

# The global consequences of China's higher than expected debt



China has recorded 250% debt according to Standard Chartered estimates. This figure, which essentially means that debt is 2.5 times greater than the size of its economy, suggests that China has also found it difficult to reconcile growth with 'bubbles'. The 250% debt figure is not distressing in itself; what has raised economists' concerns is the speed with which China's debt level

has risen: the ratio of debt to GDP in the second largest economy in the world was 251% in June 2014, while it stood at 147% at the end of 2008. Such an increase in the ratio between debt and growth in such a short period is worrisome because in other countries, increases of this magnitude in a short period of time have typically been followed by financial turmoil. China's debt is not good for the world economy, and it is especially troubling for Europe's economic recovery.

Europe's recovery, according to recent statistics and to EU officials, is struggling to emerge. Even in Germany the IFO index, which reflects the level of business confidence, at the end of June fell to its lowest level since last fall. This summer, Germany's recovery has been weaker than expected, despite the fact that it is the strongest economy in Europe. In fact, Germany's first quarter of solid growth was driven more by domestic demand than exports; now it is starting to suffer from the slowdown of international markets. In particular, China is one of the main culprits accounting for

the difficulties now faced by German exporters. The leadership of the People's Republic seems to have chosen not to artificially inflate the rate of growth – at least not at the extreme levels of the past. In the second quarter, China grew at a respectable 7.5% (annualized), which was better than expected, but there was a reduction in purchases of capital goods – often made in Germany – that will likely not resume in the short term.

Germany now faces weaker import markets in both the emerging markets and the Eurozone, which will no doubt lead to a contraction of the German economy, and with it, demand for goods made in other industrial powers such as Italy, France or the UK. Oh, and as for the United States, it is experiencing a weak economic cycle and the International Monetary Fund has reduced the United States' growth estimate to less than 2%. The IMF blames the increasing economic polarization whereby only to the richest 1% have seen their income increase, translating to a modest or insignificant increase in consumption. A collapse of the economy such as that seen since 2008 should have, in theory, produced an equally strong rebound, which has been slow in coming.

The tensions of war in Ukraine and in the Middle East may become more severe and further reduce chances for growth. The strong dollar does not help the European recovery and the stabilization of the spread between the weaker EU economies with Germany does not guarantee the low cost of debt. In 2015, the Fed may begin to raise interest rates even Europe and Italy will have to deal with a more expensive Dollar. Of course, in this scenario, commodities such as oil, gold and silver will experience higher valuations. Meanwhile, the recent BRICS (Brazil, Russia, India, China, and South Africa) countries summit in Fortaleza, Brazil, marked a further step towards the construction of a new international monetary architecture intended to break the unipolar dominance of the US Dollar and the old and the Bretton Woods system.

It is not all bad news. Resources and commodities should benefit from the new BRICS initiative designed to promote growth in regions that need it most. The heads of state of Brazil, China, India, Russia and South Africa have officially announced the creation of the new development bank and the Contingent Reserve Arrangement (CRA), namely the creation of a specific money supply fund. This allows the BRICS "to be less dependent on the dollar and more equipped to fend off any turbulence in the currency markets." The new development bank has an initial capital of \$ 100 billion. Its mission is to finance investment not only in the BRICS countries, but above all promote projects and infrastructure in developing countries, particularly in Africa. The BRICS have taken an important political step in the ever more multi-polar global chessboard. However, in this scheme the BRICS intend to become the leading supplier of machinery and other goods, thus giving a boost to their industrial and technological sectors.

In this sense, BRICS countries will try to develop more self sufficient resource bases and some, like China, may become more reluctant to export key raw materials that will be needed for internal use. Of course, these would include rare earths. In this sector, China will continue its policy of getting more foreign companies investing in downstream rare earth activity in China. And it goes without saying that the BRICS are self sufficient in energy resources, also having strong alliances with oil producers beyond the BRICS circle (Iran for instance). In Fortaleza, the BRICS accused the IMF of intervening in the richer industrialized countries (OECD), particularly those in the euro because of their persistent sovereign debt crisis. Thus the BRICS have launched alternative institutions.