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Engaging China at a Time of Transition

Capitalising on a New Era of Chinese Global Investment and Foreign Policy Initiatives

European Political Strategy Centre

China has become the world's third largest economy in terms of output – behind the European Union and the United States – thanks to a phenomenal annual growth rate of about 10% since the 1980s[1]. It is now also the third largest global player in external trade. Yet, China is slowing down in its economic race, despite having made the greatest contribution to world output growth in 2015. The significance of the Chinese economy and the questions arising about its sustainability bear strategic and direct consequences for the EU. First, what are the implications of the real danger of China experiencing a 'hard landing' as a result of unsustainable debt levels? Second, what does the rise of China as a sizeable exporter of capital to the world at large and Europe in particular mean for the EU? Finally, what are the repercussions of China's increasingly active role and rising ambitions as a sponsor of – and actor within – global multilateral institutions?

Unsustainable Debt?

Rising debt levels increase the risk of a financial crisis for China. Tackling such a challenge requires the country to shift its economic model to one based on consumption and even accept a decline in growth rates. Else, China faces a real danger of a 'hard landing', possibly together with being caught in a 'middle income trap'. The latter is due to a protracted process of deleveraging that may compromise its future growth dynamics.

Euro Area Lessons for Chinese Financial Market Reforms

The Banking Union is a potential reference for China for how to enhance prudential requirements for banks, improve depositor protection and devise better rules for managing failing banks. China has introduced reforms in some of these areas, but more can be done.

Booming Chinese Foreign Direct Investment Impacts the EU

Addressing potential risks to European security and defending the EU's openness to Foreign Direct Investments from protectionist pressures calls for a clear and effective review mechanism. It should screen non-EU Foreign Direct Investment against national and collective security concerns. This is a desirable addition to the current negotiations of a Bilateral Investment Agreement, which helps to address the question of greater symmetry in market access between China and the EU.

International Institutions Should Match Global Economic Reality

The EU can take the lead in framing the debate on reorganising international institutions so that they reflect evolving realities in the global economy. Such a proactive effort could help place China into a global financial framework that is mutually beneficial and allows for the pursuit of own interests at fair conditions. In parallel, the EU should seek greater influence in China-dominated new institutions and initiatives.

EPSC Strategic Notes are analytical papers on topics chosen by the President of the European Commission. They are produced by the European Political Strategy Centre (EPSC), the European Commission's in-house think tank.

1. Slowing Growth and Rising Debt: Is China's Growth Model Sustainable?

Chinese economic growth has been consistently slowing down in the last few years, with growth rates falling from a peak of 14.2% in 2007 to 6.9% in 2015 – the lowest rate since 1990. The phenomenon is not cyclical but it reflects structural changes in a maturing Chinese economy, whose medium-term growth potential may be as low as 5% annually.[2]

A slowdown of Chinese growth performance is natural for a country that has caught-up on economic progress in record speed. As the economy develops, returns to capital unsurprisingly diminish. At the same time, the two main sources of Chinese growth in the past have been losing importance. First, the reallocation of surplus labour from rural areas to more productive urban employment is slowing – and is likely to continue to do so. Second, technological catch-up will become less important as China moves closer to the technological frontier. In addition, Chinese society is ageing and its prime working population (aged 15-59) shrinking, as it has been doing since 2012 – a mix that will further contribute to the growth slowdown.[3]

Since 2008, in part resulting from a misguided government stimulus programme designed to shore-up growth rates, China has experienced a **credit-fuelled cycle of over-investment**[4], with gross capital formation in GDP rising from 41% in 2007 to 48% in 2010 alone.[5] This cycle of over-investment has made Chinese growth even more reliant on debt-fuelled investment in fixed capital. While the great majority of growth per capita between 1978 and 1995 derived from technological progress, the contribution of capital accumulation has become relatively more important since then. Unsustainably high investment rates have caused significant inefficiencies and additional investment in recent years has created only half as much value-added as in the 1990s, as measured by the World Bank. The boom of the last years has also exacerbated the problem of China's overcapacity (see Box below), which rose between 2008 and 2014 in several sectors.[6]

