

The Consequences of China's Development Model and the Challenges of the Pandemic

Matthew C. Klein

"Unstable, Unbalanced, Uncoordinated, and Unsustainable"

China's growth was slowing even before the pandemic.

Chinese annual GDP growth rate



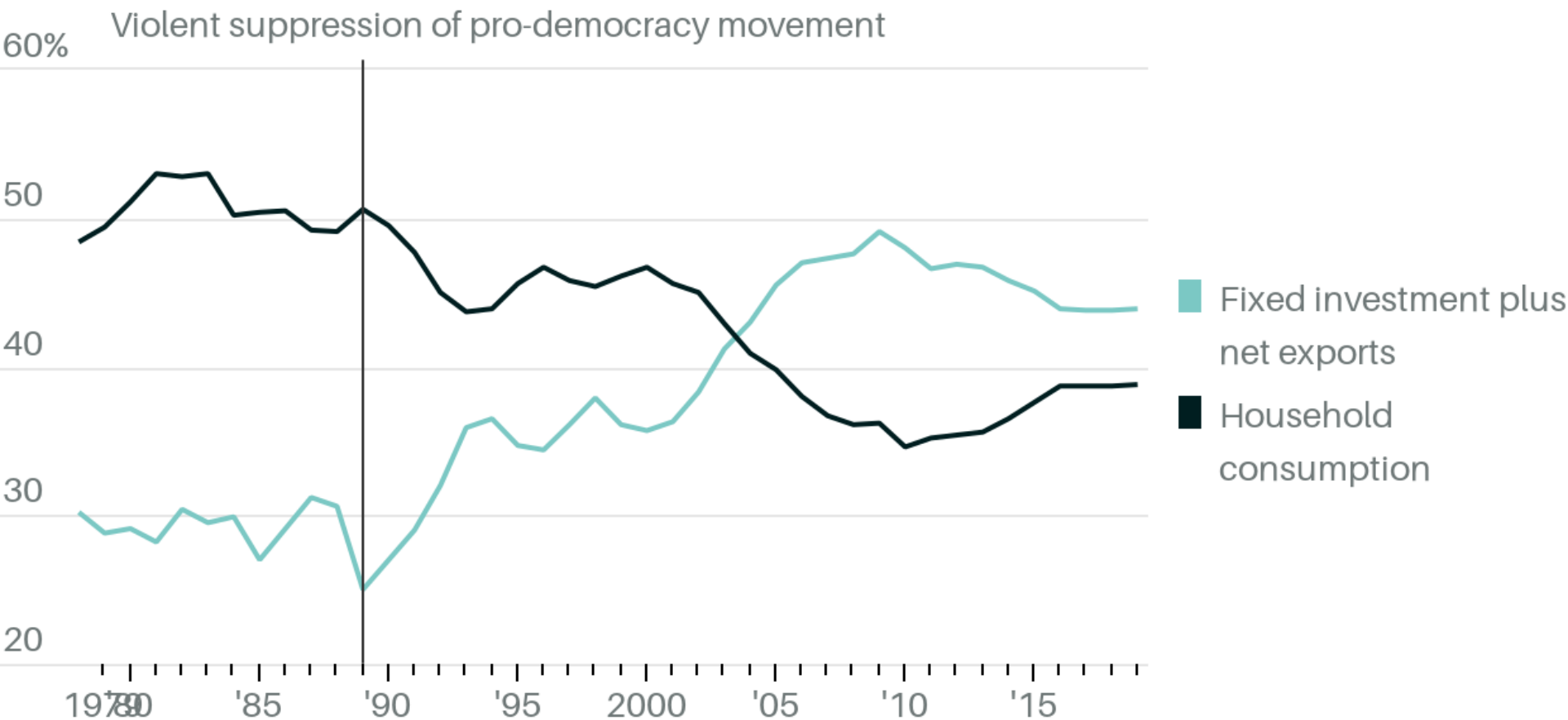
Note: 2020-2021 values are projections

Source: International Monetary Fund

China's Imbalances Began in 1989

Chinese households got a smaller share of what they produced after 1989 and the country's economic output was redirected to exports and investment.

Shares of Chinese gross domestic product



Source: China National Bureau of Statistics; Matthew Klein's calculations

China's Productivity Problem

By some estimates, China's total factor productivity is lower now than in the late 1980s.

