



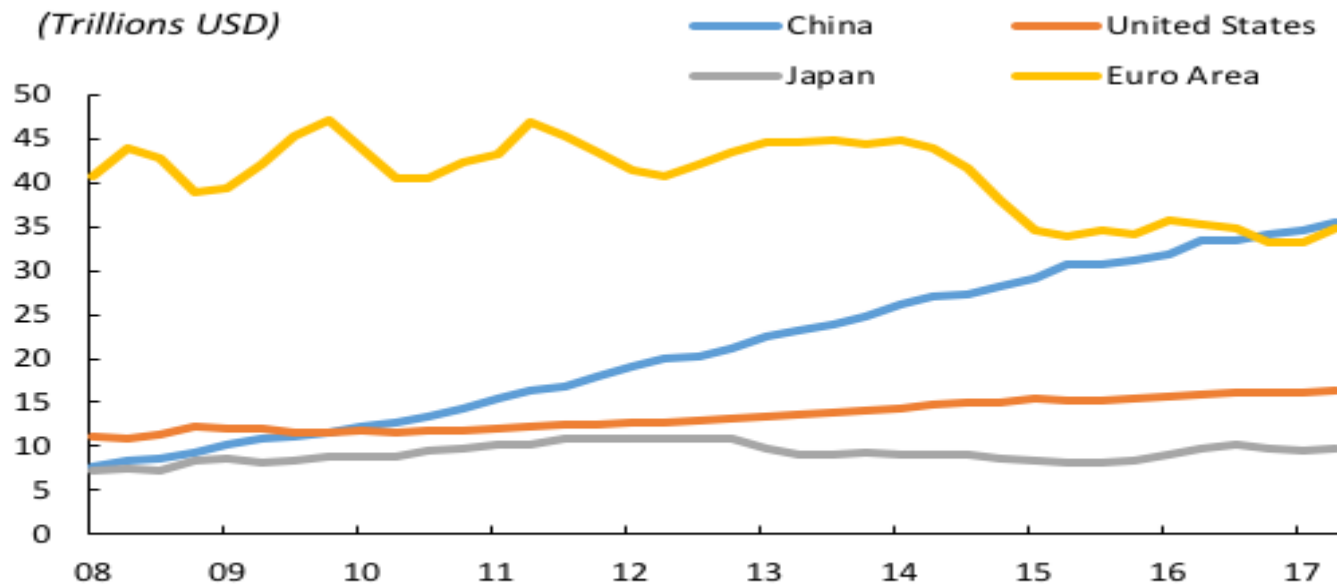
Boom to Bust in China

January 2019

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Is China's Economy Imploding?

- China's economy is 10 times larger than in the year 2000 (Source: World Bank)
- Banking system assets have grown to \$38 trillion (end 2018) from \$8 trillion in 2008
- Half of global GDP and 3 times the size of the economy
- 'Shadow Banking' Assets estimated at \$12 trillion at their peak
- Booms like this tend not to end quietly. Are we looking at boom turning to bust?



Source: Bank of Japan, CEIC, European Central Bank, FRED.

China's economy is 10 times larger than in 2000

Year	China GDP (Constant USD, billions)	US GDP (Constant USD, billions)	Eurozone GDP (Constant USD, billions)
2017	12,238	19,391	12,589
2016	11,191	18,624	11,935
2015	11,065	18,121	11,667
2014	10,482	17,428	13,478
2013	9,607	16,692	13,193
2012	8,561	16,155	12,641
2011	7,573	15,518	13,622
2010	6,100	14,964	12,641
2009	5,110	14,418	12,904
2008	4,598	14,719	14,113
2007	3,552	14,478	12,873
2006	2,752	13,856	11,179
2005	2,286	13,094	10,529
2004	1,955	12,275	10,144
2003	1,660	11,511	8,844
2002	1,470	10,978	7,168
2001	1,339	10,622	6,588
2000	1,211	10,285	6,481

Alternative investments such as managed futures investments involve substantial risk of loss, and are not suitable for all investors. Past Performance is not necessarily indicative of future results.

