

China: Vulnerability sentiment improves in August

Sumedh Deorukhkar / Alvaro Ortiz / Tomasa Rodrigo / Le Xia

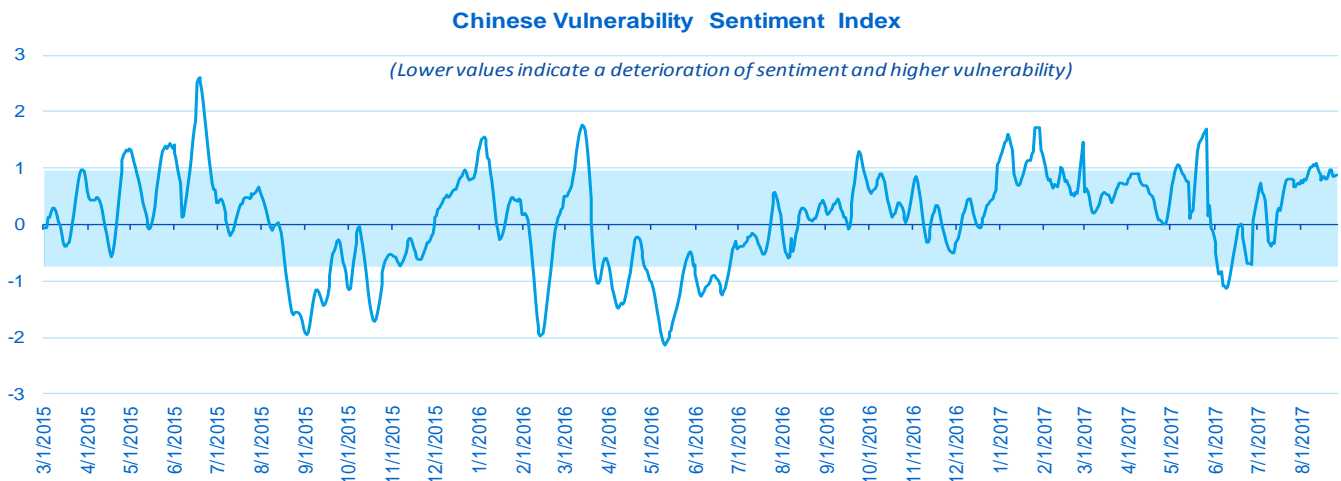
31 August 2017

Our China Vulnerability Sentiment Index (CVSI) improved in August, underpinned by gains in the SOE, Housing and Shadow banking component while FX speculative pressures persist despite slowing capital outflows. July activity data signalled near term moderation in growth momentum, following a solid first half. The softer macro data cuts across production as well as demand side indicators, led, in part, by the lagged effect of financial deleveraging. While credit flow is increasingly sustained by formal bank lending, moderating growth of Wealth Management Products and curbs on shadow credit is weighing on overall demand.

Progress on regulatory policy coordination ensures visible gains in August CVSI

The improvement in August CVSI (Figure – 1) reflects progressive and broadbased policy efforts by Chinese authorities to control shadow banking related risks and leverage while underpinning growth stability at the same time. Following transmission delays, the real impact from financial deleveraging on China’s activity, housing market and credit indicators, is expected to be increasingly evident going forward. Gains in our SOE vulnerability Index (Figure – 2 and 7) reflects a pick up in profitability in July mainly driven by improving efficiency at the petroleum refining, coal and steel industries. Meanwhile, a slowdown in home sale area and moderation in real estate investment in light of tighter regulations kept Housing Bubble vulnerability Index (Figure – 3) in check. China’s average new housing prices have slowed for the 6 straight months now. A notable improvement is seen in our Shadow Bank Vulnerability Index (Figure – 4), which reflects the ongoing rotation away from shadow banking to traditional bank financing as a part of policy efforts to repair financial fragilities in the system. With broad total social financing growth holding up, policymakers are ensuring a soft-landing in economic growth going ahead. Finally, our Exchange Rate Vulnerability Index (Figure – 5) suggests FX speculative pressures persist despite slowing capital outflows and a notably stronger and stable Yuan. While tighter capital controls have effectively restrained outbound FDI, Chinese households are still diversifying assets abroad. Also, Chinese corporate foreign debt reductions, which accounted for the bulk of capital outflows over past years, has reversed course. We continue to expect PBOC’s prudent approach to actively manage interbank liquidity to stem funding pressures and underpin Yuan stability going forward.