1980 = 100

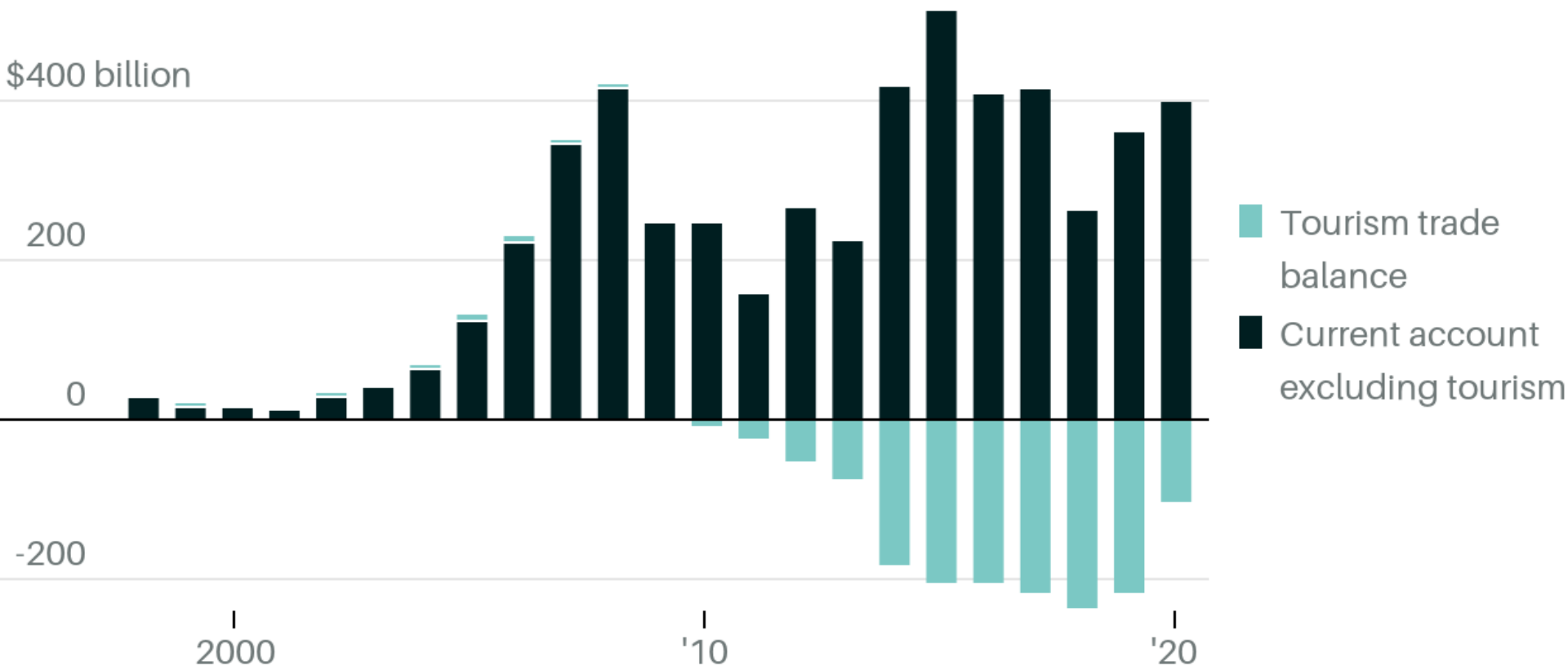


Source: Harry X. Wu

China's Persistent External Imbalance

China's external surplus is set to balloon thanks to the pandemic.

