

China: Vulnerability sentiment boosted by solid economic recovery and clarified policy stance

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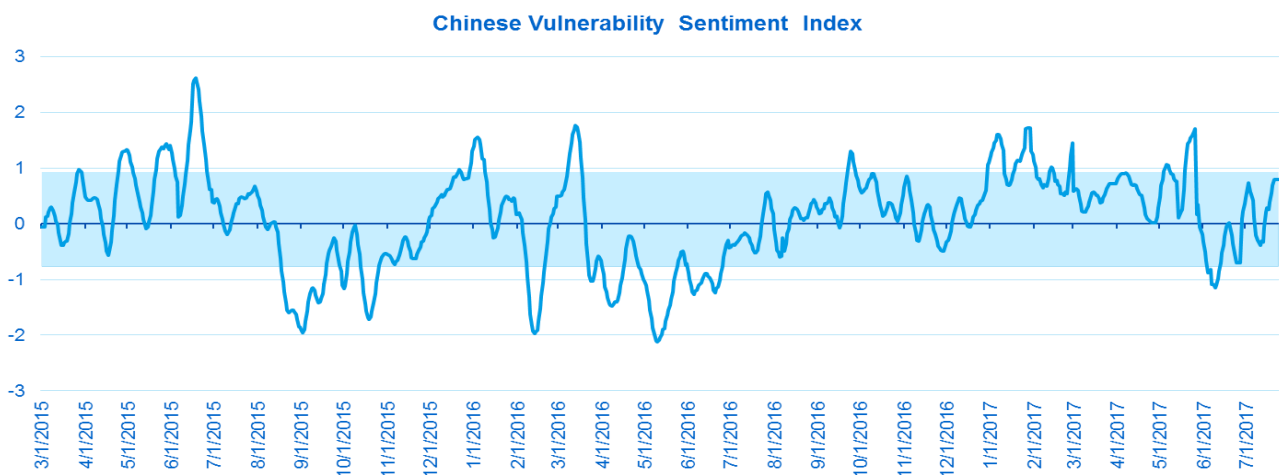
31 Jul 2017

Our China Vulnerability Sentiment Index (CVSI) improved remarkably in July, in particular led by both SOE and Shadow Banking components. Meanwhile, the components of the Exchange Rate and Housing Vulnerability Index also rebounded from the previous low levels, now staying within the neighbourhood of natural level. Behind sanguine sentiments are the ongoing solid economic recovery, which has enabled the corporate sector to register robust profit growth, and the authorities' determination to tackle financial vulnerabilities. All in all, the outturns of CVSI in July imply that investor confidence has been reinforced by recent economic performance as well as the authorities' clarified policy stance.

China's vulnerability sentiment underpinned by diminished tail risk

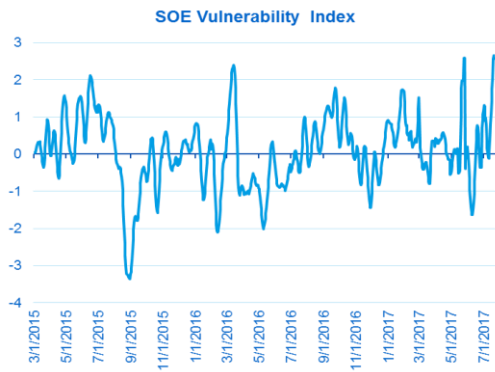
The sharp jump in July CVSI is broad-based. China's State Owned Enterprises reported a solid 24.3% y/y profit growth in the first half of 2017, led mainly by gains in oil, petrochemical, coal and steel industries. The profit growth is underpinned by robust growth performance as the GDP expanded by 6.9% y/y in Q2. Investors' concern over China's giant shadow banking sector also seem to ease somewhat after the authorities nimbly adjust the liquidity in the interbank market to avoid abrupt disruptions in the process of financial deleveraging. Moreover, in the recently concluded national financial work conference, the authorities made it clear that they will continue to curb shadow banking activities while maintaining the financial stability and averting systemic financial risks. The further clarification of policy stance helps to buoy investors' confidence in the ongoing campaign of financial deleveraging. Housing market has also showed some interesting and welcome development in July which could have moved Housing Vulnerability Index in the CVSI. On the one hand, housing prices in large cities seemed to have stabilized and even declined in certain areas, which has somewhat eased the concern of housing bubbles. On the other hand, housing sales in small cities appear to be solid, which can help these cities to reduce their high inventory level of housing. The rebound in Exchange Rate Vulnerability Index is also marked. The weak performance of the USD makes it easier for the authorities to maintain the stability of Yuan exchange rate. More importantly, the authorities have reportedly initiated some investigations against a number of Chinese private enterprises in their overseas M&A activities. Such a move has sent a signal that the authorities cannot tolerate the continuous capital outflows under the porous capital account. All in all, as long as the economic recovery continues and the authorities don't relent their efforts of maintaining financial stability, the tail risks of China are likely to be reduced substantially in the next couple of years.

Figure 1. China Vulnerability Sentiment Index (CVSI)



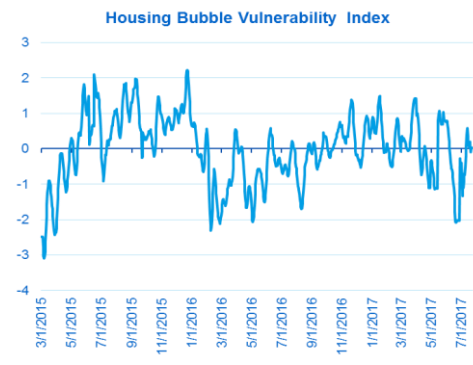
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

Figure 2. SOE Vulnerability Index



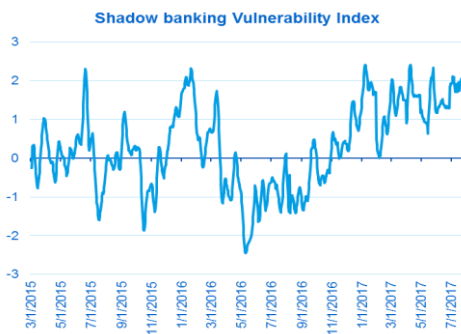
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

Figure 3. Housing Bubble Vulnerability Index



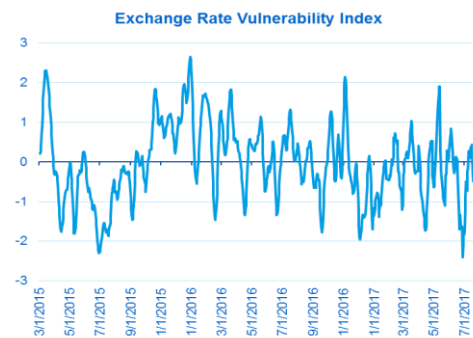
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

Figure 4. Shadow Banking Vulnerability Index



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

Figure 5. FX Speculative Pressure Vulnerability Index



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

Figure 6. Recent CNY fixings have been stronger



Source: BBVA Research, Bloomberg

Figure 7. SOE Sentiment improved vs. last month



Source: BBVA Research, Bloomberg

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