

Referee Report for the Paper

Measuring the Instability of China's Financial System: Indices Construction and an Early Warning System

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Summary

The manuscript "Measuring the Instability of China's Financial System: Indices Construction and an Early Warning System" aims at construct indices to measure and monitor the instability of China's financial system and provide an early warning system. The paper is written well with very important topic and the methods applied are well explored. However, the quality of the overall presentation need to be significantly improved, and the method of constructing CNFSI should be revised.

Comments

(1) The authors provides possible sources of financial vulnerabilities for the identified episodes of financial stress by CNFSI, however, the sources should be better identified and elaborated. One way to improve this is to disaggregate the overall CNFSI and measure the contributions of the sub-indices to the financial stress. This may provide more deep information on the sources of financial stress.

(2) The authors use the non-performing loan ratio for the state-owned commercial banks to assess the stress of banking sector in China, but the definition of the state-owned commercial banks is not clear. If it is referred to the big four state-owned commercial banks as shown in figure 1, the capital share of these banks is not as high as 70% in 2000s and is already below 50% in 2010s, according to the CBRC reports. In this case, full data of non-performing loan ratio should be applied. The authors should be careful about this.

(3) Another concern is about the non-standard financial system. One concern about China's financial system is the shadow banking system, which threatens the instability of China's financial system, especially in recent years. Therefore, the authors may find ways to include shadow banking risk in constructing CNFSI.

(4) In table 3, financial stress in reality is not defined. The authors should explain this variable and provide its data source.

(5) Presentation. For example, "Moreover, a well-constructed index' should not be meaningful as a monitoring tool, but also useful within a large EWS (Early Warning System)". There should be an "only" after "should not". In addition, in Table 1, for the episodes of Dec, 2006, it lacks possible sources of financial vulnerabilities. What's more, some literature mentioned in the paper can't be found in the reference, such as Frankel and Saravelos (2012). The authors should ensure the reference to be accurate. Overall, the paper requires careful editing.

(6) Typo. There are two "Figure 15". The first one should be figure 13.