CHINA BEIGE BOOK

Independent Data. Actionable Insights.

Testimony before the U.S. House Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party

Hearing: Risky Business: Growing Peril for American Companies in China

Shehzad H. Qazi
Chief Operating Officer & Managing Director
China Beige Book International

July 13, 2023

EXECUTIVE SUMMARY

The Chinese economy is a notorious black box. Its official economic statistics are widely understood to be unreliable and often manipulated. Worse yet, the information environment inside the People's Republic of China (PRC) has become increasingly constrained over the last decade. Censorship, especially of economic data, has risen. Beijing has forced out foreign journalists from the country, and it has also asserted greater control over the sources and flow of information critical for businesses and investors in gauging true economic conditions on the ground.

In recent months, China has also aggressively targeted firms involved in due diligence and auditing activities and revised its national security and espionage laws to prohibit the collection and sharing of data on business and investment activity. The raids at offices of companies like Mintz Group and Bain Capital as well as shutting off foreigners' access to the Wind platform (China's answer to the Bloomberg Terminal) stand out as prominent examples.

This increasingly hazy information terrain comes with the continued challenge of the PRC publishing economic data, especially during times of economic and political stress, that are inflated or otherwise manipulated.

The challenge of separating truth from fiction in China is made tougher by yet another factor: investment bank research reports—referred to in industry lingo as "sellside research"—on China's economy, its financial markets, and onshore and offshore securities. With many data series and independent reports on these subjects vanishing in recent years due to government edict, investment banks have become one of the last remaining sources of western information on China's economy.

But such sellside research suffers from at least three major problems. First, it relies almost exclusively on China's official economic numbers, becoming a loudspeaker for Beijing's economic, and often political, propaganda. Second, investment banks abide by Beijing's censorship guidelines and even self-censor to safeguard their business in China, which typically prevents them from publishing views too critical of the economy, the Chinese Communist Party (CCP), or the economic policies the Party articulates.

Finally, economic and market projections made by Wall Street analysts based on these official data have proven to be consistently and almost comically wrong over the years, particularly the past several.

The charitable interpretation here is that this is simply a case of bad research in need of better standards. The more dangerous interpretation is that Wall Street's views on China are filtered through Beijing's political calculus, and subject to its redlines, preventing these firms from honestly discussing China's economic and political challenges or the prospects of its publicly traded companies.

All this carries serious and far-reaching implications for global financial markets, particularly western corporations that operate in China.

Why? These research products are the foundation of the banks' economic and market projections and greatly influence the investment advice they provide clients. Moreover, because they are provided for free (except in Europe, where the practice is no longer allowed) this research enjoys an extraordinarily broad circulation. There are probably few if any major multinational corporations that do not use this research to help shape their strategic thinking and planning.

Even more concerningly, these analyses are then quoted endlessly in newspaper articles and across major global television and radio networks as the predominant western "expert" view. Funneled into western board rooms and the press, Beijing's "fuzzy statistics" therefore get a stamp of reliability via investment bank reports and invariably dictate the view of China's economy held by hundreds of millions of people in the United States and across the western world.

This statement addresses each of these issues and is divided into three major sections: the first section overviews the increasing censorship of business and economic data by the PRC since 2013. The second section details recent high-profile instances of data manipulation by China's statistical authorities and the reproduction of those data and talking points in sellside research, which have time and again oversold China's economic growth and investment prospects. The third section covers the problem of self-censorship and Party influence on investment banks. A final recommendations section is included at the end.

In some places I have leveraged insights from my firm China Beige Book (CBB), which gathers real-time economic data from thousands of companies across China.

CHINA'S INCREASINGLY RESTRICTIVE INFORMATION ENVIORNMENT

China's economy is notoriously opaque, owing to both the CCP's traditionally tight control over the flow of information as well as longstanding concerns about the veracity and reliability of its official economic statistics. In recent years these concerns have only been exacerbated, as Beijing has clamped down on economic data sources and other private data tracking services in China have shuttered.

For example, as reporting by the *Financial Times* has shown, over the last decade over 60,000 economic indicators once published by China's National Bureau of Statistics (NBS) and municipal bureaus have been discontinued **(Chart 1)**.[1] The discontinuation of these data series, which occurred after Xi Jinping's election to the CCP as Secretary-General, took away the ability of analysts to crosscheck China's headline economic statistics. In the past they would often help China watchers uncover instances of China overstating its GDP growth or other high-profile economic figures.

The most prominent recent example of China's economic censorship came in December 2018 when the central government banned the Purchasing Managers Index published by the Guangdong province after the gauge began showing that tariffs levied by the Trump administration were indeed hurting the export-sensitive region's economic performance.[2]

Furthermore, the independent data tracking landscape in China has also changed during this time. The private Purchasing Managers Index (PMI), once sponsored by HSBC was taken over in 2015 by Caixin Global, which despite being a well-regarded private media company has a state affiliation under PRC laws.[3]

That same year Caixin suspended the highly watched "Flash PMI," which was released ahead of the government's official PMI report. In 2015 another private indicator, the Minxin PMI, was suspended and subsequently shut down in 2016 under pressure from the Chinese government.[4]

Both PMIs would regularly disagree with the government's figures, often showcasing a more volatile economic picture than the more sedate portrayal in China's official gauges **(Chart 2)**.

In 2019 the well-regarded independent economic tracking service known as the China Reality Series also became defunct after its takeover from an affiliate of the state-owned CITIC Group catalyzed a series of high-profile resignations.[5] Another monthly economic survey produced by the *Financial Times* under its Financial Times Confidential Research unit also ended in December of the same year owing to a lack of commercial appetite for the service.

The problem of an increasingly restrictive information environment has only worsened in recent years since the passing of the 2021 data security and the 2023 anti-espionage law.[6] As reported by the *Wall Street Journal*, the new data security law has made it challenging to obtain a wide swath of information that was previously relied on by foreign companies during the normal course of business or used by investors to gauge economic activity in China:[7]

> A new data-security law has made it harder for foreign companies and investors to get information, including about supplies and financial statements. Several providers of ship locations in Chinese waters stopped sharing information outside the country, making it hard to understand port activity there. Chinese authorities have restricted information on coal use, purged documents related to political dissent cases from an official judicial database, and shut down academic exchanges with other countries.

