THE HEALTH OF CHINA'S ECONOMY

ROUNDTABLE

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

ONE HUNDRED FIFTEENTH CONGRESS
FIRST SESSION

WEDNESDAY, JULY 12, 2017

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UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

WASHINGTON: 2017

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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The Commission was created on October 30, 2000 by the Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Public Law No. 106-398, 114 STAT. 1654A-334 (2000) (codified at 22 U.S.C. § 7002 (2001), as amended by the Treasury and General Government Appropriations Act for 2002 § 645 (regarding employment status of staff) & § 648 (regarding changing annual report due date from March to June), Public Law No. 107-67, 115 STAT. 514 (Nov. 12, 2001); as amended by Division P of the "Consolidated Appropriations Resolution, 2003," Pub L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of the Commission); as amended by Public Law No. 109-108 (H.R. 2862) (Nov. 22, 2005) (regarding responsibilities of Commission and applicability of FACA); as amended by Division J of the "Consolidated Appropriations Act, 2008," Public Law Nol. 110-161 (December 26, 2007) (regarding responsibilities of the Commission, and changing the Annual Report due date from June to December); as amended by the Carl Levin and Howard P. "Buck" McKeon National Defense Authorization Act for Fiscal Year 2015, P.L. 113-291 (December 19, 2014) (regarding responsibilities of the Commission).

The Commission's full charter is available at www.uscc.gov.

August 4, 2017

The Honorable Orrin Hatch
President Pro Tempore of the Senate, Washington, DC 20510
The Honorable Paul Ryan
Speaker of the House of Representatives, Washington, DC 20515

Dear Senator Hatch and Speaker Ryan:

We are pleased to transmit the record of our July 12, 2017 public roundtable on "The Health of China's Economy." The Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Pub. L. No. 106-398 (as amended by the Carl Levin and Howard P. "Buck" McKeon National Defense Authorization Act for Fiscal Year 2015 § 1259b, Pub. L. No. 113-291) provides the basis for this roundtable.

At the roundtable, the Commissioners discussed the health of China's economy with the following participants: Gene Ma, Chief China Economist, Institute of International Finance; and Brian McCarthy, Managing Director and Chief Strategist, Emerging Sovereign Group. The subjects covered included the factors contributing or detracting from China's economic stability, the Chinese government's ability to manage China's economic slowdown, the impact of China's economic slowdown on the global economic system, and the specific implications of China's economic stability for the United States.

We note that the full transcript of the roundtable is posted to the Commission's website. The prepared statements and supporting documents submitted by the participants are now posted on the Commission's website at www.uscc.gov. Members and the staff of the Commission are available to provide more detailed briefings. We hope these materials will be helpful to the Congress as it continues its assessment of U.S.-China relations and their impact on U.S. security.

The Commission will examine in greater depth these issues, and the other issues enumerated in its statutory mandate, in its 2017 Annual Report that will be submitted to Congress in November 2017. Should you have any questions regarding this hearing or any other issue related to China, please do not hesitate to have your staff contact our Congressional Liaison, Leslie Tisdale, at 202-624-1496 or ltisdale@uscc.gov.

Sincerely yours,

Carolyn Bartholomew	Hon. Dennis C. Shea
Chairman	Vice Chairman

cc: Members of Congress and Congressional Staff

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THE HEALTH OF CHINA'S ECONOMY

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WEDNESDAY, JULY 12, 2017

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, DC

The Commission met in Room 285 of 444 North Capitol Street NW, Washington, DC at 9:28 a.m., Vice Chairman Dennis C. Shea and Commissioner Michael R. Wessel (Roundtable Co-Chairs), presiding.

OPENING STATEMENT OF VICE CHAIRMAN DENNIS C. SHEA ROUNDTABLE CO-CHAIR

VICE CHAIRMAN SHEA: Well, good morning, everyone. This is supposed to be an informal roundtable as opposed to an official Commission hearing, but I'm going to read some remarks nonetheless and make it a little bit more formal, but I want to thank you both for being here--Dr. Ma and Mr. McCarthy.

This is the seventh public event of the U.S.-China Economic and Security Review Commission's 2017 Annual Report cycle. As usual, I would like to remind our audience to visit the Commission's website, www.uscc.gov, for hearing transcripts, research papers, and Annual Reports to Congress.

In May 2017, Moody's Investor Service downgraded China's long-term local and foreign currency issuer ratings. While the downgrade is minor and leaves China comfortably within investment-grade rating range, Moody's report points to systemic and growing imbalances in China's economy. And I'm quoting Moody's here: "The downgrade reflects Moody's expectation that China's financial strength will erode somewhat over the coming years, with economy-wide debt continuing to rise as potential growth slows. While ongoing progress on reforms is likely to transform the economy and financial system over time, it is not likely to prevent a further material rise in economy-wide debt, and the consequent increase in contingent liabilities for the government."

Analysts have been warning--and this is not Moody's--analysts have been warning about China's excessive leverage since the rollout of China's massive stimulus package in the aftermath of the 2008-2009 global financial crisis. Data from the Bank of International Settlements reveal China's total debt-to-GDP ratio has grown from 151.3 percent in 2007 to 257 percent in the fourth quarter of 2016.

Perhaps more worrying is China's credit-to-GDP gap, which swelled to almost 30 percent in the first quarter of 2016--three times higher than the ten percent threshold considered an early indicator of financial overheating.

Historically, most countries with a credit-to-GDP gap this high experience a crisis. So is China heading in this direction? And if so, how will it affect the global markets?

These are some of the issues we're going to explore this morning. And with that, I'm going to just turn it over to my esteemed co-chair, Commissioner Michael Wessel, for his opening remarks.

PREPARED STATEMENT OF VICE CHAIRMAN DENNIS C. SHEA
ROUNDTABLE CO-CHAIR

Roundtable on "The Health of China's Economy"

Opening Statement of Vice Chairman Dennis C. Shea
July 12, 2017
Washington, DC

Good morning, and welcome to the seventh public event of the U.S.-China Economic and Security Review Commission's 2017 Annual Report cycle. Thank you all for joining us today. As usual, I would like to remind our audience to visit the Commission's website, www.uscc.gov, for our hearing transcripts, research papers, and Annual Reports to Congress.

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Perhaps more worrying is China's credit-to-GDP gap, which swelled to almost 30 percent in the first quarter of 2016—three times higher than the 10-percent threshold considered an early indicator of financial overheating. Historically, most countries with a credit-to-GDP gap this high experience a crisis. Is China heading in this direction? And, if so, how will it affect global markets? We hope to explore these issues and more this morning.

Let me now turn to ROUNDTABLE CO-CHAIR Commissioner Michael Wessel for his opening remarks.

OPENING STATEMENT OF COMMISSIONER MICHAEL R. WESSEL
ROUNDTABLE CO-CHAIR

ROUNDTABLE CO-CHAIR WESSEL: Thank you, Vice Chairman Shea, and again after our brief opening comments, we hope it will be relatively informal, interactive, and a conversation so that we can really understand and dive into the issues.

Even as China's debt continues to rise, and despite growing dangers, the Chinese government continues to spur new lending to keep the economy growing at rates near 6.5 percent.

Today's roundtable will seek to assess the inherent tension between pursuing higher short-term growth and ensuring more stable long-term growth, a tension which lies at the heart of Chinese leadership's economic decision-making.

To help us better understand the complexities of these critical issues, we are joined by two experts with extensive experience monitoring and analyzing China's economy.

First, we'll hear from Gene Ma, Chief China Economist at the Institute of International Finance, here in Washington. Prior to joining IIF, Dr. Ma was a China economist and strategist at Tudor Investment, an old friend, Paul Tudor Jones. Dr. Ma has also been a managing director at ISI Group, chief analyst at CEBM Group, now Caixin--correct--

DR. MA: Yeah.

ROUNDTABLE CO-CHAIR WESSEL: --chief macro analyst at Citic Securities and a staff at the Ministry of Finance in Beijing.

Dr. Ma has also taught graduate and undergraduate courses at Georgetown, George Washington, and the University of Illinois.

Then we'll hear from Brian McCarthy, Managing Director and Chief Strategist at the Emerging Sovereign Group, ESG. Mr. McCarthy manages the ESG Nexus Fund, a China-focused macro fund, and has traveled extensively throughout China conducting research on Chinese asset markets, capital flow channels, and credit creation processes.

Mr. McCarthy has over 26 years of asset management experience, including in previous positions at UBS, Barclays, Alliance Capital, and AIG.

We are happy to have you here and look forward to hearing from each of you and want to also thank Nargiza Salidjanova, the lead staffer on this, for arranging this and putting everything together today.

Also we have two of our commissioners, as I think I noted earlier, on the phone with us in addition to those in the room, Jon Stivers and Larry Wortzel.

I'd like to remind our panelists to try and keep their opening remarks short so that we have a good amount of interaction and discussion, and Dr. Ma, we'll start with you.

PREPARED STATEMENT OF MICHAEL R. WESSEL
ROUNDTABLE CO-CHAIR

Roundtable on "The Health of China's Economy"

Opening Statement of Commissioner Michael R. Wessel
July 12, 2017
Washington, DC

Thank you, Vice Chairman Shea, and good morning, everyone. Thank you all for being here.

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We are very happy to have you here, and look forward to hearing from each of you. Before we begin, I would like to remind our panelists to keep their opening remarks to seven minutes. Dr. Ma, we will start with you.

