中国金融四十人研究院
CHINA FINANCE 40 INSTITUTE
CF40 Policy Brief

A Year in Retrospect[1]

CF40 Institute Research Team

2023 has come to an end. It has been a year with both hopes and challenges.

We at CF40 hold that "good research" is even more essential in challenging times. By good research, we are referring to work that is perspective, inspiring, insightful and, very importantly, falsifiable. It is not complicated at all when put into practice - our CF40 standard is straightforward: we write reports that we genuinely believe in and would enjoy reading ourselves. We want to make research a wonderful endeavor, a journey towards truth. The road might be long and twisty, but we cherish the moment when we finally reach the destination. And if a few readers appreciate our work, that's an added bonus.

In April 2023, we started to share some of CF40's research outcomes via *CF40 Policy Briefs.* 36 briefs were published by the end of the year. In recent days, we took stock of what we have written. There is always room for improvement for each piece of work, but one thing's for sure: we haven't felt the urge to tear any of them apart.

In 2023, we put a lot of thought into what a recovery would look like for China.

1 This article was originally written in Chinese in late December 2023. In case of any discrepancy or ambiguity between the English and Chinese versions, the Chinese version shall prevail.

Based on a systematic comparison of data from 56 economies from 2020 to 2022, we concluded that everything has a cause. The strength of China's economic recovery in 2023 is a function of the macroeconomic policy efforts from 2020 to 2022, a phenomenon not only found in China, but prevailing globally (see *Macro Policy and Economic Recovery after Reopening: A Cross-Country Observation*).

When it comes to the widely discussed "excess savings" and their implications for a rebound in consumption at the beginning of the year, we made it clear that excess savings ≈ 0, and the meaning for consumption recovery should be self-evident (see *Excess Savings≈0*).

When people saw the massive credit and social financing figures in the first quarter and started asking where the money went, we were unequivocal: the question was fundamentally wrong because there was not too much money, but was insufficient (see *"Where is the Money?" May be the Wrong Question*).

And when there was a significant divergence between the micro-sensation, macro variables, and the buzz in social media, we made the observation of *K-shaped Recovery*.

As the market began to anticipate a new economic boom in the second half of the year due to inventory cycles, we pointed out a basic logic: inventory is a result of the cycle, not the cause (see *"Inventory Cycle" May Be an Illusion*).

When the economy indeed showed some signs of recovery in July and August, we believed we should not simply extrapolate (see *Three Concerns for Economic Recovery*).

In 2023, we thought hard about prices and interest rates.

Although inflation, real interest rates, and nominal interest rates appear to be the most rudimentary macroeconomic concepts, they may also be the most critical macro variables for thinking about economic cycles. *Inflation: This Time is Different* suggested that inflation can sometimes make people's livelihood better.

Our examination of liquidity traps, debt-deflation, and the real bills doctrine was aimed at exploring some macroeconomic scenarios that are theoretically possible but rare in reality. Therefore, most people have no experience about such situations in reality. Sometimes, theory serves as a guide to help you navigate in an uncharted water under such conditions (see *1. Re-read Literature: Liquidity trap? 2. Re-read Literature: When Richard Koo and Minsky met Fisher? and 3. The Forgotten Real Bills Doctrine and Less Discussed Taylor Rule Coefficients: Two Macroeconomics Open-Book Exam Questions*).

We also discussed some seemingly "micro" but macro-significant interest rate issues, such as the impact of interest rates on macro leverage (far more than you might imagine) [see *Lowering Leverage May Require Increasing Leverage (at Low Interest Rates)]*, changes in the return rates of listed companies and their implications (yield changes being much faster than changes in financing costs) (see *The Impact of Narrowing Private Sector Interest Rate Spreads on Credit Expansion*), whether there could be a better design for interest rate corridors (the answer is yes) (see *Global Comparison and Reflections on China's Interest Rate Corridor Mechanism)*, and what the redemption of wealth management products (WMP) and rising interest rates revealed (the questionable business model of WMPs) (see *Looking at Banks' Wealth Management Business Model from WMP Redemption Events*).

In 2023, we closely followed issues related to real estate, local government finances, and debt.

In a subject like real estate, where almost everyone has an opinion, we applied a research approach that solely depends on data to speak for itself. As data indicates, the real estate cycle typically has a "long tail". The good news is that, we may have already experienced the most severe economic blow that usually comes in the second or third year. (see *Long Tail: A*

Cross-Country Observation of the Bursting of the Real Estate Bubble). The slightly less optimistic news is that real estate downturn cycles often last for 6-7 years (see *Long Tail 2: A Cross-Country Observation of Real Estate Markets After the Bursting of the Real Estate Bubble*).

To determine how the real estate market correction will affect local government fiscal revenues and financing, we ran some simple calculations. Even though the figures may not be exact, we believe the magnitude should be about correct, and this is a problem that will be around for a very long time. (see *Fiscal Revenues and Government Financing under Sustainable Development of the Real Estate Market*).

Additionally, drawing a straightforward analogy, we discovered that real estate businesses' financial features considerably outweigh those of real estate development, which has important implications for the resolution of real estate companies. (see *On the "Shadow Banking" Nature of Real Estate Enterprises*).

We also reviewed the process of the European debt crisis, the transmission from "local debt" to financial risks to ECB's "whatever it takes" is evident(-see *From 'belt-tightening' to 'do whatever it takes': A review of the Eurozone 'local debt' crisis*).

The fiscal theory of the price level predicts some surprising price trends triggered by debt problems, counter-intuitive but worth considering (see *The Fiscal Theory of the Price Level – Some Inferences Based on Literature Review*).

