

## Weekly Commentary 36 – September 2023

*Financial media narratives and the true state of the Chinese economy*

If you read the English language financial press assiduously in recent weeks, you will find that the most popular words used to describe the American economy is “soft landing.”

As a matter of fact, when the news broke Friday that US GDP for the second quarter has been downgraded from the earlier reported figure of 2.5% to 2.1%, there was a palpable sense of relief in every commentator who pitched in on this update. It was an obvious slow-down in the economy, but the analysts all looked at the bright side of things – that this “cooling” of the labour markets would temper the wage inflation which may otherwise trigger yet another rate hike by the US Fed. There is a sense that the relentless tightening by the central bank has the effect of pushing the financial system to the point of implosion as high interest rates raise the cost of borrowing for businesses, student loans and mortgages. Not forgetting government debt, which has reached \$32 trillion requiring a trillion dollars, thereabouts, per year to just service that debt. The high interest rate environment would suffocate the economy. And a retreat from overly strong employment is therefore balm.

Therefore, if the economy eases off gently, it will take pressure off the Fed to keep hammering away at the economy with higher rates until it caves. That is supposed to be a good thing. Or least, the financial markets were of this sentiment.

What a perverse sense of well-being...

The strong labour market up to the recent data release is a source of inflation. At the same time, it is Biden’s claim to a job well done in formulating his economic policies for which he thinks he deserves to be conferred a second term by American voters. Now, with this latest US GDP downgrade, we don’t know whether Americans should celebrate or mourn. The poorer performance in GDP is not in itself a good thing, obviously. But the markets, now having the slowdown that they perversely wished for in order that the Fed becomes more gentle, cheered the fact that the great moderator between boom and bust, Jay Powell, will stay his hand. The goldilocks “soft landing” has come to pass.

The western press celebrated. It is quite an odd reaction. The growth of the US economy has slowed and they think this is a good thing. WTF??

That is not the end of it. At 2.1 percent revised GDP growth rate, it is now just 1/3 of China's growth during the same period. And the same newspapers and media sites were criticizing China for not creating enough stimulus measures to bring its growth rate up? The narrative is China has lost its way, no longer the dynamic economy that it once was. Really?

Let's figure out what the western media defines as a good situation. I came across an article in The Wall Street Journal which seems to provide an explanation of why a regression of American GDP growth rates on an absolute basis and relative to China is still described positively like it was designed in heaven:

### **Resilient U.S. Economy Defies Expectations**

*Strong hiring and spending are keeping recession at bay—for now*

By

Nick Timiraos and Chip Cutter

*Sept. 2, 2023 12:01 am ET*

There's a saying that economic expansions don't die of old age: They're murdered by the Federal Reserve. If that's the case, then the U.S. economy is outrunning its would-be assailant this year.

Steady hiring and robust consumer spending offer the latest evidence that the pandemic's effects and the government's unprecedented policy responses made the economy surprisingly resilient to the Fed's most aggressive interest-rate increases in 40 years.

Employers added 3.1 million jobs over the past 12 months, including 187,000 in August, the Labor Department said Friday. The unemployment rate rose to 3.8% from 3.5% in July as more Americans joined the workforce.

Three factors explain why the U.S. economy keeps defying predictions of recession.

First, a growing workforce and slower price increases have boosted Americans' inflation-adjusted or "real" incomes this year, fueling more hiring and spending.

Second, the unusual nature of the Covid-19 pandemic distorted spending patterns, leading to shortages of goods, housing and workers. This created enormous pent-up demand that has been less sensitive, for now, to higher rates.

Third, the government initially showered the economy with cash and held interest rates at rock-bottom levels, allowing businesses and consumers to lock in lower borrowing costs. Subsequent legislation, including the Inflation Reduction Act and the \$53 billion Chips and Science Act, further boosted federal spending and spurred additional private-sector investment in manufacturing.

Given that backdrop, “the real question is why would the economy have capitulated?” said Christopher Thornberg, founding partner at Beacon Economics in Los Angeles.

None of this implies the economy will be resilient forever. The Fed raised its benchmark federal-funds rate to a 22-year high in July, and officials have kept the door open to further hikes if activity accelerates.

Covid-era buffers will eventually erode—for example, as companies that locked in lower borrowing costs have to roll over their debts in coming years at higher rates and as households run down their savings. Banks are already pulling back on lending after two high-profile failures fanned concerns about their profitability. Lenders face potential losses on office buildings whose values will tumble if employers continue to embrace hybrid work.

### *A buoyant labor market*

The economy has benefited this year from an easing of pandemic-driven labor shortages as more immigrants and native-born Americans join the workforce.

Companies are holding tight to workers and bumping up their pay. Real after-tax incomes rose 3.8% in July from a year earlier and have risen year-over-year each month since January.

Those gains help fuel robust consumer spending, which accounts for roughly two-thirds of U.S. economic output. “Real incomes are what is driving the bus here,” said Neil Dutta, an economist at the research firm Renaissance Macro.

### Spending and income, year-over-year change



Source: Commerce Department via St. Louis Fed

The Fed has clearly slowed credit-sensitive activity, including private equity and commercial real estate. “But in terms of the backbone of the U.S. economy, the spine is strong” because of robust income growth, said Dutta.

Today’s tight labor market in part reflects a postpandemic shift in bargaining power. Businesses boosted worker pay as they struggled to staff up following lockdowns. Americans surveyed by the New York Fed in July expected annual salary offers in the subsequent four months of about \$67,000 upon receiving a job offer, well above \$60,000 a year earlier.

At the same time, the share of workers who are quitting their jobs—often a sign of bargaining power as employees leave for higher pay elsewhere—eased in July and is returning to prepandemic levels, suggesting a less tight labor market.

Employers report being reluctant to let workers go, given the time and effort it took over the past two years to hire them. “Even if we’re going to have a mild recession, I think a lot of employers are saying it isn’t worth the effort of laying off people,” said Bernard Baumohl, chief global economist at the Economic Outlook Group. “They don’t want to get caught short.”

Some companies report easier hiring for once-hard-to-fill roles such as truck drivers and warehouse workers. Turnover has stabilized at ArcBest, one of the nation’s largest trucking companies. The company is adding hundreds of drivers and dockworkers from its bankrupt rival Yellow, said Judy McReynolds, ArcBest’s chief executive.

