



## China Cuts its Growth Target: Is This a Dark Omen for Commodities?

### Description

When it comes to commodities it all boils down to one thing: China. Over the last three decades, its economy has expanded at a rapid rate, and it has become the world's single largest consumer of just about every commodity except crude. This means that the outlook for commodities and miners is tied to the economic fortunes of what is now the second-largest economy globally.

Despite the solid rally in coal and metals that commenced halfway through last year, latest news out of Beijing certainly doesn't bode well for these rallies to continue.

### Now what?

Beijing just recently announced that it had cut its annual GDP growth target to around 6.5%, or 20 basis points lower than the 6.7% reported for 2016, which was the lowest level of growth in almost three decades. While 6.5% may appear to be a tremendous rate of growth, especially when compared to a host of developed nations that are struggling to get the needle to stay above 2%, it is a dark portent of things to come for commodities.

This because the last time there was a massive sustainable rally in commodities such as coal, copper, zinc, iron ore and nickel, China's economy was expanding at close to a double-digit clip.

More worrying is the allegations that official data has been manipulated and actual growth has been far weaker than the official data suggests. If this is the case, then demand for coal and metals, including copper as well as zinc, may weaken far faster than predicted.

It is important to note that it was a combination of constrained supplies primarily triggered by China's decision to close mines and Beijing's credit-fueled stimulus that was responsible for the surge in commodities over the last six months. Much of this credit-led stimulus is unsustainable according to several economists.

The capital being injected into the economy is being used to prop up ailing state-owned enterprises and to complete unnecessary infrastructure build-outs rather than being invested in productive growth. While this is certainly providing a short-term boost for the economy, in the long term, it will destroy

more capital and lead to even further bad debts in a country already saddled with up to US\$2 trillion in bad debt according to some estimates.

It has been estimated by some economists that it would cost the government the equivalent of 35% of GDP to bail out the banks should the debt bubble burst. While this is manageable given the size of China's economy, the removal of 35% of China's GDP from the global economy would be a disaster, not only because China is the world's largest consumer of commodities, but because it is also the second-largest importer of goods and services globally.

This means the knock-on effects would be profound, sparking economic crises in those countries dependent on exports, especially commodities to sustain economic growth.

### So what?

China would also have a sharp impact on coal and metals miners such as **Teck Resources Ltd.** ([TSX:TECK.B](#))([NYSE:TECK](#)) and **First Quantum Minerals Ltd.** ([TSX:FM](#)). Both have enjoyed substantial rallies since mid-2016 that were triggered by the recovery in steel-making coal and copper prices. Trump's planned trillion-dollar infrastructure spend has also helped to support their stock prices, but any significant decline in coal, copper, and zinc prices because of diminishing demand from China will sharply impact earnings and spark a marked decline in their stock prices.

These reasons, along with the growing uncertainty surrounding Trump's planned fiscal stimulus, make now the time for investors to exercise caution regarding miners such as Teck and First Quantum. It might be the time to consider taking profits.

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### Date

2025/09/26

### Date Created

2017/03/07

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