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Hearing on China's Current Economy: Implications for Investors and Supply Chains

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The Chinese economy is currently in a weak position. The country's economy performed well in the early years of the pandemic. However, growth decelerated sharply in 2022 due to the implementation of draconian lockdowns in cities across the country and a severe decline in the real estate sector. Since Beijing abruptly reopened the country at the beginning of the year, the economic situation has improved somewhat (Figure 1). However, activity is substantially weaker than many of the optimistic projections that prevailed at the outset of 2023. China not only failed to have a reopening boom, it is now losing economic momentum.

Much attention has been focused on long-term factors impacting China's growth, such as an aging and shrinking population. But the current state of the Chinese economy can be more directly attributed to three policy decisions made over the past several years: a failure to moderate the real estate deleveraging campaign, a crackdown on the private sector that has damaged business confidence, and a failure to adequately prepare for the post-Covid era.

Equally important, the Chinese government has backtracked during this period on addressing fiscal imbalances between the central government and local governments. This created new financial risks and further hindered the country's economic recovery. Local governments play a key role in stimulating the economy during downturns through infrastructure investment and other spending. However, as local governments have become more indebted, they have become less able to support the economy. As a result, one of the key tools Beijing has relied upon to boost economic growth has become significantly less effective.

I. Policy Mistakes Have Damaged the Economy

Real Estate Deleveraging Campaign: In 2020, the Chinese government decided to push ahead with a major restructuring of the property sector. One of the most important policies issued during this period was the Three Red Lines, a set of balance sheet constraints for property developers that were intended to force deleveraging.[1] Economists for years had warned about the potential dangers of a real estate

[1] The policy sets out balance sheet rules that real estate developers must adhere to or face restrictions on their ability to borrow. They require developers to maintain a liabilities-to-assets ratio of less than 70%, a net-debt-to-

bubble.[2] According to international comparisons, the share of the Chinese economy connected to real estate was extraordinarily high.[3] Moreover, price levels in China's Tier 1 and Tier 2 cities had increased well beyond what could be supported by the income of a typical Chinese household.

China's real estate developers were at the heart of many of the imbalances in the property market. As China underwent the largest urbanization transition in world history, Chinese real estate developers grew to be enormous. Between 2010 and 2021, the total liabilities of Chinese real estate enterprises increased by more than 5 times, to more than 12 trillion dollars.[4]

Many real estate developers expanded their businesses in a financially reckless manner, borrowing heavily to fund an aggressive accumulation of land holdings and using pre-sales from one project to fund another. Additionally, some real estate developers used their ability to borrow to expand into completely unrelated business lines, such as electric vehicles. It is therefore unsurprising that policymakers in China would seek to tame speculation in the property market and force real estate developers to clean up their balance sheets. The problem is that the approach adopted by Beijing was too rigid and implemented during a time when the rest of the economy was facing a slowdown.

In 2021 and 2022, property developers soon faced a severe financing crunch. Obtaining funding from pre-sales, bank loans, and bond issuances all became difficult (Figure 2). The riskiest and most overleveraged property developers ran into trouble first, but the financial stress soon expanded to the entire sector. No longer able to obtain financing, property developers began pausing work on new housing projects. The Chinese residential real estate market relies heavily on pre-sales of new homes. Faced with the prospect that their pre-purchased homes would not be completed, some Chinese homebuyers refused to make mortgage payments, further increasing stress in the property market.

Once the impact of the real estate crackdown began to be fully recognized, the Chinese government moved to undo some of the damage. Policies such as the Three Red Lines were relaxed, and the government put forward a series of measures to restore financing channels to real estate developers. Moreover, at Beijing's direction, local governments started to force the completion of stalled property projects, ordering construction to resume while the debate over who would bear debts and losses continued. To help put a floor underneath the land sales market, local government financing vehicles (LGFVs) stepped in as the buyers of last resort during land auctions.

As a result of this turnabout in government policy, there is some indication that the sharp decline in real estate has been arrested. However, the property market remains weak, and the recovery has continued to significantly underperform optimistic assessments by analysts. One key problem is that the financing challenges for real estate developers have not been fully resolved. This is particularly the case for private sector developers who have faced more severe financing constraints relative to their state-owned competitors. Another major issue is that investment demand for new properties is now substantially lower.[5] The events of the past few years have convinced many Chinese investors that real

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equity ratio of less than 100%, and a cash-to-short-term-debt ratio of less than 1. Bloomberg. "What China's Three Red Lines Mean for Property Firms," October 8, 2020. https://www.bloomberg.com/news/articles/2020-10-08/what-china-s-three-red-lines-mean-for-property-firms-quicktake#xj4y7vzkg.

[2] Lardy, Nicholas. 2012. Sustaining China's Economic Growth After the Global Financial Crisis. The Peterson Institute for International Economics.

[3] Rogoff, Kenneth, and Yuanchen Yang. 2020. "Peak China Housing." National Bureau of Economic Research, August. https://www.nber.org/system/files/working_papers/w27697/w27697.pdf.

[4] CEIC Data, accessed August 7, 2023.