This trend of disappearing economic and business information sources reached yet new heights this year when Wind Information, China's answer to the Bloomberg Terminal, curtailed access to foreign investors in May. Other databases like Qichacha and TianYanCha, which provide similar services, have also been restricted to users outside China. This has blocked foreign investors from accessing a whole host of information, including bond transactions data as well important alternative economic data ranging from e-commerce trends to land sales which analysts utilized to construct a truer picture of China's economy and cross-check official numbers.[8]

Worse yet, fund managers are now being blocked under the new data laws from reporting critical information back to their headquarters such as investments in individual equities and fund performance as well as being restricted from sharing research or even attending meetings over Zoom owing to China's strict implementation of its new data-sharing rules.[9]

Finally, Beijing has also recently cracked down on firms involved in due diligence and expert network services, including raiding the offices of U.S. firms Mintz Group and Bain in addition

to the local firm Capvision. Press reports confirm due diligence companies rolling back their operations to avoid Beijing's ire.[10]

The cumulative result of these decisions and events is that China, and particularly China's economy, is more of an information blackhole today than at any point since its accession to the World Trade Organization in 2001.

Simultaneously, China's data manipulation problems have persisted, especially during politically sensitive periods, as witnessed in the last few years. This has made it virtually impossible for outsiders to discern true economic conditions on the ground.

CHINA'S DATA INTEGRITY ISSUES (2020-2023)

China's data reliability problems have been well documented over the years. But since 2020 new concerns have arisen over the integrity of official statistics as China's economy has suffered repeated downturns due to Covid and its own lockdown policy. These manipulated statistics, however, have not only regularly found their way into Wall Street research, but become the foundation of the banks' lofty—and ultimately deeply faulty—China recovery projections in these last three years.

2020-2021: China's Historic Contraction & Illusory V-Shaped Recovery

Most business activity came to a virtual standstill in China starting from January 2020 as SARS-CoV-2—then referred to as the "novel Coronavirus" or Covid-19—began ripping through the Chinese population, and Chinese authorities imposed the first iteration of their zero-COVID policy.

Well over two months of national lockdowns devastated the Chinese economy while crippling global supply chains. The severity of the losses was captured poignantly by the sentiments expressed by C-level executives in my firm China Beige Book's Q1 2020 survey, 72% of whom said their company's revenues had fallen as a direct result of the COVID-19 virus and subsequent shutdowns.

That quarter China published a 6.8% year-over-year contraction in its first quarter GDP growth rate. While Beijing ultimately did not acknowledge what appeared to be an even uglier, low-double-digit contraction in growth, this was still the worst GDP print China had ever released.[11]

Yet, it was also around this time that the leadership in Beijing began telegraphing the prospects of a rapid rebound. "Economic indicators will likely show significant improvement in the second quarter and the Chinese economy will return to its potential output level rather swiftly," said the PBOC Deputy Governor Chen Yulu in March 2020.[12]

And surely, soon enough the government's data would show this so-called "V-shaped recovery." A mere three months after China's historic contraction, the NBS released its Q2 2020 data claiming a 3.2% year-over-year *expansion* in growth.[13]

By September 2020 Premier Li Keqiang would claim that despite the historic downturn earlier in the year, China would indeed be able to hit its main annual economic targets.[14]
Over the remainder of 2020 China's GDP figures would continue to show strong positive momentum, with the economy not only recovering from the early 2020 downturn but also growing compared to 2019. Beijing would finally announce this victory with its fourth quarter data release, where it claimed an astounding year-over-year GDP growth of 6.5%—the highest since Q4 2018—and a full year GDP of 2.3%.

The triumphant statement read:

> In 2020, faced with grave and complex environment both at home and abroad and the huge impact of the epidemic in particular, under the strong leadership of the Central Committee of the Communist Party of China with Comrade Xi Jinping as the core, all regions and departments adhered to the general working guideline of making progress…As a result, the national economy recovered steadily, employment and living standards were ensured forcefully, and the main goals and tasks of economic and social development were accomplished better than expectation.[15]

By comparison, China Beige Book's survey showed pain continuing on the ground in Q2, with the economy barely escaping another contraction. It wouldn't be until Q3 2020 that the economy would solidly enter expansion territory, thanks to global demand helping fuel the manufacturing sector, with additional improvement in Q4. Still, by virtue of every major year-on-year lens the economy underwent a full year contraction in 2020 per CBB's independent data.

Why would private economic data differ so meaningfully from China's official statistics? A closer examination of official figures revealed that, whatever political sensitivities existed, statistical irregularities were at play.

Forensic survey accounting of China's 2020 official statistics quickly revealed that key economic numbers had been wildly inflated through downward revisions to their 2019 baselines. This depression of prior year figures created the appearance of growth, when in fact the economy continued to struggle in 2020 **(Charts 3 and 4)**. The author has publicly detailed these findings previously, writing[16]:

> In a series of revisions over the course of 2020, China's statistics bureau cut the aggregate amount of 2019 Fixed Asset Investment (FAI) down by over 4.7 trillion yuan (equivalent to about $720 billion) …By quietly changing the baseline, China masked what was in fact a year-long contraction in investment spending. When aggregated over the full year, the unadjusted data show FAI shrinking roughly 5.9% compared to 2019.
>
> The baseline for another critical metric, total retail sales, which gauges consumer strength, was also revised down, showing positive on-year growth each month since August 2020. The original figures indicated positive growth starting a month later, in September, and at a slower rate for the remainder of the year. More importantly, in aggregate total retail sales contracted year-over-year by 4.8% or approximately 1.97 trillion yuan (equivalent to about $280 billion). Even based on the retroactively revised

data, accumulated retail sales fell by 3.9% in 2020 compared to the previous year. No matter how you slice the official numbers, they reject the idea of China seeing a broad-based recovery that includes Chinese consumers.