China Banking System

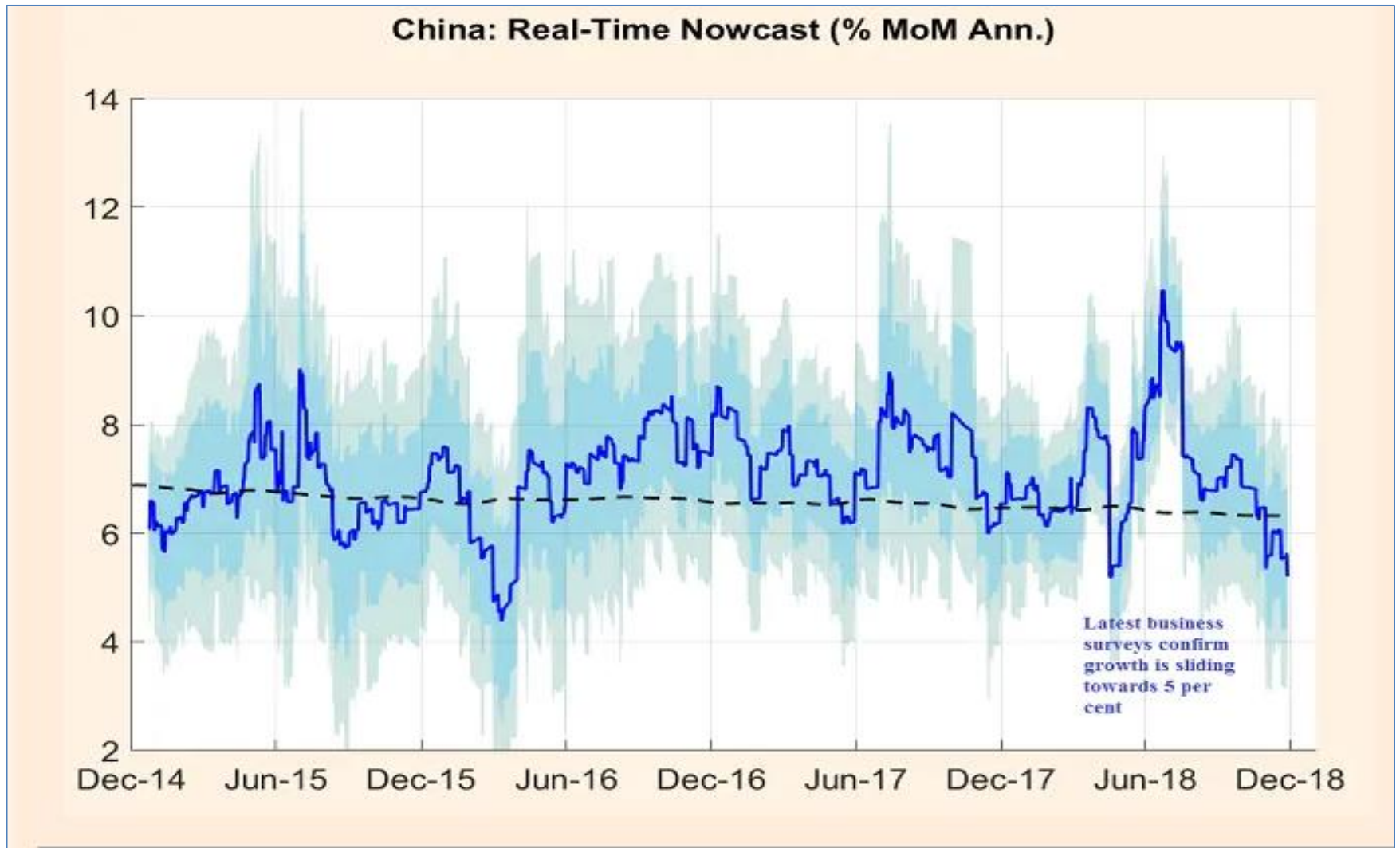
“The Chinese banking system has grown at an unprecedented 25 to 30 per cent annually over the past decade to approximate US\$35 trillion, over three times the country’s GDP. (When the GFC began, the US banking system approximated one times the country’s GDP).