OPENING STATEMENT OF DR. GENE MA
CHIEF CHINA ECONOMIST, INSTITUTE OF INTERNATIONAL FINANCE

DR. MA: Thank you. Shall I go up?

ROUNDTABLE CO-CHAIR WESSEL: Please.

DR. MA: In fact, I do not have to use the PowerPoint. I can either sit here or go up to the podium.

ROUNDTABLE CO-CHAIR WESSEL: I would probably go up there because the people in the audience--

DR. MA: Okay.

ROUNDTABLE CO-CHAIR WESSEL: --I don't know have your slide deck--

DR. MA: Thank you. Sure.

ROUNDTABLE CO-CHAIR WESSEL: --so it would enable them to see it. Is that right?

MS. SALIDJANOVA: Yes.

ROUNDTABLE CO-CHAIR WESSEL: Okay.

DR. MA: So I'll not have my back to the people.

[Laughter.]

ROUNDTABLE CO-CHAIR WESSEL: They chose where to sit. Don't worry about that.

DR. MA: Thank you. Thank you, Vice Chairman Shea and also Commissioner Wessel.

It's an honor to have this opportunity to exchange views on China's economy. I've prepared about seven, eight minutes remarks, breaking into two parts. First, on the growth outlook and the second on the outlook on China's policy responses.

In the very near-term, we think that China's growth can stabilize and probably likely grow again in the 6.8, 6.9 in the second quarter. We will have the data in a few days' time. We, however, do expect growth to slow down in the second half of this year, but still with whole-year growth at or even slightly higher than 6.7 we saw in the last year. If that's the case, that means for the first time in seven years, we see a growth acceleration in annual growth. However, we do expect China's growth slightly lower trajectory in the longer-term.

In the very near-term, the second quarter PMI was slightly lower than we saw in the first quarter for both manufacturing and the non-manufacturing sectors. However, if we look at the PBOC corporate survey, things are much better. People tend to pay a lot of attention to PMI, much less attention to PBOC survey, but I want to remind people that PBOC survey has a much wider coverage, a much larger sample size. PBOC survey show that the business condition, corporate sector picked up strongly in the second quarter, and corporates also reported better payments, profits, domestic orders and sharply higher export orders in the second quarter though households said their income and job outlook were basically flat, but they report higher consumption spending in the second quarter.

And other observations support really positive outlook in the near-term. So, for example, export and import growth in the first five months of this year have increased by eight percent and 19 percent year-over-year, compared with a decrease of eight and five percent in 2016.

Industrial revenue and profit growth have improved this year, and industrial sectors also reported better profit margin, lower finished goods inventory, and also lower accounts receivable relative to sales. Now, no doubt, indeed, corporate sector leverage is very high, but if we look at liability over asset ratio in industrial sectors, the numbers in May, the latest data that we have, is lowest in the 17-year data history.

The robust growth in the first half of 2017, of course, is a result of a lot of policy easing we saw in the previous two years. So, for example, RMB is ten percent cheaper, than two years ago, and the average lending rate was also lower by almost 200 basis points in the two years' time in 2014 and 2015. A large sum of quasi-fiscal spending was pushed out through all kinds of channels, such as policy banks, development funds, construction bonds, and also private-public partnership schemes.

Housing policies have been loosened, and moreover, fiscal spending was very much front-loaded this year so that fiscal spending in the first quarter this year was 21 percent year-over-year.

So that is why you also expect the growth to slow down in the second half because all the stimulus policy easing pushed out in the prior two years will start to fade. For example, RMB no longer depreciate, 14-day money rates and also the lending costs are much higher in the past few months. The M2 growth--we just got this data this morning--is 9.4 percent year-over-year. That's the lowest ever in the 20-year data history.

And also moreover the room of fiscal expansion in the second half will be much more constrained than we had in the first half.

Over the longer-term, China's growth will face the strong headwinds of deteriorating demographics and the also much higher debt level. China's working age population has been declining for three consecutive years, and for at least a total loss of more than three million people. China's dependency ratio is much higher, and although there is no data, it is suspected the labor participation rates, for both the migrant workers, and also for women, probably peaked and probably also dropped in the past few years.

The contribution by total factor productivity also peaked in the early 2000s. Now it's much lower. The longer-term China growth outlook really depends crucially on two things: first, whether the capital investment can compensate for the loss in labor force, and the second, whether economic reform, especially the state-owned sectors, can unleash new productivity?

Otherwise, we should expect much lower growth over the next five or ten-year horizon.

And the second, on the China policy response, I think in the past few years, the PBOC, central bank, with some luck has done an incredible job in very exceedingly difficult environment.

On the external front, PBOC's job is to break the vicious cycle of depreciation, capital outflow, the loss of reserve, which would trigger even more depreciation and outflow. On the domestic front, PBOC also has a very difficult job to contain the financial leverage also contain the financial risk at the same time. These two objectives are not entirely compatible.

So on the external front, PBOC has done a couple of things. Direct currency intervention is very costly. We saw that on the one trillion loss of FX reserves. PBOC also wants to break this vicious cycle by punishing speculators by squeezing the CNH liquidity in offshore markets. While it may be effective in squeezing the speculation, but it also causes collateral damage that killed the very nascent CNH offshore RMB market. We saw the issuance of Dim Sum bond has fallen.

Capital control may be effective at the moment in stopping the outflows. Again, the costs are very high. And Beijing knew the side effect of capital controls.

Because of uncertainty of capital control, and so even though Beijing liberalized their domestic financial market by opening up the local, the onshore bond market, by encouraging the inclusion of A-shares in the MSCI index, but it has failed to attract enough capital inflows because of the uncertainty of the capital control.

So introduction of a “counter cyclical factor” in setting the morning fixing exchange rate is the latest effort by PBOC to stabilize RMB exchange rate. Now, certain new commitment, with the help of soft patch of U.S. dollar seems to achieve the goal to stabilize the RMB-dollar exchange rate. But, again, also it’s very high costs. That is for a very long time PBOC has been asking, arguing for a more flexible exchange rate and a more independent monetary policy. Now, this I think opens the other window to achieve the near-term goal of the currency stability.

The outlook for RMB over the next year depends crucially on PBOC’s intention and commitment. The reason is because the driving force of RMB exchange rate really depends on whether you look at the trade account or you look at the capital account.

If it looks on the trade account, given a very persistent trade surplus, RMB should strengthen, not weaken. But, however, we see lot of the service account of large outflows through capital account. That’s because with a diminishing domestic investment return and the people’s desire to diversify their asset holding abroad. So there is still a very strong incentive to take money out of China, and such outflow is very highly sensitive to the signal or to signal sent by PBOC because if the market sense PBOC wants a weaker RMB, you will see surging outflow.

If the markets sense PBOC were committed, committed to a stable currency, you will see a diminishing outflow.

So I think in the near-term, with a more stable dollar outlook, PBOC can manage to stabilize currency, stabilize outflows, but the fundamental incentive for the capital outflow has not gone away. And so that’s why we can see, you can look at behavior of China corporate sector, both the public and the private corporate sector, and they still have strong incentive to take the capital out.

On the domestic front, PBOC also has a very difficult task to strike the very delicate balance to tighten enough to contain the leverage but not tighten too much to trigger a systemic financial risk. So that is why we see PBOC tighten the liquidity in the money market, in the previous year, but not raise the lending rates. So with the inflation still very muted right now, I think the chance of PBOC hiking the lending rate is very low.

M2 is at the lowest level in 20 years, but PBOC explained there is a disconnect between the money growth and the credit growth, and a very low M2 growth is mainly the result of deleveraging of the financial sector. That is the banks pulled bank lending to non-banking financial sectors, not lending to the corporate. So that means the record low M2 will not deter PBOC’s effort to continue to cap leverage. So I think there’s a good chance this year finally PBOC is going to manage to cap M2/GDP ratio and also probably the debt/GDP ratio.

And the way to do that, in late last year and early this year, is by raising, tightening the money rate, raising the lending rates, and since second quarter, maybe in the second half of this year, I think mainly through macro-prudential measures.

So even in the near-term, maybe in 2017, we can see periods we can manage to cap the money/ GDP ratio and the debt/GDP ratio, but over longer term, the China debt level and sustainability is still very high and surging, really depending on the reform progress. Without genuine bona fide reform, the state-owned sector and the local government, and they still have very strong incentive to borrow beyond their means and pursue growth at all costs.

So that is why policymakers, including PBOC, now they argue to fade the importance of growth target.

So we think at this moment, the risk or the likelihood of a systemic risk event is still low because the high state-owned company debt and local-owned debt can be eventually brought on to the balance sheet of the central government, which is still rather healthy, but note that when it transfers the leverage from the corporate sector to the central government and also to households, the debt of households is now rising. They used to have very low debt. Now the Chinese household leverage is rising very rapidly. So overall, there's still really constrained room of policy maneuver in the coming years. So I think that is the cost of such a high leverage.

So I want to keep my opening remarks rather short so we can have more Q&A afterwards. Thank you.

OPENING STATEMENT OF MR. BRIAN MCCARTHY
MANAGING DIRECTOR AND CHIEF STRATEGIST, EMERGING SOVEREIGN GROUP

ROUNDTABLE CO-CHAIR WESSEL: Mr. McCarthy.

MR. McCARTHY: Okay. So I have some visuals. I want to thank the Commission for the invitation and for providing me the opportunity to share my views on China. I have about 20 minutes of material that I'm going to try stuff in in seven to ten minutes so we may run through some of this stuff pretty quickly, but hopefully we'll at least lay out some topics for discussion.