USD billions per year



Note: 2020 data estimated from H1

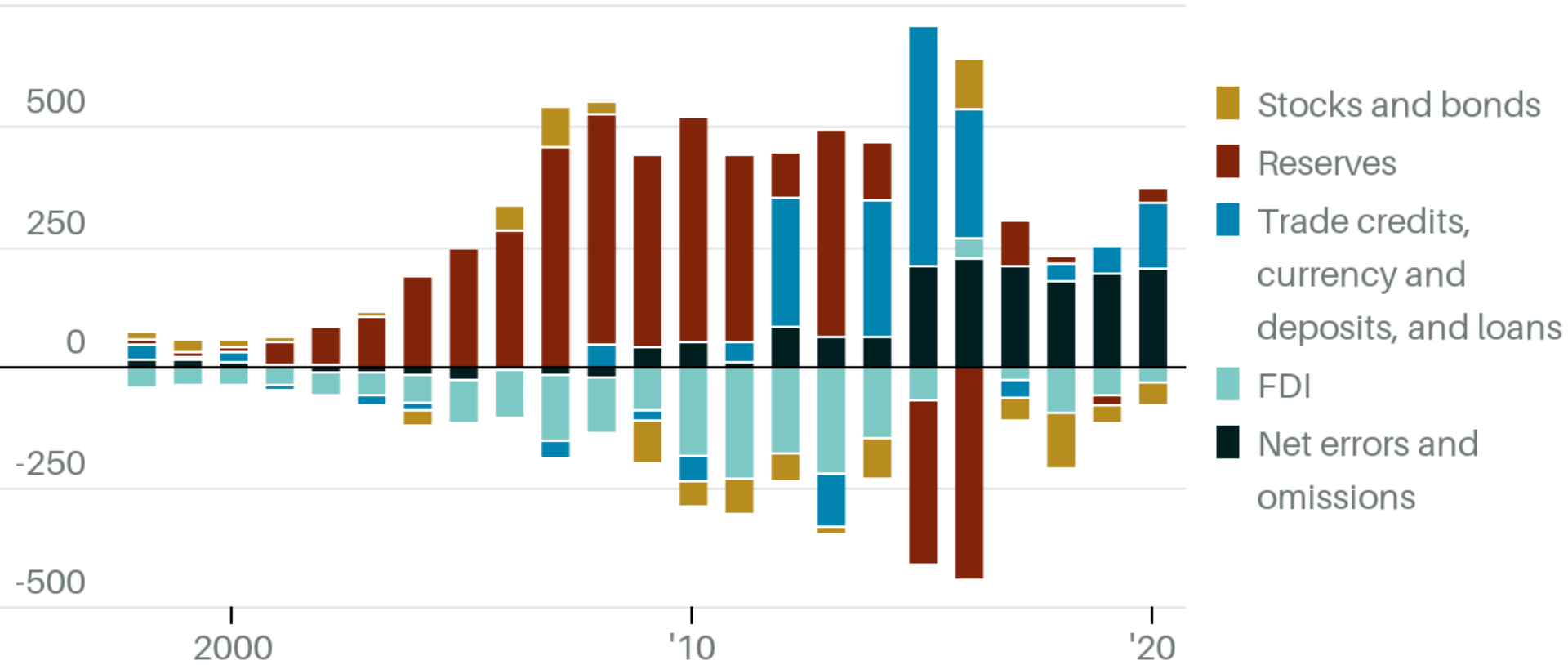
Source: China State Administration of Foreign Exchange; Matthew Klein's calculations

The Financial Flows Behind China's Persistent Surplus

Capital flight and bank lending have replaced official reserve flows.