Overcapacity in the Chinese Economy

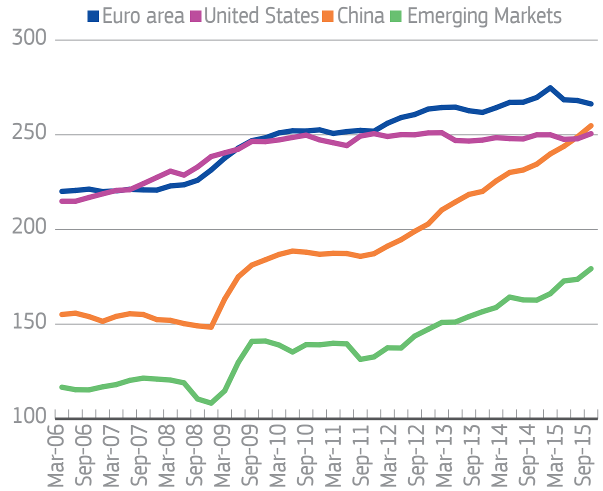
- Chinese overcapacity problems result from the government's interventionism in the economy, notably in the form of lowering input prices, state credit subsidies, protectionism by local governments and bloated state firms.
- The Asian Development Bank estimates that reducing excess capacity in iron and steel, coal mining, cement, shipbuilding, aluminium, and flat glass by 20% could eliminate 3.6 million jobs, or 0.7% of total nonfarm employment.[7]
- In addition to harming China's stability, Chinese overcapacity also affects the global economy and the EU. The EU is most exposed in the steel sector where overcapacity is almost twice the EU's annual production, i.e. about 350 million tons. Chinese steel exports into the EU increased by 50% in 2015 compared to 2014 and since 2008, the EU has lost 85,000 steel jobs, which corresponds to 20% of the workforce in the sector.

Unsustainably high investment rates cannot lead to consistently higher growth. The investment boom after 2008 has gone hand in hand with a substantial accumulation of debt, with **total non-financial debt rising from around 150% of GDP at the end of 2007 to over 250% in late 2015**. Such a debt level is far higher than any other emerging markets and comparable to that of developed economies, such as the United States and the euro area (see Figure 1). The GDP metric, in fact, underestimates the overall build-up of debt, given the high level of GDP growth experienced by China since and the appreciation of the Renminbi. In US dollars, **Chinese debt almost quadrupled, from $6.9 trillion to $26.6 trillion between 2007 and 2015. China now has one of the highest corporate debt levels worldwide**, much higher than those in the US or the euro area, with non-financial corporate debt continually rising from 124% in 2012 to 170% end of 2015.[8] A stress-test analysis by the McKinsey Global Institute found that if China were to continue to pursue its debt- and investment-led growth model, the ratio of nonperforming loans could reach 15% in 2019 from today's official figure of 1.7%. The Institute also estimates that every year that China advances on the current unsustainable path of increasingly inefficient and credit-fuelled investment could increase the cost of dealing with bad debts from $310 billion to $460 billion.

In the case of China, **risks from rising debt levels are exacerbated by three factors**.[9] First, approximately 45% of non-financial sector debt was directly or indirectly linked to the **real estate sector** in mid-2014. Non-productive investment in real estate has grown from about 4% of GDP in 1997 to 15% in

Figure 1: Non-Financial Sector (NFS) Indebtedness

Percentage of GDP



Source: Bank for International Settlements (BIS)

2014. Residential investment alone accounted for 15% of all fixed asset investment, 15% of urban employment and received 20% of all bank loans in 2014.[10] As a result, the so-called 'second and third tier cities' have developed a housing oversupply. The adjustment of excess supply in the residential real estate sector may take several years, as demonstrated by the cases of Ireland and Spain in the EU, and will possibly dampen investment and GDP growth.[11]

Second, 30% of outstanding debt and half of new lending in 2014 was provided by China's 'shadow banking sector',[12] which has grown by 36% annually between 2007 and 2014. Most of these loans of opaque origins were channelled into the real estate sector. The risk-bearing capacity of the shadow banking sector is unclear, looming over the sustainability of investments in real estate.

Third, local government debt has grown at a rate of 27% annually between 2007 and 2014 and has been accumulated in off-balance sheet financing vehicles.