“I wouldn’t say the driver shortage is over, but” for the next year “we’re going to be in a significantly improved place from where we were,” McReynolds said.

McReynolds expects slower hiring as freight demand softens. The company is still looking to bring on sales and technology employees as well as drivers to replace those retiring, but it doesn’t plan to add workers as rapidly as in 2021 and 2022, when it added thousands of new workers. ArcBest had about 15,700 employees as of December 2022.

Other companies still face staffing challenges.

*United Airlines, which expects to hire 15,000 people this year, faced such a dearth of candidates for ramp-worker roles at its Denver hub that it hosted a job fair in Guam and relocated more than 450 new hires from Guam to Colorado, said human resources chief Kate Gebo.*

#### *Catching up with pent-up demand*

The recovery from the pandemic has been uneven, creating staggered mini-recessions in different industries. Some sectors that are normally very interest-rate sensitive haven’t provided the expected drag on growth this year. Auto production couldn’t keep up with demand in 2020 and 2021 but now is catching up, so it has been less sensitive to higher rates.

Rising mortgage rates delivered a huge blow to housing affordability, which has kept many homeowners frozen in place. That has benefited home builders, who face less competition from resales and who have used stronger balance sheets to offer discounted prices in the form of mortgage-rate “buy-downs.”

“There are still buyers out there. They have very few options. They therefore find their way to us,” said Douglas Yearley, chief executive of luxury-home builder Toll Brothers in an earnings call last month.

### *Bigger buffers*

In 2020 and 2021, the U.S. and other governments provided trillions of dollars in financial assistance to households, which were also saving money as the pandemic interrupted normal spending patterns. Meanwhile, central banks cut interest rates, enabling Americans to lower their borrowing costs.

Normally, Fed rate increases force heavily indebted consumers and businesses to rein in spending because they have to pay more to service their loans. But consumers haven’t overextended themselves with debt; household debt-service payments accounted for 9.6% of disposable personal income during the first quarter, below the lowest levels recorded between 1980 and the onset of the pandemic in March 2020.

#### **Household debt-service payments as a share of disposable personal income**



Note: Seasonally adjusted

Source: Federal Reserve via St. Louis Fed

Federal funding continues to flow from President Biden’s roughly \$1 trillion infrastructure package approved in 2021 and two pieces of legislation signed last year that provide hundreds of billions of dollars to boost renewable-energy production and semiconductor manufacturing.

Construction companies are encountering the triple threat of an aging workforce, unpredictable immigration policies and overheated demand driven by federal spending and housing shortages, said John Fish, chairman and CEO of Suffolk, a \$5.5 billion construction contractor based in Boston.

Stocks have rallied this year, buoyed by the prospect that cooling inflation allows growth to slow without requiring a recession—a so-called soft landing. The S&P 500 declined 27% in

the first nine months of 2022 but has since recovered. It is up more than 17% this year and closed Friday nearly 6% below its all-time high recorded at the start of 2022.

“We’re going to come out with a soft landing,” Fish said. Bolt onto that a global economic recovery, additional federal spending and an eventual decline in interest rates, and “those ingredients will create tremendous demand in the service parts of our economy.”

### *Sidestepping the “parade of horrors”*

Other executives see storm clouds as lower-income consumers exhaust savings and face higher borrowing costs. Credit-card delinquencies at Macy’s were higher than anticipated during the second quarter. “We just believe that the customer is coming under pressure” due to higher interest rates and an end to student-debt relief, said Macy’s Chief Financial Officer Adrian Mitchell.

Economists are divided over the outlook. Some think inflation is now mostly under control as pandemic idiosyncrasies resolve themselves, helped by Fed interest-rate increases. They expect the Fed will cut rates next year, enabling a soft landing.

Others worry that the Fed has either raised rates too much or will have to lift them higher to crush demand and reduce inflation. Restrictive monetary policy could trigger a recession by leading to a sharp pullback in lending and declines in asset values.

Bank of America economists recently scrapped their forecast of a U.S. recession within the next year, while forecasters at Barclays and Citi postponed the anticipated start of a mild downturn into next spring.

Recent data have been “very, very positive” for the soft-landing view, said Jan Hatzius, chief economist at Goldman Sachs. In July, he lowered to 20% the probability of a U.S. recession over the next 12 months, down from 35% in March after the collapse of Silicon Valley Bank fanned fears of a broader banking crisis.

Strength in the U.S. raises questions over how long it can diverge from the rest of the world.

**China’s leaders are struggling to spur growth in an economy beset by weak consumer confidence, a drawn-out housing slump and sinking exports.**

Germany’s trade-dependent economy is expected to shrink this year, according to the International Monetary Fund, reflecting weakness in manufacturing and the disruptions from Russia’s invasion of Ukraine.

Some economists highlight the role of the U.S.’s good luck. “Apart from the cluster of regional-bank failures, we’ve had few” financial-market disruptions, noted Daleep Singh, chief global economist at PGIM Fixed Income. And since Russia’s 2022 invasion of Ukraine, no new geopolitical crises have erupted to disrupt supply chains or oil markets.

“We sidestepped the parade of horrors,” he said.

Basically, to put it simply, the story about the western media's favourable description of the US economy is actually based on the performance of the stock market. US equities has held up very well, and it seems like the financial writers are simply tying performance of the economy with that of the stock market. As stock prices rise, owners of corporate America do not feel that they are taking a hit from the high interest rates and hence the thought of suffering the effects of a recession are simply not there. This probably explains why the mood is still very buoyant in the US in spite of data showing that it is not doing as well as the Chinese economy. (See that sentence I marked in red in the above article, a common commentary on China by American journalists).

But is that true?

Let's just consider four simple statistics, GDP growth, inflation rate, unemployment and savings rate.

The numbers below are what I gathered from Google :

	GDP Growth Rate	Inflation	Unemployment	Savings Rate
US	2.1% Q2 2.4% 2023	3.2%	3.8%	4.3%
China	6.3% Q2 5% 2023	-0.3%	4.1%	45%

Except for the unemployment rates, which are not so different, all the most prominent economic statistics of China beat the US' numbers handily. In particular, the savings rate. This indicates the amount of resources in the economy that can be deployed to drive stimulus programs and other economic solutions – in short, China has a lot of dry powder to handle its problems. On the other hand, America only has “borrowing” left in its arsenal.

