

# China: Vulnerability sentiment resumed upward trend in 2018

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Our China Vulnerability Sentiment Index (CVSI) resumed its upward trend in 2018, underpinned by a stronger-than-expected GDP, on-going efforts to curb risks to financial stability emanating from the SOEs and shadow banking sector, shift in policy focus towards quality of growth and PBOC’s prudent monetary policy stance. Housing vulnerability index has seen significant improvement, SOE index rebounded somewhat despite its deterioration early January. Shadow banking vulnerability index showed signs of stabilization after a fresh round of regulations released. Exchange rate vulnerability index dropped as the market starts to worry about the recently fast appreciation of the RMB.

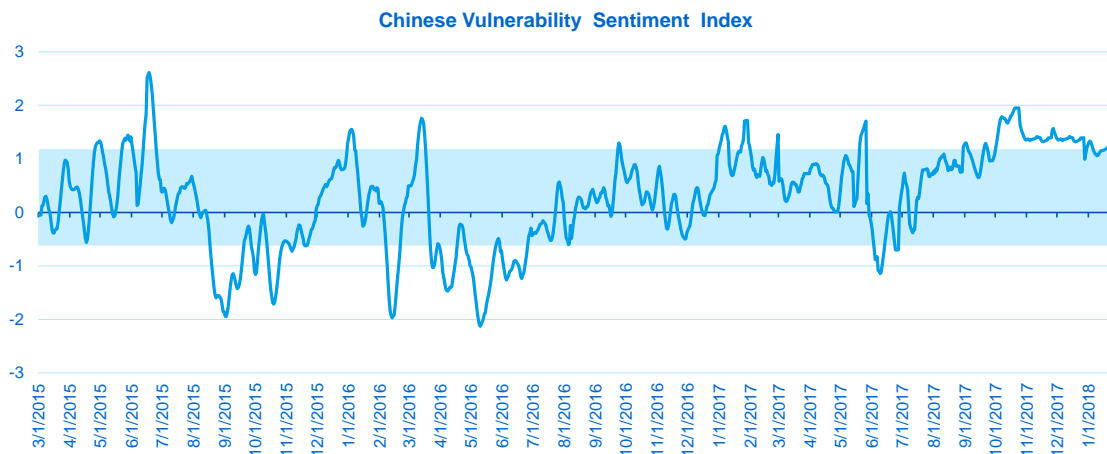
## Stronger 2017 GDP and improvement in housing vulnerability underpinned CVSI

Our CVSI resumed its upward trend in January on China’s macro economy recovery following a small drop early this month shortly after the annual Central Economic Work Conference (CEWC) (Figure – 1). China 2017 GDP came robustly than most expected at 6.9% y/y. Growth resilience has given some boost to people’s confidence. Looking closer at sub-components, our House bubble vulnerability index (Figure – 3) has improved significantly as housing sales growth has cooled markedly on the authorities’ stepped-up efforts to clampdown speculation in the housing market. Moreover, CEWC emphasized the need to increase supply of public housing. SOE vulnerability was hit earlier by the lackluster investment coupled with concerns about increased influence of communist party in operations of SOEs after the CEWC (Figures 2& 7). It has rebounded somewhat after the authorities announced robust profit growth of 15.2% y/y in 2017 this week-the highest in five years, led by ongoing capacity cuts in mining, oil and steel sectors. Meanwhile, Shadow banking vulnerability index showed signs of stabilization (Figure – 4) as the authorities reiterated their determination to curb shadow banking activities in the coming year while maintaining the financial stability and averting systemic financial risks. The shadow banking sector is still facing new pressure after a fresh wave of regulations released in mid-January, targeting on liquidity management, country-party risk, trust loans, entrusted loans, equity investment and bond market trading. Finally, the Exchange rate vulnerability index dropped (Figure – 5&6) over the concern about that the recent sharp RMB appreciation could hurt competitiveness of China’s exports.

