

FEYNMAN CAPITAL GROUP

The Chinese Rebalancing

As it makes the jump from a developing nation to a developed one, China finds itself in the same position that various other countries have faced in their development. After two decades of debt fueled growth it has become evident to many that the growth of private debt in the Chinese economy has reached unsustainable levels and furthermore the country is finding fewer sources of productive investment.

While a full blown out debt crisis is unlikely to occur due to the general economic structure of the Chinese markets the country will still face various financial costs due to being in distress. Some likely scenarios are:

- Households cutting back on spending due to worries about future income or tax increases
- Brain drain due to emigration of the best minds in the country
- Workers unionizing and cutting back on spending due to worries about their employment
- Banks cutting back on lending due to worries about collateral
- Less repatriation of earnings
- Wealthy households moving money abroad (already happening among the wealthy Chinese)
- Foreign creditors raising interest rates
- Large companies and corporation divesting their operations
- Stagnation in the growth of small and medium sized businesses

All the above are very likely outcomes in case of China chooses not to rebalancing the right way or quick enough. In order for an orderly rebalancing to occur, the government will have to close the gap between GDP and household income and the best way to meet this aim would be for a transfer of wealth from the state sector to the household sector. This will ensure that growth is buoyed by household demand as opposed to investment led demand.

As with any economic system it's possible for a country to grow by means of capital investments however this type of growth isn't infinite and is especially unsustainable for countries that have been growing at annual rates of more than 7% annually. After a certain period of time, every country runs out of productive sources of investment and it's at this point that speculation in esoteric investment strategies begins which almost always leads to a financial crash.

In order for China to rebalance successfully the growth rate of debt in the economy will have to be slowed down over the next decade, in addition to that the country will have to make due with a more manageable growth rate of around 3% as opposed to the 10% rate that has been the norm over the past ten years.

The Chinese government is going to be forced to make a decision between two keys areas; higher debt or higher wealth transfers to the household sector. The latter is the only which will lead to a successful rebalancing of the economy and the former will be akin to kicking the can down the road of financial distress.