Economic & Financial Review

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Economic & Financial Review

A Journal of the European Economics and Financial Centre

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Aims and Scope

The economics profession has divided itself into three groups: (i) the public sector economists; (ii) the private sector economists; and (iii) the academic economists; with each group tending to have its own ethos and beliefs.

While there is one economics discipline, each class of economists has its own ideologies, modes of thinking and methodologies. In practice, there is little interaction or close links among the three.

Economic & Financial Review aims to provide a medium for enabling and enhancing communications from all sides of the profession – portraying the state of the art as well as presenting the new thinking, developments, directions, emerging techniques and their applications in the area of economics and finance. The journal will address issues related to decisions, timing and implementation of alternative policies at government level. It will also concern itself with the problems, consequences and necessary steps for the reversal of a given policy when it fails to produce the desired results.

The journal will, in addition, address the difficulties facing the market decision makers, in effect, "the policy-takers" who need to incorporate into their forecasts government actions.

Finally, it is intended that the periodical will aid in removing the isolation that currently exists among the different groups so that the new theories that are formulated will be more in tune with the real workings of the economy, and guide the practitioners.

CONTENTS

ANNOUNCEMENTS

Announcement

European Economics and Financial Centre

Seminar

with

Prof. H. Scobie
Chairman, European Economics &
Financial Centre
*"Time for Action in the Ailing
German Economy"*

and

Dr. Jörg Kukies
German Finance Minister (until May 2025)
"Reflections on the German Economy"

25 September 2025

Those interested in attending should contact: Paul Andrews,
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Challenges Facing the Chinese Economy

Hubert Fromlet
Linnaeus University, Sweden

Abstract: *This study traces the transformation of China over the years. It examines the country's high debt position which is in all sectors including central government, local governments, corporates and private households which according to the IMF totals 80 percent of GDP. Local debt conditions continue to deteriorate for different reasons – particularly as a consequence of the ongoing real estate crisis but also due to the weakening economic growth potential. The author also highlights the role of BRICS II as an organisation ready for increasing Chinese influence. The study concludes China's real estate crisis may be much more serious than usually understood by most Western analysts.*

Introduction

China's GDP grew on average by 5 percent in 2024 which is in line with planned GDP growth if we express it this way. And it does not appear as a surprise that the final quarter of 2024 showed a slight growth acceleration. Remembering historical experience of previously completely predictable GDP numbers and the obviously ongoing current weaknesses of Chinese growth, it does not feel quite reliable that China officially still succeeded in meeting the official growth target of about 5 percent – despite some stimulation measures.

One may in this context reflect on the introduction of the official release by the National Bureau of Statistics (NBS), making the development of the Chinese economy mainly an achievement of the political leadership as the following initial lines demonstrate: "In 2024, in face of the complicated and severe environment with increasing external pressures and internal difficulties, under the strong leadership of the Central Committee of the Communist Party of China (CPC) with Comrade Xi Jinping at its core, all regions and departments strictly implemented the decisions and arrangements made by the CPC Central Committee and the State Council, adhered to the general principle of seeking progress while maintaining stability, fully and faithfully applied the new development philosophy on all fronts, accelerated efforts to foster a new pattern of development, and pursued high-quality development in solid steps. As a result, the national economy was generally stable with steady progress and new achievements were made in high-quality development. Particularly, with a package of incremental policies being timely rolled out, the social confidence was effectively bolstered and the economy recovered remarkably. The major targets and tasks of economic and social development were achieved successfully".[1]

Without doubt, the political message in this GDP comment can be recognised very easily. There is a lot of political self-praise – but also the realistic comment that the past year has been a very difficult one, both outside and inside China. Additionally, one may wonder how weak the Chinese economy had been performing in reality when – as commented above – the NBS also concludes that they only lately in 2024 implemented a growth package meant that "the social confidence was effectively bolstered and the economy recovered remarkably…"

Of course, Chinese political leaders still – understandably – do not want to publish any growth objective for 2025 when the new U.S. leadership is about to act harshly against China.

Debt and Global Stability

The Chinese debt problem is certainly not new. However, it has recently become more acute as a result of China's structural slowdown of GDP growth and the real estate sector disaster – but also because of the possible consequences of president-elect Donald Trump's announcement to introduce considerably higher tariffs on Chinese exports to the U.S. and following further international contagion risks.

In a worst-case scenario, China's ongoing debt crisis may jeopardise stability in China itself but also develop as the starting point of another serious global financial and economic

[1] https://www.stats.gov.cn/english/PressRelease/202501/t20250117_1958330.html

crisis. This crucial risk is mostly neglected or forgotten by Western analysts and decision-makers – probably since it still seems to be far away or insufficiently concrete. Sure, these two arguments can be neither supported nor rejected – but the risks are obvious all the same.

Debt Problems in Different Sectors

When looking more deeply into the details of the ongoing Chinese debt crisis – which is extremely difficult for transparency reasons – high debt ratios can be found in all sectors: central government (when including implicit debt commitments), local governments, corporates and private households. First, when having summed up these indebted sectors, we get to total Chinese debt which includes both the private and the public sector.

The subgroup of total public debt consists of central government debt, local and provincial debt, governmental branch debt and debt of state organisations. Ten years ago, Chinese public debt was preferably referred to central government debt, though local debt then was already higher than central government debt (see *e.g.* Fromlet[2]).

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Since Chinese statistics are not really known as transparent and illuminating, different debt numbers can be found for the same kind of summarised debt sub-group. Logically, Western debt estimates are mostly much higher than the domestic Chinese ones (if the latter can be found at all). This phenomenon can particularly be referred to large amounts of implicit governmental debt commitments and hidden off-balance operations that usually are not calculated or discussed officially.

When it comes to China's central government debt, numbers do not look too scary at the first sight. According to the

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2 https://publications.bof.fi/bitstream/handle/10024/44981/172270.pdf?sequence=1&isAllowed=y

statistical experts of CEIC in London, the ratio of central government debt to GDP is only 25 percent – but on a slightly rising trend.[3] 25 percent or even up to 50 percent – as indicated by other experts – still appears being quite a low number by comparable international standards.

However, implicit future government funding needs still seem to exist due to the weak financial positions of many state-owned enterprises (SOEs) and real estate players. This should or could imply high credit losses of the banks at some point in the future, thus making financial government support inevitable in a really negative scenario. However, such perspectives cannot be put in figures now – but may at least in qualitative terms worsen the central government debt outlook considerably in a longer perspective.

Local and provincial debt is already now a completely opaque issue, and, according to the IMF, totals 80 percent of GDP (of which 32 percentage points of GDP via explicit credits and 48 percentage points more indirectly via Local Government Financing Vehicles (called LFGVs) – see IMF[4], where also other debt-to-GDP ratios are available). And we do know that local debt conditions continue to deteriorate for different reasons – particularly as a consequence of the ongoing real estate crisis but also due to the weakening economic growth potential (which is highly related to the first explanation). By the way, official Chinese total government debt (central and local government) is these days noted at 55 percent[5]; this number of 55 percent can be compared to 80 percent for local debt only (see the IMF source above).

What we do know in our part of the world is that Chinese apartment prices have come down dramatically. This still dampens Chinese people’s confidence in the country as such and in their own future considerably. Historical experience from other countries tells us clearly that it usually takes a long

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[3] https://www.ceicdata.com/en/indicator/china/government-debt–of-nominal-gdp
[4] https://doi.org/10.5089/9798400284281.002, p 69
[5] https://www.fidelityinternational.com/editorial/article/how-china-keeps-its-debt-in-order-e1feea-en5/

time to see any kind of recovery after a burst real estate bubble. This kind of lost trust means, of course, that also Chinese people remain reluctant for quite some time as regards their potential purchases of new apartments which probably continues to keep down real estate prices on secondary markets and the creation of new dwellings (see statistics on sales prices[6]).

Declining price developments on residential markets also mean that tax revenues of local governments from their land sales remain under pressure – an important source of local tax income that for quite some time has been standing for almost half of all local income. In other words: This described setback of income induces that local borrowing needs and debt will be – *ceteris paribus* – expanding further. Altogether, the burst real estate bubble has without doubt meant an extremely negative vicious circle for local developments in China – and will go on doing so for quite some time in the future.