Local governments have limited revenue-raising sources, as evidenced by the fact that in 2014 **20% of debt repayment was financed through new loans and 40% through land sales**, underlining local governments' exposure to a slowing property market.

In addition to the three aforementioned factors, the Chinese financial market has been exposed to a mix of instability: the bursting of the stock market bubble in August 2015; further stock market volatility in early 2016 – associated with large outflows of capital that may have been as high as $1.5 trillion between June 2014 and December 2015 (see Box below); and uncertainty about a further depreciation of the Chinese currency.

The combination of these developments clearly shows that **China's debt-fuelled, investment-led growth model is reaching its limits**. As the Chinese economy reaches middle-income levels, it faces the challenge to undergo a transition away from its investment-, industry- and export-led growth model towards one in which domestic consumption, services and higher value-added manufacturing play a larger role. This entails the **reallocation of resources away from traditional sectors plagued by overcapacity** such as steel, shipbuilding, real estate and basic manufacturing, to sectors with greater potential: those with services and consumers at their core, where innovation and technology are key.

At a glance, the Chinese government would seemingly have the capacity to stabilise the financial system in the event of a credit crisis. Its central government debt is about 44% of GDP, compared to almost 100% in the US and the euro area. However, as the euro area crisis has shown, important systemic interdependencies may remain hidden until they are uncovered by stresses. In particular, 'private' corporate debt in China benefits from implicit and explicit guarantees from the Chinese government – like many of the banks that provide the credit and the companies that receive it are state-owned. This means that even if rising corporate indebtedness does not lead to a financial crisis, very high levels of debt would still have a negative impact on

Renminbi Depreciation Pressures and Reserve Outflows

- Against the backdrop of the current and expected further growth slowdown, foreign and domestic investors started to pull capital out of China since mid-2014, creating depreciation pressures. These have been exacerbated by poorly communicated central bank policies and compounded by stock market turbulences.
- In order to stabilise the Renminbi and prevent a disorderly depreciation, the Chinese authorities have drawn on their foreign exchange reserves, which have fallen by around $775 billion between July 2014 and May 2016.
- Adding up the actual decline in official reserves and the rise that ordinarily would have resulted from the trade surplus suggests that total capital outflows out of China during the second part of 2014 and 2015 may have amounted to $1.54 trillion.[13]

growth. Indeed, Cecchetti and Kharroubi (2012), using a sample of developing and developed countries, find that after exceeding a value of around 100% of GDP, **higher credit leverage is associated with an increasingly negative impact on growth**.

Supporting a More Sustainable and Balanced Growth Strategy for China

The EU has a strong interest in China successfully avoiding both a hard landing and being stuck in a middle income trap. There are multiple and inter-linked channels through which a Chinese growth slowdown will affect the EU. Among the most notable: direct trade links, spillover effects from other emerging countries, the impact on commodity prices, the effects on global financial market stability, reduced investment flows, and a generally worse economic sentiment. While EU exports are, overall, exposed to China in a limited way, they could still suffer from the above scenario and its repercussions especially on Asian partners. In 2015, EU exports to Asia constituted 35.2% of all extra-EU exports, meaning 4.5% of its GDP.[14]

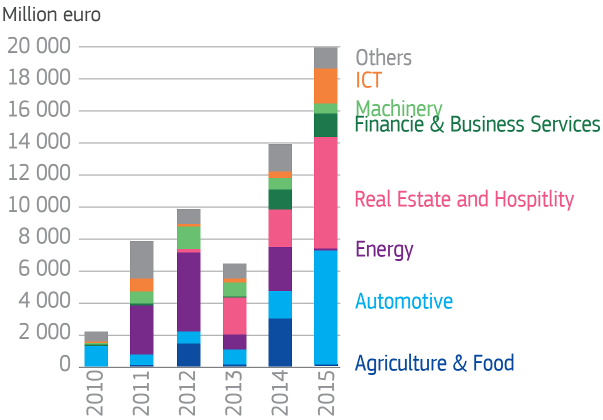
The EU can therefore offer China important policy lessons from the European financial crisis to avoid a hard landing and its global implications. Indeed, as in the comparison between the EU and the US at the time, the Chinese process of debt accumulation is comparable to that of the pre-crisis EU – even though the causes are different. This makes EU policies potentially relevant for China to achieve positive outcomes. In particular, **creating a sounder financial sector that does not rely on tax payers' money to safeguard financial stability and thereby shields a government from stresses in the financial system**. Perhaps the most prominent EU initiative – and thus most useful reference for Chinese reform of financial market regulation – is the **Banking Union**. In its institutional dimension, it encompasses the creation of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) for banks, in addition to a proposal for a European Deposit Insurance Scheme (EDIS). While China has introduced reforms in some, additional action is needed to make its financial system more safe and sound.[15]