Net financial outflows per year, USD billions

\$750 billion



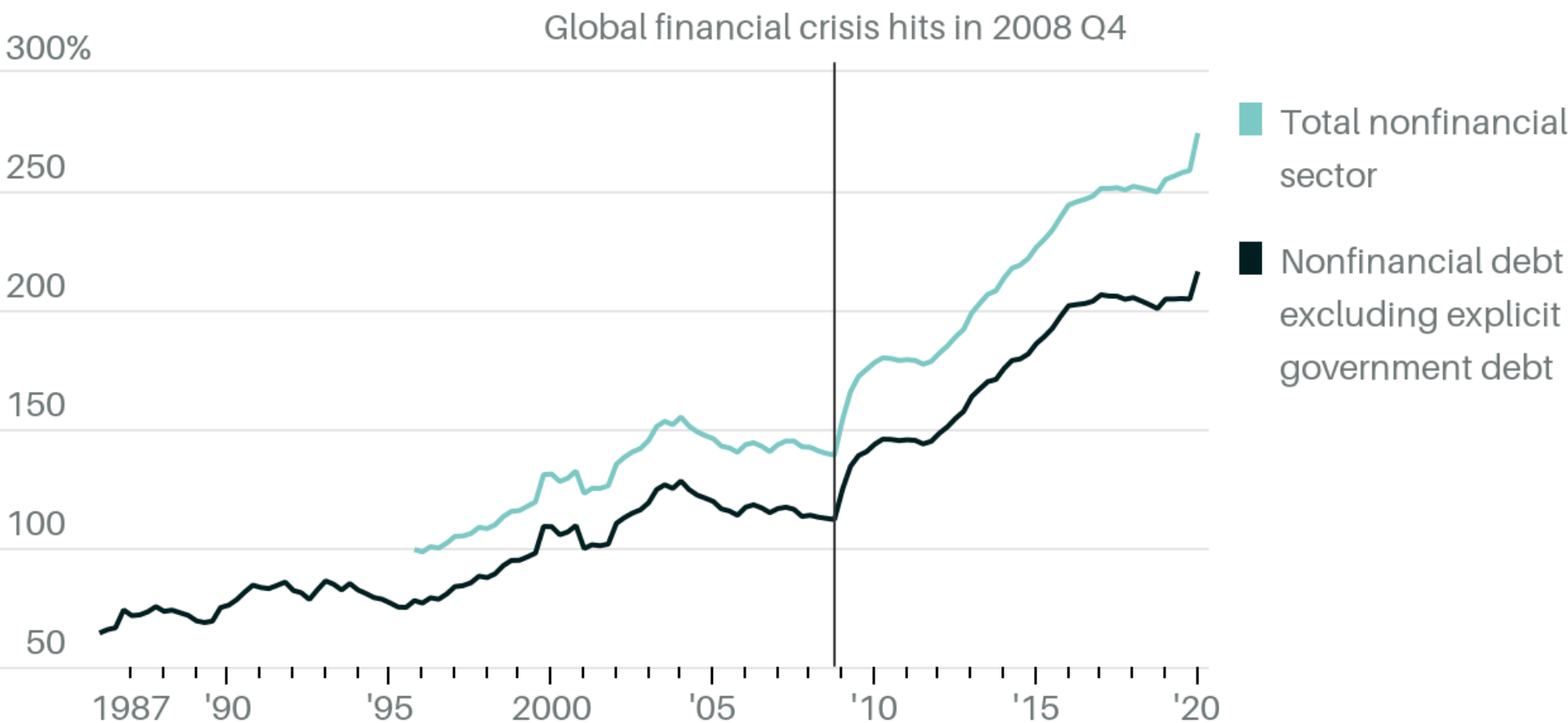
Note: 2020 estimated from H1 data

Source: China State Administration of Foreign Exchange; Matthew Klein's calculations

China's Imbalances Shift Inward

Chinese domestic indebtedness was roughly unchanged 1999-2008. From then until the coronavirus, indebtedness increased by about 100 percentage points of GDP.

Debt to GDP ratio

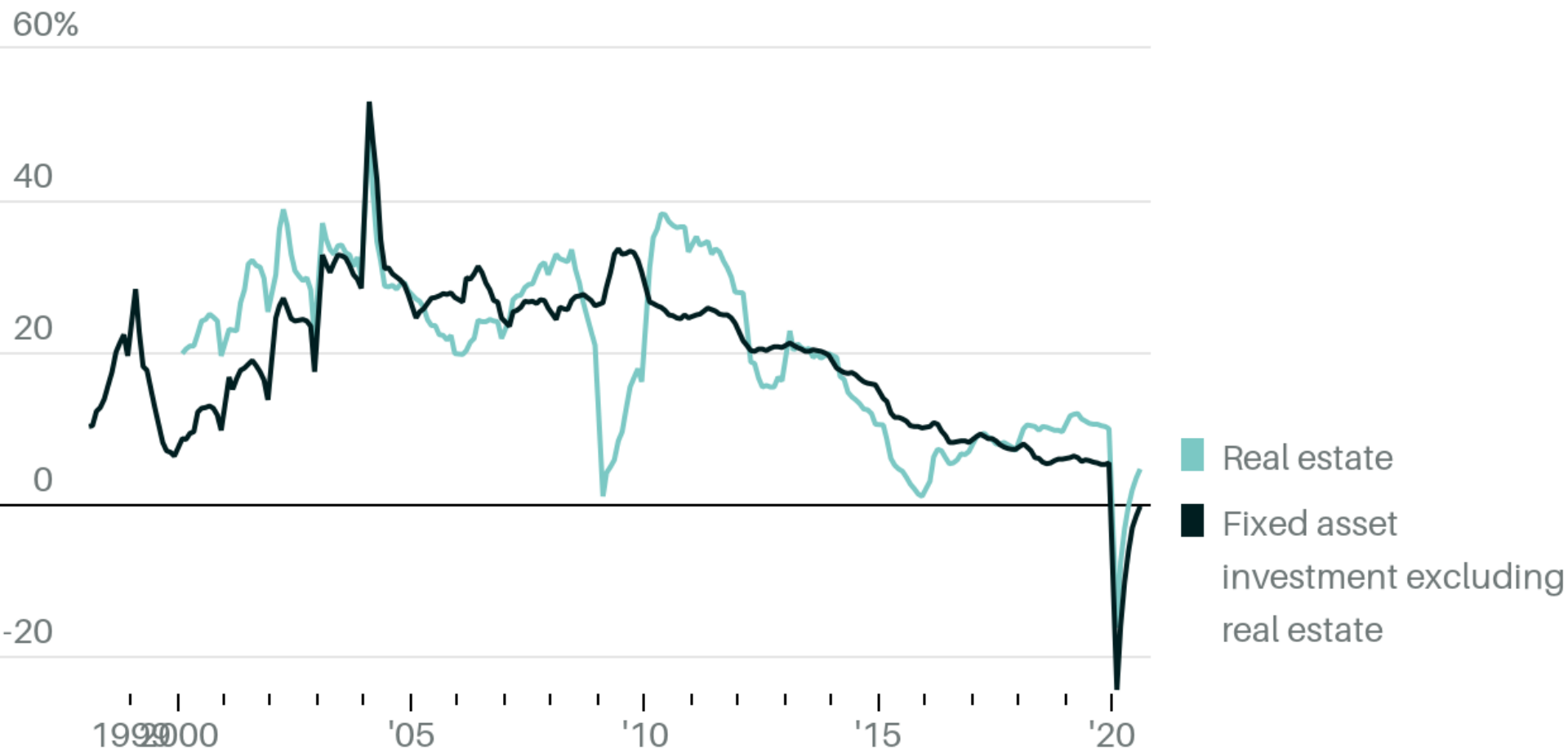


Source: Bank for International Settlements

Rebalancing, Sort Of

Chinese investment spending has slowed dramatically since 2010.