It is important to note that these revisions to economic data were not like the revisions commonly seen in Western economies. These revisions left intact the originally published 2019 growth rates for FAI and Retail Sales despite their nominal figures being revised down. Similarly, despite almost 7 trillion yuan worth of downward revisions to 2019 economic activity, the NBS did not published a revised down GDP for either quarters in question or 2019 as a whole.

This practice of downward revisions continued into 2021, where newly released growth figures for FAI again included downward revisions of originally published 2019 nominal data, continuing the mirage of strong, positive growth, where in reality FAI shrank in 2021 versus 2019 as well **(Chart 5)**.

Moreover, at some point in 2020 the NBS decided to remove all nominal FAI data from its online database, leaving only growth figures available. While these nominal figures can still be accessed through monthly press releases, these questionable statistical practices and data suppression tactics have all but destroyed what was once considered to be one of the most important pieces of official data on the Chinese economy.

Yet, China's massively manipulated statistics continued to find their way into the economic research produced by major investment banks and ultimately defined the false narrative of China accomplishing a powerful V-shaped recovery out of the pandemic in 2020.

Wall Street Blindly Reproduces China's Fuzzy Statistics

Nowadays, China-watchers and investors generally understand that the PRC's official economic statistics are often inaccurate or unreliable. Still, these numbers are nevertheless the key inputs into the China economic analysis and forecasts produced by global investment banks. More problematically, many investment bank products and "leading economic indicators" are advertised and perceived by markets as proprietary or independent gauges of China's economic performance, when in fact they are largely or entirely based on Chinese official statistics.

Goldman Sachs' China Current Activity Indicator (CCAT) is an excellent example of this type of a product. Goldman describes the CCAT as an "alternative measure with higher frequency and quality to identify shifts in the economic cycle." Yet a perusal of CCAT's methodology quickly reveals that 11 out of its 14 components are in fact official data series **(Picture 1)**.

It is worth mentioning, that this problem also extends to regional U.S. Federal Reserve banks. For example, the San Francisco Fed's China Cyclical Activity Tracker is based entirely on official Chinese statistics,.[17] Yet, it is bizarrely cited authoritatively as an "alternative" measure of Chinese economic activity.[18]

Unsurprisingly, then, investment banks were primed to duplicate China's deeply flawed statistics as they guided their clients on China's climb out of the 2020 Covid-induced downturn.

Like Chinese government officials, various investment banks also began forecasting a rapid economic rebound and victory over the virus in China from around March of that year, when in reality the economy was still in a deep hole.

At the time Goldman Sachs' China equity team head said, "we believe that China will not be a drag on global economic growth in the second quarter, but rather a stabilizing force…as domestic economic and corporate fundamentals sequentially improve."[19] The bank said it expected China's GDP to return to its pre-virus trend by the third quarter.[20]

J.P. Morgan was equally bullish in its recovery outlook, writing "J.P. Morgan Research is forecasting…a return to normalized growth in Q3 to 5.1%."[21]

In August, Morgan Stanley's chief economist affirmed that China's recovery was "on target" and its domestic consumption was steadily improving.[22] By October, Deutsche Bank wrote, "As hopes of a V-shaped recovery fade elsewhere, Deutsche Bank Research is increasingly bullish on China's prospects."[23]

Of course, by this time China's statistical irregularities had already been minimizing the economic pain from Covid for several months, and the banks were happily charging up their rapid recovery arguments on the basis of inflated numbers.

Moreover, the underlying premise of these projections—one stated explicitly by the banks—was that China's policy response to Covid-19 had been the most effective of any other economy, helping Beijing stamp out the virus and putting the country on a path to normalization.[24] This view, often referred to as "first in-first out," would look naïve—even foolish—in a matter of months, following repeated lockdowns emerging amidst fresh virus outbreaks and China's zero-COVID policy wreaking havoc on its economy over the next two years.

The thrill over China's supposed swift rebound even spurred talk of the PRC catching up to the U.S. economy in size in a shorter time span. In August 2020 the *Wall Street Journal* ran a story, the opening line of which read, "As much of the world struggles to contain the coronavirus, China's recovery is gaining momentum, positioning it to further close its gap with the U.S. economy." The *WSJ* even published a handy graphic utilizing Deutsche Bank research which showed China's accelerating upward growth trajectory versus the U.S. **(Chart 6)**. Around the same time the International Monetary Fund (IMF) also forecasted that China would be the only economy to grow in 2020 **(Chart 7)**.[25]

Unsurprisingly, at the end of the day, official data showcasing a quick recovery were uncritically accepted by Wall Street research and investment advisory teams, who simply turned a blind eye toward the serious data integrity issues that began emerging, and instead repeatedly claimed that China had indeed accomplished a V-shaped recovery in 2020.[26]

Wall Street Uses Inflated Data to Oversell China's Growth

Markets have become accustomed to lofty projections from investment banks about China on several key topics, from when China's economy might overtake the American economy, to when we will see the long-promised consumer spending boom, to how much of a threat the Chinese yuan may pose to the U.S. dollar as the world's dominant reserve currency.[27]

While such long-term forecasts are fundamentally misleading because they minimize or ignore the serious structural challenges China's economy faces, they are less troubling than cases where these same banks rely on inflated or outright manipulated official statistics to oversell their near-term China growth and investment theses, especially when they lead to clear investor losses. This has been as a serious problem this year.

Concerns around China's economic data again emerged around late 2022 and into early 2023. On December 7, 2022, Beijing suddenly announced the dismantling of its zero-COVID policy after repeated lockdowns had wrecked the economy over the course of the year. The fourth quarter of 2022 was especially bad.

China's own leading economic indicators like retail sales contracted year-on-year for three consecutive months of Q4 2022.[28] The property sector—which traditionally contributes at least 20% of GDP—saw a double-digit contraction all year with conditions worsening further in the final months of 2022.[29] Industrial Production and Fixed Asset Investment also slowed to the lowest levels recorded all year in each successive month of the final quarter.[30] And finally, the market-moving monthly Manufacturing and Non-Manufacturing PMIs too were in an outright contraction from October to December 2022.[31] In sum, the fourth quarter of 2022 was a GDP contraction story based on China's own numbers.