There are two main points I want to leave everyone with today. One is that, in my view, the Chinese economy has evolved into a finely-tuned capital misallocation machine. It is rife with market distortions, and this is no longer just China's problem. China is now too big, too integrated in the global economy for policymakers elsewhere to ignore what is going on in China.

Secondly, China has an impossible trinity problem that can be forestalled with the use of FX reserves, but it cannot be avoided. A loss of control of either Chinese domestic credit markets for the RMB is inevitable, in my view, and will be happening in a time frame that I think is relevant for the policymakers that the Commission reports to.

So whether it's this year or next year, I don't think they have a lot longer than that to continue kicking this can. So capital misallocation issues in China, four big ones, in my view:

Number one, most importantly, moral hazard, near universal in the Chinese credit markets. Heavy intermediation by state-owned banks. Debt rollover is an endemic problem. Still very low, very heavily managed default rate. So no real penalty for misallocating capital.

We saw the manipulation in the A-share markets, which I think underscored a very broad perception among Chinese investors that no matter what sort of stupid investment I make, somebody is going to be there to bail me out. This goes as far as to see actual Ponzi schemes now being bailed out or fake investment products being bailed out.

I think this is also a key driver of the housing market speculation. Having interviewed, spoken to dozens of investors in Chinese real estate in the last several years, I can tell you there's a near universal belief that the government will not let prices fall, which creates an interesting dynamic because speculators push prices up 30, 40, 50 percent, and the value of that put the government has written to the market grows pretty dramatically.

I think the crux of the problem for China is that if you tally up the value of the implicit guarantees the Chinese government has provided, you'll see pretty clearly these guarantees are actually no good.

Central planning, as we all know, still pretty dominant SOE sector in China, six-and-a-half percent GDP targets. I don't think anybody really thinks that makes a lot of sense in a modern economy. Perpetual stimulus at this point. The 2009 stimulus really hasn't ended yet, and here we are eight years later, 20 to 25 percent growth in infrastructure. I don't think anybody really believes that makes sense at this point in time.

Insufficient information flow. No free press. Latest news suggests they're looking to shut down VPN access to websites outside the Great Firewall. That is supposedly happening by February, and I would say that the street research, certainly within China, but even outside China, is somewhat influenced by the Chinese government. I really think if you want to do business as a major bank in China, you're not out there banging the table with a bearish story. That's just the reality.

I would just add I think this creates a dynamic in China where investments are--investors rather are momentum investors. And we can all see the price. We know that's real. But I don't know if the financials are real; I don't know if the news I'm reading is real. So you just jump on price trends, and we see that in Chinese markets.

Capital controls is a big one. I really scratch my head that global policymakers seem to think that this is a solution for China or something that should be continued in what is now the second-largest economy in the world.

This reduces pressure to improve asset qualities. It's essentially a means to try to create overvaluation of assets by not letting people sell, and it simply means that Chinese investments, to some extent, don't have to compete in terms of risk reward with investments in the rest of the world. Big problem, and I think it needs to be addressed.

So, again, it's simply too big for policymakers. China is too big for policymakers to say, well, China has these problems, and we'll let them sort it out. You know, that ship sailed eight or ten years ago, in my view. These are now global problems. This is an $11 trillion economy, system-wide credit, by our estimate, US$37 trillion equivalent, the largest trader on the planet in terms of gross trade flows, imports and exports totaling $3.7 billion. So I think that China's inefficiency in capital allocation has global ramifications and should be something that is addressed by global policymakers.

Simple point here. The idea that they can fix any of this and maintain a fixed exchange rate is absurd, in my view. If you think about the things that I just laid out as being capital misallocation or problems with capital efficiency, correcting any of those threatens to be heavily, heavily deflationary. The importance of the SOE sector--breaking the moral hazard.

I mean how do you get from where we are today to a system where bad investments take losses? You know, sort of ripping that Band-Aid is going to send China into credit contraction, I think something like that will make '07 look like a walk in the park frankly.

I just don't see how you get from here to there without a major, major dislocation, and the idea that you can sort of seamlessly pick out a bunch of bad assets and swipe them on the government balance sheet, yeah, the actual act of doing that is going to be massively destabilizing.

Obviously, easing the capital controls would cause problems for the RMB, and we're seeing Chinese credit growth right now slowing from 16 percent to 14-1/2 maybe, and Chinese credit markets on tenterhooks right now.

So fixing any of these issues is only imaginable if you can also imagine the PBOC saying, okay, we're in the QE game, rates are at zero, and we need to accommodate this because if they try to take these measures while managing fixed exchange rate, which handcuffs the PBOC, China will descend into debt-deflation, and I don't think anybody really wants that.

So one of the points I'm going to come back to is that an RMB depreciation sounds scary, sounds ugly. It's not a great outcome for the U.S. and other developed economies, but I think it's better than the alternative, which is an implosion in the second-largest economy on the planet.

Again, no easy choices for global policymakers. I want to talk a little bit about early 2016. China appeared to be taking steps towards a considerably more flexible exchange rate. Shouldn't surprise anybody that that was highly destabilizing. It looked very scary for Chinese leadership, which really likes stability. By my discussions with policymakers, they weren't really encouraged to continue down that path. So China sort of got scared because this was going to create instability.

The IMF and others looked at global growth and said we don't want the hit to global GDP that would happen if the RMB goes from, you know, six-and-a-half to seven-and-a-half. There was the February 2016 G-20 in Shanghai. The feds seemed to come back from that and take a bit of a detour from normalizing monetary policy in the U.S., and I would say global policymakers sort of accommodated China continuing to kick its can.

So we didn't take the tough decision then, which in my view should be to encourage China to do what we've been asking them to do for as long as I can remember, which is move to a more flexible exchange rate and marry that policy with actually making the fundamental changes, which will allow China to allocate capital more efficiently going forward.

So since early 2016, China has pumped out about $5 trillion in credit in the last six quarters. Home prices in many Chinese cities are up another 50 percent. Off-balance sheet credit duration mismatch and all the risks involved there have grown dramatically as we all know. So the decision is not easier than it was 18 months ago, and it hasn't gone away. It hasn't gone away because, in my view, this is a very basic impossible trinity problem that China faces. If you have an open capital account--and I'll come back to this in a minute--an $11 trillion economy that has the largest gross trade flows on the planet has an open capital account, period, end of story. Unless they want to become North Korea and completely shut the place down, there is no way to effectively close that capital control, capital account.

So from sort of a policymaker's perspective, they can do it for a few months, but I think we're really dealing with a reality that the top of that triangle is a given. China is in the midst of trying to make a choice of whether they want to maintain a fixed exchange rate, which ultimately means they do not have control over domestic monetary policy, or give up on the fixed exchange rate so that they can have an independent monetary policy, which, in my view, will be absolutely essential to controlling their credit markets should they either stop kicking the can or be forced to make some of the changes we highlighted at the top.

Just one interesting metric on this I think really illustrates the impossible trinity problem really well. So this chart shows a 12-month rolling sum of new credit, the blue line, and new GDP. So how much credit they pump in and how much does the economy grow in, you know, billions of RMB? So that's 5 trillion RMB, pretty steady increase in GDP per annum over the last decade or so, and the amount of credit they're pumping in to get that has gone from five to 12 to now 25.

I think this chart to me illustrates something really interesting and tells me that this impossible trinity problem is very real because you can see the step deteriorations in this relationship occur during periods of global liquidity tightness.

So we know what happened in '08. Massive global liquidity event that transmits a tightening of monetary policy to China via the exchange rate pay. They start to struggle with bad credit, but it all gets rolled over, right. Nobody defaults. So all the bad credit has to be rolled. So in my mind, the steps higher in this blue line are basically periods in which zombie assets are being created at a rapid rate and having to be rolled.

So it happens in '08, it happens in '11-12 when Europe threatens another global liquidity event that was then countered by ECB QE, and QE3 by the fed, and you see the blue line improve a little bit, and then the fed starts exiting, global commodity prices start falling in 2015-2016, and here we go again.

So I think the impossible trinity framework is really functional in this picture. As far as what China chooses along that impossible trinity sort of frontier, they can control the NPL rate if they have complete control of this blue line. They can just roll everything over. My contention is simply that that is becoming incompatible with managing a fixed exchange rate against the U.S. dollar when the fed is exiting and perhaps even against the basket if the ECB starts exiting.

There is some perception out there that the impossible trinity problem has been fixed. It hasn't been fixed. There are basically just bouncing around to whatever is the most vulnerable point in time. Even the stability in the RMB this year is consistent with this framework. They've actually tightened monetary policy. I think that's going to prove not sustainable, but we shall see.

So capital controls. I want to talk about this very quickly. There's no efficient way for China to impose its capital controls. China has had capital controls all along, yet they've seen reserves go from one to four to three and back down again. So we see very serious what are in reality capital flows in the current account.

Over a million entities in China with license to engage in foreign trade. On a transaction level basis, each foreign exchange transaction, they cannot possibly determine whether each transaction is in line with the regulations or not. So corporate entities that engage in foreign trade are primary vehicles for capital flows. There's no two ways around this.

There is one way around it, which is highly damaging, and from all reports, what they resorted to in January and February, which is nobody can buy dollars today. You all go away. And whether it was a period of weeks or a couple months, where there were very tight quotas on the supply of foreign exchange I think is still continuing to some extent right now. Maybe loosened up.