Growth rate of investment

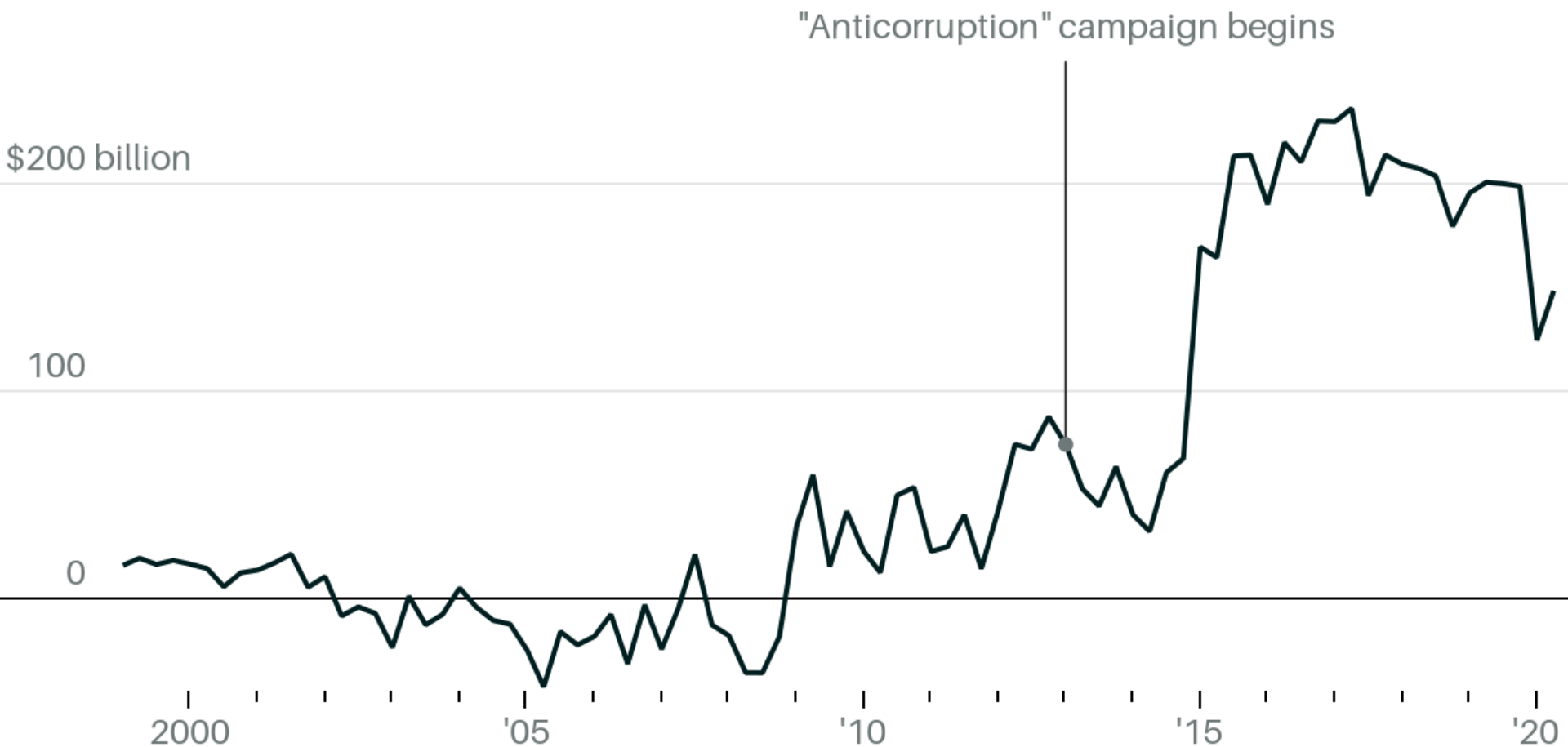


Source: China National Bureau of Statistics

Capital Flight

China's unexplained financial outflows surged to roughly \$200 billion per year by 2015