[5] Wang, Lisheng, Hui Shan, Maggie Wei, Xinquan Chen, Yuting Yang, and Andrew Tilton. "China: 'L-Shaped' Property Sector Recovery Ahead without a Quick Fix." Goldman Sachs. June 11, 2023.

estate investment is no longer a sure bet and that they may indeed face losses if they overpay for a second or third apartment. Finally, Chinese demographic trends are now turning against the housing market. A shrinking population and slowing urbanization rate mean that there will be less demand for new housing going forward. All these factors mean that the Chinese real estate market is unlikely to return to rapid growth.

Crackdown on the Private Sector: A sweeping and unpredictable regulatory campaign has damaged the business environment in China. These efforts began with the abrupt cancellation of Ant Group's much-anticipated initial public offering (IPO) mere days before it was scheduled to occur in 2020. Ant Group had originally been spun out of Alibaba Group and had quickly revolutionized the Chinese financial system by offering convenient retail payments, affordable consumer loans, and attractive savings products.

There remains significant debate about why the IPO was terminated so suddenly. Some analysts point to an October 2020 speech given by Alibaba's Jack Ma in which he is alleged to have challenged the authority of Chinese regulators and attracted the attention of Xi Jinping.[6] Others point to the speed of Ant's growth and the number of different product lines it offered as creating concerns about potential risks in the financial system. Additionally, Ant had emerged as a potent threat to China's state-owned banks, which have never been innovative or oriented toward retail customers. Regardless of the reason, after the IPO was terminated, both Ant and Alibaba were subjected to intense regulatory scrutiny, forced to change key business practices, and subjected to large fines.

Following the actions against Ant and Alibaba, China's regulators initiated a wide-ranging series of new restrictions that would become known as the "Regulatory Storm." These new policies had a devasting impact on many of China's leading private firms. China's social media and e-commerce platforms were forced to restructure their business models. Certain industries, most notably the private education sector, were nearly regulated out of business. China's creative industries faced a freeze on new movie and game approvals. Retail payments and consumer lending were put under strict new regulations, significantly reducing the profitability of private sector firms operating in these areas. The Communist Party redoubled its efforts to establish organizations within private companies.[7] A new data security law created significant regulatory uncertainty for private companies dealing with large amounts of user data. Finally, the government began pressuring private companies to play a larger role in supporting social initiatives, a policy referred to as "common prosperity."

The scope of action seen between 2020 and 2022 was far broader than what can be considered the normal purview of regulators. It can be instead understood as a renewed effort to steer the economy towards supporting Beijing's policy goals.[8] There were two primary motivations behind the campaign. First, the Chinese government had become increasingly uneasy with private companies controlling critical nodes in the economy. The Party would prefer to see the new "commanding heights" economy,

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https://marquee.gs.com/content/research/en/reports/2023/06/11/60ea2884-8c12-4e41-a5a3-f31a5c101a0b.html.

[6] Yang, Jing, and Lingling Wei. 2020. "China's President Xi Jinping Personally Scuttled Jack Ma's Ant IPO." WSJ, November 12, 2020. https://www.wsj.com/articles/china-president-xi-jinping-halted-jack-ma-ant-ipo-11605203556.

[7] Livingston, Scott. 2022. "The Chinese Communist Party Targets the Private Sector." https://www.csis.org/analysis/chinese-communist-party-targets-private-sector.

[8] Naughton, Barry. 2022. Grand Steerage as the New Paradigm for State-Economy Relations. CPC Futures: The New Era of Socialism with Chinese Characteristics. NUS Press. http://www.epress.nus.sg/cpcfutures/9789811852060-13.pdf.

focused on technology and information flow, controlled by entities it can reliably supervise and control. Thus, the campaign was focused on reshaping these industries and directing them towards activities Beijing views as productive. Second, the growing competition between China and the United States has increased the interventionist impulses of the Chinese government. Because they are engaged in increasingly fierce economic competition with the world's largest economy, Chinese leaders have become more inclined to intervene in the economy to reduce potential risks and direct resources toward national policy goals.

As acknowledged by Xi Jinping, the private sector is responsible for most of the economic growth, employment, and innovation.[9] However, the unpredictable and draconian policy changes of the last several years have significantly damaged the operating environment for private companies in China and shaken the confidence of many entrepreneurs. As a result, the market capitalization of many of China's leading private companies was significantly reduced and private sector investment growth has withered (Figure 3).

Policymakers in China have subsequently conceded the need for greater regulatory certainty for private companies. However, even some of the more recent policy documents aimed at supporting the private sector still reference the need to establish greater party oversight over companies and to increase the role of the private sector in supporting national objectives.[10] As a result, private sector business confidence in China is at a low level and unlikely to recover rapidly. Absent a significant change in government policy, private-sector business confidence will remain weak.

Lack of Planning for the Post-Pandemic Era: In the second half of 2020, it became clear that effective vaccines for Covid-19 were possible and that countries needed to begin adjusting their approach toward the pandemic. However, China did not seize that opportunity to begin preparing for an environment where Covid would become less deadly. Instead, the country held steadfast to a “zero Covid” policy that effectively sealed off China from the rest of the world.