Besides, the above numbers are just a statistical snap shot. We are all aware of other qualitative descriptions of the state of the union in the US, including the homelessness problem, the drug addiction problem and the gun violence problem, just to name a few. In California, there are now “Doom Loop” tours where guides will take you around the various sites in San Francisco and LA to show you the desperate, miserable and forlorn lives the homeless, the drugged-infested and the defecate-in-public people are reduced to. That's what life for some American citizens has become, depressed to a level which is a spectacle for thrill seekers.

You ain't gonna find that shit in China...

This leads us to think that western journalists are either negligent or callous. Negligent because they did not do their homework, checking on relative economic performance statistics before they write, and possibly callous because if they did check, they were happy to just believe blindly in American superiority, sometimes called “exceptionalism”. Frankly, I think they are just malicious.

We can examine this hypothesis of malicious intent a bit further. One of our shareholders sent me the article below, written by a professional financial analyst, who did a good job of answering the question, is China losing its way? I take pleasure in incorporating this in this week’s commentary:

### **Making Sense of the China Meltdown Story**

By [LOUIS-VINCENT GAVE](#)  
[GAVEKAL RESEARCH](#) / 23 AUG 2023

*“Mon centre cède, ma droite recule, situation excellente, j’attaque.”*

(“My center is giving way, my right is retreating, situation excellent, I am attacking.” Ferdinand Foch, French general defending Paris at the September 1914 Battle of the Marne)

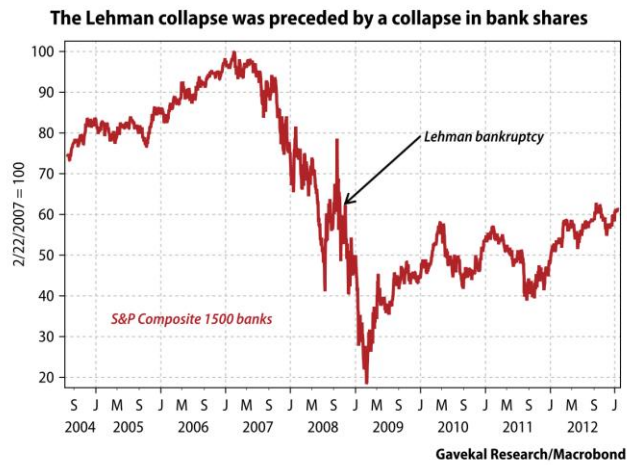
It is impossible to turn to a newspaper, financial television station or podcast today without getting told all about the unfolding implosion of the Chinese economy. Years of over-building, white elephants and unproductive infrastructure spending are finally coming home to roost. Large property conglomerates like Evergrande and Country Garden are going bust. And with them, so are hopes for any Chinese economic rebound. Meanwhile, the Chinese government is either too incompetent, too ideologically blinkered, or simply too communist to do anything about this developing disaster.

Interestingly, however, financial markets are not confirming the doom and gloom running rampant across the financial media. Consider the following points.

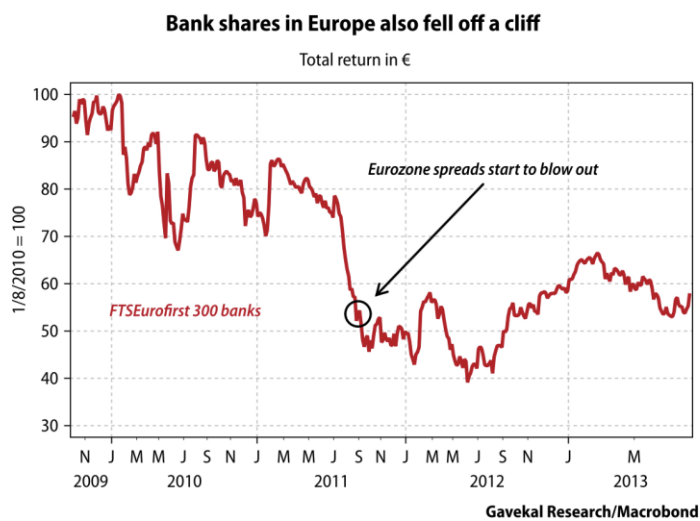
### **Bank shares**

At Gavekal, we look at bank shares as leading indicators of financial trouble. When we see bank shares break out to new lows, it is usually a signal that investors should head for the exit as quickly as possible. This was certainly the case in 2007-08 in the US. Between February 2007 and July 2008 (six weeks before the collapse of Lehman Brothers), banks shares lost -60% of their value.



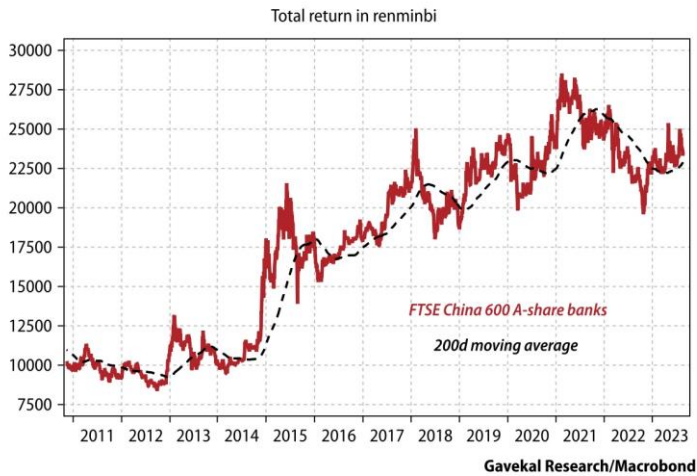


The same pattern unfolded in Europe. Between January 2010 and August 2011, eurozone bank shares fell -45%, collapsing to new lows even before Club Med spreads started to blow out.