Chinese Banks are only allowed to lend out 75 per cent of their deposits to maintain healthy balance sheets. However, to circumnavigate the rules, WMPs were devised to pay higher yields than traditional deposits due to the increased risks associated with their investments. While the WMPs generate both fee and spread income, they are not consolidated on the Chinese banks’ balance sheets, and now have an estimated value of US\$4 trillion, or 12 per cent of the banking system.

As the WMPs begin to fail – the underlying assets no longer cover the guaranteed interest and principal payments – many issuing Chinese banks have chosen to make up any shortfall. As those banks accept the position of implicit credit guarantor, the WMPs are brought back on to their balance sheets and China’s shadow banking system is slowly recognised as a ticking time bomb.”

Source: David Montgomery – Montgomery Investment Management (May 2017)

China GDP Nowcast (Nov 30th)



If Boom Was Turning to Bust What Might One Expect to Observe?

- Weakness in domestic Chinese markets
- Weakness in the markets and economies closely tied to China
- Weakness in commodity markets
- Spillovers into developed markets

Shanghai Stock Exchange Composite Index



SHCOMP Index (Shanghai Stock Exchange Composite Index) Crude Oil. Daily 20DEC201

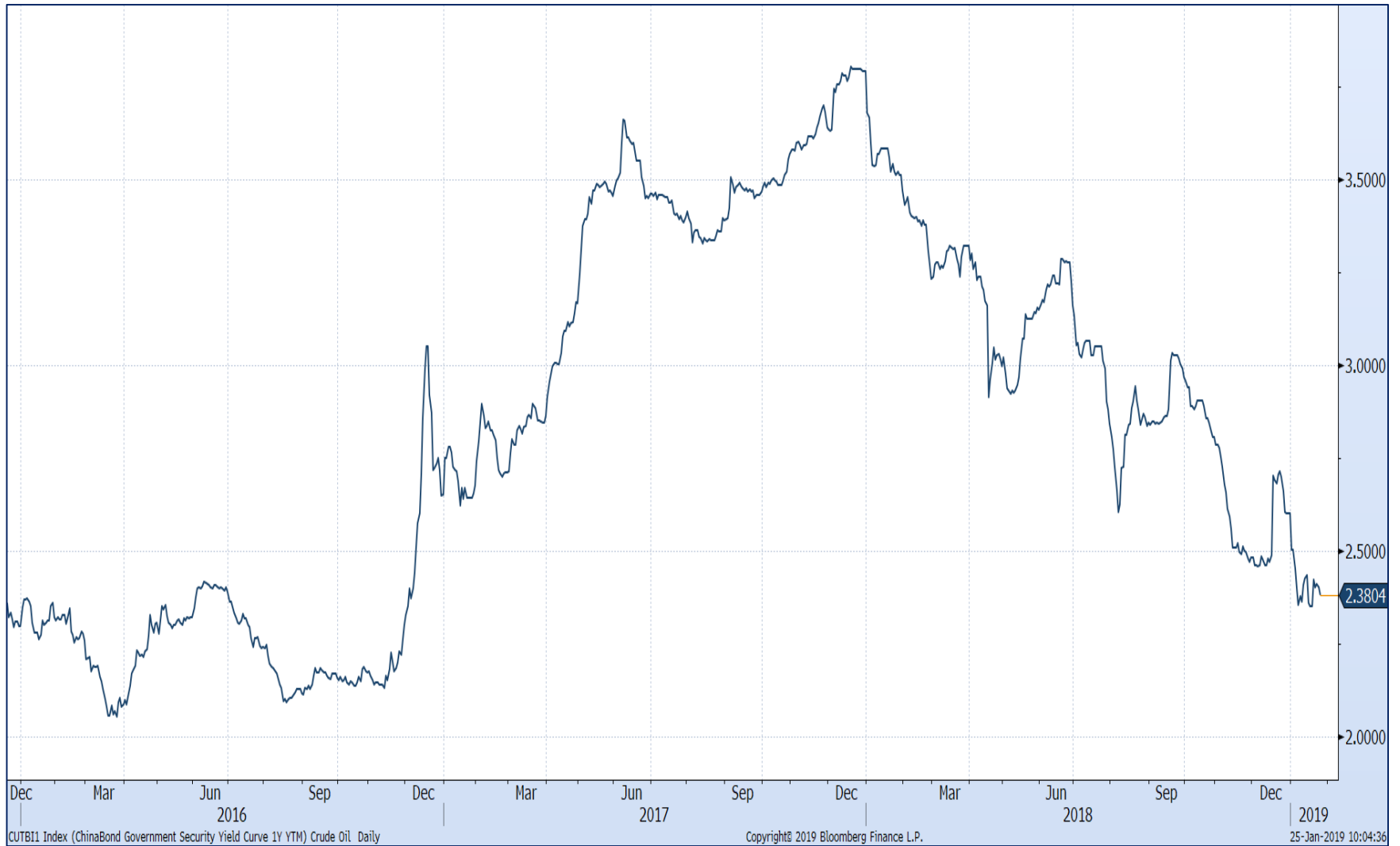
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Renminbi v USD