Net errors and omissions, rolling 4q sum, USD billions

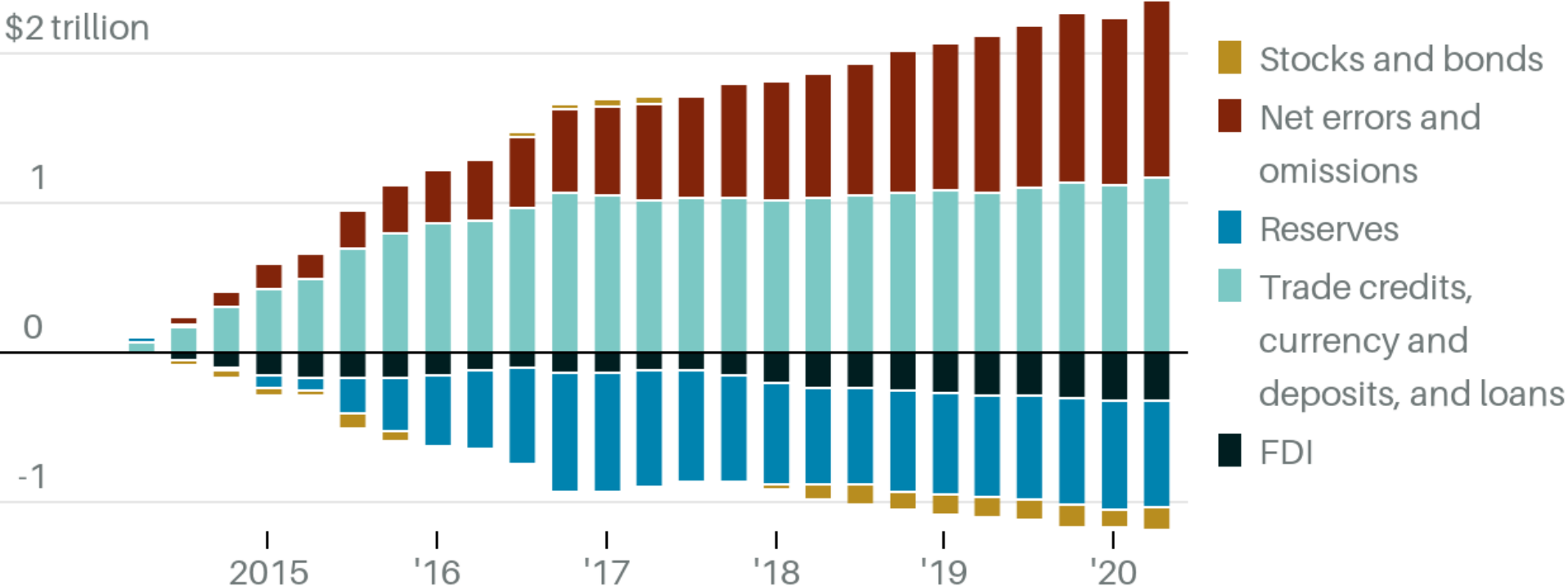


Source: China State Administration of Foreign Exchange; Matthew Klein's calculations

Go Out Policy

Capital flight and the international expansion of China's commercial banks have far outweighed the impact of the PBOC's reserve sales, FDI, and foreign investment in Chinese stocks and bonds.

Cumulative financial outflows since 2014 Q1, USD trillions



Source: China State Administration of Foreign Exchange; Matthew Klein's calculations

Stealth Intervention?

China's commercial banks have dramatically expanded their foreign lending without any commensurate increase in their foreign borrowing.

Foreign currency balance sheet of "other depository corporations"