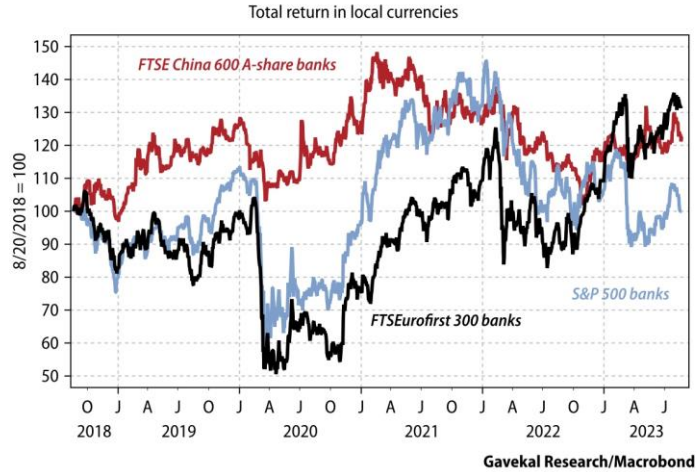
Now undeniably, Chinese bank shares have not been the place to be over the past few years. Nonetheless, Chinese bank shares are still up a significant amount over the last decade. And this year, they have not even taken out the low of 2022 made on October 31<sup>st</sup> following the Chinese Communist Party congress. To be sure, the chart below is hardly enticing, even if the slope of the 200-day moving average is positive. Still, Chinese bank shares do not seem to be heralding a near-term financial sector Armageddon.

### Chinese bank shares are not exactly heralding a meltdown



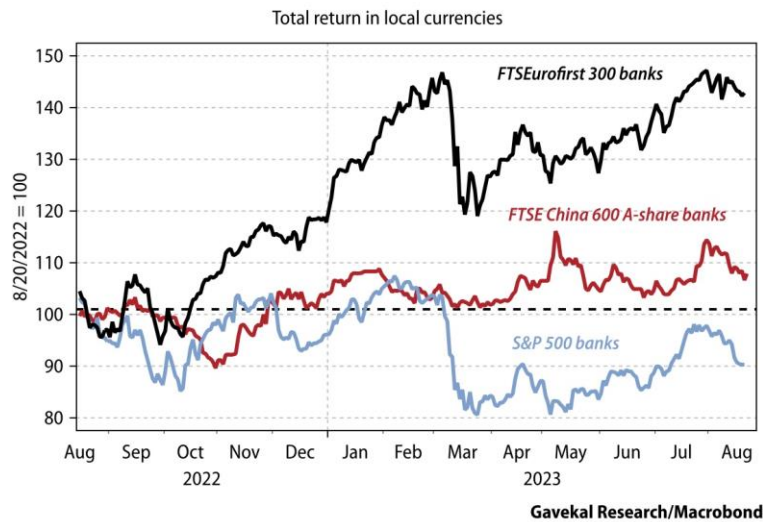
Digging further, if we look at the performance of Chinese bank shares relative to US and EU bank shares over the past five years, the banks of the world's three major economic zones have delivered roughly similar share price performance.

### Over five years, the performance of the main bank indexes is similar



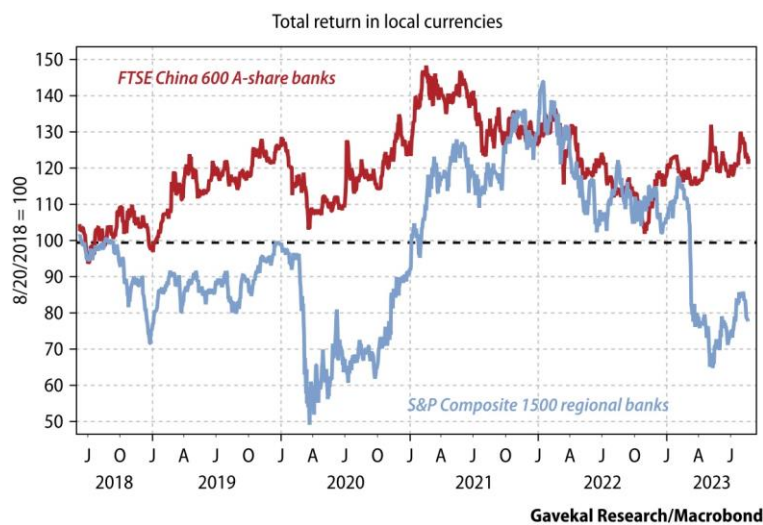
Zooming in on performance over the past year seems to indicate that if there is a problem with banks, it lies more in the US than in China, where bank shares are flat year-to-date. So, if you were to look only at the charts, you would conclude that the weak link in the system is not Chinese banks but US regional banks. In the past five years, US regional banks have registered two massive sell-offs—the kind of sell-offs that make shareholders uneasy.

### Over the last year, US bank performance has lagged China and Europe



[Interactive chart](#)

### Where are the sick banks today?



## Chinese equity markets

Given the relentless media negativity, you might expect Chinese equity markets to be making new lows. For sure, Chinese equity markets have delivered disappointing returns. Nonetheless, every major Chinese index —the Shanghai composite, the Hang Seng, H-shares—remains above its October 31<sup>st</sup> CCP Congress low, typically by between 10% and 20%. No one at Gavekal claims to be a technical analyst; and we are also well aware that all the captains lying with their ships at the bottom of the ocean relied on charts. Nevertheless, while the chart below is unenticing, it does not scream that an economic cataclysm is imminent.

### Not an enticing chart, but not a disaster either



## Commodity markets

China is the number one or two importer of almost every major commodity you can think of. So, if the Chinese economy were experiencing a meltdown, you would expect commodity prices to be soft. Today, we are seeing the opposite. The CRB index has had a strong year so far in 2023, and is trading above its 200-day moving average. Moreover, the 200-day moving average now has a positive slope. Together, all this would seem to point towards an unfolding commodity bull market more than a Chinese meltdown.

### If China is imploding, why isn't this reflected in commodity prices?



## Exchange rates

Jacques Rueff used to say that exchange rates are the “sewers in which unearned rights accumulate.” This is a fancy way of saying that exchange rates tend to be the first variable of adjustment for any economy that has accumulated imbalances. On this front, the renminbi has been weak in recent months, although, like Chinese equities, it has yet to take out October’s lows.

**The renminbi has been weak, but has not broken lower against the US\$**



That is against the US dollar. Against the yen, the currency of China's more direct competitor, Japan, the renminbi continues to grind higher and is not far off making new all-time highs. And interestingly, in recent weeks, the renminbi has been rebounding against the South Korean won.

This is somewhat counterintuitive. In recent weeks, oceans of ink have been spilled about how China is the center of a developing financial maelstrom. Typically, countries spiraling down the financial plughole do not see their currencies rise against those of their immediate neighbors and competitors.