2. China's Rise as a Global Exporter of Foreign Direct Investment and Implications for the EU

As a direct consequence of the domestic growth slowdown, and against the backdrop of gradual capital account liberalisation, China's outward Foreign Direct Investment has grown exponentially in recent years. Today, China's global **outward Foreign Direct Investment stock is triple the amount compared to five years ago** and exceeded $1 trillion in 2015.[16] This trend is set to continue, making China a leading global exporter of capital.

The EU has become a main destination of Chinese outward Foreign Direct Investment, reflecting a broader shift of Chinese flows from developing and emerging to high-income countries. While accumulated Chinese net Foreign Direct Investment stocks in the EU are still relatively small, amounting to nearly €25 billion in 2012, they had risen by a factor of eleven between 2008 and 2012.[17] Similarly, in 2012 Chinese gross Foreign Direct Investment into the EU amounted to nearly €10 billion, but in 2015 they doubled to €20 billion.[18] In recent years, Chinese investments have targeted a more diverse set of sectors in the EU as well as a growing number of Member States (see Figure 2 below).

Figure 2: Chinese Outward Foreign Direct Investment to the EU



Source: Rodium Group.

The EU grants the same openness to Foreign Direct Investment from China that EU Member States enjoy. This stands in stark contrast to China, which is one of most closed G20 countries in terms of formal restrictions on Foreign Direct Investment.[19]

Thus, as China becomes an ever more significant exporter of capital, concluding the ongoing negotiation between the EU and China to resolve this asymmetry in market access via the Bilateral Investment Agreement is important for two reasons. First, it would create a more level playing field for European companies. Secondly, greater reciprocity is vital to politically **defend Europe's openness to Foreign Direct Investment, which is beneficial for non-EU investors like China**. The latter is increasingly subject to controversy when asymmetry of access is too pronounced and perceived as unfair by the public.

The rise of China as a capital exporter to Europe also lends increased importance to the **question of how these investments are screened for their potential impact on national and European security**. Such concerns arise in the case of foreign ownership of assets that are critical to the functioning of the economy because they may open doors for surveillance and make critical infrastructures more vulnerable as well as allow for technology or know-how transfers that can be used to harm the host country.

Evidence seems to suggest that Chinese Foreign Direct Investment into Europe has been predominantly driven by commercial motives. But the question of security is especially salient when it comes to China, a still largely state-controlled economy which may use investments with political rather than commercial considerations in mind. Some EU Member States already have their national security review mechanisms. At the same time, there is a case to be made for a **more coordinated approach or even a common European review mechanism**, perhaps using the US Committee on Foreign Investment in the United States as an example (see Box below).

Committee on Foreign Investment in the United States

The United States has a framework to prevent the foreign acquisition of US companies, if this would threaten to impair US national security. This organisation, **called Committee on Foreign Investment in the United States (CFIUS),** is an interagency body led by the Department of the Treasury, created in 1975 to monitor Foreign Direct Investment into the US. It was given authority to formally review Foreign Direct Investment in 1988, which was enhanced by a 2007 law that also requires heightened scrutiny of acquisitions by government-owned companies.