\$1000 billion

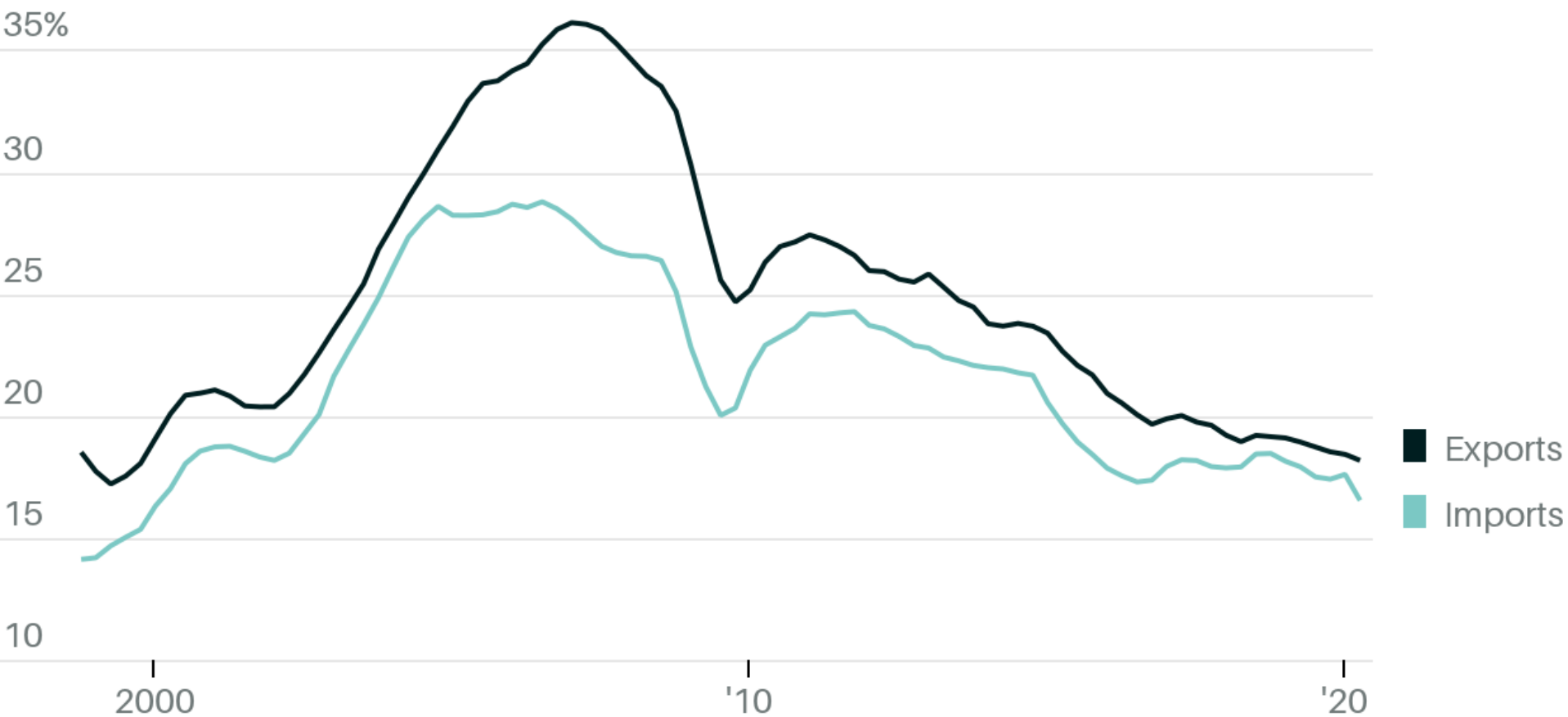


Source: People's Bank of China; Federal Reserve Board; Matthew Klein's calculations

From Globalization to Deglobalization

Trade has become far less important to the Chinese economy since the peak in 2007.

Trade as a share of GDP

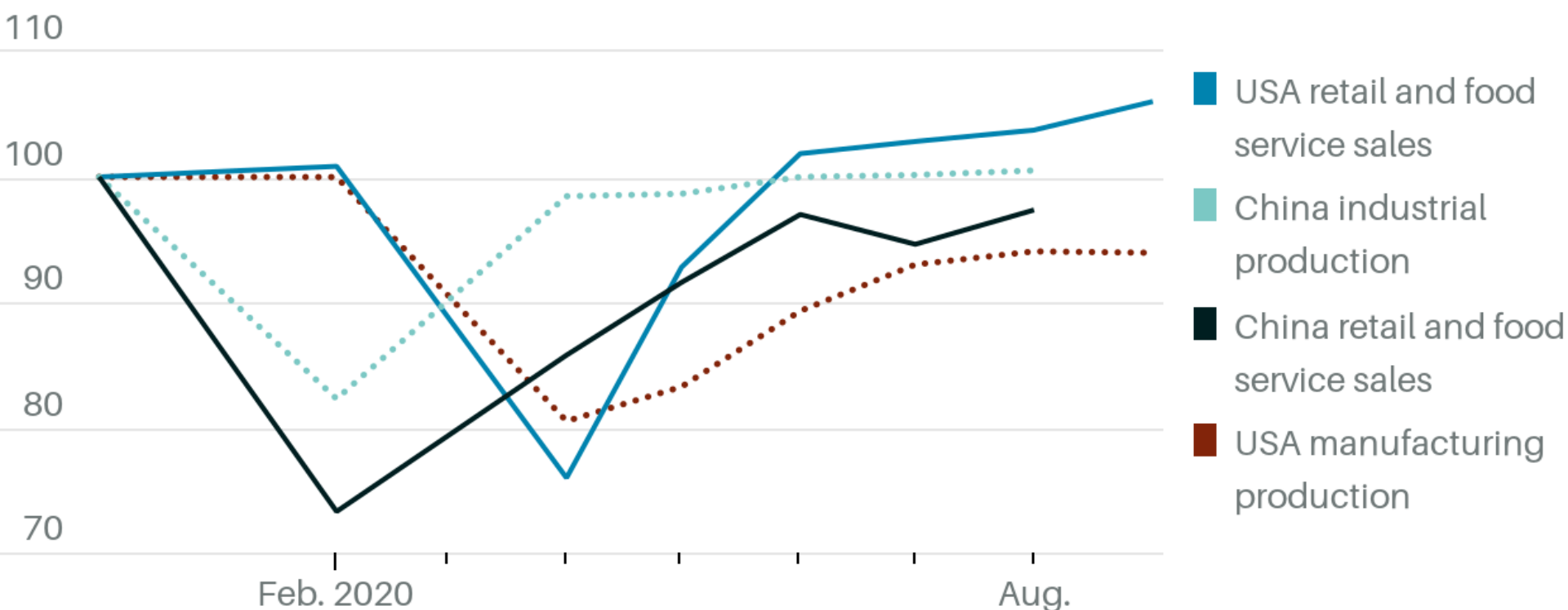


Source: China National Bureau of Statistics; Matthew Klein's calculations

Similar Downturns, Divergent Recoveries

China and the U.S. experienced comparable declines in industrial production and retail spending but the rebounds have been unbalanced.

