

The signal from China's Financial Boom

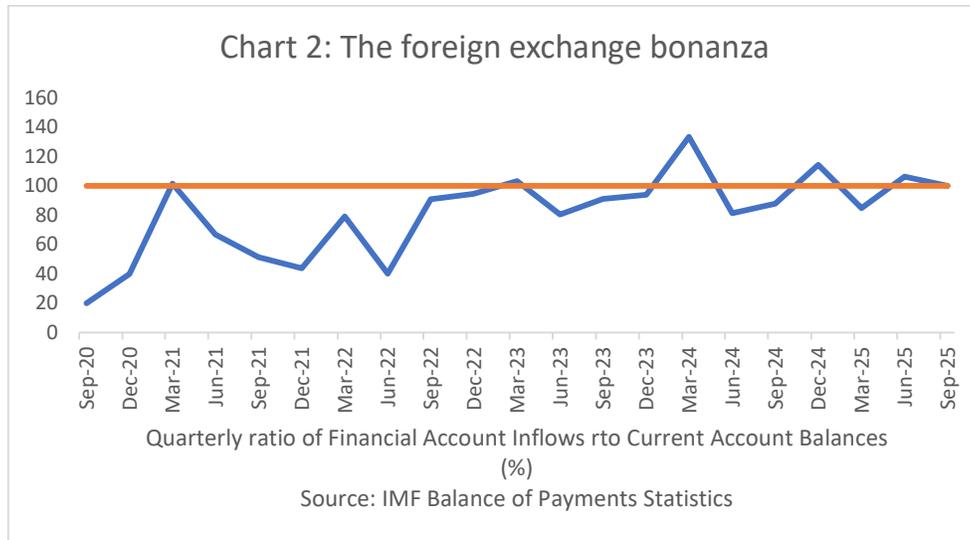
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Setting aside concerns of various kind on the resilience of the Chinese economy, foreign financial investors are rushing into the country's financial markets. The [Financial Times](#), quoting figures from the Institute of International Finance, reports that new offshore investments in Chinese stocks totalled \$50.6 billion over January to October 2025, as compared to just \$11.4 billion in the whole of 2024. That has set such investment racing towards the high recorded in the post-COVID year 2021, after which the market has been tepid. Such foreign appetite, together with domestic investor interest, has driven up the Shanghai Composite Index by close to 30 per cent compared to 15 months earlier (Chart 1).

