

HOW THE CHINA STIMULUS IMPACTS GLOBAL GROWTH

Overview

The World Bank asserts that China manufactured the fastest sustained expansion by a major economy in history. Over nearly four decades, from 1979 to 2017, China's real gross domestic product (GDP) grew at an average of 9.5 percent a year.

Presently, the Congressional Research Service describes China as:

- The world's largest economy (on a purchasing power parity basis)
- The world's largest manufacturer
- The world's largest merchandise trader
- The world's largest holder of foreign exchange reserves
- The United States' largest merchandise trading partner
- The United States' biggest source of imports
- The third-largest U.S. export market
- The largest foreign holder of U.S. Treasury securities

However, one of the drawbacks of a fast-maturing economy is that kind of growth is unsustainable. It's comparable to how relatively quickly a child grows into a young adult, yet once fully matured, his or her growth is naturally curbed.

Hence, between 2007 and 2017, China's growth rate slowed from 14.2 percent to 6.9 percent. The International Monetary Fund (IMF) projects this pace will fall ever further — to 5.8 percent by 2022.¹

Economic Stimulus

Its large-scale capital investment and rapid productivity growth are two reasons why China fared relatively well during the global recession. Another reason is because the government and banking system elected to use a different approach to drive economic stimulus.

The United States, Europe and other developed nations opted to use quantitative easing (QE) to stimulate their economies. QE is the practice of purchasing government securities and other securities in the market in order to increase the money supply and lower interest rates for banks to make loans and consumers to increase spending.

China, on the other hand, elected to invest nearly \$600 billion in infrastructure projects and loosened monetary policies to increase bank lending. In fact, this strategy not only helped buttress China's growth, but it also helped stabilize the overall global economy. However, while this action kept China's relatively thriving economy afloat, it did not jumpstart a phase of growth as stimulus programs did for other economies.² China's stimulus package created asset bubbles and, over the first three quarters of 2018, the country's deficit grew to \$12.8 billion, down from a surplus of \$102.6 billion during the same period the prior year.³

Relative to the past, China's growth pace is still waning. While other economies have tapered off or terminated their stimulus efforts, China continues to use many of the same strategies to drive growth. In recent months, the government introduced tax cuts and issued new bonds to fund

China, the U.S. and other countries launched stimulus programs starting in 2008 in an effort to mitigate the effects of the global recession. China's strategy was effective at reducing the short-term impact, but it has been problematic in terms of long-term economic growth.



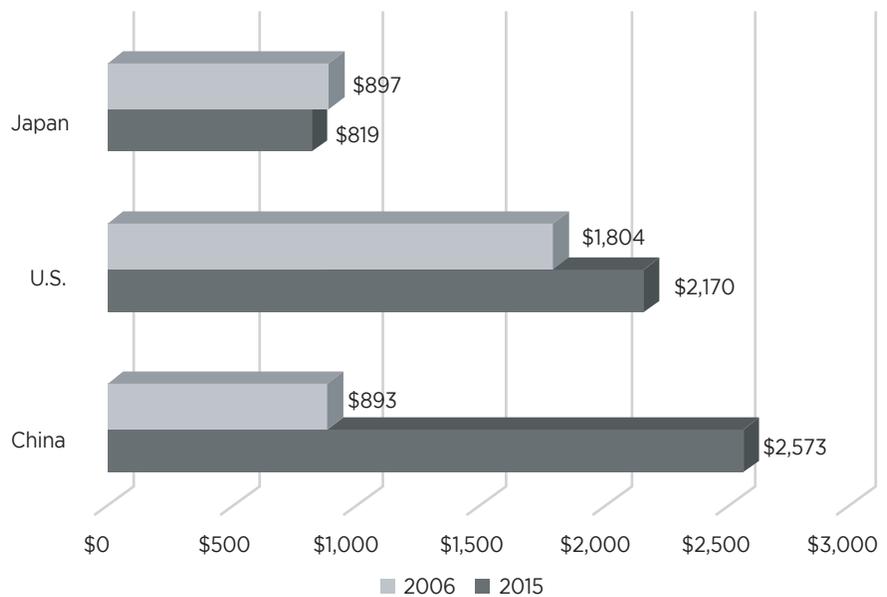
more infrastructure projects. The country's central bank, the People's Bank of China (PBOC), also pumped \$74 billion into the banking system.⁴

The China Effect

China's large population and weak currency trend created a perfect storm for manufacturing. Multinational corporations throughout the world, including those domiciled in the U.S., transferred much of their manufacturing operations to China to take advantage of cheaper raw materials and lower wages.

