

The Impact of the 2023 International Financial Market Turmoil on China's Investment Environment

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Abstract. In 2023, the international financial markets experienced severe turbulence and multiple challenges, which had a profound impact on China's investment environment. This paper first reviews the history and current situation of China's outbound investment, analyzing the evolution from the initial exploration stage to the stable development stage. Then, through a literature review, the article explores the relationship between international financial market turmoil and the investment environment. It also combines case studies to delve into the specific impacts on investment environments in certain countries. The paper focuses on analyzing events such as the Federal Reserve's interest rate hikes and monetary policy adjustments, bankruptcy of Silicon Valley Bank, and fluctuations in gold and commodity prices. The aim of this research is to provide decision-making references for Chinese enterprises, investors, and policymakers, and to offer policy recommendations to policymakers, thereby helping China's economy play a more positive and constructive role in the global financial markets.

Keywords: The international financial markets, investment environment, Silicon Valley Bank.

1. Introduction

1.1. Background

In 2023, for the global financial markets, proved to be a year full of volatility and challenges. Throughout this year, the international financial markets underwent a series of significant events, including the bankruptcy of Silicon Valley Bank in the United States, consecutive interest rate hikes by the Federal Reserve to address high inflation, a widespread slowdown in global economic growth, escalating currency crisis risks in emerging markets, and sharp fluctuations in gold and other commodity prices. These events not only garnered widespread attention globally but also significantly impacted China's investment environment.

As the largest developing country in the world and a key participant in the global economy, China's outbound investment scale and financial market stability have profound implications for both domestic and international economies. The turbulence in international financial markets directly influenced the destination and flow of China's outbound investment, adjustments in investment sectors, and the structural and industrial upgrading of the Chinese economy. Additionally, China's critical position in the global supply chain makes its economy particularly sensitive to fluctuations in international markets. Against this backdrop, Chinese enterprises, investors, and policymakers need to carefully assess the impact of international financial market turmoil on the domestic investment environment and devise corresponding response strategies.

This article aims to analyze the specific impact of the 2023 international financial market turmoil on China's investment environment, explore the response measures of Chinese enterprises, investors, and policymakers during this process, and provide relevant recommendations. Through in-depth research, this article hopes to offer decision-making references for Chinese enterprises and investors and policy suggestions for policymakers, thereby promoting the healthy and stable development of the Chinese economy and enabling it to play a more proactive and constructive role in the global financial markets.

1.2. Analysis of the History and Current Situation of China's Outbound Investment

1.2.1. History

(1) Preliminary Exploration Stage (1979-1985)

The curtain of China's outbound direct investment was lifted in 1979 when the State Council proposed "establishing enterprises overseas." During this period, China's outward investment was characterized by its small scale, relatively narrow investment fields, and the initial formation of outbound investment management systems. In the first five years of reform and opening up, China's annual outbound direct investment flows were all below \$100 million, reaching \$629 million in 1985, with a cumulative outbound investment stock of \$900 million.

(2) Accelerated Development Stage (1986-1992)

From 1986 to 1992, China's outbound investment achieved normalized management and witnessed a small upsurge in investment growth. During this stage, China's outbound investment management underwent a transition from case-by-case approval to normative approval. From 1986 to 1991, outbound investment maintained steady growth, surging to \$4 billion in 1992.

(3) Adjustment Development Stage (1993-2000)

Starting in 1993, China's outbound investment development entered a period of adjustment. After experiencing a minor upsurge, outbound direct investment showed a significant decline, but the strategic thinking on outbound investment development gradually became clear. National leaders proposed fully utilizing both domestic and international markets, integrating "bringing in" and "going global," and encouraging enterprises with comparative advantages to invest abroad.

(4) High-speed Development Stage (2001-2016)

In 2001, China joined the World Trade Organization, and the "going global" strategy was included in the Tenth Five-Year Plan for National Economic and Social Development. China's outbound direct investment scale began to expand rapidly, with investments becoming increasingly diversified in terms of regions and industries. In 2015 and 2016, China's outbound direct investment flows reached \$196.1 billion, and the outbound investment stock accumulated from \$27.2 billion to \$13.6 trillion by the end of 2016.