**The renminbi has been strong against the yen**



Gavekal Research/Macrobond

[Interactive chart](#)

**The renminbi has been rebounding against the Korean Won**

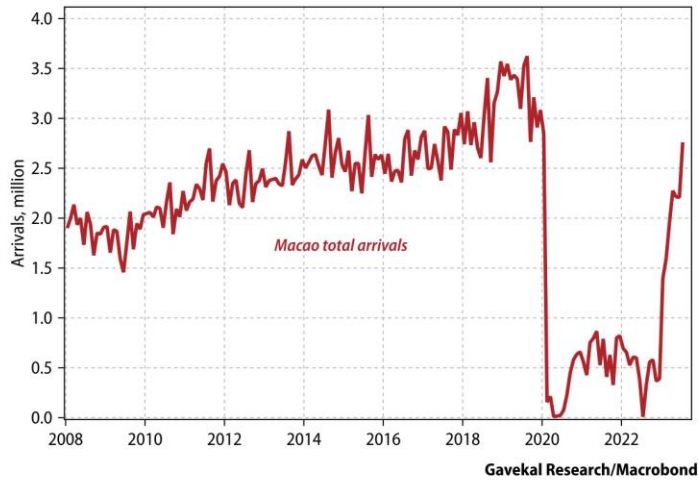


Gavekal Research/Macrobond

## Chinese consumers

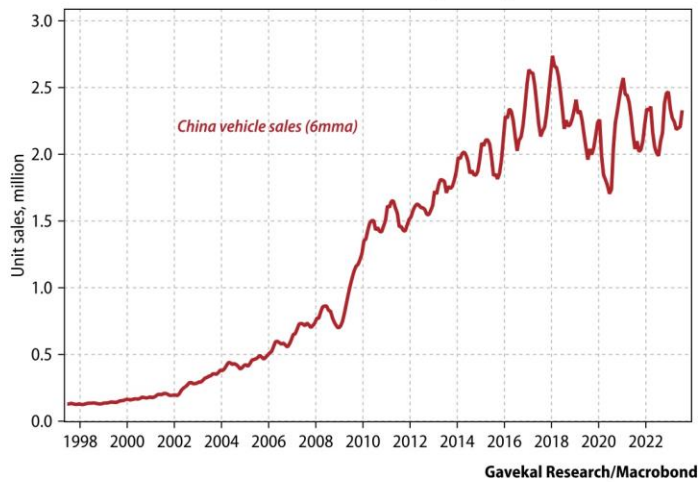
While headlines in the West are all about China's unfolding economic meltdown, recent headlines in China have been all about how tourist arrivals in Macau are returning to where they were in 2018, before Covid, before China's tech crackdown and before the real estate derisking crackdown. Either that, or the headlines are about how strong car sales continue to be.

**Macao's tourism arrivals are returning to 2018 pre-Covid levels**

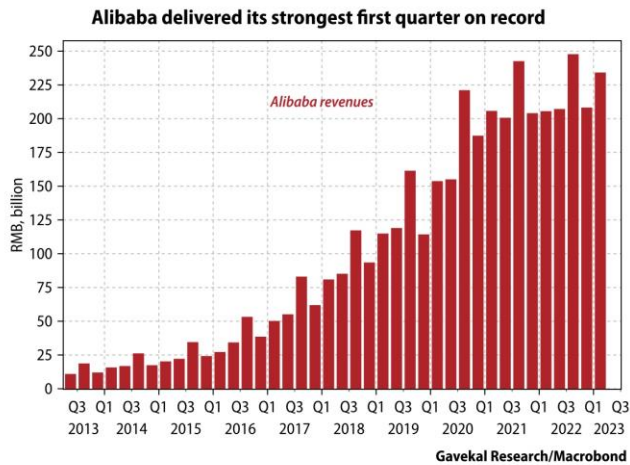


[Interactive chart](#)

**Car sales remain relatively strong**



Meanwhile, China's consumer-facing e-commerce sales continue to chug along nicely. This year, Alibaba delivered its strongest first quarter in history, with revenues 10 times what they were seven years ago.



In other words, a range of data points seems to indicate that Chinese consumption is holding up well. This might help to explain why the share prices of LVMH, Hermès, Ferrari and most other producers of luxury goods are up on the year. If China really was facing an economic crash, wouldn't you expect the share prices of luxury good manufacturers to at least reflect some degree of concern?

**Chinese consumption helps to explain the performance of luxury goods**



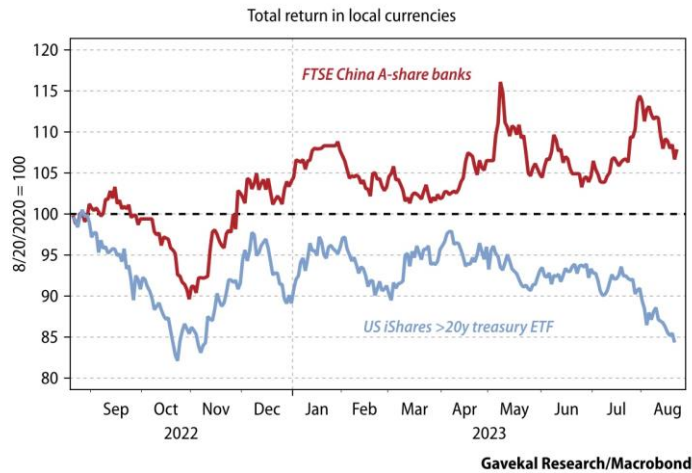
## Government debt markets

Aside from China's approaching economic meltdown, the other major story of the past few weeks has been the very real meltdown at the long end of the US treasury market—a meltdown which has captured a lot fewer headlines than the much-heralded Chinese financial implosion. Over the last 12 months long-dated US treasuries have delivered a negative total return of -



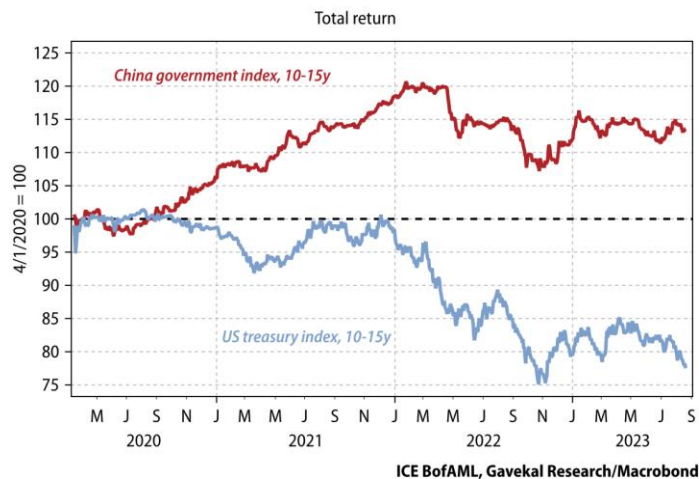
17.05%. Over the same period, Chinese bank shares have delivered positive total returns in renminbi terms of 6.7%.