But how this works is they basically just tell each bank they have a quota this month on the number of net dollars they can provide to the market. So if one of your clients sells, you can let somebody buy. Until then, you tell them no. Again, for a couple of weeks, they can do this. What we started to see was BMW, some others have been in the press, griping that they can't repatriate dividends. This is susceptible to corruption obviously because at some point, whoever pays the biggest bribe will get their dollars out.

It's created problems for Chinese importers having difficulty getting letters of credit. Roach motel. I mean this is terribly damaging to China's reputation as a destination for inward investments. It's an investor's worst nightmare to have an investment just go completely illiquid. You can't get your money out.

And it's just amateur hour stuff. It's not compatible with Xi Jinping's vision for China as a global player. And I think it's also created a dynamic in the FX market that we see today, which is people are literally in line. I've had people tell me that treasurers of large multinationals tell them that they are in queue at SAFE, the FX regulator. So, you know, they're waiting to get their dollars out, which just creates a pent-up demand situation and has created a dynamic of one-way trading in the USDCNY market that's currently being countered by PBOC reserve intervention.

I'll speed it up here so we can move to questions. Even if they tell everyone in China no one can buy dollars, I think this still doesn't work because gross exports are $US2.1 trillion per year, the bulk of that generated by non-state-owned companies. So 1.6, 1.7 trillion, that money doesn't necessarily have to come back.

So if you don't let anyone in China buy dollars, the owners of these SMEs who sell the Christmas tree lights to Walmart, they settle that trade dollars in Hong Kong, they're going to look around. None of my friends can buy dollars. This is valuable. I got something valuable by having dollars in Hong Kong. I'm not bringing those back at a manipulated rate.

So if the gross exports to any great extent don't come back to China, the balance of payments can go pear-shaped even if they don't let anyone in China buy dollars.

Increasing rates, recently, again, this is really a main drive of the stability in the exchange rate. I think this is temporary. I don't think the Chinese economy can sustain this for very long at all.

FX reserves. These are estimates. Nobody knows what the composition of China's FX reserves is exactly. Total, a little over three trillion. By our estimate, about half of that is in liquid financial assets. Something around a half has been committed to things that just really can't be liquidated.

At this point, is it a problem? I guess not, but at some point, when you go from three to two, and the liquid portion goes from one-and-a-half to a half, it can become a very big problem very quickly, and this problem is nobody knows that number is that triggers a panic and accelerated outflows.

Blue line is the headline. FX reserves in China have gone from four to three. If you net out valuation effects, and you look at the Chinese government's own data on their banks' activities, we think reality looks something more like that red line. Now we don't know exactly what's in the reserves. We don't know how they're manipulating the mark to market. We don't know whether maybe some Chinese banks are carrying short dollar forwards to help them out.

But what is pretty clear is that if you go back to last August, the blue line is down about three-quarters of a trillion dollars, but the actual provision of dollars by Chinese banks in the market is one-and-a-quarter. So a little over 18 months, a trillion-and-a-quarter.

You get a strong dollar or credit event in China, they could lose 500 billion in three to six months, and then it's decision time for everybody. So this problem is not something that's out in the indefinite future.

Just a quick estimate on government debt in China, including the local government financing vehicle borrowings. We put that at 83 percent, but look at the trajectory here. I mean it's rising 12, 13 percent a year now. So this is 2016. Right now we're at about 90. Triple digit government debt-to-GDP by early next year probably and really no end in sight.

That's really it. We can talk about what they're doing with the basket. Basically it just morphs in the impossible trinity problem. The constraint is not the dollar, but it's a blend of other currencies, which is a little easier when ECB and BOJ are still doing QE, but if ECB exits, then the little bit of easier conditions they get from targeting the basket instead of the dollar could go out the window pretty quickly as well.

So that's it. Thanks.

ROUNDTABLE CO-CHAIR WESSEL: Good. Thank you.

COMMISSIONER TOBIN: Thank you.

ROUNDTABLE DISCUSSION

ROUNDTABLE CO-CHAIR WESSEL: Senator Talent, do you have a question?

COMMISSIONER TALENT: Yeah. So I'm saying to myself that our customers, if I was still over there, and I'm listening to what you said, Mr. McCarthy and I think what Dr. Ma said. So conclusions I'm drawing. When somebody says the Chinese economy is growing 6.7 percent a year, Mr. McCarthy, if I understood you correctly, I basically should say to myself that figure may be technically accurate, but it's all a jury-rigged type growth? It's not fundamental growth. It's not--if a miracle happened, and the American economy grew six percent, we would say, wow, good times are coming; there's been some enormous new industry created or something.

But this is all sort of paper growth; right? So functionally it's all sustained by this impossible imbalance. Is that--if I was talking to you in my office, my old office on the Hill, and I said that to you, would you say that's basically correct; that's basically incorrect?

MR. McCARTHY: I think that's basically correct and, of course, Chinese policy works backwards from that growth rate. Right? They don't say let's do fiscal policy and see if we can get to six-and-a-half. They say we're going to get to six-and-a-half, and the fiscal stimulus will be whatever is required to achieve that.

You know, again, as long as they can maintain sufficient systemic liquidity to finance this investment, they can build new highways and bridges or whatever it is they choose to build to the tune of we did six-and-a-half percent more of it this year than last year.

It's just to me the currency is really showing us that the amount of liquidity that takes is just becoming incompatible with at least maintaining the value of the currency.

I think it is also this, the way you pose the question is important in thinking about what the global ramifications may be as well because if, at an extreme, some component of the six-and-a-half growth is digging holes and filling them up again, does it really matter if they stop doing that?

Like if you're selling him the shovels, it does, but beyond that, you know, there's this concept of global growth. I'm not really sure what that means if you're just adding up these GDPs. So to the extent that it is sort of make work GDP, I don't know that we should really be all that concerned if they stop doing that.

COMMISSIONER TALENT: Okay. And one other question I had because one of the things that our staff tells us is that one of the ways they're able to do this is because they have a high savings rate, personal savings rate, which they've trapped in a lot of places.

So I think you said, Mr. McCarthy, that personal debt is going up in China. So--or maybe you said it, Dr. Ma. I'm sorry. I was following both of your very interesting. So is that, are people borrowing money to consume? We do know consumption is going up. In that sense, the economy seems to be balancing some.

We had a hearing on retail in China or purchasing. Are people borrowing money to do that? Have I misunderstood what you were saying about consumer debt?

DR. MA: Regarding personal debt issue, it's mainly because of the rising housing market. Households are borrowing mortgage loans to buy ever expensive housing. If you, in fact, about maybe a year or two years ago, during an interview with Caixin, he made it very explicit that one way--a couple ways to get out of the debt trap. One is to transfer the leverage from the corporate sector to the household sector. So this is what is happening right now.

Because the household sector debt used to be very low, so there's some room to increase household sector. But they're not low anymore. That's one issue.

But also this is mainly through housing, but besides housing, we do see for the younger generations, their propensity to consume is much higher than their parents' generation. Very much with current young people and everybody has eight credit cards. So that means the room for the household sector to absorb the debt is diminishing, is one thing.

Going back to your earlier question regarding China's growth, is it real or not? I think there are three aspects to this question. First, is the growth number real? And second, is growth sustainable? And the third, what does it mean to the rest of the world?

To the first aspect of this question, it's very difficult to tell whether 6.7 published last year real or not. You have to look at much longer horizon. Let's say ten, 20 years. Is China's growth in the past ten years real? In that, if you look at China's jobs created, the wealth accumulated, and also the demand for the global commodities, this must be real. Otherwise, you would not see Chinese buying--can't afford the tuition in the U.S. or the housing in Seattle.

So no doubt the China GDP numbers is smooth. The growth should be much more volatile than the published numbers. There's no doubt in my mind. But if you stretch out over a much longer horizon, I think the growth is mostly real.

The problem is that why people ask that China does not feel such growth? The reason is that the spillover of China growth to the rest of the world is very limited. Maybe a couple of years to the commodity producers--Brazil and Australia. But spillover to the producers of consumer goods is truly limited.

So that is why China's contribution to the global growth mostly is from accounting sense if you look China's GDP, look at global GDP, China created half of global GDP in some years, but purely from accounting perspective, the spillover to the exports by the rest of the world is not big enough.

So that is why lot of China's trade partners do not feel such growth, and people start to doubt the growth number.

And the third aspect, is it sustainable, that's a much harder question to answer. Actually, Mr. McCarthy explained it very well. Yes, it's fueled by debt, and the room for such a debt-fueled growth will be much smaller in the coming years.

COMMISSIONER TALENT: I have one more.

ROUNDTABLE CO-CHAIR WESSEL: Please.

COMMISSIONER TALENT: And it will be briefer. Mr. McCarthy, you were talking about--

COMMISSIONER WORTZEL: I'll have some when you get finished. This is Larry. Thank you.

ROUNDTABLE CO-CHAIR WESSEL: All right. You're on the list.

COMMISSIONER TALENT: You talked about the reserves going down. Now, see, I'm going to show my ignorance here. I thought currency reserves definitionally meant they were just holding it in cash. That it had to be liquid. That was the definition of reserves. But I thought I heard you saying that some of that is not, is not liquid, or did I misunderstand you?

MR. McCARTHY: China, I believe until they got into the SDR didn't really adhere to any of those standards--

COMMISSIONER TALENT: Oh, I see.

DR. MA: --or provide any information at all. And they're providing that information, I think, on a piecemeal basis. So we really don't know whether, to what extent they have adhered to those definitional standards or not. There's no way to know. We can surmise from press reports and just other things we see that there have been a lot of dollars committed to various projects around the world, various loans to emerging markets from China Inc.