Consequently, it is difficult to estimate to what extent LFGVs will be able to repay their gigantic debt to their lending banks or to their municipal bond buyers. By the creation of these LFGVs, local governments were empowered to circumvent the prohibition to issue municipal bonds and to borrow money in banks. Thus, these transactions never showed up in municipal bookkeeping but seem to be partly allowed nowadays. However, in 2018 the government declared that it would not rescue LFGVs in troubles – whatever this means in reality.

When it comes to total private debt – or rather non-government sector debt – good "guestimates" cannot be found for the household and the corporate sector. Transparency appears also here very insufficient. Sure, corporate debt statistics can be found – but unfortunately without sufficient clarification. As unclear remains whether the definition of corporate debt includes both private and state-owned corporations or alternatively only the one or the other. This

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6 https://www.stats.gov.cn/english/PressRelease/202411/t20241115_1957438.html

necessary distinction remains a conundrum and is very puzzling.

An examination of different sources reveals that the ratio for corporate debt was mostly above 100 percent of GDP – but as mentioned above without giving a clear definition of the corporate sector. The IMF concluded that China's non-financial domestic corporate debt in 2023 amounted to 116 percent of GDP.[7] A good guess is that the share of SOEs dominates there – and among them probably the less successful ones. It may also happen that parts of LFGV debt are registered as corporate debt which would make the summarised corporate debt even more muddy.

For household debt, results were more mainstream-oriented. Ratios around 60-64 percent of GDP could be found quite frequently; 63.7 percent of GDP for 2023 was calculated by the IMF and is not expected to change very much in the years to come (for household debt see the IMF[8,9,10] and occasionally together with other economic indicators[11,12]).

Finally, regarding foreign debt one may conclude that China's foreign debt seems to be manageable in the shorter and medium run, due to still existing surpluses in the current account – though declining on trend. This does at least theoretically not provoke any net borrowing abroad (but it happens for reasons of diversification or favourable credit terms).

It, therefore, still seems plausible to assume that China will remain resilient to further protectionist challenges from the U.S. as far as a future necessity of sizeable borrowing abroad

7 https://www.imf.org/en/News/Articles/2024/07/31/pr24295-china-imf-exec-board-concludes-2024-art-iv-consult
8 https://www.imf.org/en/News/Articles/2024/07/31/pr24295-china-imf-exec-board-concludes-2024-art-iv-consult
9 https://tradingeconomics.com/china/households-debt-to-gdp
10 https://www.ceicdata.com/en/indicator/china/household-debt–of-nominal-gdp
11 https://data.stats.gov.cn/english/easyquery.htm?cn=A01
12 https://www.stats.gov.cn/english/Statisticaldata/yearbook/

is concerned – at least as long as major global contagion and a big trade war can be avoided.

Officially, Chinese foreign debt amounted in dollar terms to USD 2,545 billion in June 2024, of which 56 percent were taken as short-term credits and 44 percent with medium- and long-term maturities. This meant altogether at the end of 2023 total foreign credits amounted to almost 14 percent of GDP according to the experts of CEIC in London[13].

Interestingly, foreign institutions have granted a big share of their credits to China in its own currency, the renminbi (RMB) – as much as 49 percent of all Chinese foreign borrowing.[14] This is certainly an attempt by Chinese policymakers to gradually widen the role of the RMB on international currency markets and to limit debt commitments in foreign currencies.

China's Faltering Growth

Economic growth in China has been declining visibly over the years. Looking more deeply into the structural problems of China, a further downsizing of GDP growth seems unavoidable on trend – despite the latest stimulation and rescue measures.

Financial markets are short-term minded by nature. For this reason, Chinese short-term numbers cause a lot of global attention, too – more than they deserve *per se*. Nobody can sufficiently judge the correctness of official Chinese statistics for GDP, inflation, urban unemployment, the Purchasing Managers Index (PMI), bad or non-performing loans, etc.

Thus, it also seems impossible to come to a conclusion on the efficiency of the announced two financial support packages totalling an enormous 10 trillion RMB (which means in USD 838 billion) for 2024-2026 and USD 539 billion for five years to come. According to IMF sources, "hidden local debt" may

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[13] https://www.ceicdata.com/en/indicator/china/external-debt–of-nominal-gdp
[14] https://www.safe.gov.cn/en/2024/0930/2237.html

amount to as much as totally 60 trillion RMB – an amount that would be far away from tranquillising – and very contrary to what China's minister of finance described as "controllable".

The size of this latest government action indicates that Chinese political leaders now have become really worried about the local debt issue – but the real magnitude of these problems remains uncertain due to the unknown true dimension of the total provincial and local indebtedness.

Again, the institutional factor of poor transparency remains as one of China's major shortcomings – and China's recent policy reaction against overwhelming local debt came very late in this special context.

As a matter of fact, the local debt problem is not new. In 2013, I published an article on this topic though local debt in China was not really addressed as important by the international analyst community at the time.[15] It became more obvious for a broader scale of Western analysts more recently when the signals of the bursting real estate bubble became more frightening.

Relevant Structural Issues

Apart from the debt situation, other trend or long-term issues should be far more relevant for deepening corporate analysis than purchasing manager indices and quarterly GDP figures. These can include economic policy in general terms, the role of the market economy in official policy strategy, the vast government subsidies to SOEs, the frequent institutional shortcomings, the bursting apartment bubble, the structure and credibility of the financial system as a whole – plus last but not least the strongly shrinking population in the forthcoming decades[16].

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15 https://publications.bof.fi/bitstream/handle/10024/44981/172270.pdf?sequence=1&isAllowed=y

16 Regarding Chinese demography see https://blogg.lnu.se/china-research/?p=3530

We must remember that this summing up of endogenous structural risks could be extended and needs completely different analytical tools compared to the ordinary business-cycle approach.

The above-mentioned structural factors, such as “stability of the financial system”, should already have gained some strategic priority by now also by Chinese political leaders – expressed in the here-described attempt to achieve a better-balanced local debt structure. At the same time, we should not forget government-subsidised unprofitable production (for exports) which certainly hides further risks for non-performing bank loans.

Uncertainty Surrounding Financial Stability

All this should lead to the conclusion that the volume of bad or non-performing loans should be discussed more broadly than it is when official Chinese publications and comments have been published.

Altogether, China must work very hard to avoid a future financial explosion. Consequently, China may also be the biggest single financial threat to global financial markets at some point in the future. It is late for China to decrease risks – but hopefully not too late.

The number of Chinese medium- and long-term challenges could, of course, be extended further. Many obstacles still have to be tackled – either decreased or eroded.

It is well known that the quality of Chinese statistics has been underperforming for a long time, particularly as regards GDP. And there is no evidence that things have improved during the ongoing crisis – or whatever China’s growth problems may be called. Here we have one of the reasons why financial markets should not overestimate the role of business cycle analysis on China.

Even BOFIT – the specialised research institute of the Finnish central bank Suomen Pankki – wrote in its latest forecast on the Chinese economy that "BOFIT's alternative calculation of Chinese GDP suggests real growth might have been considerably lower" (in the third quarter 2024).

According to BOFIT, China's GDP will grow by around 4 percent in 2024, and when considering the latest stimuli by 3.5 percent in 2025. Since BOFIT rather estimates growth numbers than predicts precisely – which makes a lot of sense – the outlook for 2026 shows an estimated GDP growth of roughly 3 percent[17].

3 percent is also the size of BOFIT's currently estimated potential growth rate for China. Nobody knows about this exactly – but it probably wouldn't be higher. Certainly not before there is a more secure feeling that transparency finally is improving.

Role of Monetary Easing

Without doubt, the People's Bank of China (PBoC) has been very active with its fresh attempt to stimulate the sluggish economy. However, monetary policy should not be regarded as the main tool to revive growth – not fiscal policy either. Instead, far-reaching structural reforms are badly needed in China to restore confidence of consumers and investors. Monetary policy alone is not strong enough to sizeably create new consumer confidence.

Monetary Stimulus Package

The latest monetary stimulus package by the PBoC indicates clearly that China's political leadership has become increasingly concerned about the gloomy outlook for the economy which is partly linked to the highly burdened real

[17] https://www.bofit.fi/en/forecasting/latest-forecast-for-china/

estate sector as well. Different measures to reduce borrowing costs were introduced. For example, the People's Bank of China cut interest rates on existing mortgages and created new lending capacity by reducing cash requirements for banks. The PBoC also announced that the necessary deposit for buying a second home will be lowered from 25% to 15%, and that restrictions on borrowing for investments in stocks will be eased.

