

China: Vulnerability sentiment deteriorates in June

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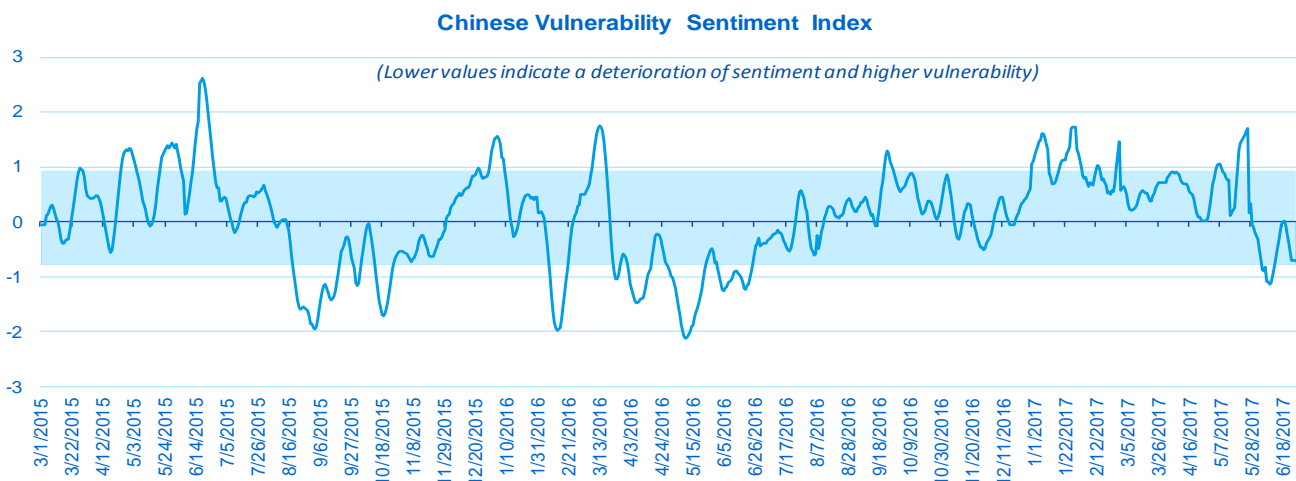
30 June 2017

Our China Vulnerability Sentiment Index (CVSI) deteriorated in June, dragged by Housing and Exchange Rate component, which together offset a stable SOE Index and improving Shadow Banking Index. While May activity data broadly matched expectations, a slowdown in real estate and infrastructure investment suggests moderating growth outlook. The deleveraging campaign has gained traction, with notable easing in shadow lending growth, though concerns over its effectiveness continues to undermine sentiment.

Concerns over effectiveness of deleveraging campaign weighed on June CVSI

The deterioration in June CVSI (Figure – 1) reflects underlying concerns over the effectiveness of China’s financial deleveraging campaign and its ability to prevent a rise in contingent liability, particularly at a time when China’s potential growth is slowing. At a granular level, our SOE vulnerability Index (Figure – 2 and 7) pared its gains over the past month as a decline in commodity prices and tighter policy oversight dragged on SOE profitability. Of greater concern was the sharp decline in Housing Bubble Index (Figure – 3) as developers turned cautious, expecting slowing sales over 2H17, in light of continued tightening measures. China’s housing market has held up relatively well so far as strong transactions in cities without tightening measures offsetting the weak activity in others. On the bright side, the improvement in our Shadow Bank Vulnerability Index (Figure – 4) suggests that policy efforts to reign in shadow and nonbank lending have gained traction. Net new Total Social Financing slowed by a sharper than expected pace in May, led by a decline in corporate bond financing, entrust loans and bankers acceptance bills. In this context, the PBOC noted that alongside financial sector deleveraging, slower M2 growth, as observed in May data, will become the ‘new normal’ going forward. How low would the new ‘slow-growth normal’ be, is clearly dependent on the efficacy of policymaking. Finally, our Exchange Rate Vulnerability Index (Figure – 5) deteriorated in June, attributed in large part to downside pressure on the Yuan led by external factors, particularly the Fed’s June 14th rate hike. That said, we expect PBOC’s prudent approach to curbing capital outflow pressures and actively manage interbank liquidity to stem funding pressures to underpin Yuan stability going forward.

Figure 1. China Vulnerability Sentiment Index (CVSI)

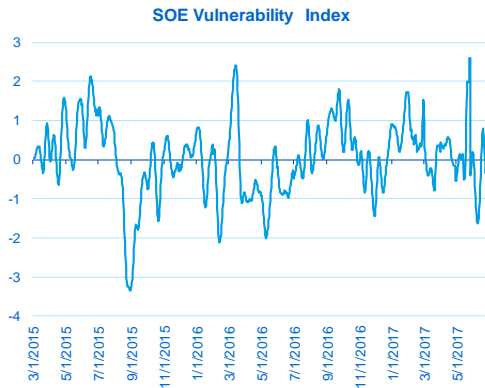


Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

In sum...

