has been approved by North Square Blue Oak Limited, which is authorised and regulated by the UK Financial Services Authority firm (reference number: 524 544).

This presentation is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning North Square Blue Oak Limited ("NSBO"), its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the presentation. The presentation should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this presentation are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of NSBO as a result of using different assumptions and criteria. NSBO is under no obligation to update or keep current the information contained herein. NSBO, its directors, officers, employees and consultants or clients may have or have had interests or long or short positions in the securities or other financial instruments referred to herein, and may at any time make purchases and/or sales in them as principal or agent.

NSBO may rely on information barriers, such as "Chinese Walls", to control the flow of information contained in one or more areas within NSBO, into other areas, units, groups or affiliates of NSBO.

The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. Options, derivative products and futures are not suitable for all investors, and trading in these instruments is considered risky. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this presentation. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither NSBO nor any of its affiliates, nor any of NSBO's or any of its affiliates, directors, employees, consultants or agents accepts any liability for any loss or damage arising out of the use of all or any part of this presentation. Additional information will be made available upon request.

Except as otherwise specified herein, this material is communicated to persons who are Professional Clients or Eligible Counterparties as that term is defined under the Markets in Financial Instruments Directive (2004/39/EC). It is not to be distributed to or relied upon by Retail Clients under any circumstances. The information contained herein does not apply to, and should not be relied upon by, private customers.

This presentation may not be reproduced or redistributed, in whole or in part, without the written permission of NSBO and NSBO accepts no liability whatsoever for the actions of third parties in this respect.