In 2022, new variants of Covid-19 began to emerge that while less deadly, were increasingly transmissible. In response, Chinese authorities engaged in a series of draconian lockdowns and quarantine measures throughout 2022. The most notable was the two-month lockdown of Shanghai, the country’s largest city. The economic damage from these Covid lockdowns was tremendous. Consumption was severely impacted as people avoided crowded areas for fear that they could face a mandatory quarantine if they were exposed to someone who later tested positive. The domestic and international tourism industries were devasted as people stayed home and the country’s borders remained largely closed. Pressures in the real estate sector were exacerbated as homebuyers stayed home instead of house shopping.

Meanwhile, China’s economic stimulus was insufficient to counteract the impact of the Covid lockdowns. The millions of small and medium enterprises that make up the backbone of the Chinese economy were severely damaged. Government tax breaks and policy-driven lending were not enough to offset the precipitous decline in demand. Chinese consumers increased their savings during the pandemic, leading some analysts to predict a surge of "revenge spending" once the country opened

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[9] Xi Jinping, “Speech at the Private Company Symposium (习近平: 在民营企业座谈会上的讲话),” Xinhua, November 1, 2018. http://www.xinhuanet.com/politics/2018-11/01/c_1123649488.htm

[10] “Opinions of the Central Committee of the Communist Party of China and the State Council on Promoting the Development and Growth of the Private Sector (中共中央 国务院关于促进民营经济发展壮大的意见).” 2023. The State Council of the People’s Republic of China. July 19, 2023. https://www.gov.cn/zhengce/202307/content_6893055.htm.

back up in 2023. However, this analysis misunderstood the drivers behind the increase in savings. Concerned about the future, Chinese households have increased their savings and are consuming and investing less, a phenomenon known as precautionary saving.[11]

China surprised most observers when it abruptly dismantled its Covid restrictions at the end of 2022. As a result, the most economically damaging pandemic controls have been removed as of today. From that perspective, China is now in a post-Covid environment, although the virus continues to circulate in the rest of the world. However, the economic impact of the country's draconian pandemic controls still lingers. Chinese consumers and small businesses have been scarred by the shocks to their income in 2022 and are behaving cautiously in terms of spending and hiring. Government financial support has been largely focused on supply-side policies and has done much less to support consumption demand. China's economy will eventually recover from the pandemic-era controls, but it will be a gradual and uneven process.

II. China's Fiscal Challenge Is Significant

History of Local Government Borrowing: One of China's most significant missed opportunities of the past several years is the failure to address the severe fiscal imbalances between the central government and local governments. These imbalances are at the heart of many of the distortions in the Chinese economy and are the most pressing financial risk facing the country.

Following the budgetary reforms of 1994, local governments began to face structural budgetary shortfalls.[12] This stemmed from spending outlays that were considerably larger than what their official revenues could cover. The financial problems of local governments were compounded by prohibitions that prevented them from directly issuing debt. To circumvent these financial constraints, local governments established various non-tax revenue streams and methods for off-balance sheet borrowing. These alternative revenue and financing sources would become critically important, often exceeding the official tax revenues for some local governments.[13]

One of the key workarounds used by local governments was off-balance sheet financing companies, known as LGFVs. Local governments used these shell companies to borrow and spend on their behalf. The debts incurred by LGFVs were not officially recognized on the balance sheets of local governments, creating a fiction that local government debt was not increasing.

LGFVs gained prominence during China's response to the 2008 global financial crisis, serving as a major tool to stimulate the economy. The central government directly financed just 30% of the headline 4 trillion Renminbi (RMB) ($580 million) economic stimulus. The rest of the spending was done by local governments, LGFVs, and state-owned enterprises (SOEs). To finance that spending, debt levels

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[11] Posen, Adam S. "The End of China's Economic Miracle: How Beijing's Struggles Could Be an Opportunity for Washington." Foreign Affairs, August 3, 2023. https://www.foreignaffairs.com/china/end-china-economic-miracle-beijing-washington.

[12] Philippe Wingender, "Intergovernmental Fiscal Reform in China," International Monetary Fund, April 13, 2018, https://www.imf.org/en/Publications/WP/Issues/2018/04/13/Intergovernmental-Fiscal-Reform-in-China-45743

[13] Carl E. Walter, The Red Dream: The Chinese Communist Party and the Financial Deterioration of China (Hoboken, NJ: Wiley, 2022).

increased substantially. By 2013, a national audit estimated that local governments had accumulated 17.9 trillion RMB ($2.6 trillion) in debt via LGFVs and other channels.[14]

The risks from growing levels of off-balance sheet debt became readily apparent to policymakers and economists. One problem was that LGFVs were borrowing short term from banks and at high interest rates, making servicing their debts very expensive. Another question was the murky issue of implicit guarantees. LGFVs were able to borrow such large amounts because lenders assumed their debts would be guaranteed by local governments, yet local governments refused to explicitly make those commitments.