Yet, on January 17, 2023, China released economic data showing that the economy had *expanded* year-on-year in Q4 2022 by 2.9%, resulting in a full-year GDP growth rate of 3%.

By then, however, investment banks were far less interested in questioning the veracity of China's economic statistics. Instead, their research teams had already begun outgunning each other on how big China's 2023 economic recovery and accompanying stock market rally would be.[32] These growth prints gave Wall Street extra fodder for its extremely bullish China re-opening outlook.

Soon after China's questionable Q4 GDP release Goldman Sachs revised up its 2023 growth forecast and projected the yuan strengthening to 6.5 per dollar.[33] Just a month later, Goldman became even more optimistic, projecting that Chinese stocks would rise 24% by end of 2023.[34] Morgan Stanley echoed those bullish bets and projected that Chinese equities would top global performance rankings in 2023.[35]

When China released its first quarter GDP for 2023, another eyebrow raising print of 4.5%, the banks turned more zealous, revising growth rates even higher than Beijing's own target for the year, and telling clients that China's economy and markets were now set to go into overdrive.[36]

If Chinese markets had seen a mania in recent years, this was it. But then came the fall, and quickly.

Chinese equity markets had rallied hard since the zero-COVID pullback and amid the banks' bullish wagers. But while the Street was upping the ante on its outlook in April, the Chinese stock market had already begun losing altitude as a range of official and China Beige Book data showed that there were no signs of a bombastic recovery on the horizon. That selloff then

rapidly intensified in May, erasing all of 2023's gains **(Chart 8 and 9)**.[37] On May 27, the Hang Seng Index officially hit bear market territory.[38]

By the end, nearly $1.5 trillion were erased from Chinese equities since their January peak.[39] The banks had claimed Chinese stocks would outrun the U.S. equity market, but the reverse was now true.[40] These stocks, instead of topping global rankings, were the worst performers globally **(Chart 10).** The Chinese yuan, instead of strengthening, had fallen to below 7 per dollar.[41] The China rebound story, like many before it, had been massively oversold.

CCP CENSORSHIP & WALL STREET'S PAY-TO-PLAY PROBLEM

A more worrisome problem than investment banks simply reproducing the PRC's economic propaganda in their research reports and using it to oversell investment prospects, is the banks engaging in censorship, especially when it results in misleading ratings on securities and subsequent investor losses.

The direct influence of the CCP on financial institutions was brought into sharp relief in 2020 when it broke that HSBC was going to install a CCP Committee in its investment bank.[42] While there is no known instance of other foreign or U.S. banks being asked by the Party to form similar committees, in at least one known instance the now defunct bank Credit Suisse did nevertheless hire a CCP official in a senior leadership position.[43]

Furthermore, there have been many known instances over the years of U.S. investment banks actively hiring the scions of CCP officials to gain advantage over their competitors and win major business deals in China.[44]

For example, per J.P. Morgan's report to the SEC, it ran a program from 2004-2013 dubbed "Sons and Daughters" internally, which was dedicated to hiring friends and family members of Chinese government officials as well as executives of state-owned companies. All-in-all the bank hired hundreds of such close contacts or children of leaders at SOEs it was responsible for privatizing and taking public in China **(Chart 11)**.[45] A *New York Times* investigation uncovered the same practices at Deutsche Bank.[46] This did eventually come under SEC inquiry and resulted in fines for J.P. Morgan in 2016 and Deutsche Bank in 2019.[47]

The Party's direct or indirect influence on Wall Street is only the tip of the iceberg. A more widespread and pernicious issue is Beijing's attempt to censor investment analysts, and even worse, the self-censorship of China-based investment professionals.

For example, in June China's Twitter-like platform Weibo "banned" a team of financial markets analysts for producing "negative and harmful information" because they were commenting on China's unemployment rate and its steep stock market route this year. This followed other similar bans on Chinese economists for presenting bearish views on the economy or even broadly commenting on monetary policy.[48]

The 2022 Party Congress (20th National Congress of the CCP) was the most recent high-profile example of the Party subjecting foreign banks to its restrictions on free speech. As was widely

reported in the press, last October the China Securities Regulatory Commission asked several investment banks to refrain from publishing any comments that would be considered politically sensitive in the lead up to the Party Congress. This came at a time when China's economy was in deep distress owing to Beijing's zero-COVID policy and investors were keenly interested in understanding the extent of the economic pain in China and future policy trajectory.[49]

But imposing blackout periods around key political events is just one aspect of the problem. It is now commonly understood that banks need to be very careful about what they say about China's economy or its domestic socio-political problems. This has only become truer in the last few years as Wall Street has sought to win full control of money management ventures in China. This has stymied the ability of banks to produce honest research that can help their clients adequately project and manage risk as they invest in Chinese or China-driven securities.

As one *Bloomberg* investigation found last year, "analysts worry even mild criticism of China could see them reprimanded, lose their jobs—or worse, face charges under the powerful national security law imposed by Beijing."[50]

While over the years these sorts of fears have led to practices like the Swiss investment bank UBS hiring content reviewers "to ensure that Chinese research publications by its analysts are free from 'sensitivities',"[51] the most damaging publicly known instance of such a practice came last year, when it was revealed that J.P. Morgan had censored an analyst's reports where he referred Chinese stocks as "un-investable."

In March 2022 J.P. Morgan downgraded a basket of 28 technology stocks, including some of China's internet giants like Alibaba and Tencent, as "un-investable."[52] It turned out, that this ratings downgrade only got released publicly as the result of a copy-editing error. Content reviewers at the bank had found 28 such instances in the analyst's other reports and asked for the word to be removed each time. Yet, they missed this description in four other cases, which were then published, helping erase almost $200 billion across U.S. and Asian markets.[53]

In the aftermath of this downgrade the bank was swiftly removed as the senior underwriter for an upcoming IPO deal.[54] And then, in what can only be described as a naked instance of pay to play in China, a mere two months after issuing the infamous "un-investable call," J.P. Morgan upgraded over a dozen Chinese internet stocks, and went as far as rating about half as "overweight."[55]

Ironically, just a year later the bank's call looks even more right. Over the last three years the market capitalization of Chinese technology companies has declined massively, with the leading firms losing nearly $300 billion in combined market value **(Chart 12)**.[56]

Moreover, foreign investor confidence in these companies has also plummeted because of Beijing's decision to acquire "golden shares" in them. Investors increasingly fear these companies will not only become less answerable to shareholders, but also be forced to undertake projects and innovations that may strengthen the Chinese state but not necessarily be profitable for the company. Yet, Wall Street has remained largely mum on the subject which carries enormous importance for its clients.