In response to the economic worries the central bank introduced in 2024 a whole package of monetary easing. This should probably be interpreted as further growing political leadership worries about the chances of meeting the 5% GDP-growth target.

Of course, one may wonder about the real size of these political leadership worries when reading on the same day of the announcement of the stimulus package that "in general, the national economy-maintained stability while making steady progress in August. Production and demand sustained a recovery, and employment and prices remained stable" (see the economic data for August[18]).

Real official belief in the above-mentioned economic analysis for August would not have made the recent central bank measures necessary.

Role of the Stimulus Package

The answer to the question above seems to be obvious – no or not enough. Some possible – but certainly limited – relief on the real estate market cannot function as a real growth stimulator when relating to all the structural imbalances in the Chinese economy. There are bad bank loans, largely indebted municipalities and provinces, high implicit state-government debt, unprofitable state-owned companies, subsidised pricing

18 https://www.chinadaily.com.cn/a/202409/24/WS66f1ee40a3103711928a9532.html

in many areas, insufficient competition, tensions with important trading partner countries, all the institutional shortcomings, the influence of the almighty Communist Party on the whole Chinese economy, etc.

Real Estate and Financial Markets

Occasionally, it appears that global financial markets get strongly worried about Chinese real estate markets – real estate markets that indeed are not very transparent. Most of the time, however, these worries still seem to be suppressed too much on global financial markets. Suffice it to say, the current real estate crisis may be much more serious than usually understood by most Western analysts.

Crisis of the Real Estate Market

The share of real estate amounted in the past decade on average to 7-8 % of GDP. But it should not be forgotten that the total real estate sector runs up to 25 percent of GDP or somewhat more when all services and other activities linked to the real estate sector are included. Different percentage numbers can be found as well since real estate statistics in China most probably have substantial shortcomings.

The dimension of the real estate crisis can be elaborated further: Apartment prices have come down sharply more recently as up to 100 million apartments are empty and many of their developers and owners have lost a fortune. There have been changes of official apartment prices which should not be applied since price downturns may be much higher in reality than in official statistics.

A brief remark: 10-15 years ago, I could see huge empty apartment units in Chinese metropolitan cities without light in dark evenings.

A major problem for private apartment owners is also that buyers of apartments usually have to borrow money even before the start of their own residential project.

Real estate is by far the biggest single Chinese contributor to GDP and has therefore also importance for global GDP growth. We already know that real estate companies have come increasingly under pressure. This may or will affect negatively both banks/non-banks and the financial situation of municipalities – the latter now losing a lot of tax income from shrinking sales of real estate.

Furthermore, the real estate crisis in China also means increasing social challenges in a country where apartment ownership functions as a kind of necessary private pension, and where the difficult demography outlook indicates that total future need of apartment areas looks quite limited in a macro sense, particularly when youth unemployment – also for academics – will dampen demand at least for some time.

Yes, China is currently sliding more and more into a critical situation – very worrisome for the whole financial world.

Ramifications of BRICS II

We recently noticed the BRICS summit in South Africa. Expectations in our part of the world were not hopeful before the summit in a sense that decisions from Johannesburg would mean an encouraging injection for the global economy. However, it was recognisable that China managed to launch another brick in its global political economic strategy by establishing its *de facto* leadership for the new and enlarged BRICS II organisation.

Lack of Representation of Democracy

BRIC(S) from its start in the early days of this century – *i.e.* before South Africa was invited to join – could be regarded as quite an unnecessary organisation. BRIC(S) was initially launched as a smart financial marketing idea of an American investment bank without any other logical unifying argument than putting together Brazil, Russia, India and China as the four largest emerging markets with – then – potentially good economic prospects.

Then, two of these four founding countries were not democratic (China – and at least partly – Russia), and two others could be described as democratic (India and Brazil, plus South Africa joining some years later).

Now, when BRICS II comes into force, this previously quite balanced democratic participation in BRICS will not be maintained when the six invited new members become part of BRICS II as well.

These six new BRICS countries are:

Iran,
Saudi Arabia,
United Arab Emirates (UAE),
Egypt,
Ethiopia, and
Argentina.

It is indeed very obvious that none of these invited six countries can offer democratic standards and/or economic strength. There is every reason to believe that democracy in the new BRICS II will become clearly underrepresented… and weak economies totally overrepresented.

Another angle may be a purely economic one. Also, in this context there is nothing encouraging to find – apart from currently more or less healthy macroeconomic stability in India, Brazil and the oil producers of Saudi Arabia and UAE.

So, what can the 11-nation BRICS II finally offer themselves and the rest of the world? Possibly not very much. There are too many internal imbalances. Maybe some increase of intra-trade (mainly for oil and other commodities) could show up.

An obvious disadvantage is the missing positive homogeneity between the countries.

Revised Geopolitical Strategy and Enlarged International Partnership

As stated before, China has been starting to work more ambitiously on its intensified and revised geopolitical strategy. Observing China's internationalisation and globalisation for many years one has to admit that China, since the start of the opening-up reform policy by the prominent reformer Deng Xiaoping, had a logical strategy in their search for enlarged international partnership throughout the years.

The international reform steps in the opening-up context were during the years about FDI and more foreign investment in China, the move of Western labour force experts to China, increasing exchange of students both from and to China, mutual cooperation in research – altogether different steps to improve skills, technology, products and productivity with ideas from outside China. So much for the traditional diversification objectives.

Gradually after China's important World Trade Organisation (WTO) entry, Chinese political leaders also announced objectives for developing China into a technological superpower and for increasing its global political power, more lately very much by focusing on emerging countries that appreciate incoming Chinese investments and expensive financial support.[19]

Accordingly, we also have some examples of China's modern diversification strategy, occurring to a high extent geographically.

When summing up some international/global organisations below with obvious strategic interest, you can find some

[19] https://blogg.lnu.se/china-research/?paged=3, from 17 February 2023.

obvious examples where China already is or will become the dominant player, such as:

- BRICS II – certainly an organisation ready for increasing Chinese influence

- Belt & Road Initiative (BRI) – infrastructure projects, fully led by China

- The Regional Comprehensive Economic Partnership (RCEP) includes 14/15 East Asian and Pacific nations working for free trade among each other in a longer perspective (without having the U.S. in the organisation). It is quite easy to imagine that China at some point will become more active within RCEP as well.

Looking at these examples makes it very clear that China wants to expand its global influence. This will happen via bilateral action or via international organisations. Strengthened global platforms will become even more important to President Xi Jinping and the Communist Party, since China nowadays domestically performs insufficiently after many years of boom.

Short- and Long-term Strategies

Attention must be paid to China's changing style in international relations. Or should it be President Xi Jinping's style? It becomes more and more obvious that China has strong political and economic ambitions globally. This may mean that even more focus will be put on Taiwan which is increasingly developing as an important U.S. issue – both politically and economically. It is therefore necessary also that the EU – and when possible and necessary Sweden itself – accelerate the formulation of a concrete China strategy. The U.S. has already come a considerably longer distance in this respect – with no major difference between Trump and Biden.

The New – or Changing – China

In recent articles I have described Chinese attitude and strategy changes that started a couple of years ago, from internationally having been a relatively humble and business-minded country to nowadays presenting itself as self-confident, tougher and less compromising.

Today, China wants to export its “superiority regime model” as much as possible to the rest of the world, particularly to Africa, South America and some countries in South East Europe. Also, China has already gained quite some influence in these continents and regions, by granting – often expensive – new loans for infrastructure, etc.

Altogether, China has become much more ideological, authoritarian and nationalist.

This change can be directly explained by the modified leadership of President Xi Jinping who in the past ten years replaced the previously collective leadership within the Standing Committee by giving substantially more power to himself. In 2013, the first year of Xi in office, the objectives by the Third Plenum with many plans – also for Westerners – toward more market economy looked quite promising. This allowed then for some cautious optimism about future economic progress – cautious optimism that, however, in the meantime to a high extent has been shattered.

Thus, economic policy has been landing on the wrong gangway after 2013 – not easy or even impossible to reverse in the forthcoming years or even decades. “Decades” could be the right term when including the Taiwan issue. Taiwan has to be regarded as the most complicated political and economic issue of the future for both China and the U.S. – with a lot of potential for escalating conflicts between both countries.