### Over 12 months, long-dated US treasuries have made negative returns



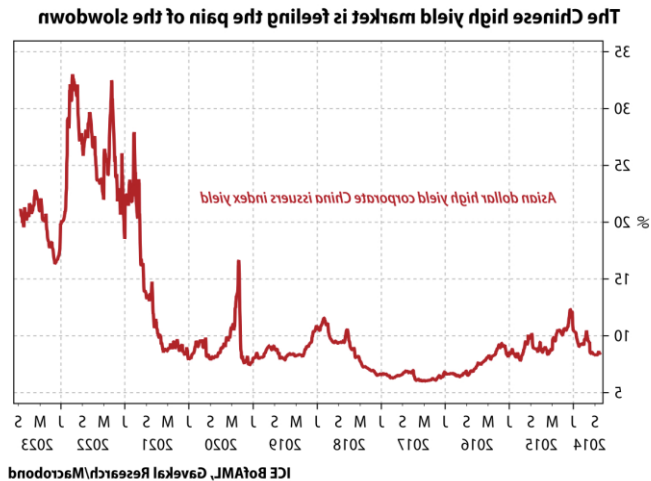
What kind of financial crisis sees the banks of the country in crisis outperform US treasuries by over 20%? It would be wholly unprecedented.

### Chinese government bonds are outperforming US treasuries



Staying on the US treasury market, it is also odd how Chinese government bonds have outperformed US treasuries so massively over the past few years. Having gone through a fair number of emerging market crises, I can say with my hand on my heart that I have never before seen the government bonds of an emerging market in crisis outperform US treasuries. Yet since the start of Covid, long-dated Chinese government bonds have outperformed long-dated US treasuries by 35.3%.

In fact, Chinese bonds have been a beacon of stability, with the five-year yield on Chinese government bonds spending most of the period since the 2008 global crisis hovering between 2.3% and 3.8%. Today, the five-year yield sits at the low end of this trading band. But for all the negativity out there, yields have yet to break out on the downside.



### High yield markets

While the Chinese government debt market has been stable, the pain has certainly been dished out in the Chinese high yield market. Yields have shot up and liquidity in the Chinese corporate bond market has all but evaporated. Perhaps this is because historically many of the end buyers have been foreign hedge funds, and the Chinese government feels no obligation to make foreign hedge funds whole. Or perhaps it is because most of the issuers were property developers, a category of economic actor that the CCP profoundly dislikes.

Whatever the reasons, the Chinese high yield debt market is where most of the pain of today's slowdown has been—and continues to be—felt. Interestingly, however, it seems that the pain in the market was worse last year than this year. Even though yields are still punishingly high, they do seem to be down from where they were a year ago.

### The Chinese high yield market is feeling the pain of the slowdown



### Where does this leave us?

Putting it all together, it seems fair to say that as things stand:

- *There is a sizable problem in the Chinese real estate sector, and companies are going bust.*
- *Amazingly, however, Chinese banks seem to be weathering the storm, at least for now.*
- *The Chinese consumer continues to consume, even if not with the same gusto as in the years before Covid.*
- *Chinese equities have been disappointing, but Chinese equity markets are not in the kind of full-blown meltdown one might expect given the apocalyptic tone of reporting in the financial media.*
- *Commodity markets do not seem all that bothered by the implosion in Chinese real estate.*
- *Government bond yields in China remain stable, and have not broken down to new lows.*
- *US treasuries continue to melt down, even as returns on Chinese government bonds remain steady.*
- *The Chinese high yield corporate debt market remains completely dislocated.*

So given the apparent lack of contagion from China's troubled real estate sector to the banking system and broader financial markets, what accounts for the sudden surge in negativity across the world's financial media towards all things related to China?

Several possible answers spring to mind:

- 1. For once, the press is running ahead of the markets.** *The first axiom everyone learns when starting off in finance is that “if it’s in the press, it’s in the price.” Most of the time, this is true, especially in today’s world of high frequency algo trading.*

*However, every now and then markets are hit by “game-changing” events—such as the Lehman and AIG bankruptcies, the Enron accounting scandal, or the Madoff fraud—which can trigger a whole new wave of forced selling by leveraged investors, or simply of panic selling.*

*This brings us to the true catalyst for most massive bear markets—what Charles likes to call the Ursus magnus of bear markets. An Ursus magnus is caused not by changes in productivity, or a slowdown in the growth of the economy, which are part and parcel of the normal economic cycle. Instead, an Ursus magnus is caused by a sudden gap between the volatility of asset values and the risk tolerance of savers. When such a gap occurs, either the government or the central bank must step in to bridge the gap when it threatens to become too wide, or risk a financial system collapse.*

*Today, the obvious fear among many in the financial media is that such a gap is developing—or about to develop—in China, and that the Chinese government is doing nothing to plug it.*

*So, the first possible explanation is that the financial journalists have correctly foreseen the crisis that is about to engulf China, even as Chinese policymakers and participants in China’s financial markets, commodity markets and OECD government bond markets remain inexplicably complacent about the financial tsunami that is about to swamp the global economy.*
- 2. The press needs a new scare story.** *Pandemic horror stories no longer sell. Neither do stories of harrowing human suffering in Ukraine or headlines about an impending world war. It’s not that the suffering has ended, or the risk has disappeared. It’s just that people have moved on. Similarly, people are tired of reading about climate change, and even more bored of gender-related culture-war posturing. What’s left? Perhaps impending economic doom might sell newspapers?*
- 3. People have the China-US treasury meltdown relationship all wrong.** *The Iraqi weapons of mass destruction, the Covid hysteria, the push for vaccination, the “Hunter Biden laptop is a Russian plant” story have all shown that critical thinking within the Western media is in short supply these days, and that most journalists would now rather be wrong with the consensus than be right alone. As a result, when a narrative starts to develop, Western media latch on to it, and lay it on thick.*

This brings me to what should be the big story of the summer: the meltdown in US treasuries. **Here is the biggest market in the world, the bedrock of the global financial system, falling by close to double digits in a month.** And perhaps most amazing, this meltdown is occurring on limited news. There have been no Federal Reserve policy changes, no hawkish speeches from Jerome Powell. Basically, long-dated US treasuries just fell -9% on no news.