Figure 1. China Vulnerability Sentiment Index (CVSI)

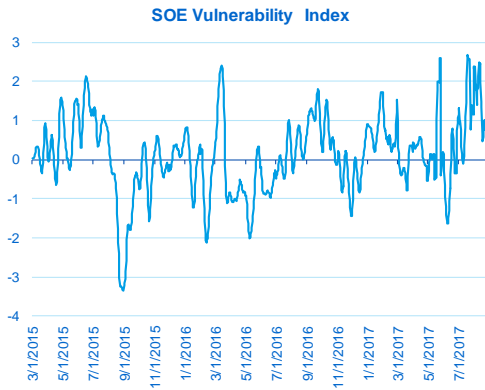


Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

In sum...

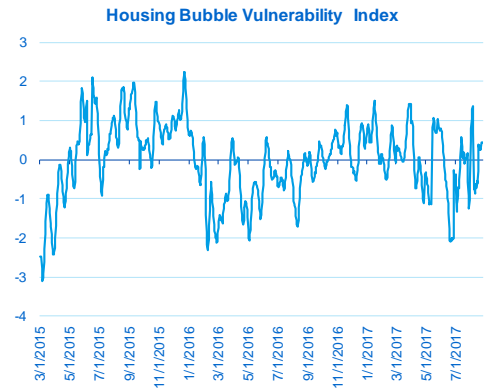
Fine tuning policy stance to ensure growth stability while curbing shadow banking risks has assumed top priority for Chinese policy makers given the political sensitivity around the approaching leadership transition of the 19th Party Congress in fall. Given elevated contingent liability risks, the key question is how long China can effectively sustain its delicate balancing Act.

Figure 2. SOE Vulnerability Index



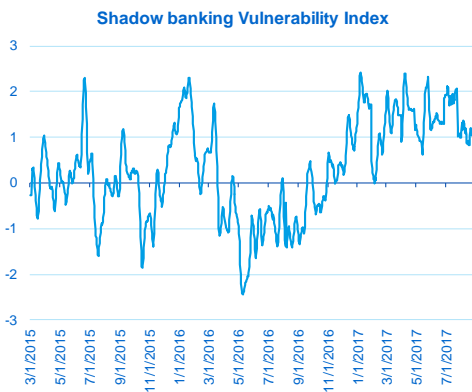
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 3. Housing Bubble Vulnerability Index



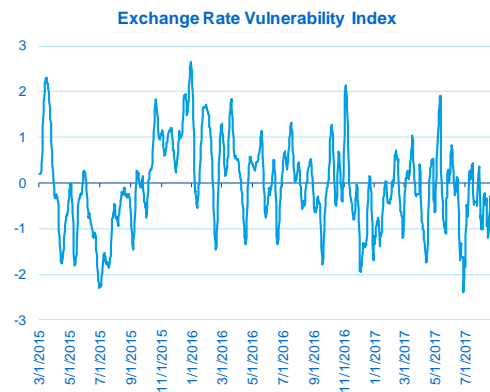
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 4. Shadow Banking Vulnerability Index



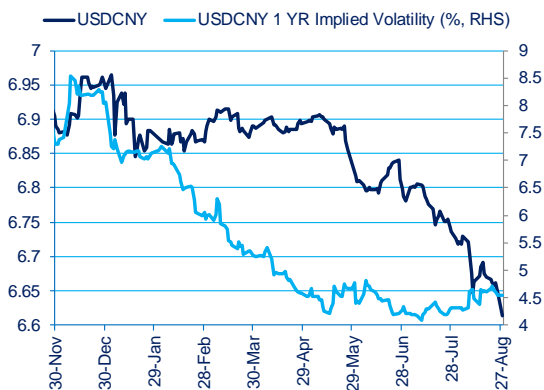
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 5. FX Speculative Pressure Vulnerability Index



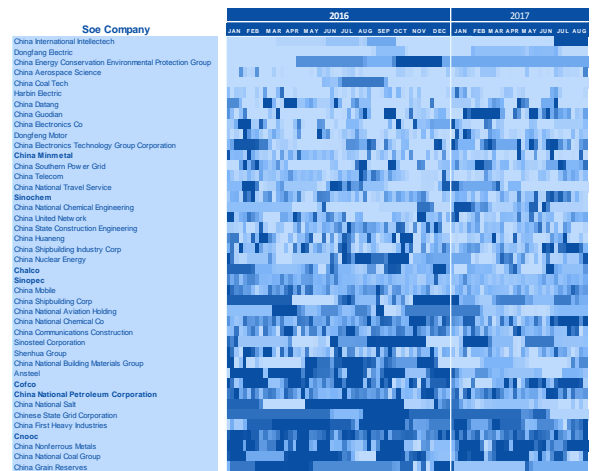
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 6. Policy effectiveness aided by a stable Yuan



Source: BBVA Research, Bloomberg

Figure 7. SOE Sentiment improved vs. last month



Source: BBVA Research, Bloomberg

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