Economic Problems in China and Your Investments

By: www.ProfitableInvestingTips.com

Ever since the then-leader of China, Deng Xiaoping introduced economic reforms in the late 1970s China has been an economic miracle. It is a middle income economy today but because it has a population of over 1.4 billion it is a superpower in the economic realm. And, it aspires to be the dominant superpower in military power and global dominance. However, the Chinese Communist Party which runs everything in China needs to keep people in China satisfied with how they are doing things and that may be more and more of an issue in China. Our concerns are about economic problems in China and your investments.

Why Has the Chinese Economic Boom Lasted So Long?

When China opened up to the world and started to reward people for their work and initiative in a quasi-capitalistic manner it opened the door to the country's economic success. The country had a virtually untapped pool of cheap labor and a huge market that other nations wanted to get into. Foreign investment poured into the country as Western nations set up shop to produce products cheaply in China and import across the globe for less than they could do from their home nations. Favorable trade status achieved in the 1990s gave China full access to nations across the globe. Along the way China got into the habit of borrowing in anticipation of greater growth which worked for years. However, China has saturated global markets and no longer has its unlimited pool of cheap labor as the one couple one child policy has left a demographic hole in their workforce and people in China today expect to make more than pennies a day.

Experts have been saying for years that China needs to develop its domestic markets more, reduce its debt, and open up its markets to foreign companies. They have kept going despite not doing these things and the answer to why their boom has lasted seems to be the grandfather of all housing bubbles.

Why Does China Have a Housing Bubble?

China does not have Social Security or a similar social safety net. Traditionally, families had lots of children so that the kids could support their parents in old age. That went out the window when China mandated that couples could only have one child. Recently the law changed to allow two kids and now three but it will take years for those children to reach working age much less the age where they can support their parents. Thus, Chinese save and save and save. One of the preferred ways to save in a society that did not allow property ownership within living memory is to buy real estate. People buy apartments in vacant cities as a way to hedge against the future. They pay property developers like Evergrande money in full up front before the first brick has been laid. We wrote about this in our article about Chinese real estate and the next financial crisis. The problem with the Evergrande situation is that they have billions of dollars of debt that they cannot pay and lots of apartment buildings for which they were paid and have never started on!

What Will the Communist Party Do to Stay in Charge?

The folks who are in charge in China are the Chinese Communist Party and today that means Xi Jinping. The Party stays in power not because they were ever elected but, currently, because they have delivered economic success to the people. However, that success is waning as we noted in our articles about the political dangers of investing in China and Chairman Mao and investing in China. The recurring way that dictators like Xi stay in power is to shift blame to "foreign enemies" when the problem is that they mismanage the government. It is a real worry that China keeps ramping up pressure on Taiwan and threatening its neighbors in the South China Sea as any of this posturing could get out of hand and lead to a war with the potential for global consequences including your investments.

In regard to Evergrande, the collapse of this company may have significant effects on China's economy and may hurt those who supply them with raw materials but will likely not have the same effects globally as the collapse of Lehman Brothers at the start of the Financial Crisis. Thus the way that a housing market collapse in China would affect your investments would be via a global slowdown and not a financial collapse. To the degree that you are invested directly in China, your investments could suffer substantially more. The more China threatens Taiwan in order to distract its unhappy population the more you may wish to consider US defense stocks as part of your portfolio.

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