

# China: Vulnerability sentiment extends gains in October

Sumedh Deorukhkar / Alvaro Ortiz / Tomasa Rodrigo / Le Xia

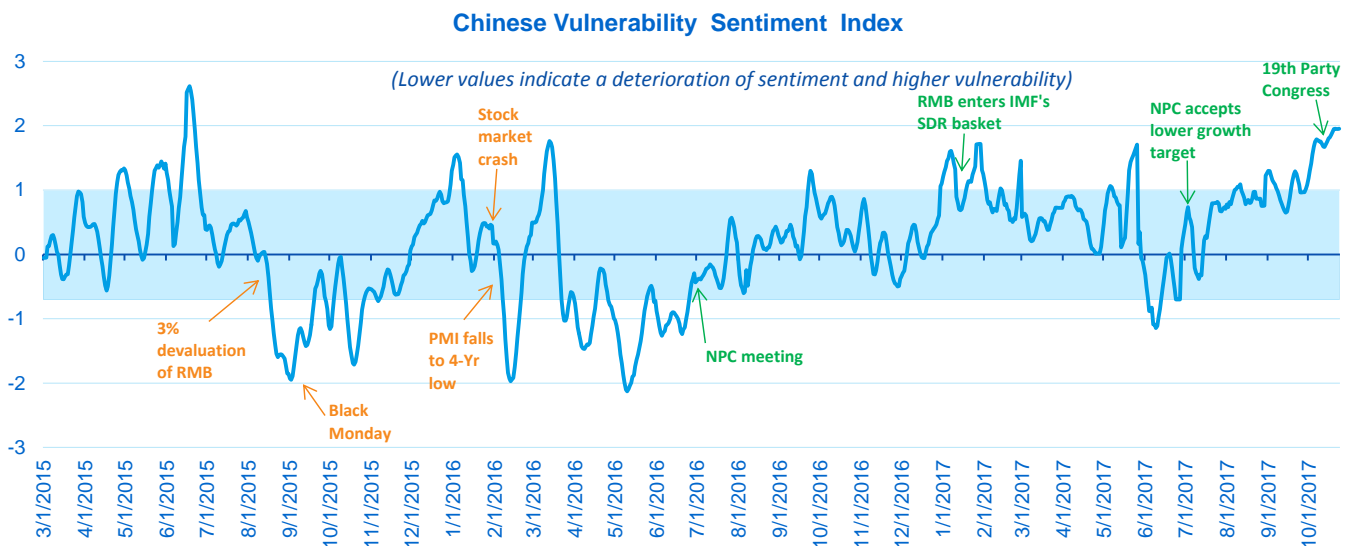
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Our China Vulnerability Sentiment Index (CVSI) notched its fourth straight month of improvement in October, reflecting favourable policy mix, marked by accommodative fiscal policy to stabilise growth and prudent monetary and regulatory measures to curb financial fragility risks related to shadow banking, SOEs and housing sector. China’s reassuring focus on quality growth and commitment to structural reforms at the 19<sup>th</sup> Party Congress bodes well for CVSI going forward. Digging deeper, while SOE, Housing and Shadow banking indices improved, exchange rate vulnerability index worsened. Last month saw Yuan under pressure in wake of the 19<sup>th</sup> Party Congress even as PBOC focused on maintaining exchange rate stability and adequate interbank liquidity.

## Reassuring policy signals from the 19<sup>th</sup> Party Congress underpins October CVSI

Our CVSI improved for the fourth straight month in October (Figure – 1). China’s activity data released over the past month confirmed a gradual growth slowdown, although still robust in level terms with consumption and services sectors acting as key stabilizers. Q3 GDP growth edged marginally lower to 6.8% yy as ongoing supply side reforms and financial deleveraging weighed on industrial activity while past Yuan appreciation hurt net exports. Reassuringly, the 19th Chinese Communist Party Congress reiterated China’s commitment to structural reforms while shifting the policy focus in its ‘principal contradiction’ to the quality of growth. It highlighted that mixed ownership will be an important element of SOE reforms going forward. SOEs liability ratios (total debt/total assets) have started to improve amid progress on corporate deleveraging and capacity cuts (See figure – 2 & 7). Separately, top tier cities saw a marked slowdown in property prices in September, reflecting payoffs from tighter lending standards, and restrictions on purchases (See Figure 3). Meanwhile, a slowdown in unaccounted shadow credit due to financial deleveraging & smaller local govt debt swap program signals lower growth in actual Total Social Financing in 2H17 (See Figure – 4). Finally, exchange rate vulnerability index worsened. Last month saw Yuan under pressure in the wake of the 19th Party Congress even as PBOC focused on maintaining exchange rate stability.