Screening for security acquires more importance as China shows increasing interest in assets with cross-country security implications such as utilities, transportation or telecommunication infrastructure. Growing Chinese investment may, for example, overwhelm a smaller country's capacity to appropriately review Chinese investments, which could also have negative regional security implications. Finally, a shared European review mechanism, which is publicly recognised as based on the principles of openness and non-discrimination, will to some extent mitigate security concerns associated with Chinese Foreign Direct Investment and thus reduce the risk of politicisation at the level of Member States. Thus, a clear and effective European review mechanism for all non-EU Foreign Direct Investment in security-related areas may contribute to defending the EU's current openness, a valuable asset that is often subject to populist attacks. Of course, maintaining societal support for the EU's current openness will also require fair competition between Chinese investors and European businesses. Thus, China has to urgently revise its use of subsidies and other non-market instruments that distort global competition.

3. Engaging a Global Power with Global Responsibilities

With power comes responsibility. Although China traditionally has tried to reduce possible vulnerabilities emerging from external dependencies, it is increasingly inclined to become more active internationally to defend its interests. Given the reality of China's increased economic and political weight, the EU has to identify where its objectives align with Chinese ones. The areas of overlap between EU and Chinese interests are substantial and should not be neglected by focusing on specific questions, such as China's Market Economy Status.

Interdependence, by definition, works both ways, and **Europe should call upon China to embrace its global responsibilities**. This includes engaging China in existing multilateral institutions and treaties (see Box), and expanding Europe's role and influence in the initiatives and new international institutions that China sponsors.

COP21 Calls for Chinese Leadership

Climate change has a pervasive multiplier effect on an increasing set of cross-cutting threats, including environmentally driven conflicts, political instability, extreme poverty, energy security, migration and the reality of climate refugees. A collective solution must be found to protect societies and help them adapt and develop. This also concerns China as it has to take its responsibilities as a rapidly developing state. Here, the COP21 agreement is an important milestone setting the framework for the future. The EU, as a frontrunner in many green technologies and instruments, and China, a country that is experiencing first-hand the downside of unsustainable growth, have great incentives to use multi- and bilateral fora to modernise their economies and continue the transition towards a low-carbon economy. A good example for bilateral cooperation is the recent announcement of a €10 million project on enhanced collaboration with China on emissions trading, which will help China with challenges related to the set-up of its national emissions trading scheme and establishment of a regular dialogue with the EU on emissions trading.

Plurilaterally, negotiations are ongoing on an Environmental Goods Agreement that would eliminate tariffs on environmentally friendly goods such as solar and wind technologies, water filtration systems, and air-pollution control equipment. An ambitious deal would be a great opportunity for EU exporting companies to get more access to the Chinese and other markets. The Chinese, on the other hand, could benefit from getting access to the latest technologies and transform their polluting industries. Pressure is growing on China to foster a deal by the G20 summit in September 2016 in order to keep the momentum after Paris COP21. If this is successful, it could form the basis for other forms of win-win collaboration in the field of climate, energy and the environment.

Global Economic Governance: Old and New Multilateral Frameworks

China stresses the need for **increased representation in international fora as well as institutions of emerging markets and developing countries in order for global economic governance to be equitable and legitimate**. In particular, China urges for the full implementation of the 2010 International Monetary Fund (IMF) quota and governance reform, for a World Bank voting share review and the increased role of IMF Special Drawing Rights, especially now that the Chinese Renminbi has been added to the basket of Special Drawing Rights currencies. Some of those discussions dovetail with the proposed reforms of the euro area representation in multilateral fora and are therefore a very **useful entry point for cooperation**. Within the **Bretton Woods** institutions, European Union countries in aggregate and China continue to have representation quotas that do not fully reflect what their relative economic weights are. In addition, China also supports greater diversity in the management of multilateral bodies, notably opposing the tradition of the US and the EU appointing the leadership of the World Bank and the IMF respectively. A genuine discussion on these aspects should not prevent the EU from standing firm on the rules, policies and standards of those institutions, where China prefers a less intrusive stance that gives countries more leeway.