Taiwan and its Complications

Taiwan is very special for both Mainland China and the U.S. Both countries may at some point find a reason to start a war. The official China wants Taiwan back and has not ruled out the use of force to achieve reunification – but without mentioning a certain year. Some analysts see 2049 – the 100th anniversary of the founding of the People's Republic of China – as a possible year of confrontation, others predict 2035 when China is expecting to achieve "the status of a moderately prosperous country". Certain China experts are even of the opinion that the price for an invasion including far-reaching Western sanctions would be too large for China – which concerns both Chinese exports and imports.

On the other hand, the belief that the U.S. most probably would not accept a Chinese invasion of Taiwan seems to be widespread among Western analysts. One can hardly imagine what such a development would mean to the global economy.

Taiwan receives American support not only for democracy reasons but also for its close link to high-tech software. 65 percent of all semiconductors and 90 percent of all advanced chips in the world are produced in Taiwan which currently does not leave much space to Mainland China, the EU and the U.S. Having pointed out this fact, nobody should be surprised that China, the EU and the U.S. now eagerly aim to visibly enlarge their own production of intermediate IT products at home. Infineon's planned chip investment in Dresden is such an example.

Political Priorities

Before Xi's entry into the highest political positions, strategic foreign policy was not really an important issue for China's political leaders. Most issues dealt with trade policy and international business relations. Now, foreign policy is judged as very important since President Xi wants to see China as the most influential country in the world.

The revival of active foreign policy means all the same that China also applies strategic policy objectives at home with new policy tools that have been explained above. New domestic policy tools and objectives are indeed badly needed for Chinese leaders in order to divert the people from the disappointing economic performance – divert by using an ideological, authoritarian and nationalist stance in communication with the Chinese people.

The analysis of China is about to become increasingly difficult – particularly when including the Taiwan issue. It is quite new in a way that China and President Xi want to become more powerful in a global perspective, not only at home by the authoritarian and nationalist leadership style. Western companies should observe these ongoing changes of Chinese political leadership.

China versus India

About 15 years ago, I published a paper trying to answer the question whether China or India will be the economic winner in the long run. The conclusion then was: “India and China have very much in common. But both countries are also characterised by major differences. At present, the Chinese economy seems to be in the lead. The analysis shows, however, that it is far from certain that China will maintain the lead 15 or 20 years from now…. But both countries are also characterised by major differences. At present, the Chinese economy seems to be in the lead. The analysis shows, however, that it is far from certain that China will maintain the lead 15 or 20 years from now…”

In that paper I also made a qualitative analysis of different growth factors. In 2021, I arrived at the following confirmed or revised judgments:

Table 1: *GDP-Growth Factors in 2005 and 2021 – China and India Compared*[20]

	2005[21]	2021[22]
Political stability (without regarding the system as such)	China +	0
Democracy	India ++	India ++
Western political support	India ++	India ++
Institutions	India ++	India ++
Property rights	India ++	India +
Banks	India ++	India +
Stock and bond markets	India ++	India ++
Productivity growth	China ++	China +
Labour-market flexibility	China ++	China ++
FDI climate	China ++	China +
Human capital (broadly based)	China ++	China +
Human capital (on top levels)	India ++	India +
Health	China +	China ++
Infrastructure	China ++	China ++
Fiscal policy / public debt	India 0/+	India +
GDP Growth (%, average) 2006-2020	**China 8.3**	**India 5.7**

Democracy, Demography or Deregulation

Looking at growth factors in the table above, the impression seems to be logical that it still remains an unanswered question whether China or India will become the long-term economic winner. India seems to have improved its relative position a little bit more than China in the past 15 years. Both countries have achieved improvements of certain factor contributions to GDP growth – but also still face lagging developments. However – when summing up developments – it seems to be impossible to give the different economic growth factors really correct weights to enable adding up to a total change. How should, for example, the growth indicator "democracy" be weighted?

[20] The author's own judgements: ++ substantial lead, + some lead, 0 roughly equal positions

[21] Fromlet, Hubert (2005), "India versus China – who will be the winner in the long run?", *Economic & Financial Review*, Vol. 12, no. 3, p. 111-143.

[22] The author's own studies of papers, (country) reports, newspapers, statistics.

Obviously, there are also three more growth-driving factors which have not been discussed enough in my article from 2005. But they are now mentioned below with the need to be considered more deeply:

Table 2: *Additional Factors – China and India Compared*

Western political sympathy points	India ++ (clearly in the lead)
The international protectionist threat	India +
Demography	India ++

The three emphasised "D"-growth contributors can play an important role when designing the growth perspectives for the next 15-year period. But we should be aware of the fact that the obvious relationship between democracy and economic growth is not shared by all economists. I myself believe in this relationship and join therefore the related research by, for example, the famous institutional economists Douglass C. North[23] and Daron Acemoglu[24]. It also should be relevant for India to maintain what I call "Western political sympathy points". In a Chinese perspective, choosing realistic positions for meeting future protectionism, presidential changes in the U.S., and the global environment commitments will remain very important issues.

India's favourable outlook for demography can be seen as a strong growth factor which, however, should be accompanied by enough focus on education – a must if India shall ever manage to pass China economically.

Possible Questions Facing China

Will China's supremacy of the Communist Party continue to dominate over Chinese commercial needs?

[23] See *Institutions, Institutional Change and Economic Performance* (1990), Cambridge University Press.

[24] See, *e.g.*, "Institutions as a Fundamental Cause of Long-Run Growth" (2005), in *Handbook of Economic Growth, Vol 1A*, (eds. P. Aghion & S.N. Durlauf), Elsevier.

Will the market economy lose further momentum compared to the objective of the Third Plenum in 2013?

What will happen to what then was envisaged as “the decisive role of markets in the economy” (chapter 1, 2 in the list of goals)? (This goal was, by the way, mainly set by President Xi Jinping and Prime Minister Li Keqiang.)

And how much will more deregulation and/or marketisation be accepted by the societies in China and India?

How big is the future risk for social unrest (which, for instance, may be caused by painful or badly planned deregulation)?

We simply don’t know. But it is relatively certain that the answers to the questions above and, finally, as regards the long-term economic winner of the two most populated countries in the world – will be decided in Beijing and not in Delhi. However, this does not mean that India can afford underestimating the urgent need of structural domestic reforms – with institutions, education, innovation, infrastructure, digitalisation, productivity, and health issues in the first place.

China’s Industry and Qualitative Upgrading

Western politicians and business representatives often point at the big future technological challenges that companies from their own country will face from Chinese competitors. This will come true in many cases but certainly not automatically. My long-time feeling remains: Western knowledge about China mostly continues to be too general.

Dimensions of Necessary Improvements

My impression from many trips to China is that certain academically-oriented views from Chinese researchers may be relatively open and humble. This seems to be possible when the Chinese feel that their discussions with foreign colleagues can be conducted in a fair way – of course, "fair" according to some kind of international scientific definition. This can even provoke critical economic standpoints about the future by the Chinese themselves which, for example, can be found in the article in *China Daily*.[25]

At a seminar in June 2021 industry experts said according to the above-quoted article that "… the industrial structure of China needs urgent transformation during which the country should establish an entire industry chain that moves limited resources to high-end industries…". Without doubt, there is an insight that China should manage a qualitative upgrading as soon as possible – meaning that China should be able to include everything in terms of industry chains.

However, we should at the same time try to understand the large-scale dimensions of the necessary improvements/ innovations of products and industry chains. So much must happen in the giant country of China to come up to relevant macroeconomic dimensions!

At least many Chinese themselves are aware of this phenomenon and necessity. They know that China will have to work very hard itself. There is no automatic success story.

The Understanding of the U.S. and China

Somewhat unexpectedly for many analysts, we notice currently some sharpening of the more or less permanently underlying psychological tensions between the United States and China. However, the pitch has become louder in recent days.

This is not really a surprise. Market expectations were too high in a sense that the new president of the United States would

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[25] http://global.chinadaily.com.cn/a/202106/12/WS60c4045ba31024ad0bac671a.html

behave less challenging in the eyes of the People's Republic – an interpretation I have been warning for right on the American election day ("Today, we do not know about the outcome of the American election. We do not even know whether a possible President Biden would work for really improving relations to China – if yes, probably not very quickly"[26]. Besides, it should not be overlooked that Democratic administrations historically have proved more protectionist than Republican.