This should be the news. Instead, the news is all about China’s financial meltdown.

My initial reaction to this odd combination of terrible Chinese news with rising US treasury yields was to think: “This is odd. Why are US treasury yields rising when the Chinese news is so bad?”

Then it struck me that perhaps I had things the wrong way round and that I ought to be asking: “Is the Chinese news so bad precisely because US treasuries are melting down?”

### **Why am I hearing this now?**

I grew up in a country—France—where about 70% of media advertisements were bought either by the government or by giant state-owned enterprises such as Air France, SNCF, and EdF. Moreover, this was a country where much of the media was owned either by weapons manufacturers such as Lagardère or Dassault, or by public works companies like Bouygues—groups that depended directly on the government’s franc for most of their revenues.

Then, having grown up—physically, if not mentally—in France, I moved to the fringes of a country that makes no bones about the importance of the Chinese Communist Party Central Committee Propaganda Department—a department important enough to occupy one of the most central locations imaginable in Beijing, right next to Tiananmen Square and the Forbidden City. As a result, whenever I read a piece of news, my first inclination is always to wonder: “Why am I reading this now?”

Why the sudden drumbeat about collapsing Chinese real estate and impending financial crisis when the Chinese real estate problem has been a slow-moving car crash over the past five years, and when, as the charts above show, markets don’t seem to indicate a crisis point?

At least, markets outside the US treasury market don’t seem to indicate a crisis point. So could the developing meltdown in US treasuries help to explain the urgency of the “China in crisis” narrative?

As the first chart below makes clear, an important divergence is now growing between the Chinese and US government debt markets.

### The Chinese and US government debt markets are diverging...

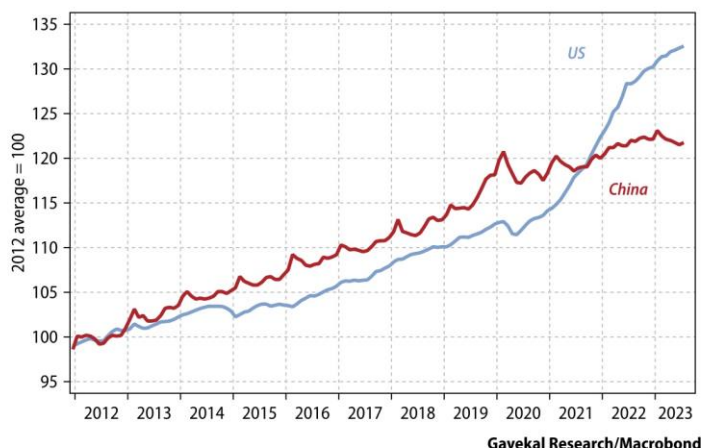
Government bonds, 10-15y indexes, total returns in US dollars



[Interactive chart](#)

### ...reflecting the divergence between Chinese and US inflation

Consumer price indexes



Basically, US treasuries have delivered no positive absolute returns to any investor who bought bonds after 2015. Meanwhile, investors who bought Chinese government bonds in recent years are in the money, unless they bought at the height of the Covid panic in late 2021 and early 2022. This probably makes sense given the extraordinary divergence between US inflation and Chinese inflation.

None of this would matter if China was not in the process of trying to dedollarize the global trade in commodities and was not playing its diplomatic cards, for example at this week's BRICS summit, in an attempt to undercut the US dollar (see [Clash Of Empires](#)). But with China actively trying to build a bigger role for the renminbi in global payments, is it really surprising to see the Western media, which long ago gave up any semblance of independence, highlighting China's warts? Probably not. But the fact that the US treasury market now seems to be entering a full-on meltdown adds even more urgency to the need to highlight China's weaknesses.

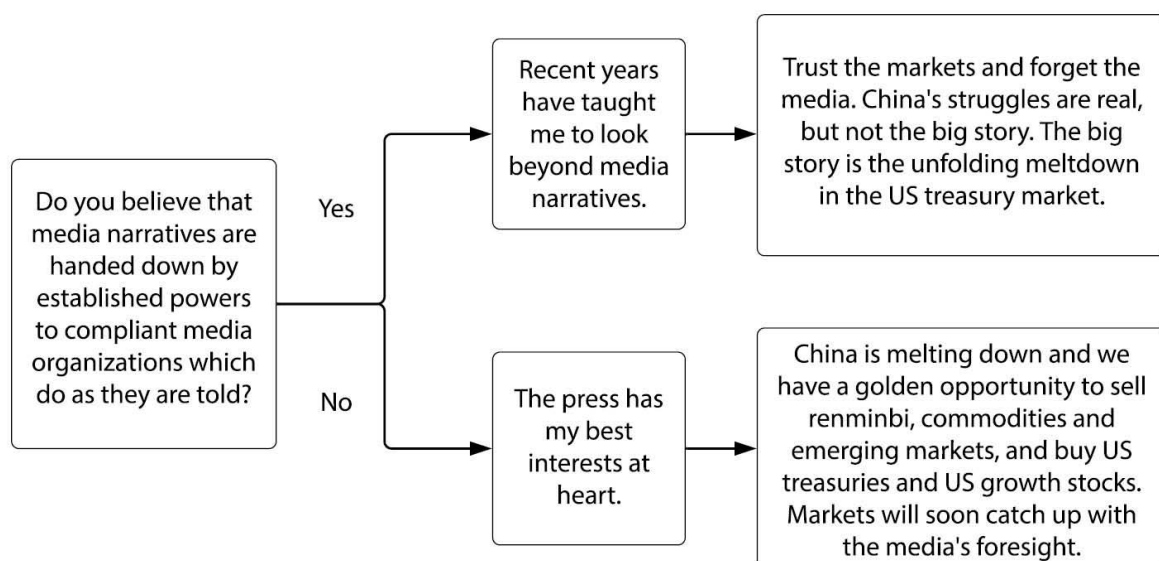
A Chinese meltdown, reminiscent of the 1997 Asian crisis, would be just what the doctor ordered for an ailing US treasury market: a global deflationary shock that would unleash a new surge of demand and a “safety bid” for US treasuries. For now, this is not materializing, hence the continued sell-off in US treasuries. But then, the Chinese meltdown isn’t materializing either.

