# Flash Note
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# *China will continue to contribute to global activity, but again exports deflation*

*The economy remains well supported.*

Chinese Q2 GDP was +6.9% y/y (above consensus of +6.8%). Why the GDP has not moderated despite the macro-prudential approach implemented by Chinese authorities? The moderation in credit growth has been concentrated at some specific end parts of the market—lending to insurers and non-bank financials-, rather than in lending to the real economy.

What next? The economy remains well supported by stronger than expected property and export sectors. Restrictive policies on the real estate sector have cooled off transactions in the most over-heated big cities but they have not affected the market in the rest of the country (nationwide housing sales that were up 13% in volume terms). As for the external sector, it also proved a bright spot in the first half, with exports growing at their strongest pace since 2011 (due to the economic recovery in developed markets and the adjustment of the renminbi exchange rate over the past two years). These factors are likely to fade slowly in the second half of the year, that's why I believe that China will continue to contribute positively to global growth (although at a lower marginal rates). That said, inflation has moderated again and is set at an incredibly low level of 1.5% per annum in June. And most importantly, after last year's stimulus, industrial production prices are once again moderating, and that explains the fall in prices in the OECD countries (see the chart overleaf). This is something that, in my humble opinion, will probably persist.

Why the GDP has not moderated despite the macro-prudential approach implemented by Chinese authorities?

*Noise from Fiscal and Monetary areas sounds reassuring*

The Macro-prudential approach is already bearing fruits. Some domestic media have begun to announce the success of financial deleveraging, arguing that interbank leverage has been reduced significantly, citing a fall in the number of new wealth management products, a balance sheet contraction in some large bank, and a deceleration in M2 growth. All this suggests the tightening process is more or less complete. Both Xi and Premier Li Keqiang stressed the importance of "deleveraging" in the real economy.

*Reforms*

The Financial Work Conference (FWC) is a big deal. Held only once every five years, and according to our sources, it has a history of making decisions that have a major impact in determining the structure and development of China's financial sector over subsequent years. In 1997 it set up the big 4 asset management companies to resolve state bank's bad debts. In 202 it stablished the China Banking Regulatory Commission and paved the way for the listing f the SOE banks. In 2007 it set up the China Investment Corporation to manage a share of the country's Fx reserves.

In the last Financial Work Conference, the focus was on stronger financial regulation…

At this last FWC, president Xi urged for, highlighting the importance of safeguarding against systemic financial risks. At this year's meeting the focus was on: (1) Stronger financial regulation to contain risks, (2) further centralizing China's financial regulatory framework -the work conference decreed the establishment of the high-level State Council Financial Stability Committee, bringing the four regulators under a single committee. This should in theory reduce turf wars and cut regulatory arbitrage-. Xi added the government will continue to deleverage the economy by firmly taking a prudent monetary policy and prioritizing reducing leverage in SOEs. (That's why we like the Shenzhen index more than the Shanghai index).

… as well as the broad based deleveraging process initiated in 2016 within the Macro-prudential approach framework.

On the other hand, we have known that China is looking at allowing foreign agencies to assign credit ratings on onshore bonds (PBoC Deputy Governor Pan Gonsheng): "This could happen very soon and within this year".