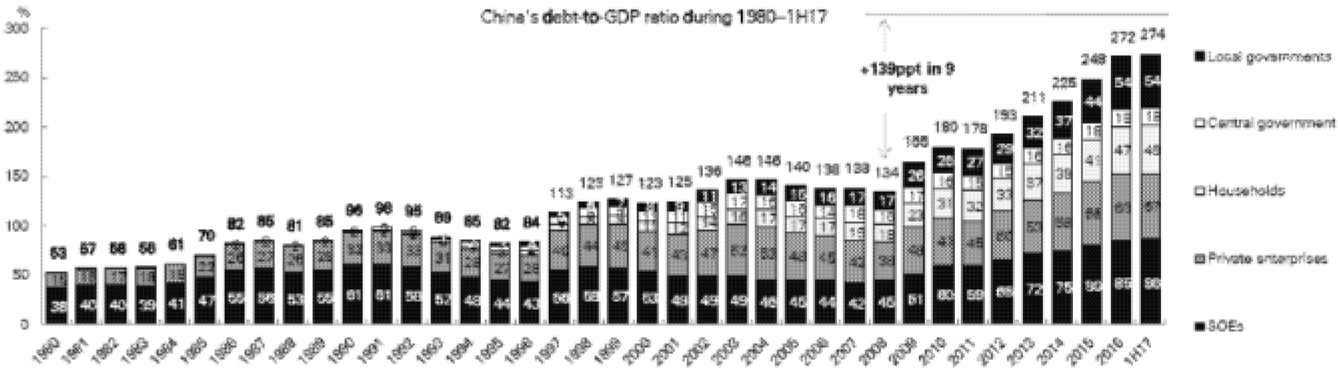
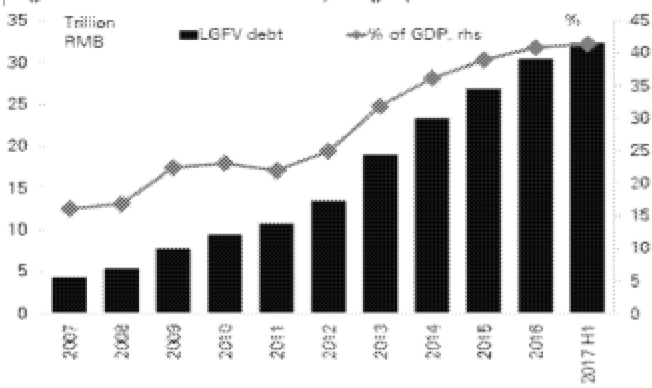
Figure 41: China's leverage is already high



Source: Deutsche Bank China Financial Institutions Research

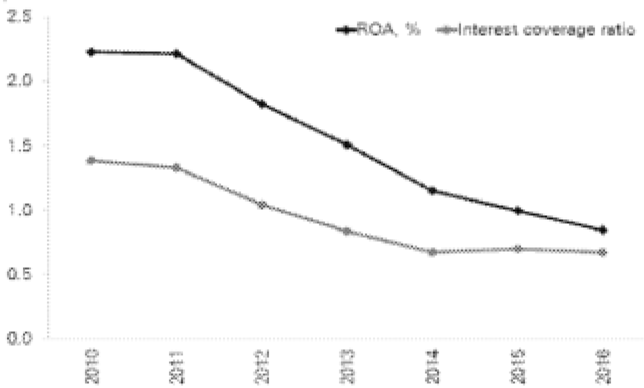
- Infrastructure investment, a major contributor to investment growth, is set to slow down. Infrastructure accounted for 54% of investment growth in Q1-3 2017. Local government financing vehicles (LGFVs) helped channel large amount of bank loans and market financing into infrastructure projects. As LGFVs continued to pile up debt, their financials deteriorated (Figure 42, 43). The central government is now putting stricter rules on LGFV financing. The debt swap program that helped relieve LGFVs of high debt is also coming to an end. These would constrain LGFVs' ability to borrow and invest in infrastructure.

Figure 42: LGFV debt is still piling up



Source: Deutsche Bank, WIND, NAO, CBRC

Figure 43: Deteriorating financials, median LGFV



Source: Deutsche Bank, WIND
Note: EBIT based ICR, adjusted for interest expense and fiscal subsidy

A tightening bias in macro policies

Following the 19th party congress in Oct, policymakers sent strong signals for a structural shift in policy focus. Headline GDP growth is no longer a priority, instead, they will focus more on growth quality and containing risks.

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- At his speech addressing the party congress, President Xi emphasized growth quality over quantity more than any of his predecessors. Improving "social productivity", which had been the main goal of the party for more than two decades, has to give way to "quality and effectiveness of development". He did not mention the growth target for 2020 in his speech.
- PBoC's veteran Governor, Zhou Xiaochuan, warned about the risk of a"Minsky Moment" during a group discussions at the party congress. What he meant was the risk of a major crisis caused by excessive risk taking in the financial sector. Zhou later published an article on PBOC's