The Prominent Role of Psychology in Both Countries

The American psychology: The recent violation by Chinese fighter planes of what the U.S. calls "Taiwanese airspace" is, of course, a strong verbal provocation for the Chinese political leaders. Taiwan as a part of the People's Republic is one of the most important issues for President Xi and his other leaders. Consequently, foreign governments are not welcome at all to regard Taiwan as some kind of independent country. Furthermore, it should not be forgotten that the U.S. now considers China increasingly as a serious technological competitor. This is why the United States also under President Biden will keep quite some distance to China. He will not work ambitiously for fundamental improvements between the two strongest superpowers. Psychology plays a major role also in this context.

The Chinese psychology: The understanding of the Chinese position *vis-à-vis* the United States needs a lot of psychological application as well. Criticising Beijing's Taiwan policy or favouring Taiwan from abroad is regarded as a no go. A second important obstacle for normal Sino-American relations can be found in the fact that China in 2021 is celebrating the 100th anniversary of the foundation of the Communist Party. American verbal interference cannot be accepted. Chinese leaders want to meet their people and the whole world from a position of strength.

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[26] chinaresearch.se, November 3, 2020

Here, the Chinese have a very important and prestigious event that does not allow for what the Chinese may call provocation or humiliation from the United States without reaction.

The conclusion is there is no room for visible improvements of Sino-American political relations for the time being, contrary to market expectations. Psychology plays a prominent role also in this context.

Unemployment as an Indicator

After having dealt with Chinese official statistics for 30 years, I still have the concrete impression that the monthly, quarterly and annually published economic numbers never give a feeling of applicable and comfortable accuracy[27]. Too many statistical inconsistencies could be found more or less regularly over the years. Other academic economists came to the same conclusion.

Referring to the corona virus, I pointed some months ago at the new opportunity for the official China to create better transparency – and by a new policy of improved openness to achieve an upgrading of its international reputation. And I strongly argued for the view that China itself could have benefited from such a policy change.

Unfortunately, China did not want to go for such a new direction. This also means that unemployment numbers will continue to be the same conundrum as they have been in the past decades.

Limitations of Unemployment Statistics

Two different measurements of unemployment rates can quite easily be found in official statistics, one for 31 metropolitan cities and one for total urban unemployment.[28]

[27] See *e.g. Finance India. The Quarterly Journal of Indian Institute of Finance,* Vol. 25, no 4, pp. 1189-1207.

[28] http://data.stats.gov.cn/english/easyquery.htm?cn=A01

But also, in this paper's limited context show up a number of questions without good possible answers, quoting here some of them.

- Rural unemployment is not included in the official – survey-based – unemployment numbers. Is this a curable major shortcoming?

- There is no good estimate about migrant workers working occasionally in the cities, in good times according to the authorities up to 300 million people – and now may be half of it. One has to wonder where these newly unemployed people have gone in reality and in statistics?

- Also officially confirmed, migrant workers accounted last year for roughly one third of the Chinese labour force. Based on this number, it puzzles quite a lot that total urban unemployment in the 31 major cities merely rose from 5.3 % in July 2019 to 5.9 % in April 2020.

No Clear Answers on the Horizon

Increasing unemployment may be the most crucial issue for China's leadership, both politically and socially (which is interconnected). For this reason, the promised opening up in unemployment communication will not take place in the foreseeable future – unless the economy unexpectedly faces an explosive and sustainably strong recovery. But who believes in such a development?

Understanding China's GDP

China's GDP increased by "only" 6.0 % in q3 (yoy) compared to 6.2 % in q2, the lowest growth rate in nearly three decades.

In quite a number of external comments, I could read that China's political leadership should be contented with the above-mentioned growth rate. However, I can see no reason why.

The point is that 6% in GDP growth today is not always equal with a 6 %-rate at another occasion or somewhere else. Here we come to the issue of the quality of economy growth. I would agree with the supposed satisfaction of Chinese leaders if growth had come down in recent quarters as the result of future-oriented reforms of the state-owned enterprises (SoEs) and other kinds of necessary structural downsizing. In this case, we would regard the slower growth as an intended result, some years ago often called "the new normal".

Deceleration of GDP Growth

China's latest growth deceleration is caused involuntarily and cannot be seen as the result of structural reforms and confirmation of the planned "new normal". Instead, the current slowdown seems to be much the result of the trade war with the U.S., the weakening global demand, and the related deterioration of the business sentiment which at some point also started to affect Chinese investments more negatively.

The dampened growth of Chinese investments should not be related to domestic structural reforms but rather to exogenous factors. This means that the political leaders of China do not like the current rate of GDP growth since it is not the result of their own forward-looking Chinese reform policy. It would not be a surprise if the next quarter will show a very limited renewed improvement of the GDP-growth rate, possibly to 6.1 or back to 6.2 %. Such a reversal could be motivated by a number of growth-supporting measures regarding taxes, lowered cash requirements for banks in the PBoC and easing conditions for foreign investors on Chinese stock markets.

To summarise: A further weakening of GDP growth below 6 % does not seem to be probable – particularly not for several quarters in a row. Analysts should not forget the importance of nice statistical GDP numbers for the forthcoming evaluation and anniversary events taking place in 2020 and 2021.

Psychology of Trump's Trade War

The ongoing trade war between the United States and China has been widened further only recently. Also, Mexico was included in American trade protectionism only recently.

Protectionism is not a new phenomenon. It showed up historically in politically and/or bad economic times. The main objective of protectionist measures used to be the support to less competitive industries at home.

The American president still uses this historical explanation of protectionism. But he has also widened this historical application by adding political and immigration issues to the list. China and Mexico are hit in this specific case.

In recent months, I was persistently doubtful about President Trump's suggested progress during negotiations with China and North Korea – particularly due to his frequently exaggerating and changing attitudes. Trump simply functions this way and will most probably do so in the future.

Economists are no psychologists and have, of course, no professional skills to analyse people's behaviour more deeply. But we should understand that neither Trump nor the Chinese apply traditional Western ways of thinking. This fact makes them different in analytical terms.

Trump lives in a world with five foreign main opponents: China, Iran, Mexican immigrants, German/EU non-American car buyers and mostly – but not always – North Korea. Fundamentally, the current American president regards China and Mexico as the outstanding challenges: China because it may threaten the American global supremacy and Mexico because of its refugees and emigrants still coming to the U.S. Also in this latter context, Trump shows no empathy.

The currently relevant psychology of the Chinese is different from the American. The Chinese do not want to be treated as second after “America first”. The Chinese want to be respected and be regarded as equal partners – partners who also would compromise themselves quite a bit in difficult trade issues. The key words for the Chinese are doubtless “respect by the Americans”. This has indeed a lot to do with psychology.

The French economist Bastiat[29] wrote roughly 200 years ago: “When goods do not pass borders, soldiers will”.

Nowadays soldiers are not relevant in this context anymore – but certainly trade barriers are. The previous Fed Chair Janet Yellen seriously questioned Trump’s skills in macroeconomics and economic policy. We are still waiting for Trump to prove the opposite.

Altogether this shortcoming and peculiar psychological conditions will make it extremely difficult also in the future to comment on potential negotiation progress between the U.S. and China.

By action President Trump is certainly neglecting all harmonising research in foreign trade. Professor Greg Mankiw, for example, writes on this issue: “Economists are famous for disagreeing with one another… but economists reach near unanimity on some topics, including international trade…”

We learn from this analysis that the U.S. currently applies trade policy in a non-conventional way. Therefore, psychological aspects currently gain momentum in Trump’s trade protectionism.

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[29] Claude-Frédéric Bastiat (1801-1850)

Superficial Analysis of China

There is much focus on China these days by professional forecasters, major international organisations like the IMF and the OECD included. In most cases, the current concerns are related to the trade war between the U.S. and China and to China's dampened GDP growth – and, at the end of the day, to future exports from the rest of the world and their own country to China.

Most of these analysing people know well about the growing political and economic importance of China. However, the background analysis is in most cases still too superficial or too cautious. Below, are ten examples for this premise.

1. Dampened GDP – what's behind it?

China's GDP grew in 2018 by 6.4 % – with falling growth rates throughout the year. This development was easily predictable – with an outcome each time only slightly down from the previous quarter (q1: +6.8 %, q2: +6.7 %, q3: + 6.5 % and q4: +6.4 %).