In 2015, the central government tried to fix the situation and end off-balance sheet borrowing by LGFVs. A swap program was created whereby LGFV debts could be converted into local government bonds that were longer in duration and had lower interest rates. The policy led to the creation of China's municipal bond market, where local governments, subject to central government approval, could issue debt directly. It also led to the official recognition of a significant portion of LGFV debts as official local government debt.

The 2015 reform was successful in creating a transparent and low-cost financing channel for local governments. However, it did not solve the underlying revenue issues facing local governments. Local governments continued to use LGFVs to engage in off-balance sheet borrowing (Figure 4). As a result, LGFVs would go on to issue more than $5 trillion in debt in less than a decade, an amount larger than that of the U.S. municipal bond market.[15]

The Risks from LGFV Debt: The sustainability of LGFV debt will ultimately depend on how wisely these funds were invested. Some spending by LGFVs may be useful, particularly investments in infrastructure that provide critical social goods, such as better transportation and cleaner water. These projects may result in a more productive Chinese economy and a healthier population. However, it is also apparent that a large portion of LGFV investment has been driven by political imperatives. Local governments are tasked with making sure their economies continue to grow rapidly and supporting national policy initiatives from the central government. As a result, LGFVs have spent heavily in real estate projects and politically driven policy objectives, like creating a domestic semiconductor industry. Much of this spending is likely to prove to be wasteful.

Another key problem for many LGFVs is that their investments, productive or wasteful, do not generate sufficient revenues to service their debt. An IMF analysis highlights that LGFVs engage in new external financing to cover 80–90% of their spending because the income from their operating activities is minimal.[16] Thus, to remain financially solvent, LGFVs must continue to borrow and receive financial support from local governments. In the past, local governments could transfer land to LGFVs and assume that real estate demand would lead to price appreciation of that land. However, with land sales and prices decreasing in many markets, this method of asset injection into the balance sheets of LGFVs has come under pressure.

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[14] "National Government Debt Audit Results" (全国政府性债务审计结果), National Audit Office of the People's Republic of China (中华人民共和国审计署), December 30, 2013, accessed January 31, 2023, https://www.audit.gov.cn/n5/n25/c63642/part/27403.pdf.

[15] SIFMA. "US Municipal Bonds Statistics - SIFMA." August 2, 2023. https://www.sifma.org/resources/research/us-municipal-bonds-statistics.

[16] "People's Republic of China: Selected Issues," International Monetary Fund, February 4, 2022, accessed January 31, 2023, https://www.imf.org/en/Publications/CR/Issues/2022/01/26/Peoples-Republic-of-China-Selected-Issues-512253

The ability of local governments to support LGFVs has deteriorated due to increased spending requirements and flagging revenues. Over the past several years, the central government delegated the bulk of Covid spending and economic stimulus to local governments, increasing their spending requirements without an offsetting increase in revenues. At the same time, the problems in the real estate market have led to slowing growth of land transfer revenues, a major revenue source for local governments. As a result, local governments' financial resources have become strained at the precise moment when LGFVs require more support.

The level of risk varies significantly across China as the distribution of total local government debt (direct and LGFV) is uneven. While the average local government debt-to-GDP ratio was 68%, several provinces had debt loads over 100% of GDP (Figure 5). The less economically developed and slower-growing provinces will have trouble supporting these levels of debt.

Options for Addressing Local Government Debt: China has several options available to it to address local government debt issues. However, none of these options will be easy to implement given the current political environment in the country.

The first option and most immediate way to address local government debt is to use the central government's balance sheet. By global standards, the balance sheet of China's central government is exceptionally strong, with a debt-to-GDP ratio that is significantly lower than that of any other major economy. Moreover, the central government can currently borrow at low rates over long durations: China's Ministry of Finance is able to issue 10-year bonds at lower interest rates than the U.S. Treasury. Thus, the central government could likely increase its borrowing without substantially increasing its borrowing costs. The central government could set up bailout funds for troubled local governments and LGFVs or explicitly transfer some local government debts onto its balance sheet. Alternatively, the central government could recapitalize the state-owned banks, policy banks, and asset management companies so that they could provide additional financial support to local governments.

The second option to address local government debt is to readjust the fiscal balance between the central and local governments. The central government could grant local governments control over a larger share of total tax revenues. Despite having a highly centralized political system, China's fiscal system is among the most decentralized in the world, with most of the government spending happening at the local level. Local governments face a perpetual funding gap, which Beijing partially helps to fill through transfers to local governments that account for over 40% of local government revenues.[17] If Beijing is unwilling to adjust the current fiscal balance, it could create new sources of revenue for local governments. As mentioned above, local governments have been highly dependent on land sales for revenues. However, land sales are a cyclical and unreliable source of funding compared to a residential real estate tax that taxes existing properties based on a periodic assessment of value.