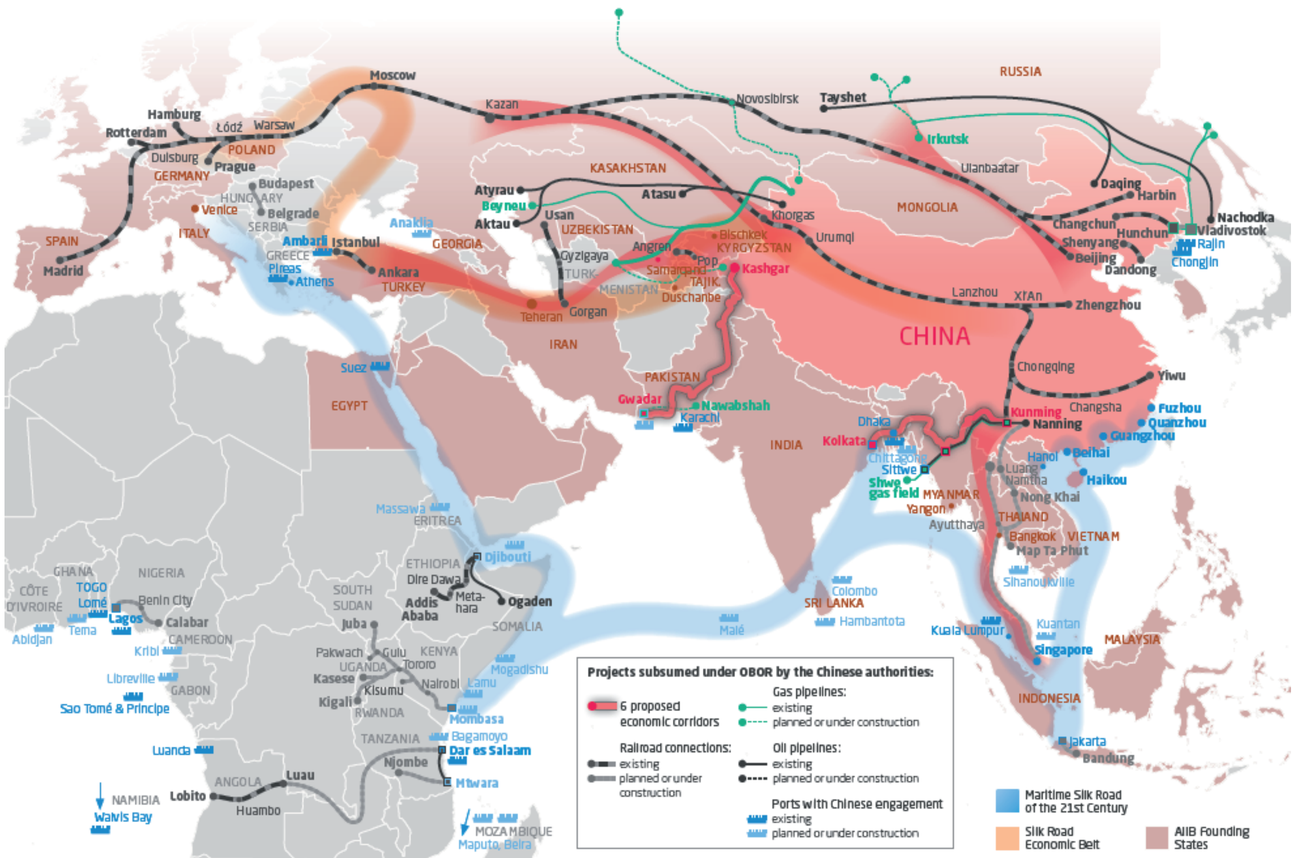
Another concrete example of Chinese engagement in existing multilateral fora – this time with a **clear mutual benefit** – is the current **G20 Chairmanship.** China's G20 Presidency sets four key priorities: 'breaking a new path for growth', 'inclusive and interconnected development', 'more effective and efficient global economic and financial governance', and 'robust international trade and investment'. These priorities reflect China's interest in harnessing the G20 to address its multiple domestic vulnerabilities but also its ambition to expand the G20 agenda to 'a modified long-term global economic governance mechanism'.[20]

The **Financial Stability Board**, founded by the G20 in 2009 in the aftermath of the financial crisis, holds particular potential for further cooperation. As the central body for the coordination of global financial regulation, it is mandated to develop new financial standards. The European representation in the Financial Stability Board includes the European Commission and the European Central Bank as well as six EU Member States (France, Germany, Italy, Spain, the Netherlands and the United Kingdom). China has joined the Financial Stability Board even though this increases peer pressure on its domestic financial sector reforms. The country participates actively in the Financial Stability Board and currently its main interest lies in learning about how to combine the assimilation of international financial standards with the promotion of its domestic financial market reforms.