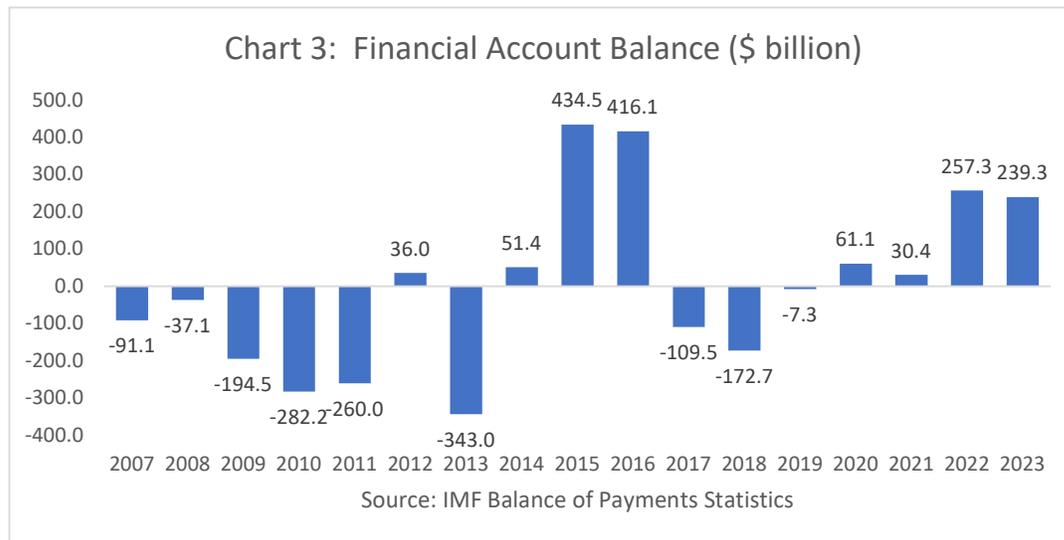


But it is not only the stock market that is buoyant. Interest in dollar and euro denominated bonds issued by Chinese banks and by the government is also at an all-time high. According to [Bloomberg](#), over the two weeks ending November 19 this year, China raised a combined total of \$8.6 billion with a \$4 billion dollar-bond sale and a \$4.6 billion euro-bond sale. It was not just the size of this mobilisation that was surprising. It was the demand for the bonds that was remarkable. Total bids for the two bonds together touched \$234 billion, with the dollar bonds eliciting demand of 30 times the issue volume and the euro bonds 25 times the announced volume. In the event, issuers have been able to raise funds offering yields similar to or slightly higher than US and German official instruments.

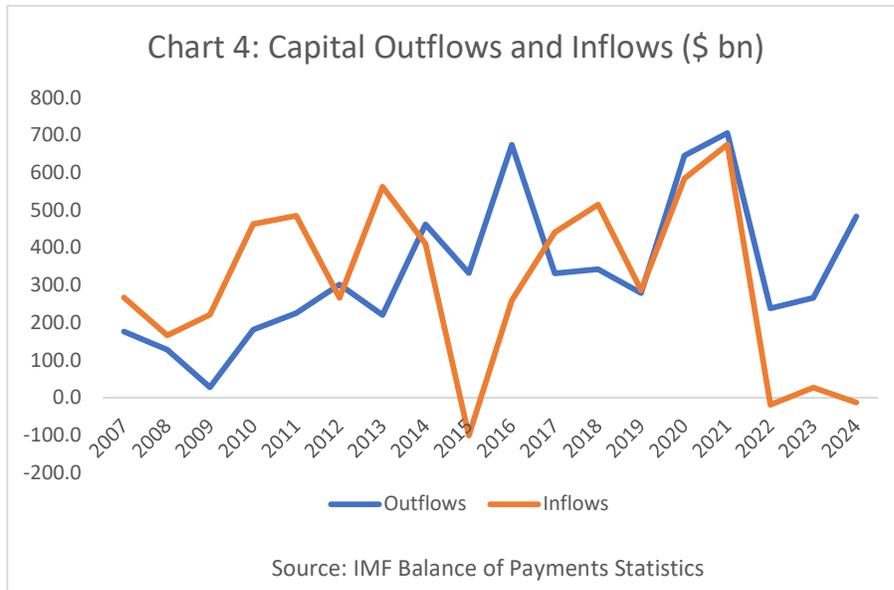
One consequence has been that a country that records a current account surplus has become a capital importer. In two of the three quarters ending September 2025, net financial account inflows have equalled or exceeded the current account surplus on China's balance of payments. This tendency to accumulate large foreign exchange surpluses by adding capital inflows to current account surpluses appears to be on the rise. In the period since the COVID-19 pandemic, the ratio of financial account inflows to the current account surplus has risen from 20 per in the quarter ending September 2020, to equal or exceed 100 per cent in 6 out of the 21 subsequent quarters (Chart 2).



The long-term movement in net capital flows into and out of China has been volatile. As Chart 3 shows, *negative* net financial account balances (which as per the IMF’s BPM6 methodology indicates a net inflow) prevailed over 2007 to 2013. That turned net positive (implying capital outflow) over 2014 to 2016, briefly returned to negative (inflow) territory over 2017-2019. net outflows rose sharply starting 2020 and on to 2024, when net outflows totalled \$496 billion.



These fluctuations are reflective of the fact that while China has been for long a country of interest for foreign investors, with foreign direct investment inflows initially and portfolio flows subsequently, China has also been a source of capital for the rest of the world. As revealed in Chart 4, there have been periods in which the direction of movement or the magnitude of shifts in these inward and outward flows have significantly diverged. That explains the fluctuations in net inflows.