The third option to address the balance sheet problems of local governments is to sell state assets. Beijing could authorize local governments to sell assets to help cover their debt and those of their LGFVs. According to an estimate from a Chinese government think tank, the central and local governments held around $19 trillion in financial assets at the end of 2019 and around 60% of that was the listed and unlisted equity of SOEs.[18] It's impossible to say how much this equity is currently worth,

[17] Nicholas Borst, "The Balance Sheet Constraints on China's Economic Stimulus," Seafarer Capital Partners, August 2022, https://www.seafarerfunds.com/prevailing-winds/the-balance-sheet-constraints-on-chinas-economic-stimulus.

[18] Yang Li and Xiaojing Zhang, 中国国家资产负债表 2020 (China's National Balance Sheet 2020) (Beijing: 中国社会科学出版社 [China Social Sciences Press], 2020).

much may be illiquid and overvalued. However, some of the assets could likely be sold to private investors at a discount. While Beijing has indicated some openness to this approach through policies like mixed ownership reform and debt-to-equity swaps, overall, it remains extremely unlikely that the Xi Jinping administration would approve the large-scale sale of state assets.

Rather than any of the options above, Beijing is most likely to muddle through utilizing its old playbook. If systemic risks appear, the Chinese government will take action to prevent a financial crisis. Previously, Beijing has used the balance sheets of commercial banks, policy banks, and asset management companies to absorb risks and conduct indirect bailouts. As the controlling shareholder of China's largest banks, Beijing operates them as public utilities, directing them to lend to preferred sectors, help resolve troubled debt and defuse financial risks. They are directed to put the central government's interests ahead of their commercial interests. This approach may work in the immediate term, but it risks the further accumulation of financial risks and a substantial decline in economic growth.

III. China Faces the Risk of a Balance Sheet-Driven Slowdown

Beijing's historical approach to debt problems has been to muddle through by providing indirect support to struggling borrowers and relying on rapid economic growth to lessen debt burdens over time. However, this approach is unlikely to work as it has in the past. The entities that Beijing has relied upon to provide support to struggling borrowers are facing balance sheet challenges of their own. Additionally, the economy's slowing trajectory means that China cannot easily grow its way out of debt. Therefore, if China neglects to undertake important fiscal reforms, it faces the risk of a prolonged period of slow economic growth.

Without support, China's highly indebted local governments face the difficult task of repairing their balance sheets, a project that could stretch on for years. To service their debts, local governments will be forced to reduce spending and investment. This will lead to a further slowdown in economic growth, thereby reducing tax revenues for local governments and further straining their balance sheets. The property sector is currently in this type of negative feedback loop whereby lower property prices lead to less investment, less government revenue, and slower growth, which will ultimately put further pressure on property prices.[19] The net economic effect of many borrowers cutting spending and investment to pay down debt is referred to as a balance sheet recession. In this environment, the tools frequently used by governments to stimulate the economy, such as lowering interest rates, have little effect.

Japan of the 1990s is the classic example of how balance sheet problems can affect an economy. After its real estate bubble burst in the late 1980s, the country entered a prolonged economic slowdown. The Japanese government, fearing significant unemployment, was reluctant to force the recognition of bad debts. Troubled banks were unable to lend, and corporations were reluctant to borrow given the collapse in the value of their assets. Over the next decade, overindebted borrowers focused on repairing their balance sheets, cutting investment to pay down debts. The fiscal stimulus done by the government was insufficient to counterbalance the loss in demand. After a prolonged period, Japan finally ended its economic malaise when the central government began using its balance sheet to stimulate the economy.

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[19] Michael Pettis, "China's Overextended Real Estate Sector Is a Systemic Problem," Carnegie Endowment for International Peace, August 24, 2022, accessed January 31, 2023, https://carnegieendowment.org/chinafinancialmarkets/87751

If China refuses to address its local government debt problem, the economy faces the risk of a Japanese-style lost decade.[20] Local governments have been essential in stimulating the economy, especially during downturns. However, in doing so they have incurred enormous debts. Absent help from Beijing, they now face a lengthy period of balance sheet deleveraging and will therefore be constrained in their ability to spend. Fiscal reform could be an opportunity to set China on the path to more rapid growth and address many of the core imbalances in the economy. However, this course of action is unlikely given that many of the adjustments required conflict with the ideological priorities of Xi Jinping's government.

IV. Recommendations for Congress

I. Recognize that the Economic Challenge Represented by China Has Changed

a. China's economy has slowed, and it is unlikely to recover to its previous rapid growth trajectory.
b. The Chinese government is likely to be intensely focused on efforts to address its economic challenges over the next several years.
c. The Party's efforts to exert greater control over the private sector have damaged the most dynamic and innovative parts of the Chinese economy.
d. Chinese local governments will have fewer financial resources to support Beijing's policy initiatives.

II. Use the Moment to Press for Concessions that will Benefit American Firms

a. China's economic slowdown, combined with the strong performance of the American economy, provides U.S. policymakers with a strong negotiating position.
b. China needs foreign investment and access to overseas markets to sustain its economy.
c. China is still one of the United States' most important export and investment markets and improving conditions for American companies doing business with China should be a priority.
d. The current moment is a favorable one to seek greater market access and other reforms that will directly benefit American firms and boost exports.

