

Bill Gary's

PRICE PERCEPTIONS

48 YEARS

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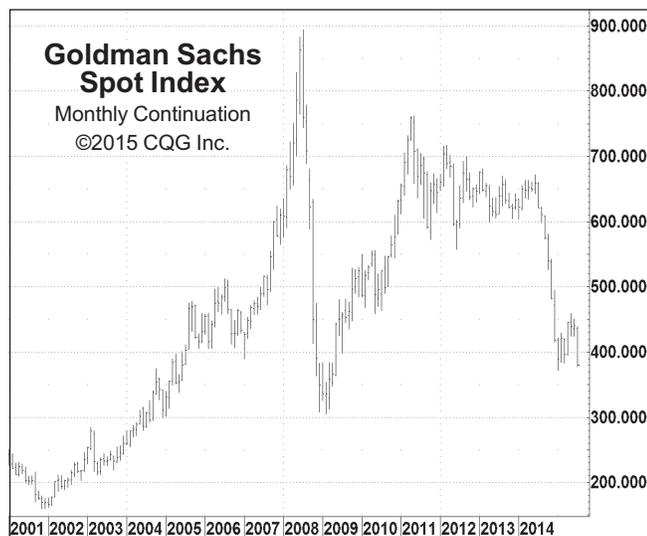


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Can China's Economic Miracle be Revived?

China became a member of the World Trade Organization (WTO) in December 2001, opening the gates of global trade for the most populace nation in the world. Following China's joining the WTO, their economy exploded and became the strongest growing nation in the world. They turned into a global commodity powerhouse, consuming nearly half of global industrial metals and becoming the world's largest importer of crude oil, cement and other commodities. As a result, a "commodity supercycle" unfolded as illustrated by the Goldman Sachs commodity index chart below. Commodity prices advanced a staggering 450% from late 2001 to their peak in 2008.

Following the 2008 financial crisis, commodity prices again exploded into 2011. But, since that time prices have fallen 51% and have nearly lost all gains acquired following the 2008 financial crisis. What is happening? Is the commodity supercycle over?



Private credit in China has grown exponentially since the financial crisis. It is currently estimated at 160% of GDP. It appears government printing of money to expand credit has reached a saturation point. Each new yuan of credit produced .8 yuan in GDP before the financial crisis. Now, it produces only .2. Therefore, to maintain GDP at pre-crisis levels, private credit must grow nearly four times as great. But, if government stimulus were to reach that rate, the yuan would collapse, resulting in much higher inflation. In addition, each yuan would buy fewer dollars and Chinese companies currently hold \$1.2 trillion in dollar denominated debt. It would be virtually impossible to pay back.

It appears China's economy may be caught in no man's land. If they resort to more stimulus, they risk depreciating the yuan and losing exports due to an unfavorable exchange rate. If they do nothing, the overcapacity in their manufacturing sector will reduce profits and force businesses into bankruptcy. However, Chinese producer prices have already declined for 40 consecutive months. Therefore, it appears the world's most important commodity buyer may not return to the dynamism of recent years. Commodity prices can be expected to continue suffering unless China's economic miracle can be revived.