(5) Steady Development Stage (2017-2023)

In 2017, China's outbound direct investment entered a stage of steady development. Policy guidance had a significant impact on investment, with non-financial outbound direct investment flows amounting to \$120.08 billion, down 29.4% year-on-year. The investment industry structure continued to optimize, with investments in information transmission, software, and information technology services accounting for 8.6%.

1.2.2. Current Situation

(1) Investment Scale and Global Ranking

As of 2021, China's outbound direct investment flows have ranked among the top three globally for ten consecutive years and have accounted for over 10% of the global share for six consecutive years. In 2021, China's outbound direct investment flow reached \$178.82 billion, a 16.3% increase from the previous year, ranking second globally in terms of flow size and accounting for 10.5% of the global share.

(2) Investment Structure and Industry Layout

China's outbound investment structure continues to optimize, with solid progress in high-quality construction of the Belt and Road Initiative. Chinese enterprises' international competitiveness has further strengthened, steadily expanding investments in new areas such as digital economy and green

development. In 2021, outbound direct investment flow into manufacturing reached \$21.6 billion, a 17.4% increase, accounting for 18.5% of the total.

(3) Investment Regions and International Cooperation

China's outbound investment regional layout is becoming more balanced, with investments in Asia accounting for 71.6% of the outbound direct investment flow in 2021, a decrease compared to 2020. China continues to promote international cooperation mechanisms for outbound investment, actively participating in global investment governance system reforms and construction.

1.3. Research Significance

In the context of globalization, the stability of international financial markets is crucial for all countries. With the continuous integration of the Chinese economy into the global system and the expansion of outbound investment scale, the impact of instability in international financial markets on Chinese enterprises, investors, and policymakers is becoming increasingly evident. This study analyzes the impact of the 2023 international financial market turmoil on China's investment environment, aiming to deepen the understanding of the interaction between fluctuations in international financial markets and national-level investment decisions.

For businesses and investors, the findings of this study will help optimize investment portfolios, mitigate risks, seize investment opportunities, provide theoretical support for investor education and financial product design, and develop strategies to cope with market fluctuations. For policymakers, understanding the impact of international financial market turmoil on the domestic investment environment is crucial for formulating effective macroeconomic policies and financial regulatory measures. This study will provide policy recommendations to assist governments in accurately assessing the impact, formulating response measures, maintaining financial market stability, and promoting economic health in the face of external shocks.

In summary, this study is not only academically significant but also has significant practical value in guiding investment decisions, formulating macroeconomic policies, promoting international financial cooperation, and enhancing the resilience of economies against risks.