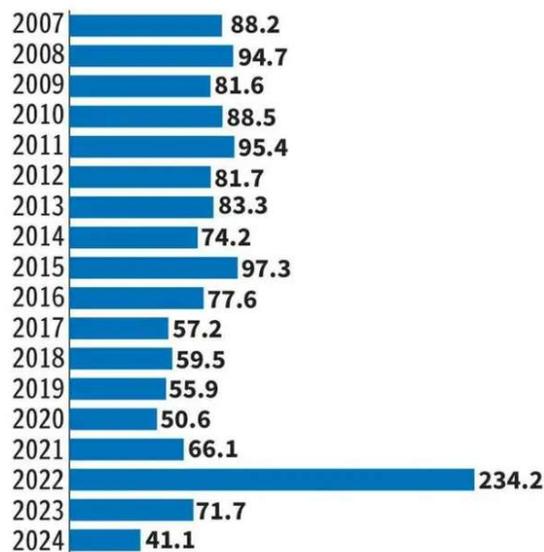


There are a few noteworthy features of the inflows alone. The first is that there has been a significant shift in inflows away from direct to portfolio investment. Till 2015, barring a few years, foreign direct investment inflows accounted for between 80 and 100 per cent of the total, in keeping with the perception that foreign invested enterprise-driven exports contributed to China’s explosive growth. There has since been a significant and almost continuous decline in that share (barring 2022 when it fell because of an exceptional outflow of *portfolio capital* to the tune of \$109 billion). The share of direct investment in total flows had come down to 41 per cent in 2024 (Chart 5).

Chart 5

FDI trends

Ratio of direct to portfolio investment (%)



Source: CEIC, IMF Balance of Payments Statistics

The other notable feature is the waning of direct investor interest, possibly driven by the deterioration in the relationship between the US and China, with the absolute level of direct investment inflows falling from \$344 billion in 2021 to \$51.3 billion in 2023 and just \$18.6 billion in 2024. Given the recent trends in stock and bond markets noted earlier, the still incipient 'boom' in foreign investor interest in Chinese stocks and bonds is likely to intensify.

In sum, China is increasingly reflecting trends of other 'emerging' market economies. A corollary is that, with the shift in the pattern of foreign investment flows, China would be exposed to whimsical financial investor behaviour, leading to an amplification of the observed fluctuations in flows on the financial account of the balance of payments.

The explanation for this turn is still unclear. However, the growing divergence between trade, current account and real economy trends, on the one hand, and financial indicators, on the other, point to the differing role of multiple Chinese actors and agents with varying incentives. And, more granular evidence suggests that the disproportionate role of one set of actors could add to fragility.

Foreign bond issuance appears to be driven by provincial governments addicted to large scale off-budget spending financed with debt incurred by local government financing vehicles (LGFVs). [According to Vincent Chan of law firm Appleby](#), offshore bond issuance by these entities rose 74 per cent to \$55.8 billion in 2024. LGFVs are already heavily indebted, with the IMF estimating their total debt had touched 60 trillion yuan by 2023, equivalent to 48 per cent of China's GDP. That debt is straining local governments trying to ensure that the LGFVs burdened with huge interest payments meet their commitments. There is evidence that this has been done by covering high interest bills with receipts from land sales. But the unwinding of a property bubble has seen property prices slide sharply, reducing the ability of these governments to trade in land to mobilise resources to cover interest.

These are not good signs, as they speak of a kind of entanglement that increases financial vulnerability. Even if that does not matter normally, it could in a context where China is being targeted with tariffs and sanctions of various kinds.

The government is indeed aware of this. Besides working to cool property markets, it has also announced a relaxation of limits on bond issuance by local governments, to raise money that can pay off hidden and costly debt. That may explain the desire of such entities to issue bonds at comfortable interest rates. But in the final analysis, this too is debt, and involves exposure to ruthless foreign creditors who have mastered the art of squeezing out every possible penny to shore up their profits or cut their losses.

It is true that China has the reserves to ensure resilience despite these large foreign liabilities. But this could prove a distraction that China can do well without, at a time when it is trying to rebalance away from exports and investment to sustain its still impressive dynamism.

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