CONCLUSION

The PRC’s censorship and manipulation of economic data holds serious financial risks for U.S. investors and companies operating in the country. These moves by the PRC have lowered foreign investors’ and businesses’ visibility into the true economic conditions on the ground and hinders them from accurately judging the soundness of their investments. In short, it forces them to fly blind.

The reproduction of China’s questionable statistics by investment banks and the self-censorship practices of these institutions, further misleads investors and corporate decisionmakers. The banks consistently echo the CCP’s economic talking points and oversell the prospect of China’s economic growth and investment returns. When reality fails to live up to the hype, the banks’ clients are left holding the bag.

These issues also hold important implications for U.S. policymakers, who require credible and actionable information on China in order to develop sound, long-term policies. Few tasks ahead will be more critical for the United States geopolitically than avoiding dangerous miscalculations that could arise from a misunderstanding of China’s economic strengths and weaknesses.

Below are some recommended steps the U.S. House Select Committee on the Strategic Competition Between the United States and the CCP and the U.S. Congress more broadly can take to begin addressing these problems.

RECOMMENDATIONS

- The Select Committee should invite the CEOs of all major U.S. investment banks to testify at a hearing dedicated to Wall Street's business activities in China. These executives should be asked to address the longstanding problem of their institutions relying almost exclusively on the PRC's unreliable official data in their economic models, forecasts, and investment calls on China. Furthermore, the executives should detail the risks posed to their investment management operations from China's economic and myriad financial challenges as well as how recent changes to the PRC's laws have impacted the risk assessment and risk management functions of their banks.

- Select Committee members serving on the House Committee on Financial Services should also consider initiating similar reviews and hearings through their own committee.

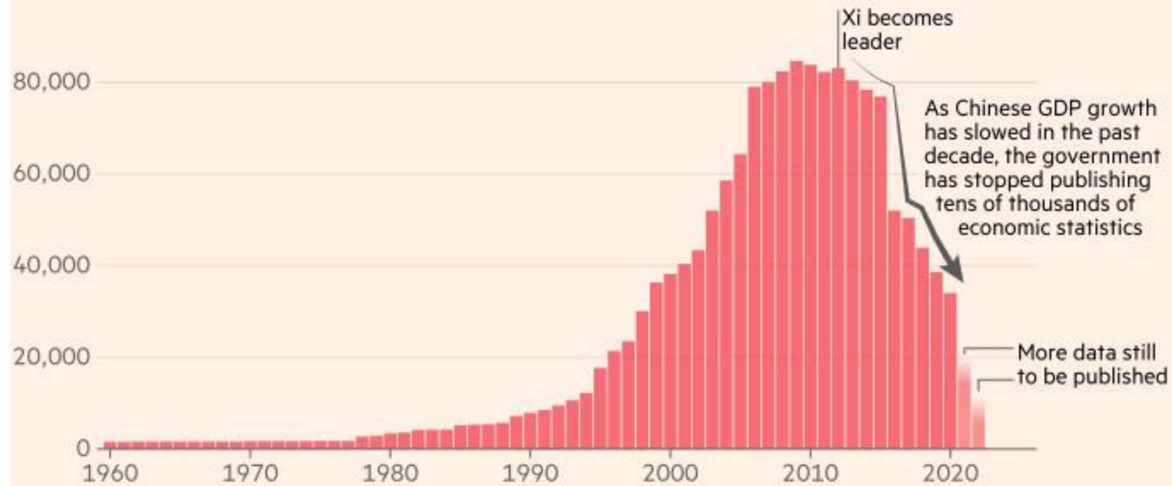
- The Select Committee should also ask SEC Chairman Gary Gensler to provide an update on how the PRC's new laws are impacting disclosure requirements around the investment banks' China operations and the SEC's planned response.

- The U.S. Congress should pass legislation requiring banks to include their investment exposure to China in annual reports and disclosures.

- Finally, to address the core problem of investment banks flooding the zone with their poor-quality, freely distributed research, the U.S. Congress should pass legislation requiring banks to "unbundle" research from their larger package of services and charge their clients a fee for it as a separate line item. This legislation would put U.S. standards on par with the same standards American and all other investment banks must comply with in Europe under the European Union's 2018 Markets in Financial Instruments Directive (MiFID) II laws.