2. Literature Review

2.1. The Relationship between International Financial Market Turmoil and Investment Environment

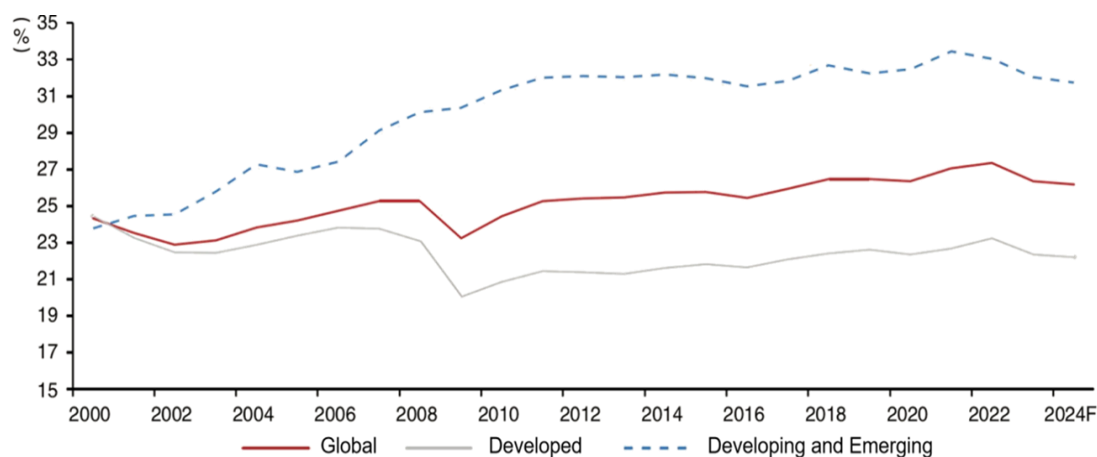
Tan Xiaofen and Zhang Keke (2023) found that since the 2008 global financial crisis, international capital flows have exhibited new characteristics and trends. The growth rate of global cross-border capital flows has declined, the proportion of portfolio investment flows in securities has increased, and non-bank financial institutions' role as intermediaries for cross-border funds has strengthened. These changes have had a significant impact on the investment environment, including diversification of funding sources and optimization of investment structures. Xiao Qi and Liao Hongyan (2020) found that global financial cycles, the degree of financial openness, financial innovation, and the instability of international capital flows have all to some extent altered the investment environment, bringing about a dual impact on it. Scheubel et al. (2019), using a structural factor model, found that the correlation between global financial cycles and all types of capital flows except repatriation is significant and robust (repatriation is mainly influenced by domestic investors' behavior), with a higher correlation in stages where capital inflows abruptly halt. Buera et al. (2011), through theoretical models and empirical analysis, found a close link between financial liberalization and capital inflows, which promoted the allocation of resources among enterprises, thereby enhancing total factor productivity (TFP). This indicates that international capital flows play a positive role in the economic growth of recipient countries.

2.2. Case Study on Specific Countries

Li Hongyan's (2018) research shows that the investment environment of emerging market countries is particularly vulnerable during periods of turmoil in the international financial markets. Because these countries' economies and financial systems are often more reliant on external financing, changes in global capital liquidity directly impact their investment costs and availability. For example, during the 2013 'Taper Tantrum' period, expectations of the Federal Reserve's tapering of quantitative easing led to a rise in global interest rates, putting pressure on emerging market countries with capital outflows and currency depreciation, deteriorating the investment environment. Similarly, the investment environment of developed economies is also affected by turmoil in the international financial markets. For instance, during the 2008 global financial crisis, financial institutions in the United States and Europe faced severe liquidity crises, leading to a freeze in credit markets, making it difficult for businesses and individual investors to obtain financing, resulting in a significant decrease in investment activities. Furthermore, financial market instability also increases investors' risk aversion, reduces the attractiveness of capital markets, and affects the stability and predictability of long-term investments.

Ou Minggang and Yang Peiwei's (2023) research indicates that financial market instability leads multinational corporations to reassess their global investment portfolios, potentially delaying or canceling investments in certain high-risk projects, especially in emerging markets and unstable regions. Additionally, financial market turmoil may also affect multinational corporations' financing costs and channels, thereby impacting the scale and direction of their outbound direct investments.

Chen Weidong et al. found that investment in developed economies is significantly impacted by interest rate hike policies, with both domestic and cross-border investments continuing to be under pressure. Under tightening monetary policies, macro leverage ratios in the corporate sectors of developed economies decrease, and there is insufficient willingness for leveraged or debt investments by enterprises. The International Monetary Fund (IMF) predicts that the global investment rate (the proportion of investment to GDP) will decrease by 1.0 percentage point to 26.4% in 2023."



Pic. 1 The Trend of Global Investment Rate Changes

Data Source: IMF, China Banking Research Institute

3. Analysis of major events of international financial market turbulence

3.1. Federal Reserve Rate Hikes and Monetary Policy Adjustments

As one of the most important central banks globally, the Federal Reserve's adjustments to its monetary policy have profound impacts on global financial markets and economic trends. To address persistent high inflation pressures, the Federal Reserve began gradually tapering its quantitative easing policy since late 2015 and raised the federal funds rate target range multiple times in the subsequent years. Particularly in 2022, facing an inflation environment not seen in nearly four decades, the Federal

Reserve adopted a more aggressive rate-hiking strategy, raising rates consecutively and shrinking its balance sheet to curb inflation and stabilize the economy. The Fed's rate hikes led to a global capital reallocation, especially flowing from emerging markets to the United States, seeking higher returns. Rate hikes also imply higher borrowing costs, increasing global debt financing costs, especially for countries and regions with significant dollar-denominated debts, significantly increasing their debt repayment pressures. Under expectations of rate hikes, global stock markets also generally faced downward pressure, with bond yields rising and bond prices falling.