III. Give Investors Clear Rules and Chinese Companies an Opportunity to Comply

a. U.S. policymakers have rightfully put into effect national security restrictions around investment into and from China.
b. These rules should focus on transparency and predictability, and provide scope for adjustment in case unintended consequences occur.
c. U.S. policymakers should adopt an approach that uses both positive (access to U.S. markets and capital) and negative (sanctions and other restrictions) incentives to encourage Chinese companies to cease problematic behavior.
d. A push for hard economic decoupling would be counterproductive for U.S. interests as it would reinforce the worst trends in both Chinese economic policy and Chinese companies.

[20] Richard Koo, "China's Balance Sheet Recession and Structural Problems in Light of 1990s Japan." Nomura Research Institute. July 19, 2023. https://researchcdn.nomuranow.com/03/prod/1145961.file.

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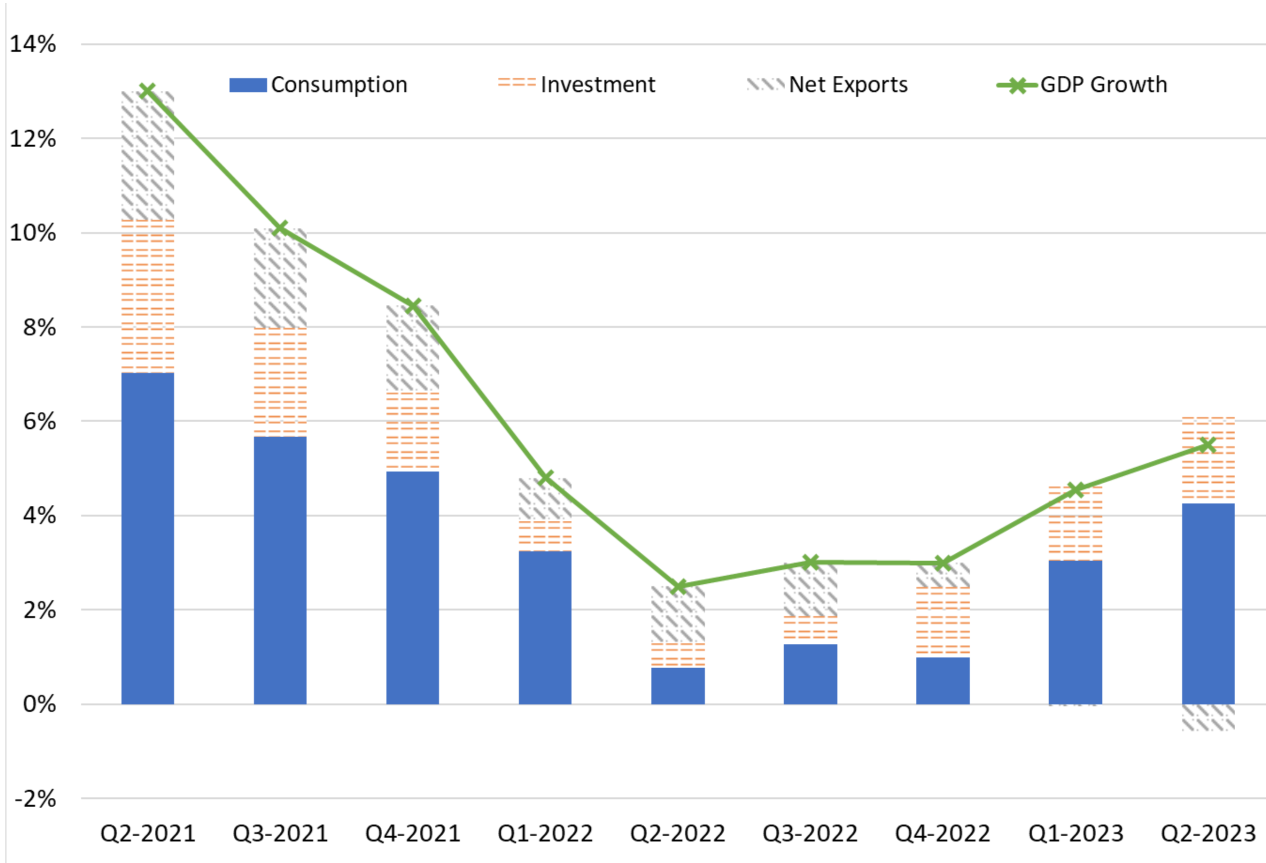
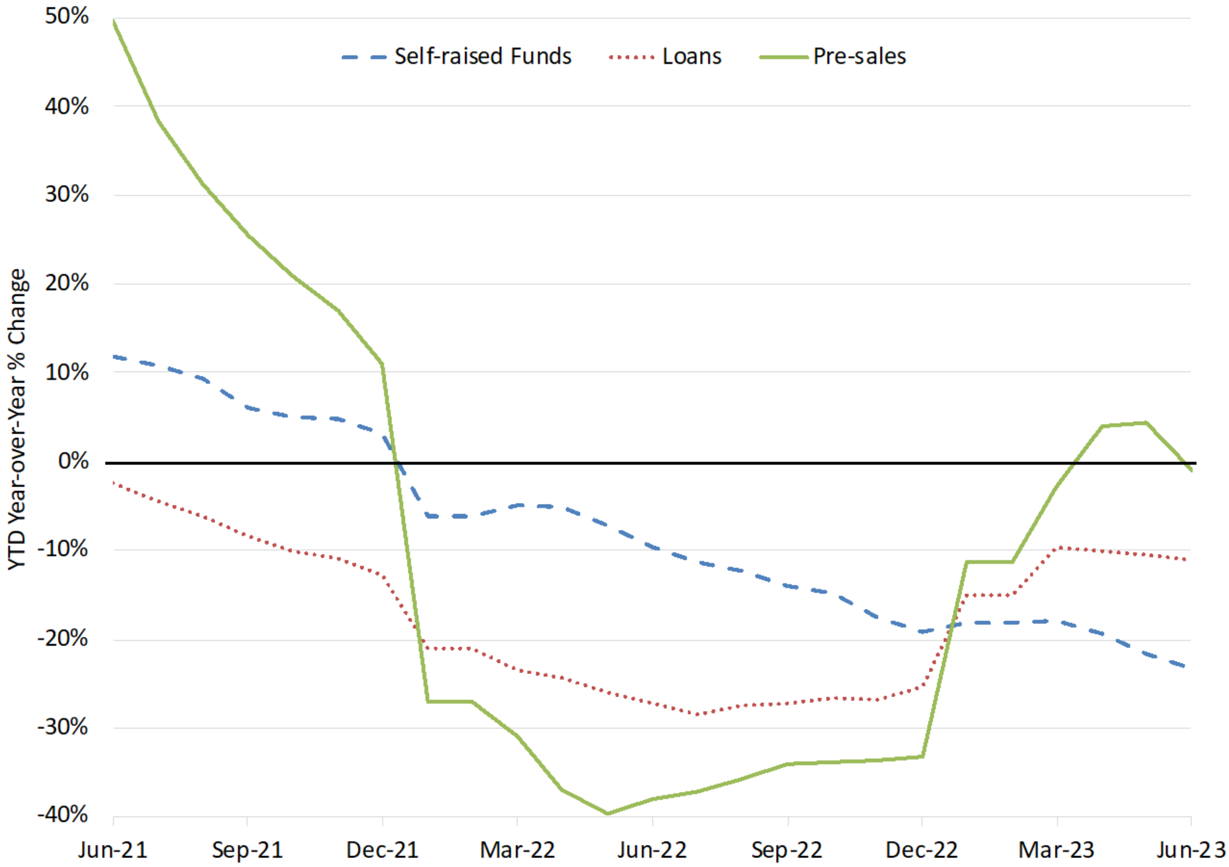
V. Figures