CHARTS & GRAPHICS

Chart 1.: Annual number of economic indicators made available by China's NBS

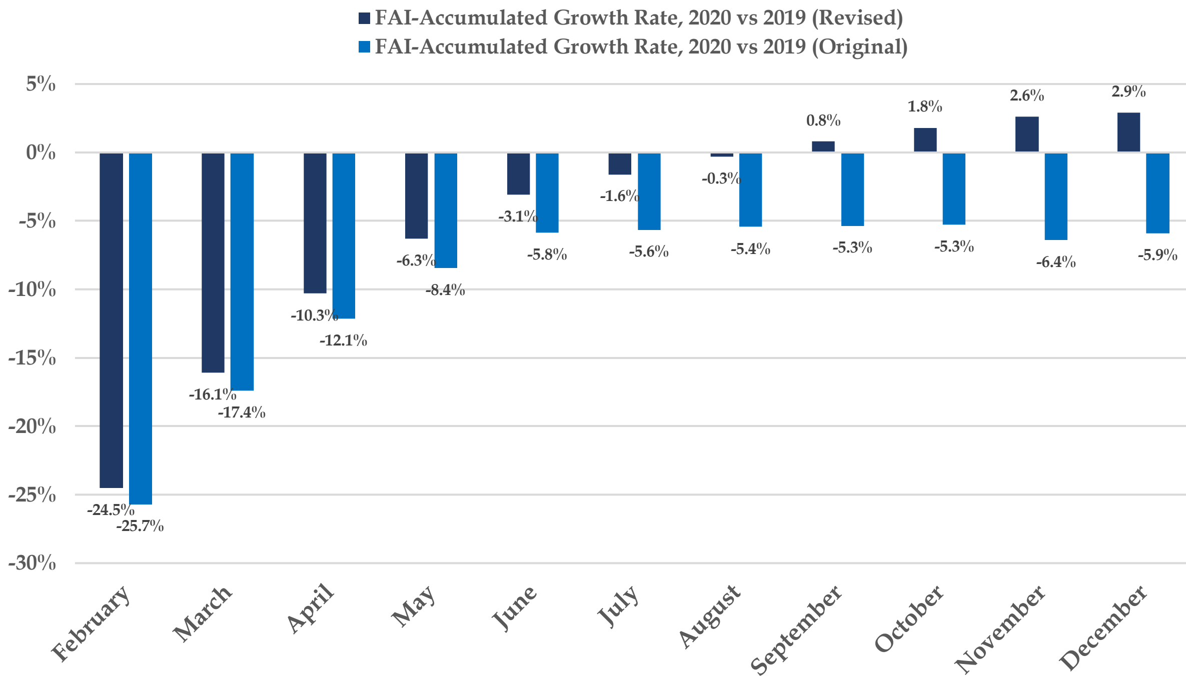


Source: Financial Times

Chart 2.: Private Minxin PMI vs China's Official PMI

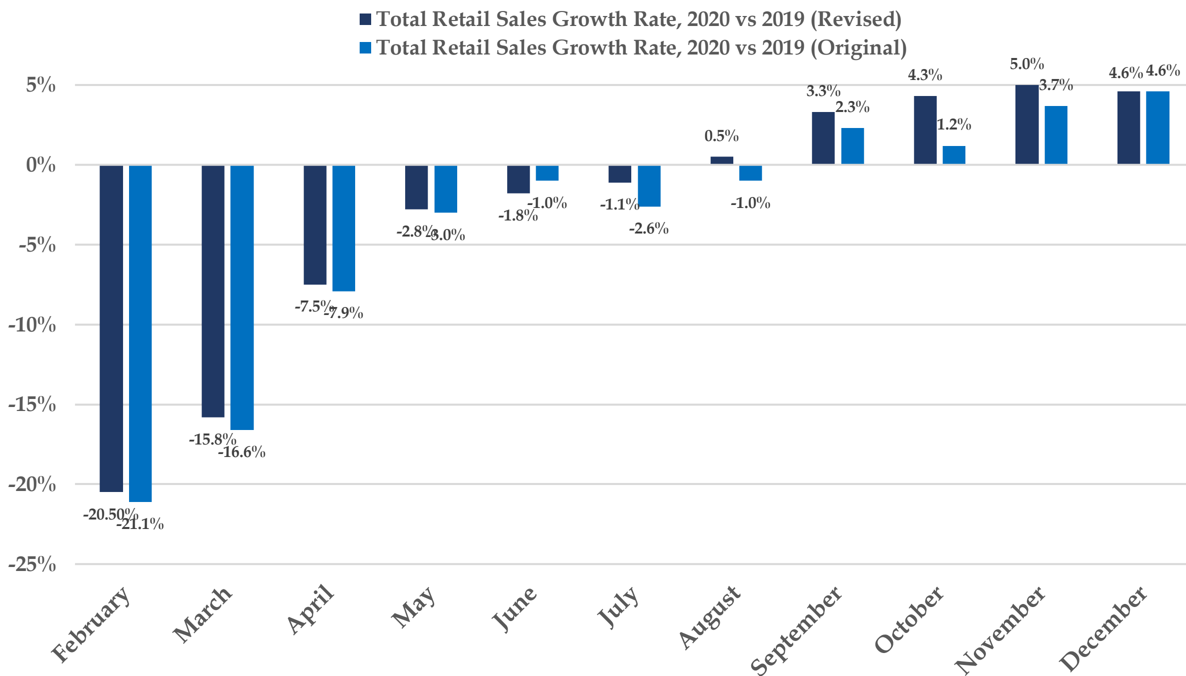
Source: Bloomberg

Chart 3.: Fixed Asset Investment Growth (Year-on-Year)



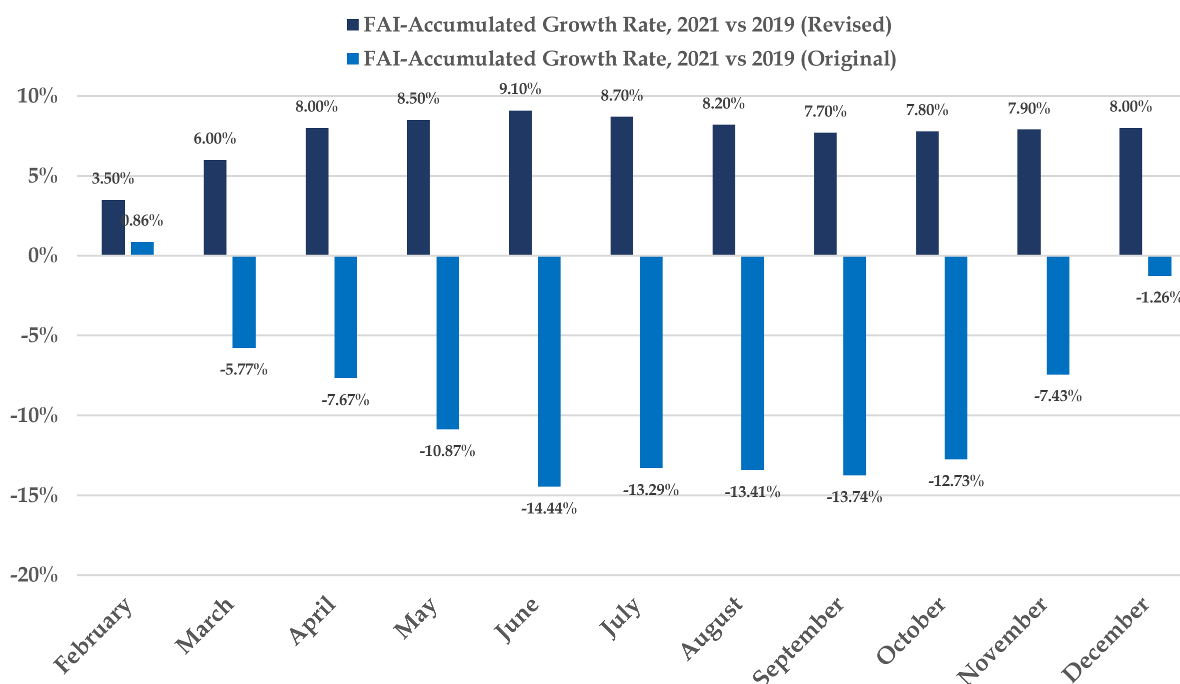
Source: National Bureau of Statistics; Authors own calculations