December 2019 = 100



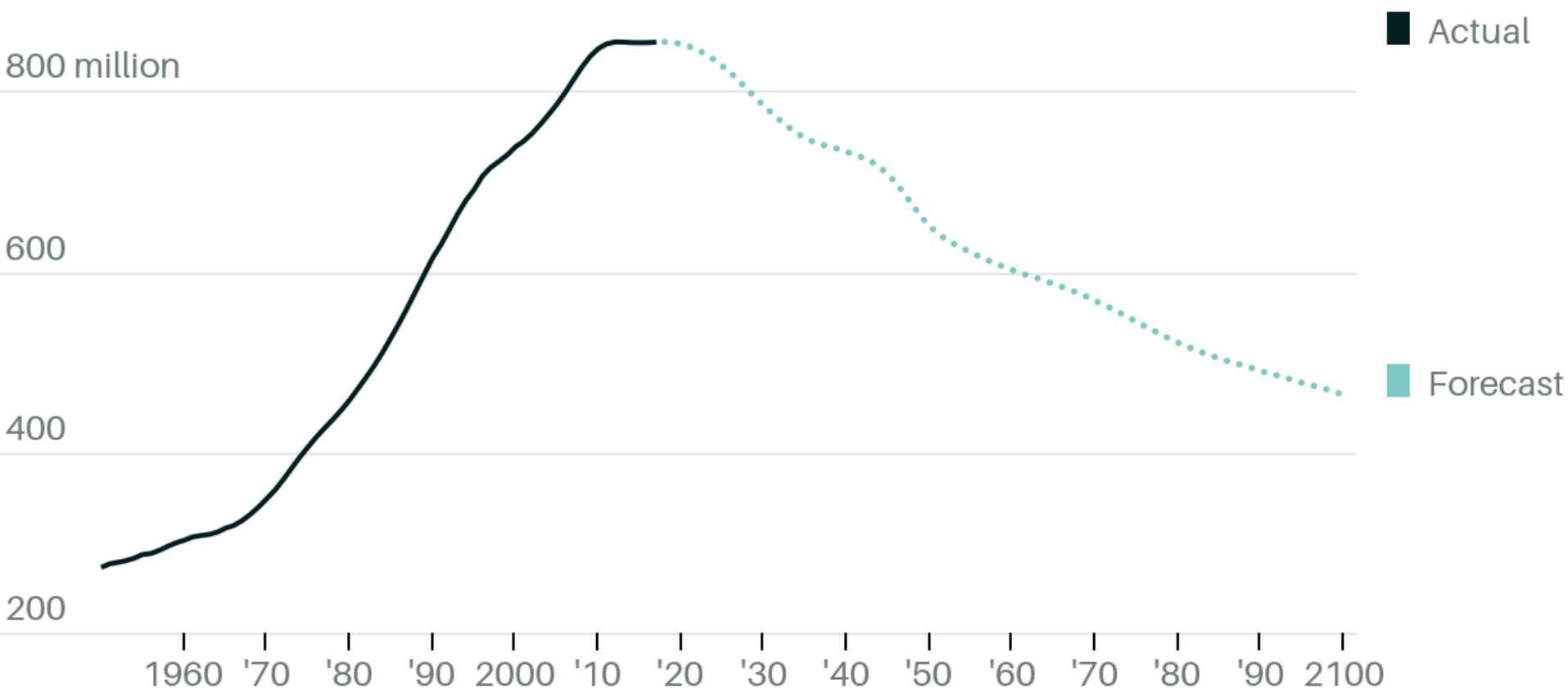
Note: Retail excludes groceries and fuel

Source: China National Bureau of Statistics; Census Bureau; Federal Reserve Board; Matthew Klein's calculations

Demographic Headwinds

China's prime working-age population nearly tripled between 1970 and 2010 but is poised to enter decades of long-term decline.

Chinese aged 20-59, millions



Source: United Nations Department of Economic and Social Affairs; Matthew Klein's calculations

Matthew C. Klein and Michael Pettis

**TRADE
WARS
ARE
CLASS
WARS**

**How Rising Inequality Distorts the Global Economy
and Threatens International Peace**