Is George Soros Right About China?

Description

The rapid deceleration of China's economy is playing havoc with global financial markets, creating considerable concern among investors that the next major global economic crisis may be unfolding.

One investment heavyweight who has joined the fray is controversial billionaire investor George Soros. The man who once famously broke the Bank of England claims that an economic hard landing in China is inevitable, and when it occurs it will add to global deflationary pressures, deepen the commodity rout, and drag down global stock markets.

There are those who doubt if Soros is right and believe that while China's economic growth is slowing, its economy will remain robust and the global impact will be minimal.

So the question is, Will Soros be right yet again?

Now what?

The former hedge fund manager has built an impressive US$24 billion fortune by making a number of savvy bets on markets over the decades.

Recent data out of China certainly supports his theory.

You see, the country's construction industry is caught in a protracted slump, while manufacturing activity has contracted for six months in a row.

Meanwhile, revenue and profit growth in China's industrial sector continues to decline, and this is acting as a disincentive for further investment in the country's manufacturing sector.

It is also part of the reason for the slowing rate of rural-to-urban migration with declining opportunities and stagnant wage growth acting as a strong disincentive. This, along with excessive housing, doesn't bode well for any recovery in China's construction industry as it is causing demand growth for residential properties to decline.

For 2015, China's GDP growth slowed to 6.9%, its lowest level in two and a half decades. Of greater concern is that GDP growth is expected to fall even further, dropping to 6.5% in 2016 and even lower again in 2017.

This doesn't bode well for commodities.

It will place considerable pressure on heavily levered miners such as **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) and **First Quantum Minerals Limited** (TSX:FM) because weak commodity prices are causing their cash flows to diminish.

There are concerns that this is only the tip of the iceberg as China's rapid growth over the last decade fueled a massive credit bubble that is valued at US$28 trillion or even more.

If it were to implode, it would have a cataclysmic impact not only on China but the global economy. The recent market turbulence is linked to worries about China's rating being a mere blip in comparison to the turmoil this would trigger. The likelihood of this occurring is high thanks to China's trillion dollar–and largely unregulated–shadow banking system and the rapidly cooling property market in a country where real estate investment is one of the single largest investment markets.

This means that any sharp collapse in housing prices due to a continued property slump will have a considerable impact on personal wealth and the overall economy. Such a slump would certainly spread to the banking system and possibly bring those institutions that are outside of the formal regulatory framework and have lent heavily to real estate investors to the point of collapse.

Let's not forget that the stimulus measures implemented by Beijing, including devaluating the yuan twice in the last seven months, have largely failed.

So what?

Whether Soros is right in predicting a hard landing is difficult to tell, but there are signs that China is facing considerable headwinds as the majority of measures taken by Beijing to stimulate growth have failed to work.

Even a modest slowdown in China represents a fundamental shift that will have a sharp impact on financial markets and cause the commodities rout to deepen. It would not only impact miners but also Canada's banks. **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) is the most vulnerable because it has the greatest direct exposure of any major bank to the patch and to business levels in China.

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