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'This newsletter is translated from the Japanese edition distributed on October 21st
Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

Global Risk Watch Newsletter

Narrower Paths for Major Central Banks Now Face the Risk of Being Clogged by Another European Shock, etc.

Global Risk Watch Vol.19
28 October 2016

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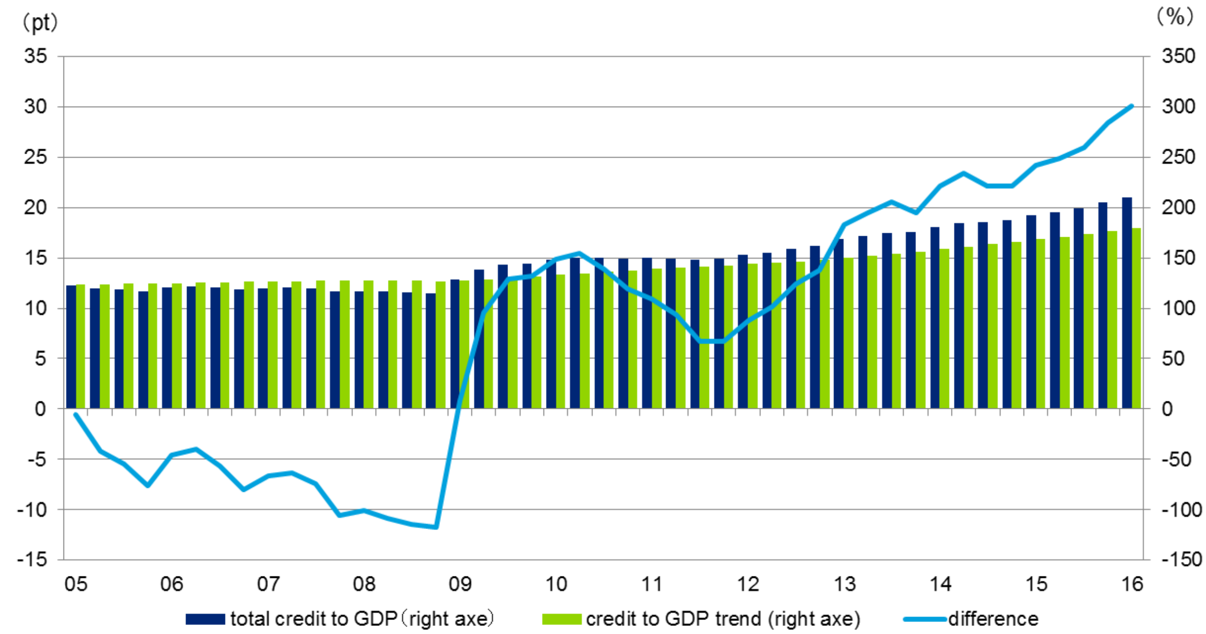
3. Highlight of Indicator for this Month

 # Whether Inflated China Debt is Close to Crisis (Toshikazu Kumagai, Senior Staff, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

In the Bank for International Settlements (BIS) quarterly report, increase of China's private debt to GDP ratio was pointed out to be excessively high compared to the trend in the past (Chart 1). BIS likewise issued a warning against Canada, but the excessiveness of the trend is much higher in China compared to Canada. This warning cautions on the possibility of a crisis within the next 3 years, even though China received its first warning in the second quarter of 2012 and 4 years have passed since then. Would the crisis not happen? Taking examples from past crisis situations, we have compared the situations from Thailand's Asian currency crisis, Japan's collapse of the bubble economy, and US' Lehman shock.