And there are hints that I think make it reasonable to presume that much of that was ultimately funded from these reserves. So if a Chinese development bank lent money to a country in Latin America, for instance, it's quite possible that the PBOC made a loan to the Chinese entity that made the loan. So they have a security that says China development bank owes PBOC $100 million or whatever the number is, but then that money has been on lent to someone who may or may not pay it back, and even if they're going to pay it back, you can't say I want it tomorrow because I need it to intervene in the FX market.

COMMISSIONER TALENT: Okay. I see.

So just to understand the concept I think you were saying, or make sure I understand it, so when we think of however much they may have in currency reserves, say it's three trillion, policymakers should not think of it in terms of, well, when that gets at or near zero, they're in trouble. What policymakers should be thinking is if there is a point where if it dips too low, the market says there's not enough there to guarantee my investment or my situation, even in the short term, I've got to get out now; right?

In other words, there's a point where they say two trillion, whatever it is, it's not enough, and the pressure then to get out and for everybody to protect themselves, the panic starts. Is that what you were saying in your--

MR. McCARTHY: If you were to presume that there's a financial bubble in China because of these distortions and very high credit growth, I mean we're talking credit growth compounding at a 20 percent rate for over a dozen years now, you, the dynamic, as I see it, is that on the margin of that system, people figure out that this, this asset I own in RMB, they're propping up the asset price and they're propping up the RMB. If I sell the asset and hold another RMB asset, I'm not really out.

There is this pool of hard assets at the PBOC that if you can get a piece of those,--

COMMISSIONER TALENT: Right.

MR. McCARTHY: --that's how you're out effectively.

COMMISSIONER TALENT: Yeah.

MR. McCARTHY: So, you know, in a fiat currency system, we don't have runs on individual banks because there's no point in just taking your money out of the bank and holding RMB. They'll just print more RMB. This is like the systemic bank run is that the PBOC is the one with the actual real assets. So there's no telling at what point that process accelerates because people see this pool of actual cash dwindling, and then the desire to get some grows even further.

COMMISSIONER TALENT: Okay. But your thinking is we're closer to that than probably people on the Hill may think?

MR. McCARTHY: Oh, my, my speculation would be that the next period of significant strength in the dollar globally along the lines of what we saw as recently as like November and December, where, in the last four months of last year, they probably lost 300 billion. I think they could probably survive one more of those episodes, and then it's decision time.

So--

COMMISSIONER TALENT: Thank you.

MR. McCARTHY: The other thing to keep in mind is in this impossible trinity framework, the constraint is the exchange rate, which has two sides. So what China's strategy right now is, as I can decipher it, if they have one hope of sort of not having this thing blow up in the next couple of years, it's that the U.S. goes off the rails and the fed has to start easing again.

So if they can make it to the next fed easing cycle, and we get to a period of very easy global liquidity again, then the constraint via the exchange rate loosens, and then maybe they can make some fundamental decisions while still maintaining some ability to control it. Maybe. That's the Hail Mary that they're throwing at this point, I believe.

I'd like to make one comment about the savings rate.

ROUNDTABLE CO-CHAIR WESSEL: Let us go. We have other questions.

MR. McCARTHY: Okay.

ROUNDTABLE CO-CHAIR WESSEL: So let me--Dr. Ma, just quickly, did you have--you nodded your head yes as Mr. McCarthy was speaking. Do you agree? I'm doing this for Larry and Jon Stivers, who are on the call.

DR. MA: Two things. Is China's reserve liquid? And second, is three trillion enough? Right? It's true Beijing has dipped the hand into reserves, used the money to fund Export Import Bank to fund the Silk Road fund. That means a lot of money becomes illiquid. But remember those assets, once they've taken the money out of the reserve to fund those activities, they're no longer in the reserve. They are classified as other foreign assets, other reserves.

So the illiquid part are not in the reserves anymore. They're still in the form of asset.

ROUNDTABLE CO-CHAIR WESSEL: So the three trillion is 2.7 at that point? If it's a $300 billion movement; is that what you're saying?

DR. MA: The reserve, the foreign exchange reserve--

ROUNDTABLE CO-CHAIR WESSEL: Yes.

DR. MA: --is three trillion, but on top from exchange reserve, the other foreign assets.

ROUNDTABLE CO-CHAIR WESSEL: So additive.

DR. MA: That's right.

ROUNDTABLE CO-CHAIR WESSEL: Okay.

DR. MA: So when they take the money out of reserves to fund those entities, the money went to the other foreign assets. So that means we do not know how liquid the reserve actually is, but it should be more liquid than some people thought. So we do not know the details. The first one.

The second question, is three trillion reserve enough? Yes, sure, China has a lot of reserves. But also remember the years and years of double digit growth of money, or the M2, China has also has a lot of domestic liabilities by PBOC, so the total sum to the broad defined money right now, I have to check the number again, probably is seven or eight times of effective reserves, which means if one out of every seven or eight RMB are taken out of country, the reserve can be completely wiped out.

So I think that is why when the reserves dropped from four to three trillion, you can see PBOC change the tactics, start to stabilize currency, and I think the main, the real purpose is not to stabilize the currency level per se, but to stabilize or stop an outflow to preserve the reserve.

MR. McCARTHY: One more comment on the liquidity of the reserves if I could. What we do know is that not necessarily PBOC, but all of China owns a little over one trillion U.S. treasuries. We get that from the tick data. And if you presume, as many in the market do, that they had some treasuries warehoused in Belgium, which have come down a lot in the last 18 months, you can see the decline in China's holdings in treasuries is, you know, approaching two-thirds of the $750 billion decline overall, which would sort of tie in with they've got a trillion treasuries. They've got five or six or 700 billion JGBs and bonds, and that's like their liquid assets at this point.

ROUNDTABLE CO-CHAIR WESSEL: Senator Dorgan.

COMMISSIONER DORGAN: Thank you. Thanks to both to both of you.

This is a fascinating subject, and I regret I had to depart for ten minutes during the last half of your presentation, Mr. McCarthy, for a conference call I had to take.

But I've looked through your material. I think you've done us a great service, both of you, in trying to describe to us what, what you see. I was thinking about Henry Kaufman, they used to say predicted ten of the last two recessions.

[Laughter.]

COMMISSIONER DORGAN: It's really hard to predict the economic future anywhere of China, of the U.S., and if you know what it is in the U.S., let me know, and we'll make some investments and both do well.

You know, this issue of a financial bubble, there's no question, if you look at what has happened in China, they've created a very significant bubble. My interest is in looking at China in two to five years, and trying to think through what's the best case and what's the worst case?

I just finished reading a book by Graham Allison, Destined for War, which you probably have read. It's talking about China, and it's a book that talks about an ascending power when it intersects with a descending power, China being the ascending power. And I was thinking, Mr. McCarthy, in your presentation, Graham Allison would probably include a couple more chapters in that book if he saw what you were saying about the economy because it's a pretty ominous predictive future on your point.

So I guess what I want to ask you, two things. One, we're pretty involved in all of this in the fortunes of China in lots of ways, one of which is the listing on U.S. exchanges of Chinese companies and the lack of loud transparency of audit data from Chinese auditors for those companies that are on our exchanges. And I personally have seen examples of what appear to be blatant fraud that the American investors would not have been aware of.

I'd like you to talk about that risk that exists, number one. And then, number two, just give me, if you can, based, particularly Mr. McCarthy, but also Dr. Ma, based on what you described here in pretty ominous tones about what you think will happen next year or the year after. Give me the best case and worst case of how this ends up. Can this get unraveled in a positive way with a good outcome or is it destined to be very significant trouble both for China and trouble related, as well, to the U.S. economy?

MR. McCARTHY: Sure. So on the first question, and Dr. Ma might have some better insights on this, I think it's just a problem inherent in a non-market system. I mean there's bigger issues here about whether China's political system is compatible with it continuing to grow and continuing to be integrated in a global what we like to think is a market economy.

If you look at what's going on right now with some of the political intrigue in China, investors have to grapple not only with the fact that the financials might not be up to snuff, but if the CEO ends up on the wrong side of some political fight that nobody can handicap or can even understand at this point, that company can be shut down.

Anbang is a $300 billion insurance company that looks like it may have to be unwound because we're not quite sure, but because the chairman ended up on the wrong side of a political fight. So I just think these are all issues inherent in the fact that this is not a market economy. There is no rule of law, and I think it makes it very difficult, particularly in an environment where China is now inviting in global asset managers, come on in, the water is warm. There are a lot of sharks in that pond. So that's really all I'll say on that.

As far as the second question, to me the optimistic outcome here is that we can all work with the Chinese to make the changes they need in their system to allocate capital more efficiently and get back on track of marketizing that economy.

Now as I said in my presentation, I don't think that is possible while they're managing a fixed exchange rate against a fed that's not doing QE anymore because these changes will be highly destabilizing.

So as we saw in 2016, that's not an easy choice for policymakers because what you're guaranteed down that path is instability tomorrow because the Chinese currency is going to go down a lot. So that you know you're going to get.

And then hopefully they do these changes. I don't know how the U.S. or other sort of G-20 nations can help China along that path, but in my view encouraging them to maintain strict capital controls, maintain a fixed currency, is shortsighted.

So I think ultimately, the least bad case is we have some kind of managed move to a float of the RMB, which allows China to use accommodative monetary policy to make the fundamental changes that everybody has been sort of demanding of them, and that China themselves for years has been acknowledging sort of needs to happen.