3.2. Silicon Valley Bank Bankruptcy Event

The bankruptcy of Silicon Valley Bank (SVB) in the United States was a significant event in the international financial markets in 2023. Due to the Federal Reserve's consecutive rate hikes since March 2022, long-term interest rates rose, leading to substantial unrealized losses on long-term bonds held by Silicon Valley Bank. To meet liquidity demands, the bank had to sell these bonds, confirming the losses and triggering concerns and runs on its solvency. The collapse of Silicon Valley Bank caused turmoil in global financial markets, especially with bank stocks being severely affected. Markets feared that this event could trigger broader financial risks, similar to the 2008 financial crisis. Additionally, global investors' confidence in the banking sector was affected, leading to tight capital liquidity and increased risk premiums.

3.3. Gold and Commodity Price Volatility

The turbulence in the international financial markets, particularly due to the Federal Reserve's rate hikes and monetary policy adjustments, has had a complex impact on the volatility of gold and commodity prices. Gold, as a safe-haven asset, tends to be sought after when market uncertainty increases. For example, expectations of Fed rate hikes, geopolitical tensions, and other factors contributing to market uncertainty lead investors to seek safety assets, thereby pushing up gold prices. The rise in gold prices reflects the market's demand for compensation for potential risks. On the other hand, commodity prices are influenced by various factors such as supply and demand dynamics, investor sentiment, and monetary policies. In the current international financial environment, the volatility of gold and commodity prices may increase, and investors need to closely monitor market dynamics to make informed investment decisions.

3.4. Impact of Israel-Palestine Conflict on Global Supply Chains

The Israel-Palestine conflict, a long-standing dispute and conflict between Israel and Palestine, is one of the most complex and enduring issues in the Middle East region. It has not only had a profound impact on the lives of local residents but also on the geopolitical stability, economic development, and energy security of the Middle East and the world. The Israel-Palestine conflict may lead to disruptions in port operations in Israel and its surrounding areas, thereby affecting international trade reliant on maritime transportation. Given the critical role of the Middle East in global energy supply, any geopolitical tensions can trigger fluctuations in energy prices, impacting global economic and trade costs. Furthermore, increased geopolitical risks may weaken investor confidence, leading to capital withdrawal from high-risk areas, thereby affecting the economic growth and supply chain stability of relevant countries. Additionally, insurance companies may raise rates in response to increased risks, transportation costs may also rise, and these additional costs may be passed on to consumers. Companies may adjust their supply chains to reduce dependence on conflict areas, leading to increased restructuring costs and reduced efficiency. Long-term conflict may also have a negative impact on the Middle East and global economies, increasing the risk of economic recession and further affecting global trade and investment.

3.5. Expectations for Policy Adjustments by the Bank of Japan

In 2023, the Bank of Japan announced a series of significant policy adjustments, including ending its eight-year-long negative interest rate policy and setting the short-term interest rate target range at 0%

to 0.1%. Additionally, the central bank released six documents outlining adjustments to its monetary policy framework, deciding to halt the purchase of Japanese stock ETFs and Japanese real estate investment trusts, and planning to gradually reduce purchases of commercial paper and corporate bonds. Furthermore, the Bank of Japan significantly raised its inflation expectations for the fiscal year 2022, from 2.3% in July to 2.9%, but expects the inflation rate for the fiscal year 2023 to decline to 1.6%. Influenced by factors such as the resurgence of the COVID-19 pandemic, the Bank of Japan also lowered its expectations for economic growth for the fiscal years 2022 and 2023, adjusting them from 2.4% and 2.0% to 2.0% and 1.9%, respectively. Despite ending the negative interest rate policy, the Bank of Japan has pledged to maintain an ultra-loose monetary policy stance and stated that it will take further easing measures if necessary. These adjustments reflect the Bank of Japan's assessment of the current economic situation and expectations for future policy directions, while also demonstrating the central bank's commitment to inflation and economic growth targets.