2. Still a problem: China's GDP calculations.

Of course, one may wonder why GDP in reality has not fallen more than from 6.8 to 6.4 percent in 2018 when, for example, at the same time the negative impact from U.S. protectionism on Chinese exports, the falling passenger car registrations, and at least some industrial restructuring could be noted (downsizing of coal and steel capacity). It remains a major problem that the changes of the GDP components – according to my knowledge – still are not presented in volume terms. This is not really in line with what should be expected from the largest economy in the world (in purchasing power parity (PPP) terms). External pressure on China to improve the statistical quality seems to be non-existent (whereas sometimes – in other economic areas such as exchange rate policy – too much foreign pressure on China can/could be noted).

3. The “need” to keep up GDP growth at around 6 percent.

The Chinese political leadership is obviously under strong growth pressure in the forthcoming years – more than can be found in Western analysis. First, there is next year the evaluation of the results of the structural strategy paper from the Third Plenum. Xi Jinping – CP Chairman and President of the People’s Republic of China – is inevitably committed to give the Chinese people a positive summary of his time as China’s main political leader.

Second, in 2021, China will celebrate the 100^{th} anniversary of the founding of the Communist Party of China. Such an important event simply has to be decorated by positive and undistorted developments. This includes that the political leadership will be able to confirm that the still valid vision of having provided China with the status of “modestly prosperous nation” has come true in 2020.

Third, China strives to keep GDP-growth rates close to 6 percent for both optical and psychological reasons – and last but not least for being able to create sufficient new jobs; however, there is no scientific evidence that this latter bottom line really should be set at 6 percent. The quality of growth should receive much more emphasis – but is instead rarely mentioned in Western analysis.

Unfortunately, there is still too little analysis on all these important issues.

4. Economic growth of 6% today is much more than 6% ten years ago.

Chinese GDP growth has been downsizing in the past few years – a development that is described by China’s political leaders as the way to a “new normal”. The “new normal” means, consequently, a new equilibrium for growth, job creation and inflation and more lately probably also the environment.

However, it should be stressed that a real GDP-growth rate of 6 % today means much more than an additional growth rate by 6 % ten years ago. Then it would have been as much as roughly 15% (when calculating with an average GDP-growth by somewhat more than 8 % during the past decade).

If China really could achieve a trustworthy annual growth rate of GDP around 6 % in the forthcoming years, it would be a great performance. 6 % could be so good! It is still difficult to understand that the Chinese do not want or manage to offer statistics that Chinese and foreign analysts really can apply. Analysts still pay too little attention to this topic.

5. The conundrum or art of regularly meeting the official growth target.

China seems to have a unique capability of regularly meeting the official growth objectives. This was also the case in 2018. The official objective for GDP growth in 2018 was set at “around 6.5 %” – and the official number came in at 6.6 %. This is rather a phenomenon for a planned economy than for a market economy. Looking at 2019, the official objective for GDP growth is “located” at 6-6 ½ percent – and this objective will under all circumstances safely be met (see point 3 above).

6. The insufficient updating of planned reform activities since 2014.

It is indeed striking how little we can read about progress of the structural reform agenda from 2013. However, it would be unfair to summarise that we learn no details from official communication. Some numerical details are spread, for example, by the National Bureau of Statistics (NBS) in its comments on the development of GDP in 2018 (from January 21). However, not even these limited details are discussed in our part of the world.

7. The total absence of a current account analysis.

The current account balance of China has weakened substantially during the past few years (even if any exact measuring of the net cross-border development of mainly trade, services, transfers, dividends and interest payment proves to be difficult in most countries). In 2007, the surplus was as much as 10% of GDP, indeed a very high ratio, in 2018 probably quite close to zero. These previously high surpluses in the current account contributed simultaneously to the rapid rise of China's currency reserves, by far the largest in the world. Technically, a current account surplus can be "used" in five ways:

- Portfolio investments abroad,
- foreign direct investment abroad (FDI),
- cross-border lending,
- further accumulation of the currency reserve,
- interventions on the currency market to strengthen their own currency.

Officially, the Chinese currency reserve has been shrinking by around 1 trillion USD in the past five years, from roughly 4 trillion to now around 3 trillion USD. 3 trillion USD is, of course, still a lot. However, a more or less stagnating development of the current account balance in the future would probably mean less capacity to be financially active in other countries – unless China and foreign lenders show willingness to accept an increasing Chinese foreign debt or unexpected and steadily high inflows of investment money should occur. Who predicts such sustained trends?

So, what about China's future capacity for outward investment if the current account continuously will develop without sizeable surpluses? What would happen if China even started to run major deficits in the current account at some point in the future, stimulated by continuously high or even growing imports for managing the transition to a consumption-led growth? Or the other way around in a more positive scenario: What about the chances that China may return to considerable surpluses in the current account balance?

These and a number of other questions related to the current account are not even taken up briefly in Western analysis.

8. Demography and urbanisation

There is indeed some ongoing discussion about these two long-term issues – but certainly not enough. What seems to be missing is the link between demographic/urban developments and corporate application. I would like to read much more about these important developments from demography and urbanisation which probably will change the structure of the Chinese economy substantially in the next few decades.

9. Will Trump and Xi ever get along?

It seems to be clear that the President of the United States and the President of China do not like each other. One reason is certainly that Trump accuses China of violating the global rules of fair play in business on a broad scale. The Trump administration has a lot of distrust against Chinese politics which cannot be eroded any time soon.

Any optimism in this respect seems to be premature – even if the result of the next meeting with the political leaders of the U.S. and China on the sensitive trade issues initially should receive some encouraging recognition. In this context, I have a feeling that financial analysts do not consider Trump's psychology sufficiently. Also, the mixed or offended feelings of the Chinese may be underestimated.

10. China's still neglected long-term objective: champion of science

The Chinese have the rare ability to think, plan and act simultaneously in both short- and long-term perspectives. Despite current short-term attempts to keep the economy performing roughly well, the political leaders are also working hard for quite a number of long-term projects such as the Belt & Road Initiative. Digitalisation and artificial intelligence (AI) have a lot strategic priority already today – but one can assume that this priority will be in place even more visibly in the longer run.

As I have described in a previous note[30], there are actually three Chinas:

- the traditional and conservative China,
- the slowly reforming China,
- the rapidly changing China.

In the context here, I am talking about the third classification, the rapidly changing China which is particularly focusing on science and innovation. The Chinese know that scientific progress is necessary to give China a promising and encouraging future in the longer run. They will work hard for this objective, supported by the huge absolute number of scientists. However, today we cannot even know about all areas of possible scientific breakthroughs. China really wants to become a champion of science.

Diffentiating Conclusions from Forecasts

According to a large number of conclusions on the Chinese economy – in most cases coming from Western press and financial economists – the current state and also the future of the Chinese economy seem to be quite obvious. However, this view should be modified. My own experience – after having studied the Chinese economy for several decades – looks somewhat different. I would rather differentiate conclusions and forecasts on the Chinese economy between

- more or less obvious ones (little or no conundrum),
- more or less uncertain ones – but still logical and understandable (limited conundrum),
- more or less non-transparent ones (total conundrum).

Applying the above-mentioned differentiation to current conditions, almost any evaluation of the Chinese economy becomes more complicated. At the same time, it becomes more obvious that the Chinese economy cannot be analysed only occasionally. Instead, regular studies of the Chinese economy must be considered as inevitable.

Below, there is an attempt to use the suggested conundrum classifications in a practical and updated sense. This kind of analysis pattern could serve as a kind of analytical guideline for corporations and financial experts.

Quarter to Quarter Variation in GDP

Statistics still do not show a visible weakening of the Chinese economy. GDP growth uses to vary with only around 0.1 percent from quarter to quarter since around three years ago. Official objectives and expectations are met. This phenomenon is very unusual, also for emerging economies. We are waiting impatiently for official GDP statistics for Q3 on October 19 – and the "allowed" deviation from official expectations and forecasts.

Also, the Purchasing Managers Index (PMI) appears too stable; numbers above and below the borderline of 50 are interpreted and defined too strictly. The current official NBS number of the PMI at 50.8 is therefore not safely above the positive borderline since the different corporate answers to the PMI diffusion index do not measure the strength of possible changes on individual corporate levels – but only the categories "stronger/unchanged/weaker".