Chart 4.: Total Retail Sales Growth (Year-on-Year)



Source: National Bureau of Statistics; Authors own calculations

Chart 5.: Fixed Asset Investment Growth (2021 vs 2019)



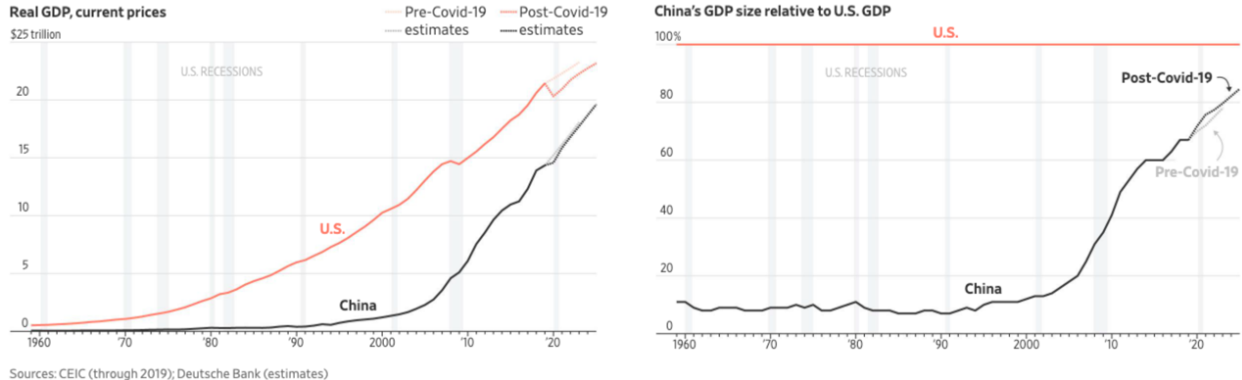
Source: National Bureau of Statistics; Authors own calculations

Picture 1: Goldman Sachs China Current Activity Indicator Overview

Overview

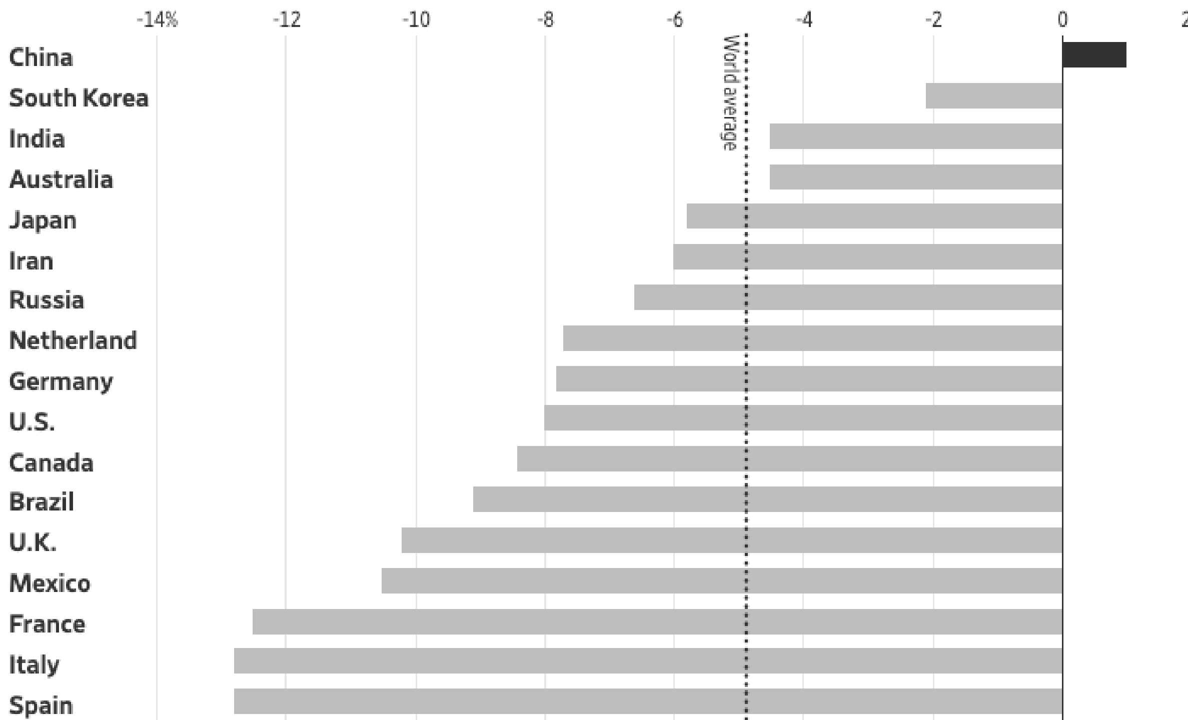
- The Goldman Sachs China Current Activity Indicator (GS China-CAI) was created to provide an alternative measure with higher frequency and quality to identify shifts in the economic cycle[8]. It attempts to encompass indicators from the main producing sectors of the economy – manufacturing, construction, and services – as well as the labor market. The China CAI is shown on a month-over-month annualized basis, after recent adjustments to harmonize CAIs around the world by the GS global economics team (it is available on the GS research portal or on Bloomberg at ticker: GSCNCAI[9]). The components of CAI include: industrial production, NBS non-manufacturing PMI, employment tracker, electricity consumption, real retail sales, cement production, freight volume, real exports, floor area started, the Caixin Service PMI, automobile sales, the Caixin Manufacturing PMI, passenger volumes, and real imports.
- The CAI is calculated on a sequential basis. Statistically, our CAI is constructed as the first principal component of 14 standardized monthly economic indicators after seasonal adjustment, converted to GDP-equivalent terms through a regression of historical real GDP growth on this principal component.
- We extend the CAI back to 2006, by backcasting a few series (mainly survey indicators) for which a complete history is not available. Other indicators on activity growth such as trade flows, corporate revenue and sector-level data all showed a higher amplitude of fluctuation than the official GDP data, so we adjusted for volatility when constructing the CAI.