### Investment conclusions

All this leaves investors at an important crossroads. On one hand, you can look at China’s recent travails and conclude—along with most Western financial journalists—that the world’s second largest economy is about to implode. From there, the investment conclusions follow pretty swiftly: sell all things related to China, sell commodities, other emerging markets, global financials and global value stocks. In a world in which China implodes, salvation will likely only be found in long-dated US treasuries and US growth stocks—which by sheer coincidence happen to be the very assets that the US and most global investors need to do well.

On the other hand, you can look at recent market behavior and conclude that as Chinese banks have spent the last year outperforming US treasuries, the immediate problem is not in the Chinese financial system, but in the US treasury market itself. If so, we are entering a new world in which US treasuries can no longer be thought of as the bedrock on which to build portfolios.

This was the thesis that underpinned my 2021 book [Avoiding The Punch](#). So it is small surprise that I favor the second explanation. Investors should make up their own minds. In an attempt to help, I have summarized the arguments presented in this paper in the following decision tree. Its title should probably be: “Who are you going to trust? The financial media or your lying eyes?”



Well, Mr Gave has given a more extensive analysis of the diatribe stoked up by western journalists about the economy of China than I did earlier in this commentary. I think he did a very comprehensive job giving us credible conclusions. I would also say that the earlier article in the WSJ which I cited, where the conclusion seems to be that the US is doing better than China because its stock market is recovering faster, lacks intellectual rigour. The fundamentals provided by Mr Gave shows that the WSJ article is rather superficial, much like what the American policy makers do, which is to “watch the short term data” and respond by giving the economy the next steroid injection. Long term deterioration in the American economy is hardly addressed.

As such, in addition to Mr Gave’s conclusions, I would further suggest that :

- 1) Western journalists are not trained to work with numbers and their conclusions about China are just childishly superficial at elementary school level;
- 2) They don’t heed the superior analyses of financial analysts like Mr Gave, who tend to be more objective and infinitely more numerate, a basic requirement for economic science;
- 3) They have an axe to grind, and this may be rooted in their belief that if the collective west loses the economic competition to China, then their future will be circumscribed within a second-tier existence in the world. And since these journalists can’t read Chinese, they will become less relevant. Hence, their attitude is to pretend that the rise of China is not a sure thing...and their reaction is rather insecure or reduced to envy. I am not surprised by their behaviour, which is to engage in platitudinous comment, rather than do the deep dives which Mr Gave, a Frenchman, could have done;
- 4) They are white supremacists who believe that the world should be as it was for the last 150 years with the west on top, while the Chinese economic phenomenon is fleeting and must revert to a level that is subsidiary to the supremacy of the collective west;
- 5) They are influenced by the writings of Gordon Chang, a self-proclaimed China critic, who has written about “The Coming Collapse of China” since 2000 and have repeated that erroneous contention every year since then in the face of overwhelmingly simple evidence to the contrary. For a man who continually proves how ill-informed he is, he obviously does it to retain a role as a China critic to gain influence (and hence money) with those people in the west who belong to category 4 above; and finally,
- 6) They are paid propagandists, rather than independent purveyors of wordcraft acting on the behest of the Biden government which actually has a budget (in the billions, as I remember it) aimed at countering China through negative publicity. And given the weakness of the media industry, hurt by the loss of revenue due to the rise in non-traditional media, it seems like western media is grabbing at straws to survive, by falling in line with Biden propaganda to badmouth China, and are in fact leading the charge in bullshit dissemination.



So no, there is no coming collapse of China and the current Chinese economy is doing much better than anything you would read about in western media. The relative performance of the two stock markets do not reflect simple economic fundamentals, largely because the American stock market is driven by large pools of institutional money which is organized to divert to stocks, during an era when they are avoiding bonds. If this institutional money is not investing in bonds (which is the only sensible thing to do for the foreseeable future), the stock market has to take up the slack.

In short, when the normal asset allocation between stocks and bonds is 40-60 and in current market circumstances that 60 percent is no longer in bonds, there is arithmetically a greater proportion going into equities. Equities therefore invariably go up, not because the US economy is going great guns but more because the US economy is like shit, killing the bond market which institutional investors have to avoid.

In other words, the transient good performance of American equities is NOT that the US economy is doing better than China, but because US bonds are crashing, with indebtedness, the disruption of the credit creation process and the mortgaging of the country's financial future are in full swing, which is not yet fully recognized by the politicians or the press. And certainly, there is no recognition of this misallocation of assets in the WSJ article above, leading to an erroneous reading of how the US economy is behaving, on absolute terms and relative to China.

And as I said in my choice of the four basic statistics to best describe the two economies, one has a 45% saving rate compared to 4.3% in the other. The one with the higher savings rate will have the fuel, the ammunition and the reserves of financial power to move ahead far more strongly than the other one running on fumes. There is therefore more to it than the simplistic story related by the WSJ article above in which American companies are resilient, resulting in stock prices booming, because the economy is robust. Sorry, that is hardly the case...

On the other hand, the western media is bleating about the failure of the Chinese government not to pursue decisive stimulus measures. That is a pursuit up the wrong alley...

If a government is confident of its own economy, there is no need to do things too differently from what is already in place. Why react to the vagaries of short-term data which is the mistake that American policy makers have made. Why do the stupid things that the Biden White House has been responsible for, that will leave the American economy with fewer options for its people to better their lives? When Americans prefer the option of a steroid powered economy and reward those who can deliver it, both economic resources as well as political power are inappropriately misallocated to the people who essentially dispense drugs.

Whether you accept my big picture approach to analysing the comparative performance of the US economy vs the Chinese economy, or you prefer Mr Gave's more detailed analysis using specific indicators, the conclusion is the same. The bigger problems are with the US, not with China. And the gap between them is opening up, as my numbers above summararily show.

The western media, when it says things about China, is parroting nothing more than pure Biden propaganda designed for the idiotic.

Be careful what you read.

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