Some regional institutions witness a more active China as well. At the end of 2015, shareholders of the **European Bank for Reconstruction and Development (EBRD)**, including the EU, accepted China's application for membership. This will open up opportunities for Chinese companies to invest in the countries where the EBRD works and which overlap in part with the countries where China seeks to encourage investment as part of its One Belt, One Road initiative (Figure 3). This aims to create land and sea transport infrastructure that links Asia to Europe. Accordingly, in June 2016, a cooperation agreement was reached between the EBRD and China's state-owned Silk Road Investment Fund, with both parties agreeing to inform each other about potential projects for co-investment in their regions of operations.[21] However, China is simultaneously developing China-centred institutions where it can impose its standards. Here, the EU and the Member States should act in a coordinated fashion and actively push for the respect of international standards as well as defend European interests.

The **Asian Infrastructure Investment Bank (AIIB)** is a case in point. Created by China in 2014, headquartered in Beijing, with 57 prospective non-founding members and an authorised capital of $100 billion, more than twice that of the EBRD. The geostrategic motivation of this initiative must be understood against the backdrop of China's criticism of alleged Western dominance within the World Bank. Regional members will hold a minimum of 75% of the capital stock and this will be split among Asian nations based on their relative economic size. China will pledge half of the $100 billion authorised capital and European contributors will only reach a combined voting power of 20%. By the deadline of 2015, fourteen EU Member States had applied to join it in an uncoordinated fashion. Although there are legitimate concerns that the AIIB will be a rival to the World Bank or Asian Development Bank – and with lower standards on governance or procurement – a consolidated EU membership and consistent coordination among EU Member States can be an opportunity to improve investment conditions for European companies in Asia. At the same time, such an EU presence in China-driven institutions would contribute to the adoption of best practices and fair, global standards. Adherence to such standards will be promoted by the AIIB entering into partnership with existing Multilateral Development Banks. In April and May 2016, it signed co-financing and broader cooperation agreements as well as concrete joint projects with the World Bank, the Asian Development Bank and the European Bank for Reconstruction and Development.

Figure 3: One Belt, One Road Projects



Source: Merics.org

There is considerably less leverage for Europe in the **New Development Bank (NDB)**, established by the BRICS countries (i.e. Brazil, Russia, India, China and South Africa) and based in Shanghai. Its focus is on infrastructure and sustainable development projects in BRICS, emerging and developing countries. Although the initiative is very recent and concrete experience of its functioning is limited, the EU should avoid another uncoordinated approach to its membership in order to have the NDB uphold international standards. Membership is not exclusive and is open to all members of the United Nations, but the voting power of the founding members cannot drop below 55% of the total voting power – making an even more compelling case for coordinated influence among EU countries.

Geopolitics and Economic Diplomacy: One Belt, One Road

The One Belt, One Road initiative is **a combination of geopolitical ambition and a measure to mitigate domestic overcapacity problems in China**.[22] Internationally, the **One Belt, One Road is a vehicle of Chinese economic diplomacy to project an inclusive narrative for economic development that invites Asia, Africa and Europe to cooperate**. In terms of public relations and outreach, the initiative has been a success. Domestically, the One Belt, One Road initiative is a demonstration of Chinese leadership but also an attempt to integrate its Western hinterland provinces with the wider Chinese economy to create more markets in these regions and thereby maintain domestic stability. The political aim to double the GDP and the income per capita by 2020 as proposed in the 13th Five Year Plan seems unlikely for coastal provinces but not necessarily for the relatively poor Western hinterland which has the potential to rapidly develop.

The One Belt, One Road is a comprehensive framework. Virtually any initiative in the large geographical area between China and Europe can be – and is – branded as part of this initiative. Despite the popularity of the concept, China already faces difficulties in implementing its ambitions, especially in Central Asia where it is extremely challenging to deliver profitable projects. Some One Belt, One Road projects in the region such as the rail between Kazakhstan and Xinjiang were already planned years ago – before the initiative ever saw the light of day. Yet, they have made little progress. The vagueness of the concept gives room for Europe to participate and shape projects on its own terms. At the same time, the large amount of investments promised in the context of the One Belt, One Road holds the potential to split the EU as China is negotiating parallel with regions, cities, private companies, EU institutions, individual Member States and geographical groupings such as the 16+1 Framework (a heterogeneous set of Central and Eastern European countries, including both EU members and EU candidate countries).

