# Will China Trigger the Next Economic Crisis?

## Description

China’s economic deceleration is already playing out across the world, causing many commodities to weaken to levels not witnessed since the global financial crisis and the economies of major trading partners to deteriorate. This has created uncertainty in a global economy replete with economic and political cleavages.



All of this is occurring while China’s economy has been growing at close to 7% annually; if growth were to slow further, the impact would be tremendous.

You see, China’s rapid economic expansion over the past three decades has caused it to be responsible for 15% of global GDP, a 10th of world trade, and it’s become the world’s single largest consumer of commodities. For these reasons, it’s now rated among the most systemically important economies globally. When you have famed billionaire investor George Soros claiming that China is headed for an economic hard landing, it is time to pay attention.

**Now what?**

Through a series of strategic moves at the start of its economic accession, China was able to shift the global manufacturing base to its shores. This not only saw it become the world’s manufacturing hub, but made it highly dependent on manufacturing to drive growth, employment, foreign investment, and desperately needed technology transfers.

Now this economic sector is in decline.

The Caixin Purchasing Managers Index–a gauge of manufacturing activity–for August 2016 it fell to 50%, which is 0.6% lower than July, indicating that activity is stagnating. While some analysts believe this has been caused by a tightening of fiscal policy, it hints at deeper problems.

Key among them is a sharp deterioration in demand from traditionally important export markets, such as the European Union, which is battling its own economic problems.

Weak demand isn't the only problem. China's massive overcapacity is a ticking time bomb for industry.

Excess production is forcing margins ever lower, impacting the profitability of many firms, especially ineptly managed state enterprises. It's another reason for manufacturing's growing demise; many firms are simply unable to remain competitive in environment where excess supply is causing prices to fall. This is forcing Beijing to prop up ailing enterprises with credit as it fights to stimulate industrial activity.

The reasoning behind this is easy to understand.

According to the World Bank, manufacturing's added value to the economy is equal to about a third of China's GDP, and it is also responsible for employing a fifth of its urban workforce.

This pattern is being repeated across the construction sector, which–after being caught in a protracted slump–is having life breathed into it by Beijing's credit-reliant stimulus.

The reliance on credit is causing China's trillion-dollar debt bubble to snowball. Analysts are claiming that unproductive or speculative debt is now at levels far in excess of what was witnessed during the U.S. subprime bubble.

Instead of resolving the underlying issues, Beijing's preference is to keep "kicking the can down the road" for as long as possible. It does this by propping up the stock market and devaluing the yuan as required as well as facilitating regular debt-for-equity swaps for companies that are incapable of meeting their financial obligations**.**



**So what?**

For these reasons, Soros could very well be right. If a hard landing occurs, the spillover into the global economy would be huge, potentially sparking the next financial crisis. This would trigger a flight to safe-haven assets–gold being among the best recognized.

Soros has done just this, investing US$29 million in the **SPDR Gold Trust ETF** (NYSE:GLD) during the second quarter 2016. A better bet would be a low-cost miner such as **Barrick Gold Corp.** ( TSX:ABX)(NYSE:ABX). It provides leveraged exposure to gold, is one of the lowest-cost producers among the mining majors, has restored its balance sheet, and, along with growing production, holds a portfolio of high-quality, long-life assets.

**CATEGORY**

1. Investing
2. Metals and Mining Stocks

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1. NYSE:B (Barrick Mining)
2. NYSEMKT:GLD (SPDR Gold Trust)
3. TSX:ABX (Barrick Mining)

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