My own interpretation of the currently somewhat decelerating growth path of the Chinese economy is preferably based on official statements, speeches and interesting headlines in the Chinese press. Some recent examples can be given here:

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[30] April 4, 2018

- "China to adopt more proactive fiscal policy"[31] – a signal for the need of some growth injection

- "China cuts banks' cash reserve requirement"[32] – the fourth cut in 2018 points at GDP worries

- "Manufacturing growth slower in September … partly due to weakened export performance"[33]

- "No need to worry about China's economy…"[34] – why saying so if there are no concerns?

It should not be neglected that these quoted – and other – articles also include encouraging comments on the resilience and modernisation of the manufacturing industry and the assumed ongoing progress of the service sector. But Prime Minister Li Keqiang by using the words "current pressure on the economy" should be taken more seriously than the more positive comments by less highly ranked officials.

On the other hand, it is indeed obvious that China is working hard on education and innovation systems, co-operation with foreign countries and companies included. This is badly needed for moving forward. The New Growth Theory (NGT) of 2018's Nobel Prize winner Paul Romer is at least partly applied in China.

"Chinese premier says foreign talent important to China's innovation"[35] – a relatively safe conclusion about Chinese awareness of what is needed to compete globally.

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[31] (*Xinhua*, 8 October, 2018)
[32] (*China Daily*, 8 October, 2018)
[33] (*China Daily*, 1 October, 2018)
[34] (*China Daily*, 1 October, 2018)
[35] (*China Daily*, 1 October, 2018)

State of Economic Reforms

In November 2013, the Chinese political leadership's Third Plenum set up 60, quite concrete strategic objectives – to be met by 2020. Most of the objectives mean marketisation and improved institutions – in line with the broad definition of institutions by Nobel Prize winner Douglass North; they would bring China forward substantially if implemented ambitiously.

However, more concrete discussions or presentations on already achieved reform progress are still absent or extremely rare. Transparency is by far too limited also in this specific respect (even if it has been improving on trend at least for the economy). This is a serious shortcoming and could damage China's image in the whole world – and criticism may be at some point even become wrong or unfair once improvements really have taken place. Comments on the strategic reform policy issues are usually formulated like this:

The central bank "will optimise financing and credit structure so that the private sector will be better served"[36] – confirmation that the private sector should receive better financial conditions, but how and when? (see also "Tasks set out for advancing law-based governance in China"[37]).

Optimal Level of Debt

Here we come to parts of the Chinese economy where guiding conclusions seem to be impossible. But more or less totally lagging transparency also means that related risks from China's total indebtedness – may be around 275-300 percent of GDP and roughly twice the ratio of ten years ago – cannot be considered in an appropriate way. The risks can either be underestimated or overestimated. It may even happen also in this context that really occurring improvements will not be recognised or appreciated because of the historical credibility

[36] (*Xinhua*, 30 September, 2018)
[37] (*Xinhua*, 4 October, 2018)

deficits. This special – somewhat different – kind of risk is also linked to behavioural economics and behavioural finance.

Institutional Conditions and Economic Development

Quite a number of economic researchers (North, de Soto, Acemoglu, Blanchard, etc.) consider well-working institutions as the key – or at least a main key – for economic development. Sometimes, however, institutional improvements are conflicting with political positions or strategies. Altogether, there is a clear political strategy in China to improve institutions. Thus, institutional progress will be made – but how fast and how wide-ranging will these institutional reforms be at the end of the day?

Possible New Opportunities

This article is mainly based on the risks of future development. Conundrums do exist – however, also as regards the possibilities – which good economic, educational and institutional policies plus technological achievements indeed may offer. Some more progress is certainly on the cards. However, there should be doubts about the verifications of the opportunities in their entirety. Nobody knows – whatever so-called China experts pretend to know. This conclusion makes it necessary to remain steadily updated.

Impossible Interpretations

Here we have special cases of conundrums that cannot be judged at all what concerns size, time and reactions. China offers a number of these conundrums, both when it comes to political, social and economic conditions.

Outcome of Economic Reforms

There is no way to foresee the outcome of all economic reforms. There are many good plans, many of them in line with Western economic research. But economic and political goal conflicts exist which may mean obvious impediments to the future growth potential.

Ramifications of the Credit Bubble

One of the main economic questions of the future: Will China trigger the next global financial crisis because of its enormous debt problem and possible/probable contagion to other countries?

Non-performing Loans of Chinese Banks

"Government support for major banks will remain strong in China to keep public confidence and systemic stability healthy"[38] – however, why is government support actually needed?

There are few areas in the Chinese economy where official numbers and private estimates differ as much as in the case of non-performing loans (NPLs). Nobody knows exactly the real NPL-numbers of the bad bank credits and the off-balance financing operations by the banks; and even fewer people are aware of the corresponding statistics for the so-called shadow banks which – surprisingly for many analysts – use to have direct links to the big banks. If we then, for example, add implicit and hidden bad loans coming from state-owned enterprises, the conundrum of the total amount of non-performing loans becomes totally puzzling. We do know about the problems of NPLs *per se* – but we have not got a clue about the real dimension of this conundrum; however, the

[38] (*China Daily*, 2 October, 2018)

official number for 2017 for NPLs of commercial banks appears by far too low and unrealistic (1.74 % of total loans).[39]

Risks of Local Government Debt

The uncertainty about the size of local government debt has not declined. Chinese officials point at their version that current debt levels of local governments do not indicate major problems in the future – very much contrary to what financial markets and more critical experts believe with their much more pessimistic stance – including also, for example, comments directly from China ("China battles hidden local government debt"[40]).

Damages of Global Supply Chain

Potential future protectionist threats cannot be analysed well these days – and do not at all allow for any meaningful long-term prediction. Analysts are confronted with a total conundrum. At least in the short run, China may suffer from damages of the global supply chain.

Current Account Surpluses and the Opening of the Capital Balance

China has been – and still is – a country with surpluses in the current account. This phenomenon gives partly a position of strength on global financial markets since China by definition does not need net cross-border capital inflows as long as these surpluses exist; instead, China is able to work with net exports of capital – either by short-term portfolio investments or long-

39 http://www.chinadaily.com.cn/a/201802/09/WS5a7d8c78a3106e7dcc13bdca.html

40 https://www.caixinglobal.com/2018-03-11/china-battles-hidden-local-government-debt-101219793.html

term investments (FDI) abroad or by granting credits over the border.

However, the surpluses in the current account have been shrinking in recent years. Regarding possible further enlargement of foreign protectionist pressure, further concentration on loans for private consumption at home and more imports, and also more widening protectionism could finally make the current account more vulnerable – and, consequently have an impact on the future speed of opening the capital balance for free financial cross-border transactions of stocks, bonds and foreign currencies. All these theoretically possible developments are not foreseeable at all; we find here a most puzzling conundrum.

Future of Social Conditions

Here we have another, completely secret box which cannot be opened any time soon. What we do know about this is the experience and results from research that there is often an existing relationship of the economy to social developments or the other way around. There is no doubt that the Chinese need more and better social security.

Conclusions

The discussions above should show that China’s short-term economic outlook – despite certain statistical problems – seems to be more predictable than the structural long-term perspectives. This can be concluded despite the current shortcomings in Chinese statistics, transparency and communication (which make also short-term forecasts more complicated than necessary). Altogether: China’s economy is characterised by many conundrums – but not all of them with completely unforeseeable outcome.

It will, for example, be interesting to see whether China will keep up its opaqueness when it comes to the development of digitalisation and artificial intelligence. China is still a country that can surprise – hopefully in an increasing number of cases in a positive sense. But I also remember the words coined by an outstanding China expert in Hong Kong in the 1990s who repeatedly during each and every meeting there reminded me of his own “law” – simply asking the following question: What do we really know about China?

While economic transparency is better – it is still insufficient. This is exactly the reason why this article deals with different alternatives of conundrums in the political and economic powerhouse of China – from quite limited conundrums to very large ones.

However, despite all these conundrums, China will remain a most exciting country, for both analysis and business.