4. The impact on China's investment environment

4.1. Changes in investment destination selection

(1) Increase in Investment in Belt and Road Countries

Against the backdrop of turbulence in the international financial markets, China's outbound direct investment tends to focus more on stable regions with policy support. The Chinese government's promotion of the Belt and Road Initiative provides a mechanism for policy guidance and risk mitigation for outbound investment, making Chinese enterprises more inclined to invest in these countries. Data from 2023 shows steady growth in investment cooperation between China and Belt and Road countries, indicating that in an increasingly uncertain international environment, Chinese enterprises prefer to invest in regions with policy coordination and economic cooperation.

(2) Stable Growth in Investment in the Asian Region

Despite turbulence in global financial markets, China's investment in the Asian region continues to grow steadily. Investments flowing into Asia account for a significant proportion of the annual outbound direct investment flow, reflecting Chinese enterprises' strategic preference for stable growth in relatively familiar geographical and cultural environments. The geographical proximity and economic complementarity between Asian countries and China make this region an important destination for China's outbound direct investment.

(3) Varying Degrees of Growth in Investment in Developed Economies in Europe and America

During periods of financial market turbulence, China's outbound direct investment towards Europe and the United States shows a growing trend. This change may be related to Chinese enterprises seeking diversified investments in technology and markets, while also reflecting strategic considerations of risk mitigation and optimizing global presence. The mature markets and technological innovation environment in developed countries are attractive to Chinese enterprises, leading them to seek investment in these regions even amidst turbulence in the global financial markets.

4.2. Adjustment in Investment Preferences by Industry and Sector

Against the backdrop of turbulence in the international financial markets, Chinese investors and enterprises are adjusting their investment strategies to adapt to the new changes in the global economy. The technology and innovation sectors have become hotspots for investment, especially in emerging fields such as the digital economy and green development. This trend reflects China's proactive stance in seeking new growth points and cooperation opportunities in the global economy. By signing investment cooperation memorandums with countries like Singapore and Russia, China is committed to establishing deeper cooperation in these sectors. Additionally, investors are increasingly focusing on the stability and long-term growth potential of the real economy. This has led to a significant

increase in outbound direct investment flowing into the manufacturing sector, especially in equipment manufacturing. In 2023, China's investment in this sector reached \$21.6 billion, growing by 17.4% and accounting for 18.5% of total outbound direct investment, highlighting the importance of manufacturing in the Chinese economy.

In the food supply chain, due to increased price fluctuations and supply chain uncertainties, investors are paying more attention to the stability of agriculture and the food supply chain. Therefore, investment preferences are shifting towards areas such as agricultural technology, modern agricultural facilities, and supply chain management to ensure food safety and increase agricultural production efficiency. These adjustments not only help mitigate the impact of market volatility but also lay the foundation for the long-term stability and sustainable development of the Chinese economy.

4.3. China's Economic Structure and Industrial Upgrading

The turbulence in international financial markets has had complex effects on China's external demand and export-oriented industries. With global economic growth slowing down, especially with downward revisions in growth expectations for major developed economies, China's external demand has come under pressure, leading to reduced demand for Chinese goods from key trading partners such as the United States and the European Union. The sluggish growth in global trade and the decline in production sentiment in various countries further affected China's export performance.

However, against the backdrop of these changes in external demand, China's export structure is undergoing a significant transformation. The proportion of exports of technology-intensive products is continuously increasing, while the proportion of exports of traditional labor-intensive products is relatively decreasing, indicating a shift towards higher value-added products in China's export-oriented industries. Although demand in developed markets has weakened, emerging markets such as ASEAN, Russia, Africa, and Latin America have shown relatively stable demand and growth trends, providing new growth opportunities for China's exports.