I think the less optimistic scenario is that doesn't happen. They fight; they kick cans. At some point we'll see a two percent funds rate again in my lifetime, I would imagine. At some point, the dollar will go up again, and when that happens, I think there's a very real risk of an unruly unwind here where the next time you see five, six, $700 billion come out of those reserves, what do they do? Do they let the currency go then from a position where they have very little ability to control it?

Do they shut down as a way to predict the political stability? Maybe they retreat from global integration as a way to avoid that instability. I have--you know, who the heck knows? But, again, just the fundamentals suggest to me that this is something where we're heading towards, and you can see the dynamic in the exchange rate, the reserves basically. The reserves tell you that there's a disequilibrium in this impossible trinity, that if they don't tighten monetary policy, as the fed does, the reserve drain will continue at some pace, and at some point in time, we hit the number where it freaks everyone out.

And nobody knows what that pace is exactly or what that number is, but I think it's getting harder to make a case that it's not out there somewhere in a time frame in which, again, decisions are going to have to be made.

COMMISSIONER DORGAN: With respect to economies, you're always all right until you're not.

MR. McCARTHY: Yeah.

COMMISSIONER DORGAN: And you never know when that you're not exists.

COMMISSIONER TOBIN: Right.

COMMISSIONER DORGAN: Nobody does. Yeah.

ROUNDTABLE CO-CHAIR WESSEL: Dr. Tobin.

COMMISSIONER TOBIN: Great. Thank you both.

As you were each giving your testimony, I couldn't help but think of how we will connect what you're giving us today to some of the other themes that we're following, and two of them are large national initiatives.

One being the 13th Five Year Plan, where there is, as you well know, major investment, billions and hundreds of billions of dollars in high-performance computing, robotics and the bio-economy. So there is that. It's being financed by the nation. What happens, how is this drive of a nation financed? That's one initiative.

The other initiative is the One Belt, One Road. Where is that money coming from? So I'm wondering if you, both Dr. Ma and Mr. McCarthy, could speak about how does this financial monetary situation which you've described play to that?

DR. MA: Thank you.

Yes, Beijing pushed very hard to promote so-called emerging strategic sectors, but I think the record has been pretty mixed. China high-speed rail is a success, but at the same time it created overcapacity, a lot of wasting in other sectors. At the same time, we noticed some real successful innovative companies are not promoted by the states. The example can be the telecoms and genetic editing. Most of those firms are usually private owned.

And so I think, I think the best we can say is that when state puts weight behind these initiatives, you just get a very mixed result sometimes with a very high cost.

Even for the One Belt, One Road, I had a friend spend a lot of time in Central Asia and asked him how do you see this investment in the Central Asia? He said, well a lot of private investor, private companies, are already there before the One Belt, One Road initiative. And in fact, he said, his concern is that when those investments are done by state-owned companies, they can only backfire. The investment by private sector is much more successful.

COMMISSIONER TOBIN: Will they be able to get real and sufficient funding, because one of you is showing that the credit, the loans won't be there for the smaller corporations, will they be able to get the monies they need to do the innovation?

DR. MA: Correct, yes. So I think that is why for a while many people, especially at the premier, tried very hard to promote growth of the equity market, which can fund a lot of small emerging sectors, and very unfortunately, we had the market crash in 2015, then the meltdown in early 2016.

But at the same time, I think the private equity investors and the venture capital funds in China have been very active in promoting some of the private companies. So I think the record has been pretty mixed.

COMMISSIONER TOBIN: Thank you.

MR. McCARTHY: On the One Belt, One Road financing, I'd say to the extent they can manage to have this infrastructure built by Chinese firms that can be funded in RMB, it's basically an export. It's exporting the investment-led growth model at an extreme. China is now papered over with new highways with nobody on them and bridges and everything else. Let's do that in the rest of the Asia.

So if they need to hire non-Chinese firms and pay dollars, I think it's going to be extraordinarily difficult because one of the things we saw last year was heavy intervention in the dollar CNH, the Hong Kong RMB forward market, which involved Chinese banks borrowing dollars from non-Chinese banks to intervene with. And from discussions I've had with people at these banks, there's a finite appetite for banks in the rest of the world to lend dollars to Chinese banks, and I think they're sort of close to that.

As far as these strategic plans, I would completely agree with Dr. Ma that this is just a distortion basically. It's, they're still largely managing this economy by central plan. It's not a recipe for China to get rich in a real sense because they would be better off if they let entrepreneurs in the marketplace--

COMMISSIONER TOBIN: Absolutely.

MR. McCARTHY: --basing their decisions on risk-reward decide what sectors to invest in. But this does create very real problems for companies and investment in the rest of the world. It's a distortion that goes global. So--

COMMISSIONER TOBIN: I'll just conclude by saying there really has to be a culture that fosters innovation, and it can't exist on that thread for a long time.

Thank you.

ROUNDTABLE CO-CHAIR WESSEL: Dr. Wortzel.

COMMISSIONER WORTZEL: Yeah. Thank you very much.

I want to follow up on one word that Mr. McCarthy used in his discussion. He mentioned the word "panic," which I take to mean, you know, kind of a panic, a run on banks, people--now, and I want to follow that up and give you a couple of potential scenarios.

The housing bubble collapsed in a major city or in secondary cities. When they feel there is not enough liquid capital around that people might need, fear of instability where people want to get their money and rat it away in case they need to use it. And then one other sort of panic that has occurred in two businesses in the past is the old state-owned enterprises were unable to pay the retirees, and those people ran to the bank.

Now I'd like, if you could, both of you, to talk to us about what might bring that about and what it would do to political stability in China if that happened?

MR. McCARTHY: Let me start, and Dr. Ma may have more information than I do on the state of funding of the pensions at the SOE, but in terms of a potential for a market panic, I'll fully acknowledge one of the things I've gotten wrong about China in the last couple of years is that the abiding faith in the government's ability to make magic has been much more robust than I ever would have imagined.

I'm shocked there wasn't a panic three years ago frankly. So when that happens is anybody's guess at this point. And again--

COMMISSIONER WORTZEL: But you're saying it could happen?

MR. McCARTHY: Well, I mean one huge problem is there is some risk that the politics aren't going as smoothly as people had thought so there are a lot of indications that this so-called power consolidation by Xi Jinping isn't complete yet. You could have an upset politically that then immediately undercuts that widespread belief that the government will take care of everything because, oh, my gosh, the government itself is not stable.

I mean talk about black swans, we could have in three months a global crisis. I don't think that's likely, but it's non-zero. So, you know, it could work that way.

Assuming the stability of the Chinese Communist Party continues, I think it's just, it's been a longer drawn-out process than I had envisioned. No real sign yet of widespread disbelief in the government's ability to make good on the put option it's given people on every asset in China, but again it's on the margin, people are starting to figure out that the checks the Chinese government has written in this regard are not cashable, and they're trying to get dollars.

So again I could only guess. I will just tell you I have been very surprised at the way this belief that the government will just take care of it has held up frankly.

COMMISSIONER WORTZEL: Okay.

ROUNDTABLE CO-CHAIR WESSEL: Dr. Ma--

COMMISSIONER WORTZEL: Do you want to add anything?

DR. MA: Yes, I want to touch on two things. One is the thing you mentioned about the jobs, labor market and the political stability. The other thing is the chance of financial panic and systemic risk.

The answer to the first question is relatively easy. The second one is extremely hard. Even though China's growth, the real growth has slowed down from 14 percent to only six to seven right now, or even lower in the next couple of years, so far we haven't seen a massive labor issue, and the key is that China's working age labor force and also labor participating rate are falling.

So if China's demographics is more like those in Morocco and Middle Eastern countries rather than Japan, who are facing really imminent trouble in the labor market and the political stability.

So I wanted to touch on something. Even though this is on the record, I want to touch on something more sensitive. Recall during the Morocco thing, and a lot of people expect things like Jasmine Revolution can happen in China too. We have U.S. ambassador went to the shopping street to watch the event, but the problem is that the younger generation in China, they are having better jobs than their parents. They are earning more than their parents. So the demographics, the income distribution, the wage growth for the younger generation is completely different from those in the Middle East and North Africa.

So that is if China can manage to create 11, 12 million jobs a year, I do not expect much trouble in the labor market. You have some pockets of unemployment in the steel sector, the coal sector that's really manageable.

In fact, I do not have one relative or classmate or friends who are not meaningfully employed at this moment.

The second question--

COMMISSIONER WORTZEL: May I follow-up with one other question when you get done?

ROUNDTABLE CO-CHAIR WESSEL: Yes, please.

DR. MA: Yeah, the second question is much harder to figure out. That is what can trigger the financial panic and systemic risk so you have sudden stop? I think probably the way to figure that out is that to look at the other financial crises around the world in history--Indonesia, Thailand, housing bubble, Spain, or for that matter the U.S. saving and loans or subprime. No doubt China's debt is very high. China's debt level increased very quickly, as you mentioned, 150 percent of GDP in the space of ten years.

But the key difference in China's credit bubble and those of Thailand and Indonesia is that it is funded domestically with very little external debt. So that we do not expect a sudden withdrawal of outside funding and sudden collapse.

That doesn't mean there's no risk. There is. I think the risk people tend to pay too much attention on the level of debt, even the pace of the increasing debt. I think people need to pay more attention to the funding of this debt and the plumbing and the liability to decide how the debt is funded. That's where the risks are.