Figure 1 - Demand Side Contribution to China's GDP Growth YTD., (Q2 2021 – Q2 2023)



Source: CEIC.

Figure 2 - Major Sources of Funding for Real Estate Developers in China (June 2021 – June 2023)

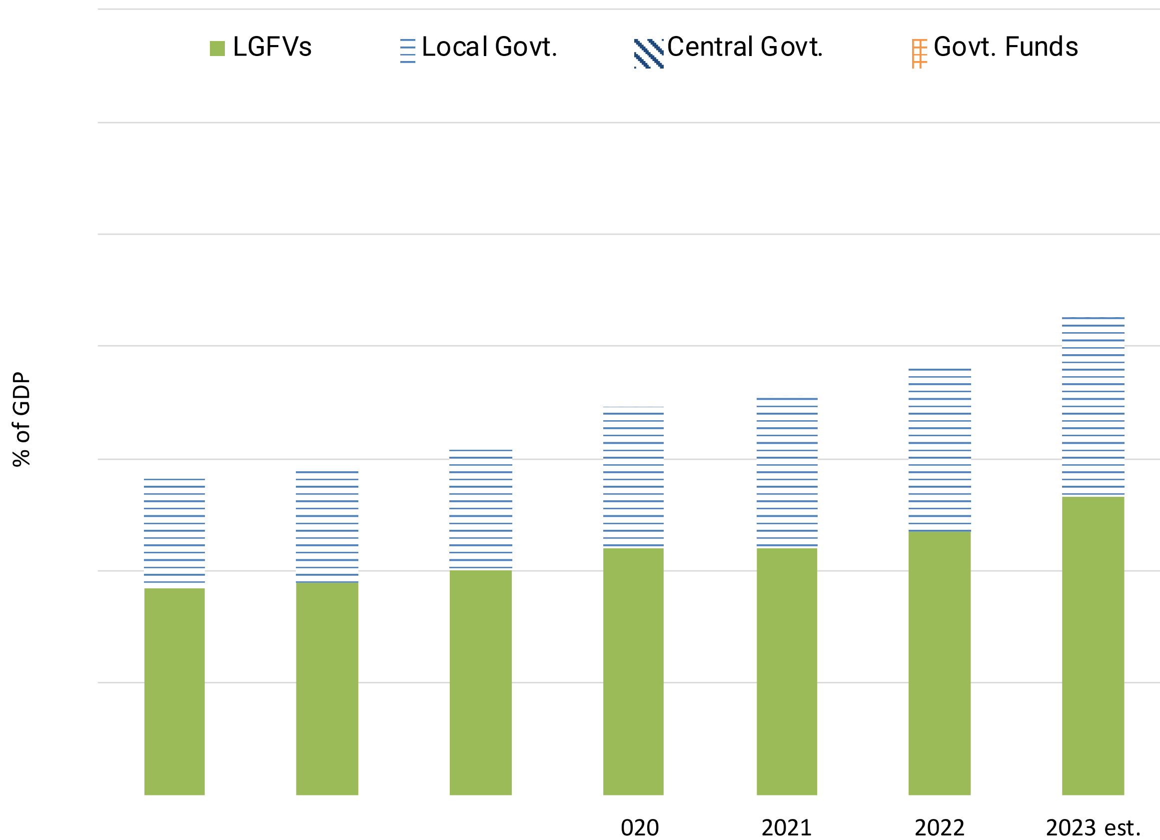


Source: CEIC.

Figure 3 - Private Sector Share of Fixed Asset Investment in China (January 2013 – June 2023)

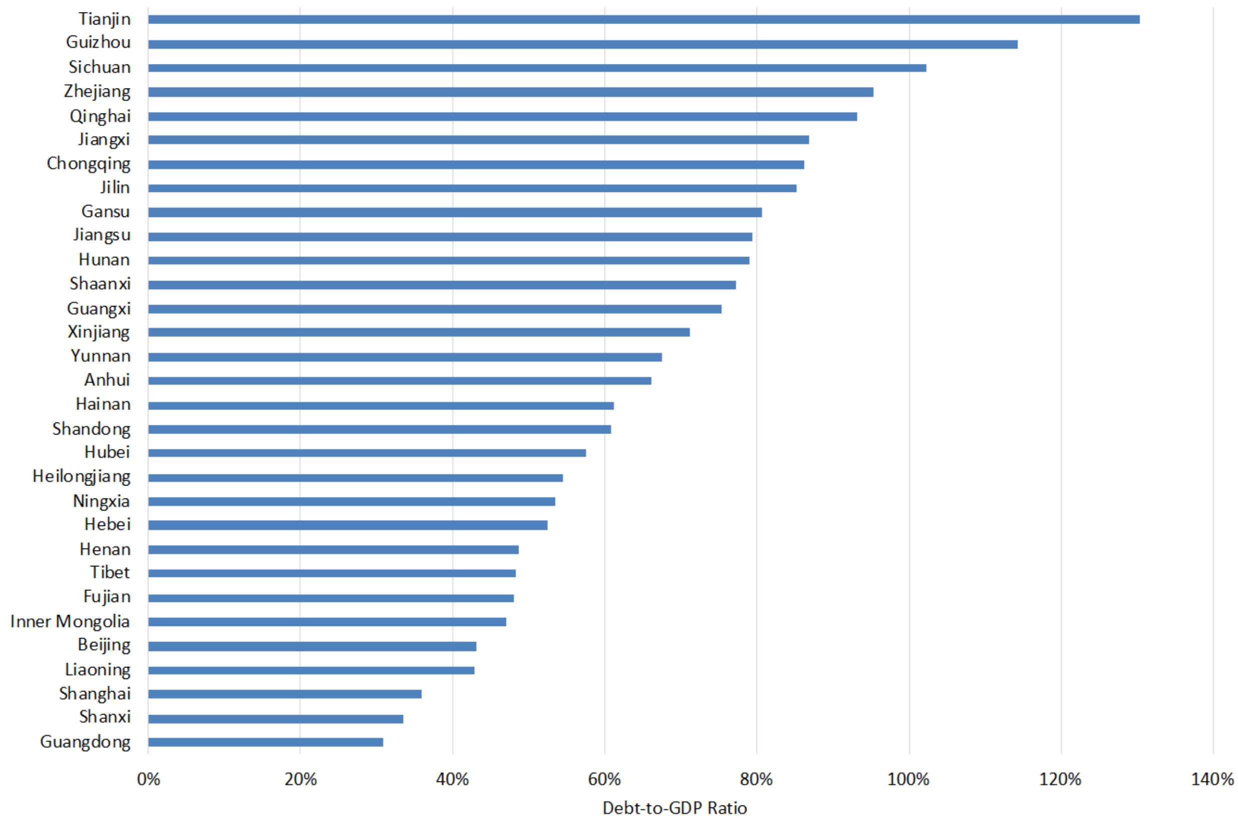
Source: CEIC.

Figure 4 - China's Total Government Debt, by Source (2017 –2023 Est.)



Source: International Monetary Fund.

Figure 5 – Local Government Debt-to-GDP Ratios in China (2022)



Source: Wind Information.
Note: Debt is calculated as (Local Debt + LGFV Interest-bearing Debt) / GDP