Additionally, service trade, especially exports of knowledge-intensive services such as information technology and financial insurance services, has grown rapidly, becoming a new highlight in China's export-oriented industries. The digitization of industries has also provided new opportunities for Chinese enterprises by improving production efficiency and reducing costs, enhancing the international competitiveness of products, and opening up new export channels and markets.

5. Policy Suggestions

5.1. Measures for Enterprises and Investors

(1) Risk Management and Diversified Investments

Enterprises should establish comprehensive risk management systems, conduct regular risk assessments, and remain sensitive to market fluctuations to adjust investment strategies and asset allocations promptly. Furthermore, diversifying investment portfolios helps reduce reliance on a single market or asset category, thereby spreading investment risks. Investors should also enhance their risk identification capabilities, make investment decisions cautiously, and adopt a prudent asset allocation based on their risk tolerance and investment objectives.

(2) Market Analysis and Professional Consultation

Enterprises and investors should enhance in-depth market analysis, focus on long-term value rather than short-term fluctuations, and leverage professional financial institutions for advice and recommendations to make more informed investment decisions. By improving personal financial literacy and risk management capabilities, investors can better identify and mitigate market risks, avoiding unfavorable investment choices due to information asymmetry or blind following.

(3) Compliance Operation and International Cooperation

Enterprises engaging in international operations should strictly comply with local laws and regulations, enhance compliance levels, and avoid losses due to non-compliant operations. Additionally, through strengthening cooperation with international partners, enterprises can collectively address market risks, achieve mutually beneficial outcomes, and enhance international competitiveness.

(4) Monitoring Policy Trends and Long-Term Strategies

Enterprises should closely monitor domestic and international policy changes, especially macro-prudential policies and industry regulatory policies, to adjust business strategies promptly to adapt to policy changes. Investors should also pay attention to policy trends to better plan their investment strategies. Furthermore, both enterprises and investors should focus on long-term strategic planning, consider the long-term value and fundamentals of the business to achieve long-term stable investment returns.

5.2. Measures for Policy Makers

(1) Strengthen Macro-Prudential Management

Policy makers should closely monitor the dynamics of international financial markets and adjust monetary policies and regulatory measures promptly to stabilize the financial markets. This includes but is not limited to strengthening capital adequacy requirements for banks and other financial institutions, implementing dynamic provisioning systems, and enhancing monitoring of cross-border capital flows. Through these measures, potential systemic risks can be identified and prevented in advance, ensuring the stable operation of the financial system.

(2) Provide Policy Support

Governments can use fiscal policies and tax incentives to provide necessary support to enterprises to help them cope with the uncertainty of the external environment. For example, providing loan guarantees, tax exemptions, and introducing specific fiscal subsidy policies can reduce the operating costs of enterprises and enhance their competitiveness in the international market. Additionally, governments can establish special funds to support enterprises in technological innovation and market expansion.

(3) Improve Financial Regulatory System

Policy makers should continuously improve the financial regulatory system to ensure transparency and fairness in the financial markets. This includes strengthening supervision of financial market participants, raising standards for information disclosure, and enhancing scrutiny of financial products and services. At the same time, efforts should be made to promote the development of financial technology (Fintech) by leveraging modern technologies such as big data and artificial intelligence to enhance regulatory efficiency and effectiveness.

(4) Promote International Cooperation

Policy makers should actively participate in international financial cooperation and dialogues to promote the establishment of fairer and more transparent international financial rules. By engaging in international financial organizations and mechanisms such as the G20 and the International Monetary Fund (IMF), China can play a greater role in global financial governance, advocating for more interests and influence for Chinese enterprises and investors.

(5) Facilitate Economic Restructuring

Policy makers should guide resources toward industries with high value-added and high technological content through industrial policies and innovation-driven strategies, promoting the optimization and upgrading of economic structure. This not only enhances the resilience of the economy against risks but also drives sustainable economic development. Additionally, governments should encourage

increased investment in research and development (R&D), support the transformation and application of innovative outcomes, and cultivate new drivers of economic growth.

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