Figure 1. China Vulnerability Sentiment Index (CVSI)

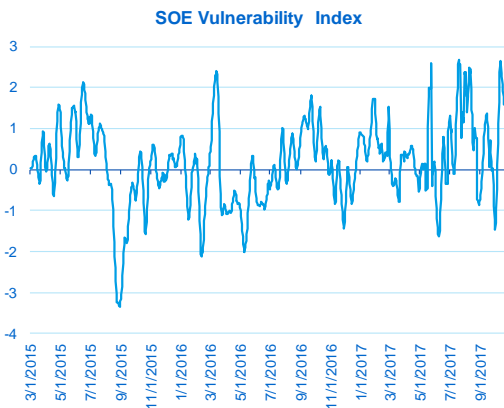


Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

### In sum...

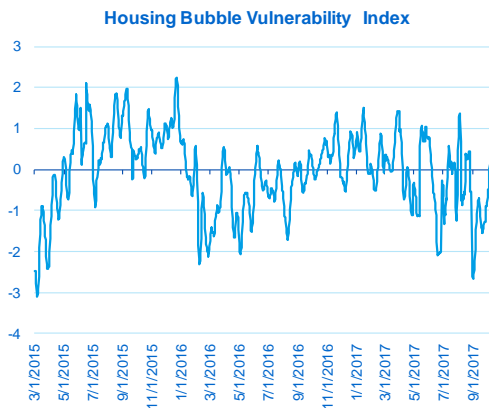
A reiteration of the Party’s commitment to structural reforms at the 19th CPC is reassuring. While China’s growth slowdown is inevitable amid rising credit intensity of GDP growth, credible policy efforts to address financial stability risks by reducing the massive debt overhang is necessary to sustain long term growth prospects. The shift in policy focus to balanced and quality growth could expedite efforts at local government level to reign in activities that lead to imbalanced growth.

**Figure 2. SOE Vulnerability Index**



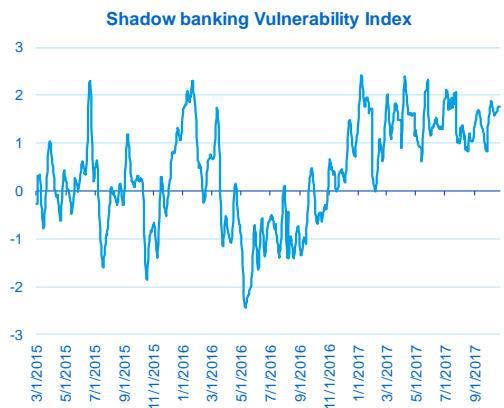
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

**Figure 3. Housing Bubble Vulnerability Index**



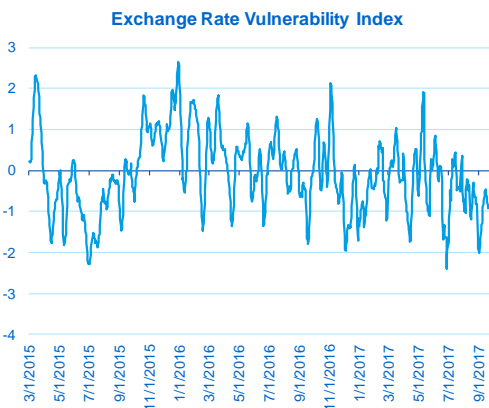
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

**Figure 4. Shadow Banking Vulnerability Index**



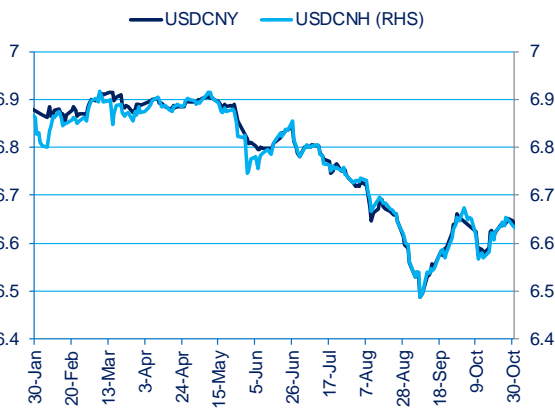
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

**Figure 5. FX Speculative Pressure Vulnerability Index**



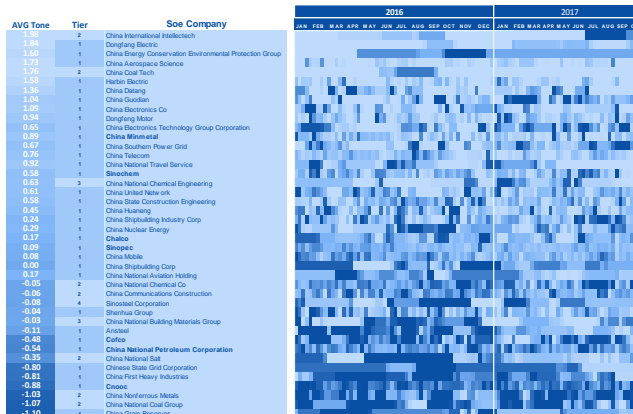
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

**Figure 6. PBOC's actions underpinning Yuan stability**



Source: BBVA Research, Bloomberg

**Figure 7. SOE Sentiment softened vs. last month**



Source: BBVA Research, Bloomberg

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