As a result, China has emerged as the world's largest manufacturer (overtaking Japan) with gross value-added manufacturing equal to 27.7 percent of its GDP. The accompanying chart illustrates its prolific growth in this area since 2006.⁵

Gross Value-Added Manufacturing in China, the U.S. & Japan: 2006 and 2015⁶
(\$ billions)



Trump Trade Deal

A weak currency is one that has decreased in value relative to other currencies. The more in demand it is, the higher the price. In China, the value of the renminbi (RMB), which also is referred to as the yuan (CNY), is assigned a daily exchange rate by China's central bank based on the prices of other currencies. RMB trades against the U.S. dollar in a range that fluctuates by as much as 2 percent above or below that level.

China's currency has been a point of contention with the Trump Administration. Ever since the campaign trail, candidate Donald Trump promised to label China as a currency manipulator, as have other U.S. presidents before him. This move, which could potentially trigger punitive actions, has not occurred since the early 1990s. Even as recently as the U.S. Treasury Department's 2018 October internal report on foreign exchange rate practices, the U.S. has not named China as a currency manipulator — though it remains on the list to be closely monitored.⁷



Presently, the dollar is very strong versus many other global currencies, but the yuan weakness is a particular irritant to the Trump Administration. That's because it makes Chinese exports less expensive, which helps mitigate the impact of U.S. tariffs. The less drag Trump's tariffs have on the Chinese economy, the less power the U.S. has to negotiate a more advantageous trade agreement. In fact, some analysts predict that future trade proceedings may well rest with China's willingness to prop up the value of the RMB.⁸

“With trade issues straining relations, there have been rising concerns that China is intentionally weakening its currency to deflect the impact of tariffs on its goods.”⁹

Final Thoughts

The objective of government stimulus is to increase spending as a means to kickstart economic growth. To date, China has opted to take a different approach than other major economies, but then again, its accelerated path of development, manufacturing, trading and foreign investment is significantly different than other growth markets.

As we move forward, be aware that all countries are expecting the pace of economic growth to slow down relative to the past six or seven years. If you are concerned about your investments and what this might mean for your financial return opportunities, speak with your financial advisor.

¹ Wayne M. Morrison. Congressional Research Service. Feb. 5, 2018. “China’s Economic Rise: History, Trends, Challenges, and Implications for the United States.” <https://fas.org/sgp/crs/row/RL33534.pdf>. Accessed Dec. 12, 2018.

² Ibid.

³ Joe Quinlan. ValueWalk. Dec. 6, 2018. “What China’s Current Account Deficit Means For Investors.” <https://www.valuwalk.com/2018/12/chinas-current-account-deficit/>. Accessed Dec. 21, 2018.

⁴ The Guardian. July 24, 2018. “Chinese shares jump as Beijing announces new stimulus.” <https://www.theguardian.com/business/live/2018/jul/24/markets-cheered-google-alphabet-results-eurozone-pmi-uk-factory-growth-business-live?page=with:block-5b56f654e4b0f7abbc8f1dc6#block-5b56f654e4b0f7abbc8f1dc6>. Accessed Dec. 12, 2018.

⁵ Wayne M. Morrison. Congressional Research Service. Feb. 5, 2018. “China’s Economic Rise: History, Trends, Challenges, and Implications for the United States.” <https://fas.org/sgp/crs/row/RL33534.pdf>. Accessed Dec. 12, 2018.

⁶ Ibid.

⁷ Ismail Shakil. Reuters. Oct. 11, 2018. “China not a currency manipulator according to U.S. Treasury’s internal findings: media reports.”

<https://www.reuters.com/article/us-usa-trump-china-yuan/china-not-a-currency-manipulator-according-to-u-s-treasurys-internal-findings-media-reports-idUSKCN1MM02E>. Accessed Dec. 12, 2018.

⁸ Patti Domm and Hailee Lee. CNBC. Oct. 8, 2018. “US growing concerned about China’s falling currency and ‘turn away from market-oriented policies.’” <https://www.cnbc.com/2018/10/08/us-growing-concerned-about-chinas-falling-currency-and-turn-away-from-market-oriented-policies.html>. Accessed Dec. 12, 2018.

⁹ Ibid.

Investment advisory services offered only by duly registered individuals through AE Wealth Management, LLC. The advisory firm providing you this report is an independent financial services firm and is not an affiliate company of AE Wealth Management, LLC. Investing involves risk, including the potential loss of principal. No investment strategy can guarantee a profit or protect against loss in periods of declining values. The information and opinions contained herein, provided by third parties, have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed by AE Wealth Management. This information is not intended to be used as the sole basis for financial decisions, nor should it be construed as advice designed to meet the particular needs of an individual's situation. None of the information contained herein shall constitute an offer to sell or solicit any offer to buy a security or insurance product.