APPENDIX

Table 1: *Chinese GDP Data*

Year	*GDP (Current prices, NSA, bn CNY)*	*GDP (Current prices, bn CNY)*	*GDP (Constant prices, bn CNY)*	*GDP Growth (Constant prices, % y/y)*
2000	2.94886E+12	1.01025E+13	1.76375E+13	8.572
2001	3.20869E+12	1.11855E+13	1.91048E+13	8.319
2002	3.54307E+12	1.23047E+13	2.08652E+13	9.214
2003	4.03388E+12	1.39132E+13	2.2977E+13	10.121
2004	4.74203E+12	1.63797E+13	2.53012E+13	10.115
2005	5.47468E+12	1.90566E+13	2.81948E+13	11.437
2006	6.45108E+12	2.23037E+13	3.17656E+13	12.665
2007	7.9854E+12	2.74802E+13	3.62616E+13	14.154
2008	9.0075E+12	3.23351E+13	3.97565E+13	9.638
2009	1.02495E+13	3.53606E+13	4.35115E+13	9.445
2010	1.2126E+13	4.15625E+13	4.8118E+13	10.587
2011	1.4015E+13	4.9268E+13	5.26656E+13	9.451
2012	1.54258E+13	5.48089E+13	5.67986E+13	7.848
2013	1.70695E+13	6.06125E+13	6.12122E+13	7.771
2014	1.84179E+13	6.57433E+13	6.57978E+13	7.491
2015	1.96334E+13	7.04158E+13	7.04157E+13	7.018
2016	2.15618E+13	7.60672E+13	7.51868E+13	6.776
2017	2.39688E+13	8.45067E+13	8.03679E+13	6.891
2018	2.63436E+13	9.33581E+13	8.57996E+13	6.759
2019	2.82201E+13	1.00672E+14	9.10032E+13	6.065
2020	3.01836E+13	1.04224E+14	9.31295E+13	2.337
2021	3.32827E+13	1.17311E+14	1.01097E+14	8.556
2022	3.42342E+13	1.23341E+14	1.04244E+14	3.112
2023	3.57225E+13	1.29427E+14	1.09849E+14	5.377
2024	3.73726E+13	1.34908E+14	1.15344E+14	5.003

Source: IMF (International Financial Statistics)

Table 2: *Chinese Exchange Rates*

Year	*Exchange Rate (CNY per USD, period average)*	*Exchange Rate (CNY per USD, EoP)*	*Nominal Effective Exchange Rate (NEER, Index (2010=100) Weighted index)*	*Real Effective Exchange Rate (REER, Index (2010=100) Adjusted by relative)*
2000	8.2772	8.2774	95.6818	94.9493
2001	8.2769	8.2768	99.6906	97.5782
2002	8.2772	8.2773	95.5859	91.5267
2003	8.2770	8.2767	88.3521	86.1837
2004	8.2765	8.2765	84.1172	82.0510
2005	8.0757	8.0702	90.8675	87.9697
2006	7.8240	7.8087	89.2216	87.0797
2007	7.3720	7.3046	90.1158	90.6690
2008	6.8427	6.8346	104.1359	103.4763
2009	6.8279	6.8282	97.9504	97.2703
2010	6.6536	6.6229	99.9473	101.3098
2011	6.3286	6.3009	105.5383	107.9826
2012	6.2901	6.2896	106.2099	108.9327
2013	6.1172	6.1024	114.2155	117.4370
2014	6.1242	6.1190	122.7589	125.8344
2015	6.4527	6.4915	125.9841	129.4630
2016	6.9220	6.9498	118.4405	121.8343
2017	6.5936	6.5116	118.0006	121.0880
2018	6.8855	6.8530	116.9447	119.9344
2019	7.0205	6.9870	115.1578	120.7425
2020	6.5442	6.5349	120.1550	124.8941
2021	6.3672	6.3704	129.6435	130.2732
2022	6.9829	6.9860	125.6630	120.1728
2023	7.1496	7.1436	124.0695	113.4779
2024	7.2767	7.2992	126.6269	112.1989

Source: IMF (International Financial Statistics)

Table 3: *Chinese Interest Rates*

Year	*Real Interest Rate (% y/y)*	*Lending Interest Rate (% y/y)*	*Deposit Interest Rate (% y/y)*	*Interest Rate Spread (lending rate minus deposit rate, % y/y)*
2000	3.673088686	5.85	2.25	3.6
2001	3.559219168	5.85	2.25	3.6
2002	4.637498974	5.31	1.98	3.33
2003	2.598646301	5.31	1.98	3.33
2004	-1.318057461	5.58	2.25	3.33
2005	1.76511319	5.58	2.25	3.33
2006	2.019374501	6.12	2.52	3.6
2007	-0.411124456	7.47	4.14	3.33
2008	-2.361085723	5.31	2.25	3.06
2009	5.396390198	5.31	2.25	3.06
2010	-1.045986579	5.81	2.75	3.06
2011	-1.348005925	6.56	3.5	3.06
2012	3.510384658	6.0	3.0	3.0
2013	3.618845182	6.0	3.0	3.0
2014	4.460243408	5.6	2.75	2.85
2015	4.20696427	4.35	1.5	2.85
2016	2.830736322	4.35	1.5	2.85
2017	0.195857336	4.35	1.5	2.85
2018	0.852537112	4.35	1.5	2.85
2019	2.995092852	4.35	1.5	2.85
2020	2.995092852	4.35	1.5	2.85
2021	-0.118557235	4.35	1.5	2.85
2022	2.369885834	4.35	1.5	2.85
2023	4.880384867	4.35	1.5	2.85
2024	5.093219257	4.35	1.5	2.85

Source: IMF (International Financial Statistics)

Table 4: *Chinese CPI*

Year	*CPI (All items, Standard reference period (2010=100), Index)*	*CPI Growth (All items, Standard reference period (2010=100), period average, %)*	*PPI (Index)*	*PPI (Index,% y/y)*
2000	81.6659	1.5000	N/A	N/A
2001	81.4209	-0.3000	N/A	N/A
2002	81.0727	-0.4276	N/A	N/A
2003	83.6727	3.2070	N/A	N/A
2004	85.6027	2.3066	N/A	N/A
2005	86.9569	1.5820	N/A	N/A
2006	89.4015	2.8112	N/A	N/A
2007	95.2830	6.5787	N/A	N/A
2008	96.4836	1.2600	N/A	N/A
2009	98.1276	1.7039	N/A	N/A
2010	102.6133	4.5713	103.7063	N/A
2011	106.7459	4.0273	105.4998	1.7294
2012	109.4479	2.5313	103.4922	-1.9029
2013	112.1914	2.5066	102.0869	-1.3579
2014	113.7729	1.4097	98.6740	-3.3432
2015	115.6117	1.6162	92.8519	-5.9003
2016	117.9101	1.9881	103.1911	11.1351
2017	120.0936	1.8518	108.2101	4.8638
2018	122.3921	1.9139	109.2139	0.9276
2019	127.7934	4.4132	108.6116	-0.5515
2020	128.1382	0.2698	108.2101	-0.3697
2021	129.9858	1.4419	112.2253	3.7106
2022	132.2932	1.7751	111.4223	-0.7156
2023	131.9087	-0.2907	N/A	N/A
2024	132.0369	0.0972	N/A	N/A

Source: IMF (International Financial Statistics)

Table 5: *Chinese Exports and Imports*

Year	*Exports (USD)*	*Imports (USD)*
2000	253,092,089,742.30	224,306,238,156.07
2001	272,060,010,513.39	243,973,790,223.79
2002	333,002,310,921.76	295,619,639,657.43
2003	447,958,253,780.91	412,137,124,710.21
2004	607,356,934,122.25	556,182,551,580.01
2005	773,339,005,398.50	648,712,207,875.29
2006	991,731,387,765.23	782,812,463,256.13
2007	1,258,056,795,935.92	950,020,767,155.50
2008	1,497,868,782,937.13	1,149,036,249,792.23
2009	1,262,664,161,017.28	1,042,533,759,648.07
2010	1,654,823,329,663.86	1,432,422,435,977.06
2011	2,006,308,960,976.47	1,825,413,639,206.37
2012	2,175,069,254,663.85	1,943,205,232,867.15
2013	2,354,264,539,609.20	2,119,392,421,427.69
2014	2,462,825,804,851.16	2,241,276,198,979.27
2015	2,362,097,053,274.60	2,003,260,696,068.67
2016	2,199,974,853,570.14	1,944,490,534,275.23
2017	2,424,216,052,098.35	2,208,518,918,632.20
2018	2,655,609,176,087.45	2,564,121,910,994.89
2019	2,628,941,104,657.60	2,496,153,305,902.90
2020	2,729,884,575,163.89	2,374,737,462,777.69
2021	3,554,107,780,957.44	3,093,278,397,249.18
2022	3,717,887,818,646.97	3,140,040,863,536.23
2023	3,513,236,885,527.07	3,127,201,616,050.71

Source: The World Bank

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