Conclusion

China finds itself at a crossroads. Given that the EU has an inherent interest in the stability and economic progress of China, this is also a decisive moment for Europe. If China continues to bolster slowing growth by building up dangerously high levels of debt, it runs the real risk of a 'hard landing'. Combined with a protracted process of deleveraging, this may compromise China's future growth dynamics. Alternatively, the country can accept growth rates to fall to a more sustainable level and more decisively shift its economic model away from a traditional over-reliance on investment.

In trying to avoid a hard landing, the Chinese economy can learn from some of the euro area financial market reforms, notably from the Banking Union's enhanced prudential requirements for banks, improved depositor protection and rules for managing failing banks. Creating a more sound financial sector that does not rely on tax payers' money to safeguard financial stability and thereby shield a government from stresses in the financial system would be very useful. While China has introduced reforms in some of these areas, more can – and needs to – be done.

The EU has to respond to the changed realities of China as a leading global exporter of Foreign Direct Investment and its growing importance in international institutions. This calls for a clear and effective review mechanism that screens non-EU Foreign Direct Investment against European security concerns. This is a desirable addition to the current negotiations of a Bilateral Investment Agreement, which addresses the question of greater symmetry in market access between China and the EU.

The EU can also play a leading role in resolving the tensions emerging from China's increased economic importance and its still limited representation in some existing international financial institutions. Proactively working to match international institutions to evolving economic realities is an EU interest as it would help place China firmly into a global financial framework that is mutually beneficial, transparent and commonly agreed. In parallel, the EU should seek greater influence in China-dominated new institutions, such as the Asian Infrastructure Development Bank and initiatives like the One Belt, One Road.

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Notes

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7. ADB Outlook 2016.
8. Bank for International Settlements.
9. McKinsey Global Institute (2015), 'Debt and (Not Much) Deleveraging'.
10. Property also plays an important role as mortgage collateral in corporate borrowing, and land sales are a significant source of revenue for local governments. See 'Understanding Residential Real Estate in China', IMF Working Paper.
11. Ibid.
12. Shadow banks are financial institutions (like hedge funds and investment banks) that provide the same services as traditional banks but that do not have a banking license and therefore are not subject to financial regulation and have no access to central bank liquidity or public sector guarantees.
13. When assessing the outflow of capital based on the official reserve assets, one also needs to take into account the counterfactual, i.e. where would official reserve assets stand given the trade balance, which is the source of official reserves.
14. Estimations by the European Commission of the negative impact through the trade channel of a Chinese growth slowdown of 1 percentage points (pp) below the 2016 and 2017 forecast suggest a reduction in output in the euro area by 0.2 pp in 2016 and 0.3 pp in 2017 and by 0.1 pp and 0.3 pp for remaining EU countries, see the European Commission 2015 Autumn forecast based on DG ECFIN's QUEST III model.
15. See Financial Stability Board (2015), 'Peer Review of China'. This report, while recognizing China's progress, recommends some actions similar to those discussed in this note, namely:
    - Clarifying the mandate and roles of different inter-agency bodies in assessing systemic risks and designing macroprudential policies, and strengthening the supporting infrastructure accordingly.
    - Further developing an integrated systemic risk assessment framework that incorporates the views of different agencies and takes into account cross-sectoral policy interactions and implications for the overall stance of macroprudential policy.
    - Developing an inter-agency protocol specifically for financial stability monitoring/assessment and related information sharing, based on the respective role of each authority in the macroprudential policy framework.
    - Publishing the outcome of key inter-agency meetings and deliberations periodically as a means of communicating the authorities' macroprudential outlook and policy stance.
16. A large share of this accumulated stock is in Hong Kong.
17. Latest UNCTAD official figures.
18. Rhodium Group.
19. Based on the Foreign Direct Investment Regulatory Restrictiveness Index of the OECD.
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