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Investor Info
Investment Comment

China’s growth

The current investment comment is discussing China’s role for the world economy and possible consequences of a slowdown in growth.

Our ARVEST Global Stars and ARVEST Eurasia Stars stock funds are both heavily invested in Asian markets (46% and 58% respectively) based on our expectation of continued growth in the region. To the surprise of many, in the worst economic crisis in decades, Asia turned out to be not an accelerant of the problem but rather a stabilizing factor for the world economy. This phenomenon is primarily attributable to China. Skirmishes between the two Koreas will do little to change that.

The World Bank expects China’s economy to grow by 10% during the current year, slowing to 9%, however, as early as next year. In more precise terms, the Chinese government is making a purposeful attempt at curbing growth to reduce the risk of bubble formation (such as in the real estate market). Consequently, actions have been taken to limit the increase in the money supply through loans.

In 2009, banks granted loans totaling 9.6 trillion renminbi. In the current year, the limit was lowered to just 7.5 trillion renminbi. Not included in this figure, however, are an additional 6 trillion renminbi expected to be lent this year by the shadow banking system outside the government’s control.

It also appears that the Chinese government is increasingly seeking to restructure its industry by shutting down antiquated production facilities. This more frugal use of resources offers the benefit of not only lowering emissions but also of once again reducing the growing dependence on foreign energy imports to some extent. The Vice President of the Development Research Center of the State Council, Liu Shijin, expects growth to fall to 7% in the next three to five years as the country’s competitiveness is weakened by increasing input costs. A rise in the value of the renminbi would further increase the impact of this development.

Consequences for the world economy

Some economists are warning of fast and sharp appreciation of the renminbi, as the weakening of the Chinese economy removes some of the drivers of growth that had served as stabilizing factors for the world economy in recent years. These growth drivers impact the world economy at multiple levels.

Grafik: Chinas Wirtschaftswachstum über die letzten 10 Jahre

The more well known of these levels, often mentioned in the media, is that of the raw material markets. The more China grows, the greater its hunger for raw materials, allowing raw material exporters like Australia to prosper. The other level is that of the capital markets. China reinvests a good portion of its income generated via surpluses on current accounts overseas. The supply of Chinese capital leads to lower interest rates worldwide, which under the right conditions can have growth-stimulating effects. Without Chinese investment, US interest rates in particular would likely be quite a bit higher, increasing the costs of investments in the real economy and refinancing of the government.

On the other side of the coin, however, there are those that emphasize that a slowdown in Chinese economic growth does not necessarily signify a decline in the world economy. Michael Pettis, a finance professor at the Guanghua School of Management in Beijing, points to the fact that in the 1980s, Japan, too, played a major role in the growth dynamics of the world economy. After the real estate bubble burst in 1990, however, the world economy continued to grow robustly – to the surprise of many – even without Japan. This is due to the fact that many economists make no distinction between export-driven and domestic-market-driven growth when providing rapid analyses. While export-driven growth in a country tends to slow down growth in other regions, domestic-market-driven growth plays a more important role in the growth of other national economies. This explains why the collapse of export-driven growth in Japan did not have a lasting global impact. This could also be the case for China.

The ARVEST Investment Committee assumes that domestic consumption in China will continue to grow irrespective of its export economy. Based on this assessment, ARVEST has enlarged its investment universe with several favorably valued companies that stand to profit from this trend.

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