Okay. Yes, it's true that debt is not funded from external sources so you have a little peace in mind. But, however, the difference between--well, a lot of people say China's debt situation is more like Japan so it's funded domestically. So it can sustain for very long.

But two things make China different from Japan. One is on the exchange rate and then who holds the external assets. In Japan, the exchange rate is flexible. So when Japan's yen depreciated on and off, nobody cared. People just think something positive. When RMB was devalued by two percentage points in August of ’15, it triggered panic because it was fixed for too long.

The second is that in Japan, the foreign assets are held by households. But in China, vast majority of the foreign assets was held in the reserves. So that’s why you do not see a sudden panic or drop of the reserve in Japan. You do see reserve drop from four to three trillion in China. So that sent out a very bad signal, trigger even more outflow and the depreciation. So that makes China different from Japan.

The other things are even more opaque and difficult to figure out. In Japan, I think the financial sector dominated by the large banks, which tend to be, even though some of the banks are zombie, are still a lot more stable. But China has seen frantic pace explosion of the shadow banking sector, which are very opaque and funded with very short-term deposits and then channel the money into the banking sector. So that makes the system less stable than that of Japan.

So to make it simple, the summary is that China’s debt sustainability and the risk is lower than those we saw in Thailand and Indonesia, but it’s higher than that of Japan.

MR. McCARTHY: I would just note very quickly the Japan thing was no walk in the park either because their real estate and equity prices fell by 80 percent at the beginning of that episode.

The overvaluation in the assets has to be corrected either by a decline in asset prices or by a decline in the currency.

ROUNDTABLE CO-CHAIR WESSEL: Larry, did you have a follow-up?

COMMISSIONER WORTZEL: I did. Thank you very much. And I appreciate your explanation. I’m taking a couple of points from that, and that is if there is going to be a panic, it’s going to be--there would be some indication--loss of confidence in the Party, some form of government instability between the center and the provinces, something along that line. And I appreciate if you could comment on that.

But also from a broader perspective, if you were watching this in the U.S. government, what triggers or indications would you look for? And the second question I have is you’ve been talking about the financial market, is the same true of the domestic bond market?

MR. McCARTHY: So what should the U.S. government be looking at to sort of gauge this?

COMMISSIONER WORTZEL: Yeah, triggers, should we look at, problems between the central government and the provinces that lead to instability or a loss of confidence in the Party? Can we divine some triggers that--

MR. McCARTHY: So there’s been some speculation recently that the central government may be preparing to allow a local government financing vehicle to default because the dynamic is that these corporate entities, quasi-government, quasi-local government entities are widely presumed to be guaranteed, which reduces their borrowing costs, provides them sort of infinite access to credit and allows the local governments to sort of do whatever they want.

So the central government has a lot of difficulty controlling these local government entities, and I think that really the only way they could control them at this point would be to let some of them fail. If you see a default at a local government financing vehicle in China, I think that would be, that would be potentially earth shattering for Chinese credit markets in terms of undercutting this moral hazard to some extent.

So that’s a news item that I think would be a really big deal, which some are speculating could be on the horizon.

Other than that, it's really this FX reserve drain I think tells you sort of how much fuse there is on this thing, but again those numbers are sort of opaque and on a month to month basis. We don't exactly know what they're doing with marking to market their asset book, and it's pretty esoteric to actually decipher how many dollars they're spending.

But if you start reading about capital outflows or reserve loss back to a 30, 40, 50 billion a month rate, which I think will happen the next time the dollar strengthens, then I think you can start the countdown to some kind of decision having to be made in China.

DR. MA: I think in the near-term--

COMMISSIONER WORTZEL: How about bond markets, domestic bond market?

MR. McCARTHY: I would just say that there is something very specific going on this year in that the PBOC is--the monetary tightening we've seen is largely directed at off-balance sheet financial products that were levering corporate bond holding. So we've seen a pretty severe backup in corporate bond yields. We've seen net negative issuance of corporate bond yields so far this year.

To this point, they seem to have somehow ring-fenced that, but I think if that were to continue, then you will see pockets of credit risk emerge, and it would be my view that any significant outbreak of credit risk is going to be very hard to ring-fence given the widespread belief that everything is good. Once a few things start being proven to be not good, I think it's going to be very hard to control that process.

So if corporate bond issuance continues to be net negative for the remainder of this year, I think that would be a very dangerous path.

ROUNDTABLE CO-CHAIR WESSEL: Dr. Ma, you had a follow-up thought?

DR. MA: Yes. I think in the near term the financial risk is the accident triggered by the PBOC effort to delever the financial sector. While that's the right thing to do, no doubt, but to defuse time bomb is difficult. If you're not careful, you may set off some time bombs while you try to defuse all those bombs, and I think they know this very well.

That's why you can see the tightening process by PBOC starting from fall last year. It's been extremely careful, and also, luckily, it seems there is some coordination between PBOC and the banking regulators. For example, the tightening was mainly carried out by PBOC initially in the money markets in the last fall. In the second quarter, such tightening has been handed over to the banking regulators. So the PBOC has kept its liquidity stable. So it seems there is some coordination.

But in the longer term, the financial risk, you need to look at what can be the environmental conditions for financial risk. I think with very high existing leverage, the situation can become very dangerous if you have very high inflation, loss of confidence in the currency, and direct capital outflow. So I think risk of outflow is still there. But, luckily, global inflation right now has been low.

ROUNDTABLE CO-CHAIR WESSEL: We've now made it through an hour and a half without Trump's name coming up so I'm going to have to add that too.

COMMISSIONER WORTZEL: Uh-oh.

ROUNDTABLE CO-CHAIR WESSEL: Sorry. We're in Washington. I have to do it. And doing so because you've described a precarious situation in some ways in China, and, Mr. McCarthy, if I heard you correctly, I heard, understanding the figure may not be exact, that we're $300 billion away potentially from accelerating a hard landing within the next year to two years.

There are a number of China related policies the Administration has advocated, whether it's the two 232s, one on steel and one on aluminum, the trade deficit, the focus on the trade deficit, and certainly the U.S.-China trade deficit looms large there, as well as currency manipulation.

Nothing has really happened since, you know, the first months of the Administration, but the rhetoric is high, the activities are deep. There's a U.S.-China meeting here next week.

What do you see as the impact of any of those potential action on any of those policies in terms of China's economy? Are they going to shove China into a hard landing? Are there minor events on the horizon? What are your thoughts, and what are the risks and opportunities in any of those?

MR. McCARTHY: Sure. I would say that I think the Trump campaign sort of elucidated a policy shift that was underway even in the latter half of the Obama Administration. I think there's a general understanding that, again, China is too big for us to accommodate these distortions because they are global distortions, and if China is not going to address these distortions, then we really probably don't want them to be more integrated into the global economy. It's simply dangerous.

Now using whatever leverage we may have to try to force those changes is an uncomfortable situation as well. And to this point, it looks like the Trump Administration's bark was a little worse than its bite on this front, and that's more of a continuum with what we started to see in the last administration.

I do really believe that broadly that should be the thinking though, that if we want to continue to integrate China, then these changes have to be made now, and I think that those involved in making those decisions will make better decisions with the better understanding of the vulnerabilities China is in. There are no easy decisions at this point.

I'm sure the Trump Administration would love China's commitment to not devaluing the RMB against the dollar indefinitely. It's simply not possible given the relative economic cycles. Where China is in its credit bubble and we are after ours, I don't believe it's possible. It's just at this rate, at this point in these cycles, it's just not possible.

So I think understanding that reality, trying to come up with a way to get China to do what we would like to see them do, while managing that market reality, and perhaps I would say setting up the relationship with China so that's perhaps a chip we use. It's inevitable anyway. They're going to have to do that. We're going to have to acquiesce in that because it's economic gravity, in my view, but maybe we can get some leverage out of it in terms of I would say China will need our cooperation in managing that situation.

So it may be an opportunity to finally lever them into making the changes that we've sort of highlighted at the top that need to be made in terms of domestic capital allocation efficiencies and the distortions that exist.

ROUNDTABLE CO-CHAIR WESSEL: Dr. Ma.

DR. MA: I think the relationship between two countries is different from that between Coca Cola and Pepsi. No doubt U.S.-China would compete on many fronts, both in economic sphere but also geopolitically. But at the same time, two such large countries should be able to find some areas to work together.

On some specific issues regarding 232, I think those trade measures probably can gain politically, but I don't think you really can solve the trade issue because the total China export of steel to the U.S., I think it's only about three percent, no more than five percent, of U.S. consumption, steel consumption.

And if you ranked all the steel exports to the U.S., China probably ranked between ten or 12, right, much smaller than those--

ROUNDTABLE CO-CHAIR WESSEL: They're 11 right now. Correct.

DR. MA: Yes. I think a better solution is look at much broader issue to encourage or push China to open its imports a bit more. Just like I mentioned in the past, previously, even though China has been growing very rapidly, the spillover to the global growth has been limited.

We do see some rising China imports of U.S. energy products and also China made a commitment to imports of agricultural products. But I think there is more we can do, which also benefits China in that sense.

I think another issue the two countries need to work up together is how to accommodate China's outbound investment into the U.S. I know it's highly sensitive, and I've been to some Midwest states early this year. I find out there are some sectors the two governments can work together. So, for example, I think the local government much more welcoming the China direct investment into the U.S.

When we visited Beijing earlier this year, when we talked to IIF members, which are the financial institution in China, they seem to be very eager to invest in the U.S. infrastructure projects, probably also pumped up by the promise of infrastructure investment in the U.S.