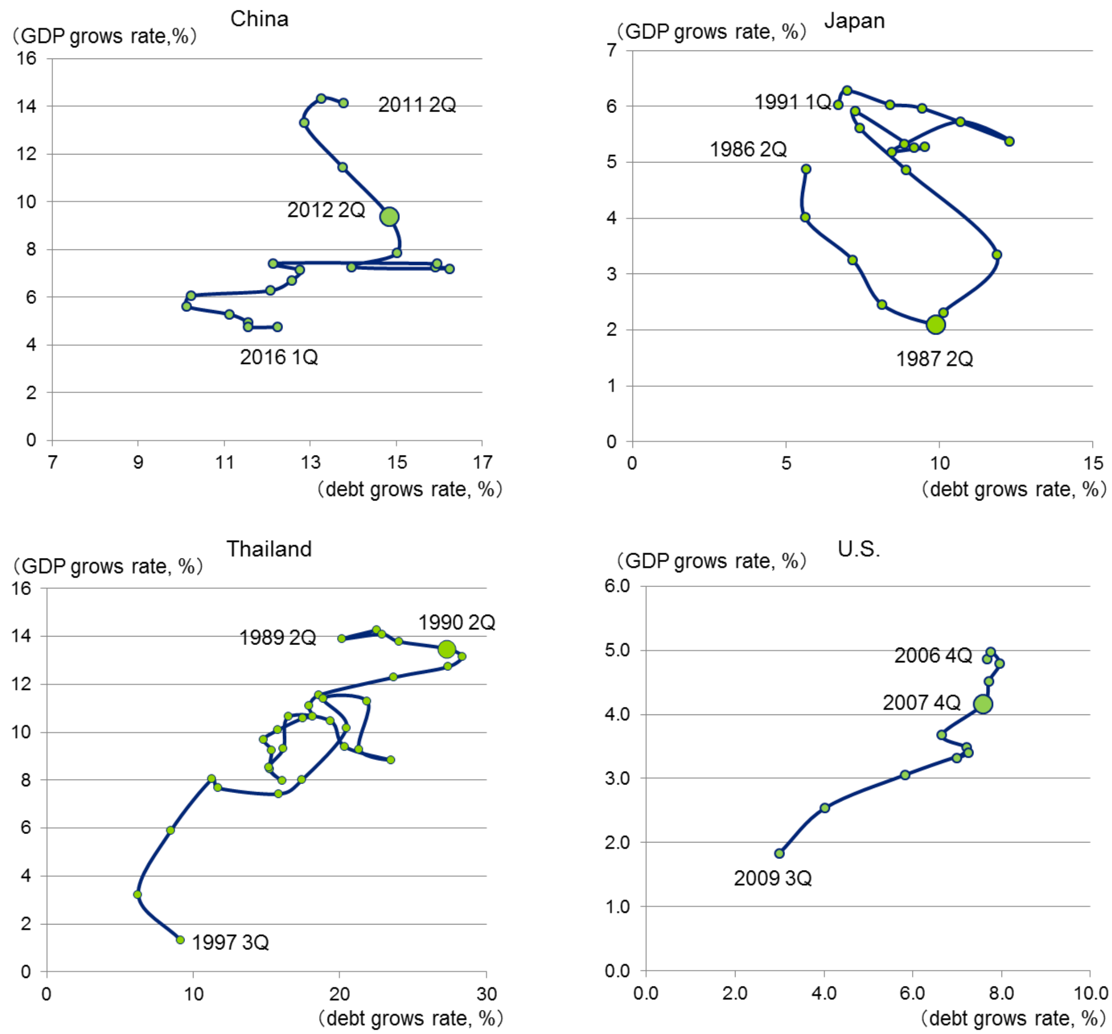
On the increase in debt to GDP ratio, it seems Thailand's case is relatively similar to China's case by taking a close look at the debt and GDP trends (Chart 2). In the case of Thailand, the debt growth rate expanded until it reached the 10% pts alert level. Afterwards, the economic growth growth rate slowed faster than the pace of debt growth rate, which led to the crisis. China is also showing similar trend since 2012. In the case of Thailand in 1997, 7 years after the initial alert and when the currency Bahts was a dollar peg, the views of an overvalued led to speculative selling of the Bahts, which resulted in the Asian currency crisis. The Yuan market has continued to show gradual decline recently, but is not yet up to the level to be cautious on speculative selling. Hereafter, Tt is necessary to keep close attention to uncertain factors, such as escalating domestic political struggles and slowdown of economic growth, which could consequently triggering a wave of capital outflows.

Chart 1 : Credit to GDP of CHINA



Souce : BIS

Chart2 : Credit and GDP until crisis occuring



Source : BIS
Note : the graph illustrates(1) 1 year prior of debt-to-GDP gap teaches 10% pts deviation from the trend; (2) at the time of debt-to-GDP gap reaches 10% pts; (3) at the time when crisis occurs