China 1Yr Treasury Bill

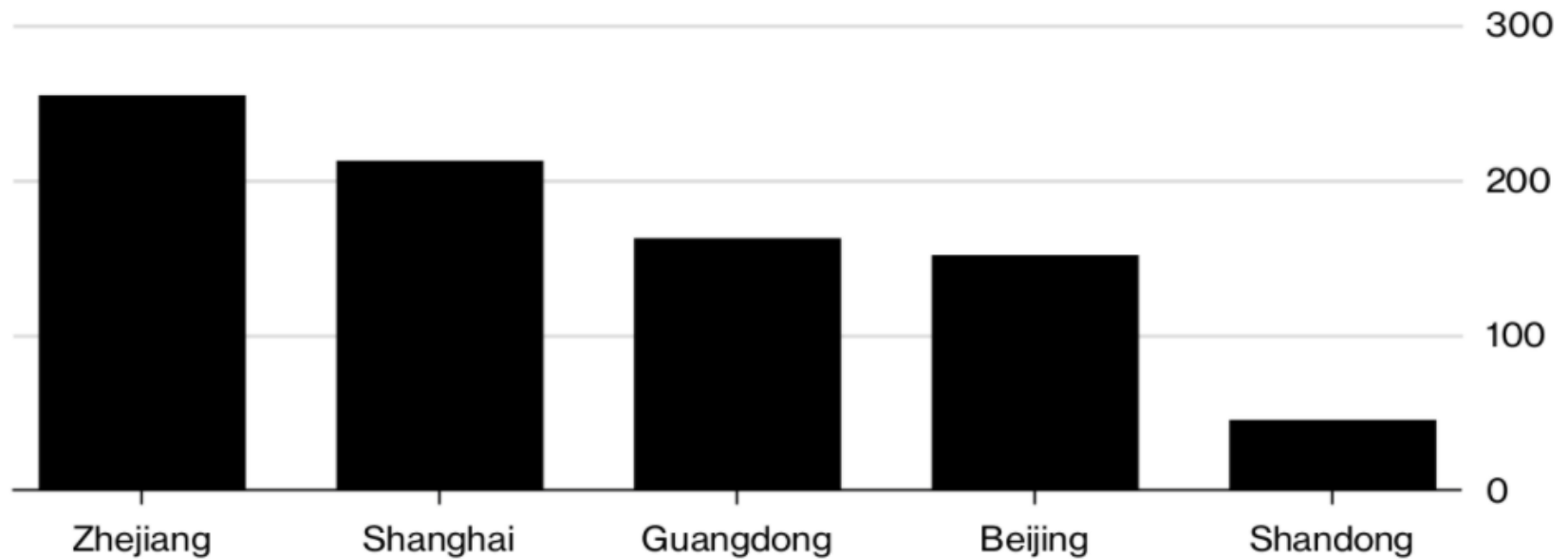


Bad Debts

Nationwide Problem

China wants to keep shrinking the P2P industry after hundreds of platforms failed