Speaking of debt, we systematically analyzed the mechanisms of global sovereign debt restructuring. We concentrated on this topic for the reason that China has become one of the major creditor countries in the world. After years of shocks, many heavily indebted countries have been caught in the predicament of debt restructuring. Major countries must participate in the process constructively (see *Why Should We Pay Attention to the Sovereign Debt Problem of Developing Countries?*).

What's more, a close look at the evolution and core elements of the existing sovereign debt restructuring mechanisms could help us to think about how they can be improved. To be frank, existing mechanisms exist for good reasons. Unjustified intervention can be avoided by making the background and reasoning behind the sovereign debt restructuring mechanisms' development clear. The adage "establish first, then break" should also apply to sovereign debt restructuring mechanisms because it is far more difficult to establish than to break (see *The Historical Evolution and Core Elements of the International Sovereign Debt Restructuring Mechanism*).

In 2023, we gave serious thought to the issue of "balance sheet recession."

On the one hand, our conclusion is clear: it is not as complicated as a balance sheet recession. The Chinese economy does not exhibit the characteristics of a balance sheet recession, and more importantly, the policy implications of balance sheet recession do not apply to today's China. For example, we believe that China's monetary policy has room and can make a difference (see *It's Not as Complicated as a "Balance Sheet Recession"*).

On the other hand, we also believe that it is necessary to carefully analyze the balance sheets of various sectors in the economy because improving balance sheets will benefit economic recovery. From the data we tracked, whether in the second or third quarter, the improvement in the balance sheets of various sectors was not particularly evident (see1. *Is the Balance Sheet Starting to Repair? —Observation on Cash Flow and Balance Sheet of Various Departments in China in the Second Quarter of 2023* and 2. *Limited Progress in Sectoral Balance Sheet Restoration: Analyzing Cash Flow and Balance Sheets Across China's Sectors in Q3 2023*).

In 2023, we were concerned about how to boost domestic demand and understand external demand.

We reviewed the historical experiences of demand deficiencies and low inflation in the US, Japan, and Europe, and concluded that monetary policy is the key to addressing domestic demand shortages and getting out of low inflation (see *Navigating Weak Demand and Low Inflation: Lessons from the US, Japan and Europe*).

We analyzed how to stimulate consumption in the short term, and from a macro perspective, broad credit growth remains the key. Both monetary and fiscal policies can facilitate broad credit growth (see *How to Expand Consumption in the Short Run*).

As for external demand, we made an endogenous interpretation. Many people believe that external demand depends on external factors and is less influenced by China's domestic situation. After observing the data, we believe that China's external demand is largely a result of the "involution" of Chinese enterprises. This explains why China's export data exhibits a divergence between quantity and price (see *The "Involution" of China's Export and Its Causes*).

Based on this logic, we predicted that China's trade surplus would continue to narrow next year, but net exports' contribution to economic growth would turn positive (see *China's Current Account Surplus May Further Narrow in 2024*).

In 2023, we closely followed the ups and downs on the other side of the ocean.

After the collapse of the Silicon Valley Bank, we made two very clear predictions: there would be no systemic risk, and it would not affect the Federal Reserve's monetary policy tightening. Time has proven us right. In hindsight, these outcomes were not inevitable, so luck played a significant role in making a right guess. However, what reassures us is that our analytical framework for predicting these outcomes should be reasonable. This makes us more likely to have correct guesses in similar situations in the future (see *Analysis of the Impact of the Risk Events in the US and European Banking Sector on Financial Stability and Monetary Policy*).

The Silicon Valley Bank failure also led us to reflect on another question: What is a systemically important bank? Are China's criteria for systemically important banks reasonable? Our preliminary answer is that there is room for improvement (see *Thoughts on Improving the Classification Standards of China's Systemically Important Banks*).

Regarding the view that the Fed should modify its 2% inflation target, we had a clear stance: the Fed would not change it, nor should it change the target under the circumstances at that time. Whether this judgment is accurate will take some time to know, but time and facts seem to be in our favor (see 1. *Why Is the Inflation Target Set at 2%? 2. Why Does the Fed Continue to Insist on 2%?* and 3. *Powell's Jackson Hole Speech: A Few Impressions*).

In August, we speculated about the endpoint for US Treasury yields, concluding that it would be in China's hands. Our specific advice was that anyone bullish on Chinese government bonds should also be bullish on US Treasury bonds (see *Where US Interest Rate Ends Depends on China*).

In September, after a fascinating discussion on central bank policy at 2023 Bund Summit, we asked ourselves: Has the inflection point for foreign interest rates been reached? Has the turning point for asset prices abroad been reached? In hindsight, it would have been better not to add those two question marks at that time (see *When the Bund Summit Meets Super Central Bank Week - Let's Talk about Monetary Policy*).

Around that time, we also posed another question that may never have a definitive answer: *Why Haven't the Fed's Aggressive Rate Hikes Triggered an Emerging Market Crisis This Time?* We found three reasons which seem to hold true for a long time to come. Therefore, if our analysis is correct, emerging economies may have relatively smoothly navigated this round of interest rate hikes.

Finally, we did *A Historical Review of US Industrial Policy,* trying to understand the historical background and possible effects of the US government's large-scale implementation of industrial policy in recent years. At least from the situations we reviewed, the only truly successful industrial policy in the US before 2020 may have been the Defense Advanced Research Projects Agency (DARPA), and the rest of the industrial policies have been less effective.

As 2024 unfolds, we will keep up with our curious quest for “good research”, go through all the ups and downs of the research journey, and craft reports that we genuinely believe in and would enjoy reading ourselves. If there are also readers out there who are keen on reading our work, it will certainly add an extra sparkle to our journey ahead.

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