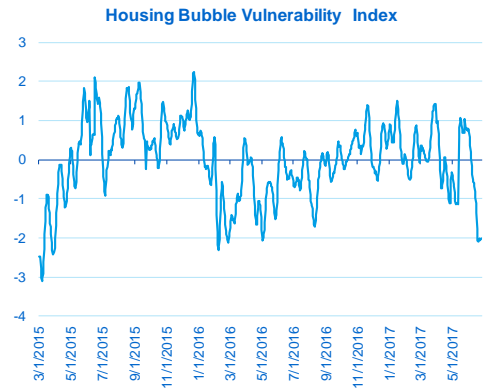
The deterioration in China Vulnerability Sentiment Index (CVSI) over the past month is a harbinger of investor doubts over the ability of China’s ongoing reforms to stem contingent liability risks, particularly in the wake of slowing growth potential. That said, such risks remain manageable so far given the economy’s financial and institutional capacity to support growth.

Figure 2. SOE Vulnerability Index



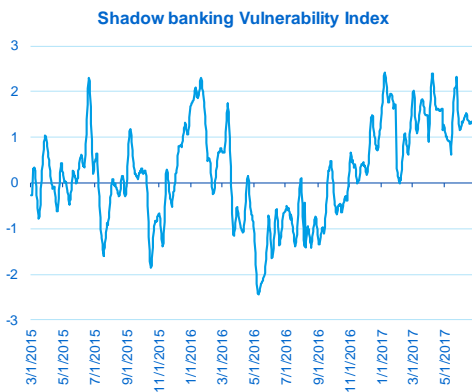
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 3. Housing Bubble Vulnerability Index



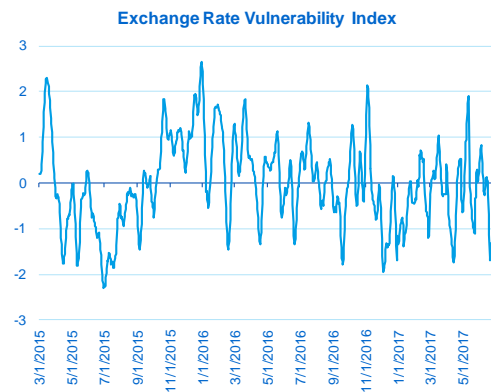
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 4. Shadow Banking Vulnerability Index



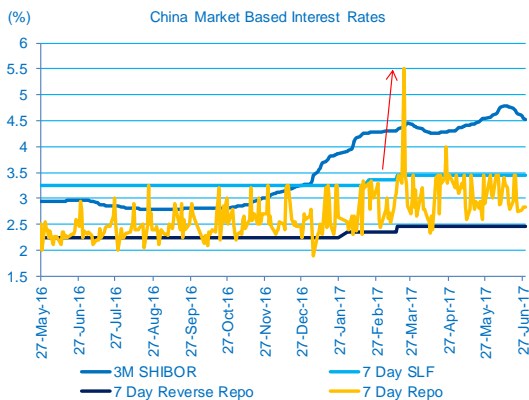
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 5. FX Speculative Pressure Vulnerability Index



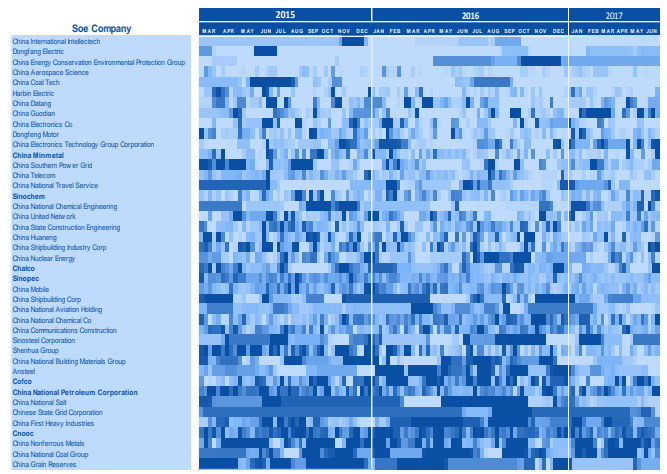
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

Figure 6. Focus on prudent monetary policy



Source: BBVA Research, Bloomberg

Figure 7. SOE Sentiment improved vs. last month



Source: BBVA Research, Bloomberg

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