### In sum...

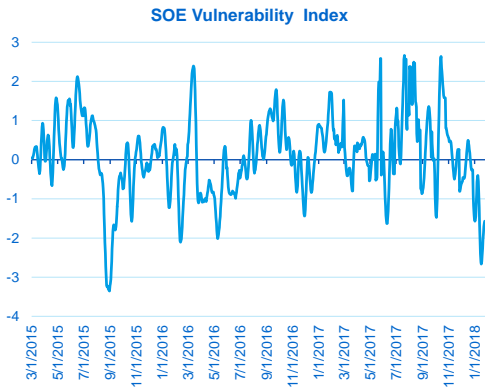
The 2018 growth target is still on a solid footing at around 6.3%, although the focus of policy shifts away from quantitative targets and towards improving the quality of growth. Markets will test whether policymakers can repeat the successful balancing act in the coming year.

**Figure 1.** China Vulnerability Sentiment Index (CVSI)



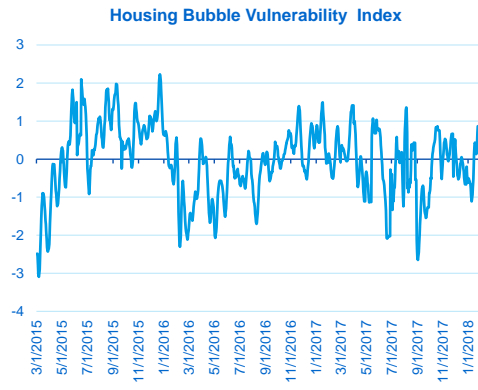
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC and Wind

**Figure 2. SOE Vulnerability index**



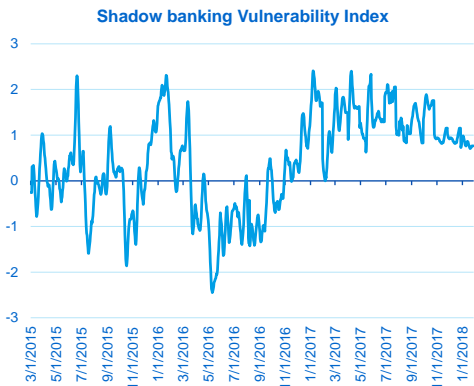
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**Figure 3. Housing Bubble Vulnerability index**



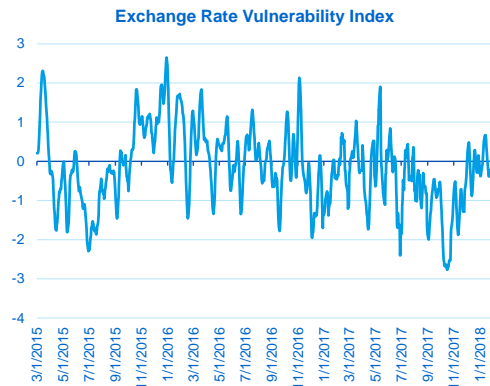
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

**Figure 4. Shadow Banking Vulnerability Index**



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

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



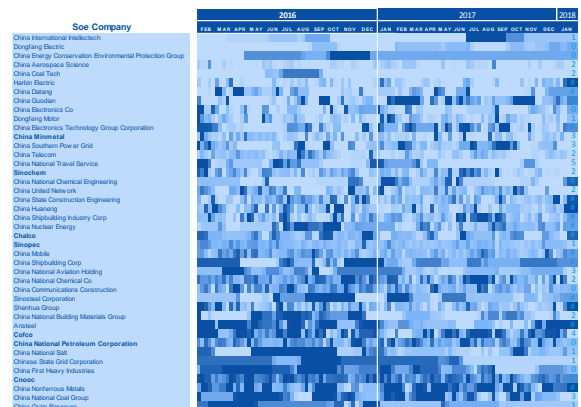
Source: BBVA Research based on figures by Gdelt, Bloomberg, CEIC, Wind

**Figure 6. Chinese Yuan started 2018 on a strong note**



Source: BBVA Research, Bloomberg

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



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

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