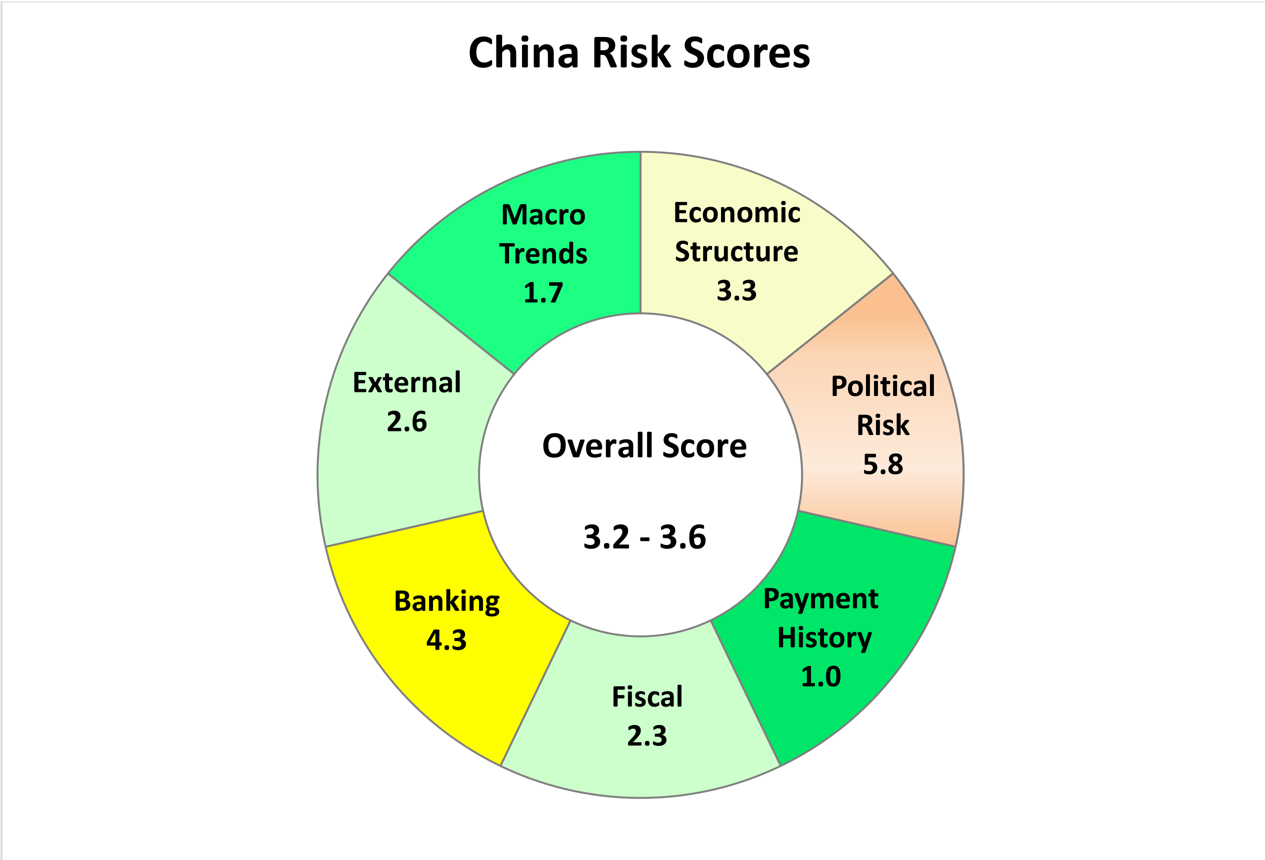

China Trend Risks

As Chinese leaders seek to rebalance the economy away from exports and toward domestic spending, growth will continue to slow. Real GDP is forecast to rise 6.2% in 2017, down from an average of 7.2% in recent years. Infrastructure spending is still one tool for the government to keep output near target levels, but rebalancing is well underway. Inflation is subdued at 2.3%.

Exports remain fairly buoyant, resulting in a current account surplus of 2.4% of GDP. Limited exchange rate flexibility and capital outflows have paced a decline in fx reserves to $3.2 trillion. Fiscal policy reflects this policy shift: the overall deficit reached 3% of GDP in 2016, while net public debt is a mere 14% of GDP. The central government has restructured municipal debt markets, curbing one of most worrisome market concerns. Banking reforms are also advancing. The central bank set limits on loans from “shadow banks”, although private credit growth remains vigorous at 17% p.a. The authorities are preparing plans to restructure corporate balance sheets, where indebtedness now exceeds 140% of GDP.

Political leadership in China is increasingly concentrated in the hands of President Xi Jin-ping. He is replacing many Party Central Committee members to consolidate his control over power.