But I know this relationship may be, it's harder than what they realized. But I think some investment in the traditional manufacturing sectors maybe is more feasible than the high tech or the infrastructure. I think this is something I think in the meeting next week the two sides can work out.

ROUNDTABLE CO-CHAIR WESSEL: Senator Dorgan.

COMMISSIONER DORGAN: Just a final quick question about our trade imbalance. I pulled up some numbers I had in my briefcase. You know our trade imbalance with China over the last five years, is about $1.6 trillion, about $350 billion a year.

And some would say that's probably not mutually beneficial in terms of our trade relationship, and ultimately you need to have some balanced trade, and you try to work that down.

What does that $350 billion a year trade surplus with the U.S. mean to the Chinese economy, and what are the consequences of eliminating that $350 billion a year deficit for the U.S. or surplus for the Chinese economy? Is that consequential?

MR. McCARTHY: Given the precarious state of balance of payments in China, at this point, it is actually, and I think the market, one of the risks with the steel tariffs or the like is that I think if the market were to think that that persistent inflow to China were at risk, it would really exacerbate all these potential outflow problems.

So the balance of payments is in a precarious enough state right now that I think it would be a big problem.

DR. MA: So given the large--

COMMISSIONER STIVERS: Put me down to ask a question if there's a chance.

ROUNDTABLE CO-CHAIR WESSEL: Yes, you got it.

COMMISSIONER STIVERS: Thank you. Thank you. Thank you all for being here--

ROUNDTABLE CO-CHAIR WESSEL: No, I'm sorry. Jon, Jon, just one second. Dr. Ma, I think was going to answer, and then we'll turn to you.

DR. MA: Just very quickly, given the large trade imbalance and China's large capital outflow in the past two years due to the fear of RMB depreciation, isn't the strong RMB the main idea? It will solve two issues. It will help to rebalance the U.S. trade relationship. At the same time help Beijing to stop the outflow. So that can kill two birds.

ROUNDTABLE CO-CHAIR WESSEL: Jon.

COMMISSIONER STIVERS: Okay. Great. Thank you. Thank you all.

There is a debate that's always been going on, kind of philosophical debate here, on whether the U.S. should retaliate against the policies of the Chinese government that either bolster or protect and provide incentives to Chinese companies. It's obviously difficult for the U.S. to compete on that playing field.

And some would argue that the U.S. doesn't really need to take any significant action because, as you described, the Chinese government intervention in its economy is inherently inefficient and wasteful compared to a kind of freer economic system like in the United States.

In your view, the weaknesses that you described, do you think that negates the need for the U.S. to retaliate against some of the unfair trade policies by the Chinese government? And what else should we be doing besides watching and worrying about the state of a China's economy?

MR. McCARTHY: Sure. So I think the reality is viewed in isolation, protectionist measures on the part of the U.S. are a net negative for both sides. I think everyone understands this. I think at this point unfortunately that needs to be weighed against the alternative, which is we have a non-market economy that's getting bigger and bigger and more integrated in the global economy, now is really trying to invite in U.S. retail investors inside to invest in their markets, and it's a system which seems to me unsustainable.

So I think that's really the way I would look at the equation. There's, again, no doubt, protectionist measures are--would rather not go down that road, and in the short term, it's a net negative. This bigger issue I think is just very, it's going to be very, very difficult.

But I do get a sense, particularly within some of the Trump campaign rhetoric, and again this goes back to discussions I've had with the IMF and people in the Obama Administration prior to that, that people are aware of this conundrum, and I think there's an increased willingness to take some aggressive measures to address it.

If the U.S. economy and the global economy, Europe, Japan, were on a sounder footing internally, I think you'll see more willingness to take a little short-term risk with the U.S.-China, G-3 China relationship to try to get China on a more sustainable medium-term path. I don't know if that answered the question, but--

COMMISSIONER STIVERS: Yeah, to some extent. I'm worried that people may listen to this roundtable, and they see all the difficulties in the Chinese economy and think that we need to do anything--the U.S. wouldn't need to take any action to bolster our companies in terms of an economic competition. And I kind of want you all to make the case on why that's not the case, if that's how you feel.

DR. MA: I think, again, I think the relationship between two countries is not a zero sum game. It's true all the subsidies and distortions to China may be detrimental to China's economic efficiency. But that doesn't mean it's good for the U.S. It may hurt both. So I think that is why both the reformers in China and the policymakers in Washington should have a consensus to promote the growth of private sector and make the China economy really market driven rather than state dictated.

In fact, Beijing itself has made a promise in 2013 during the Third Plenum Party Congress to make, let the market, to make the decisions. So far the progress has been limited. So I think both sides should work on this front a bit more.

MR. McCARTHY: I would just say, you know, we have this Party Congress coming up in October or November in China. This is like the last stop for the reform train because, again, it was 2013, the market was going to take a more decisive role in allocating capital, and here we are in 2017, it hasn't happened.

And, well, after this Party Congress, when Xi consolidates power, then he'll make these changes. Maybe they will. I think that would be, it's going to be difficult and destabilizing, but we'll all be better off if they do that. If they don't, then there's really nothing else. Then what is--what are they waiting for? It's not going to happen.

And I think that will be, it's a big event. I have no idea what President Xi and President Trump may have talked about behind the scenes, but perhaps there was some indication that, hey, let me get through November; we're going to make these changes.

I don't know, but if we get into February-March of next year, and they haven't still done anything, and they're accelerating credit growth again, then we can all be very clear as to the path they're on, I think.

ROUNDTABLE CO-CHAIR WESSEL: But it sounds to me--I'm sorry. Jon, did you have something else?

COMMISSIONER STIVERS: No. Just to say thank you.

ROUNDTABLE CO-CHAIR WESSEL: But it sounds to me, again, based on your earlier analysis and the leverage we have because of the precarious nature, that if there was to be a clear consistent comprehensive policy, it doesn't necessarily have to all be public, between the U.S. and China, that perhaps we can drive them further and more expeditiously on the reform route, and we'll see that, again, hopefully, by November.

If not, we shouldn't underestimate the tools that we have to disengage, to advance our own economic interests without all the cost that has been occurred with China's policies. Is that accurate?

MR. McCARTHY: I guess I would say if there's a deal to be made, it would be along the lines of acknowledging the economic reality that the Chinese currency is not in an equilibrium state right now. Providing some kind of cooperation to keep global markets as settled as possible as that is resolving itself in return for which China actually does the things that it pledged to do in 2013, opens up its markets to U.S. companies, and in a host of macro measures to address some of the capital misallocation problems.

If, I think if U.S. policymakers come at this from the perspective of China can't depreciate its currency under any circumstances, it's going to be very difficult, if not impossible, to get to a good place, in my view.

DR. MA: I think to go back to 2015, the summer 2015, the decision on RMB depreciation devaluation in August, I think both Beijing and Washington made a mistake in how it was carried out. If the flexibility is introduced by the market, the consequence would be much benign, but however it was delivered through two percent devaluation, handed out by the PBOC, the people immediately interpreted this as Beijing's intention.

So the cost of the large outflows and further depreciation in the next year or two. And also you recall right after Beijing's action, if you read the press release by the Treasury, it says we welcome the market determined exchange rate, but at that moment, the market determined exchange rate was no longer and stronger RMB but a weaker RMB. So the action by both Beijing and Washington in the summer of 2015 sent a signal to the global market of a weaker RMB. And I think that was, I think that did not play very well in the next two years.

ROUNDTABLE CO-CHAIR WESSEL: And how deep do you believe the impact is if China is on the potential road for a hard landing, how deep is the impact on the U.S.?

MR. McCARTHY: Again, it depends sort of on the form. I think in the optimistic scenario I envision, it's not really the worst thing. My personal view is that people tend to overestimate the influence of exchange rates on trade balances and everything else.

If we coupled it a flotation of the RMB with an opening of their markets, it's not clear to me that a couple years later, the trade deficit wouldn't be smaller. You'd get a burst of inflation in China, which would undercut some of the competitiveness, but that would also help their asset overvaluation problem.

So they would inflate away some of the debt, inflate away some of the competitiveness advantage, and if they also opened our market, U.S. companies would be doing more business in China.

The alternative path where China accepts a debt deflation and a Japan path where housing prices in China are down 60, 70, 80 percent, that's devastating for emerging markets that are supplying China's investment-led growth actually. A devaluation in a way would reset their ability to continue generating some investment, and I think be less destabilizing for commodity producers, particularly in the emerging world, but there's a mispricing here regardless.

China's ability to consume commodities and funnel it into state-directed investment is nearing an end either way, in my view.

ROUNDTABLE CO-CHAIR WESSEL: Thank you both. This has been very helpful to us. We will be actually tomorrow begin putting pen to paper on our Annual Report. So the conversation today has been very helpful in terms of giving us some information guidance and quite a bit to think on. So thank you for your time.

MR. McCARTHY: Thanks very much.

ROUNDTABLE CO-CHAIR WESSEL: Thank you for your travel to be here, and we look forward to further discussions.

MR. McCARTHY: Great.

DR. MA: Thank you.

COMMISSIONER TOBIN: It's almost like next year we'll have to look at what happened or didn't happen; right?

[Laughter.]

MR. McCARTHY: Certainly hope so.

ROUNDTABLE CO-CHAIR WESSEL: That's true. Thank you.

COMMISSIONER TOBIN: Yes. A lot's on hold. Thank you.

[Whereupon, at 11:16 a.m., the roundtable was adjourned.]