Chart 6.: U.S. & China's GDP Growth Estimates After "Quick" Covid-19 Rebound



Source: Wall Street Journal; Deutsche Bank

Chart 7.: IMF's 2020 GDP Growth Projections



Source: Wall Street Journal

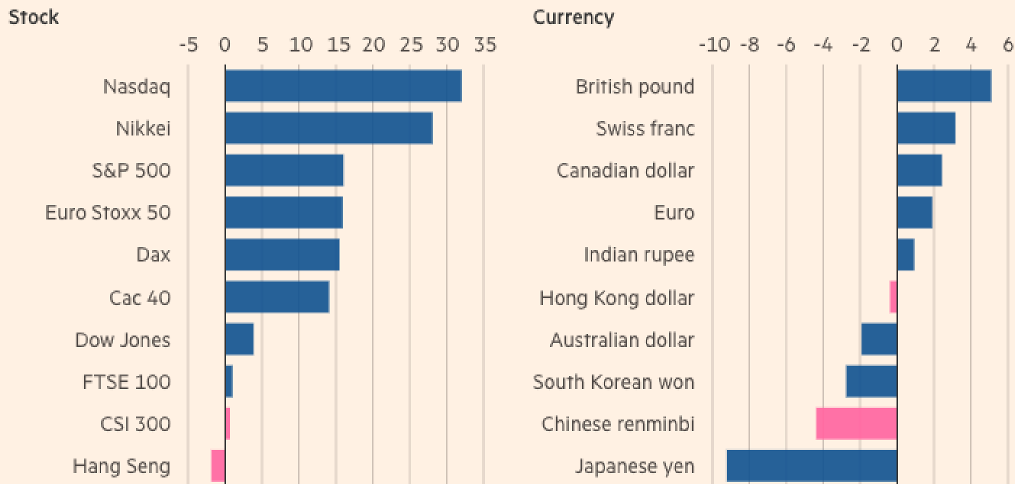
Chart 8.: China CSI 300 and Hang Seng Index Performance (October 2022 – May 2023)

Source: Bloomberg

Chart 9.: China CSI 300 and Hang Seng Index Performance (January – May 2023)

Source: Bloomberg

Chart 10.: China Stock and Currency Performance Versus Global Peers



Source: Financial Times

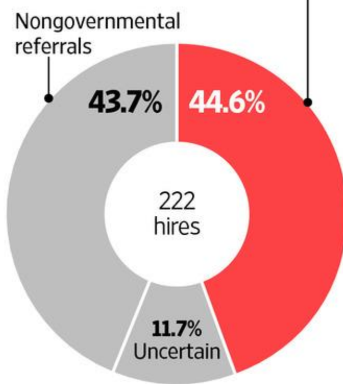
Chart 11.: J.P. Morgan's Hires Under its CCP "Sons & Daughters" Program

Friends and Family

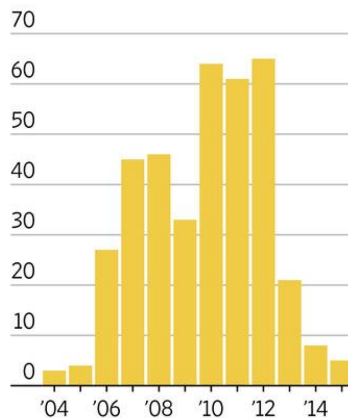
J.P. Morgan Chase hired 222 people referred by business contacts, many with connections to the Chinese government.

Referred by government officials or employees of state-owned companies

Nongovernmental referrals



Number of referral hires employed in a given year*



*Hires include a small number of people from outside of China

Source: the company

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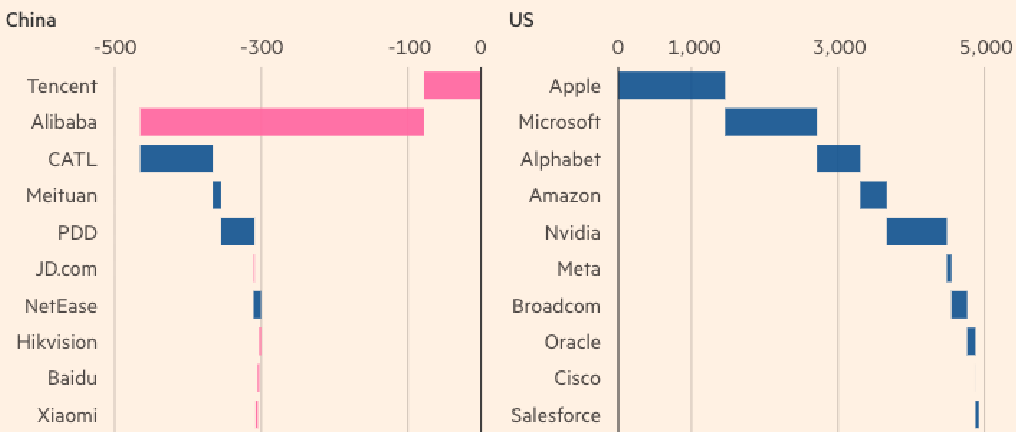
Source: Wall Street Journal

Chart 12.: Change in market capitalization of leading Chinese and US tech companies



Source: Financial Times

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