■ Number of failed platforms in 2018



Note: Failed platforms include those that have either closed or encountered serious difficulties

Source: Yingcan Group

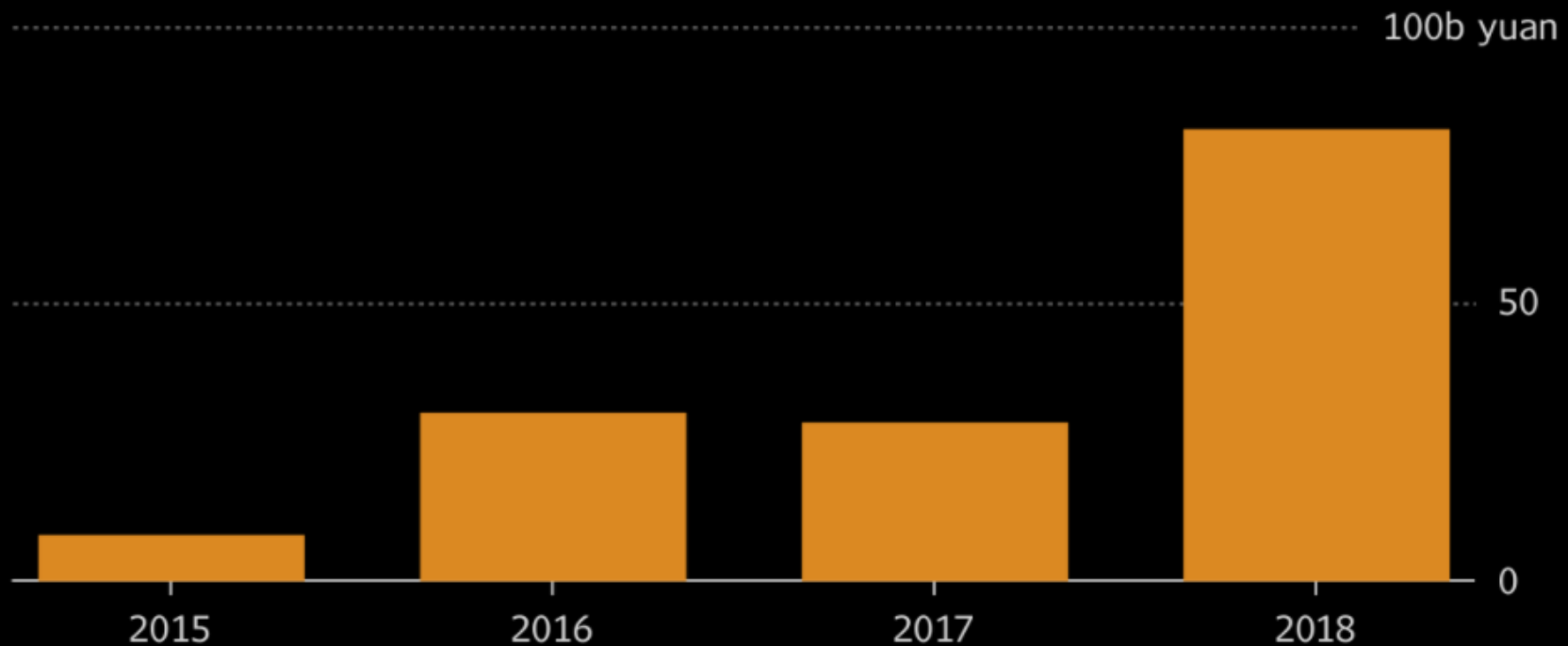
Bloomberg

Defaults

Record Defaults

Missed bond repayments in 2018 have already surpassed previous highs

■ Defaulted bonds in China



Source: Bloomberg

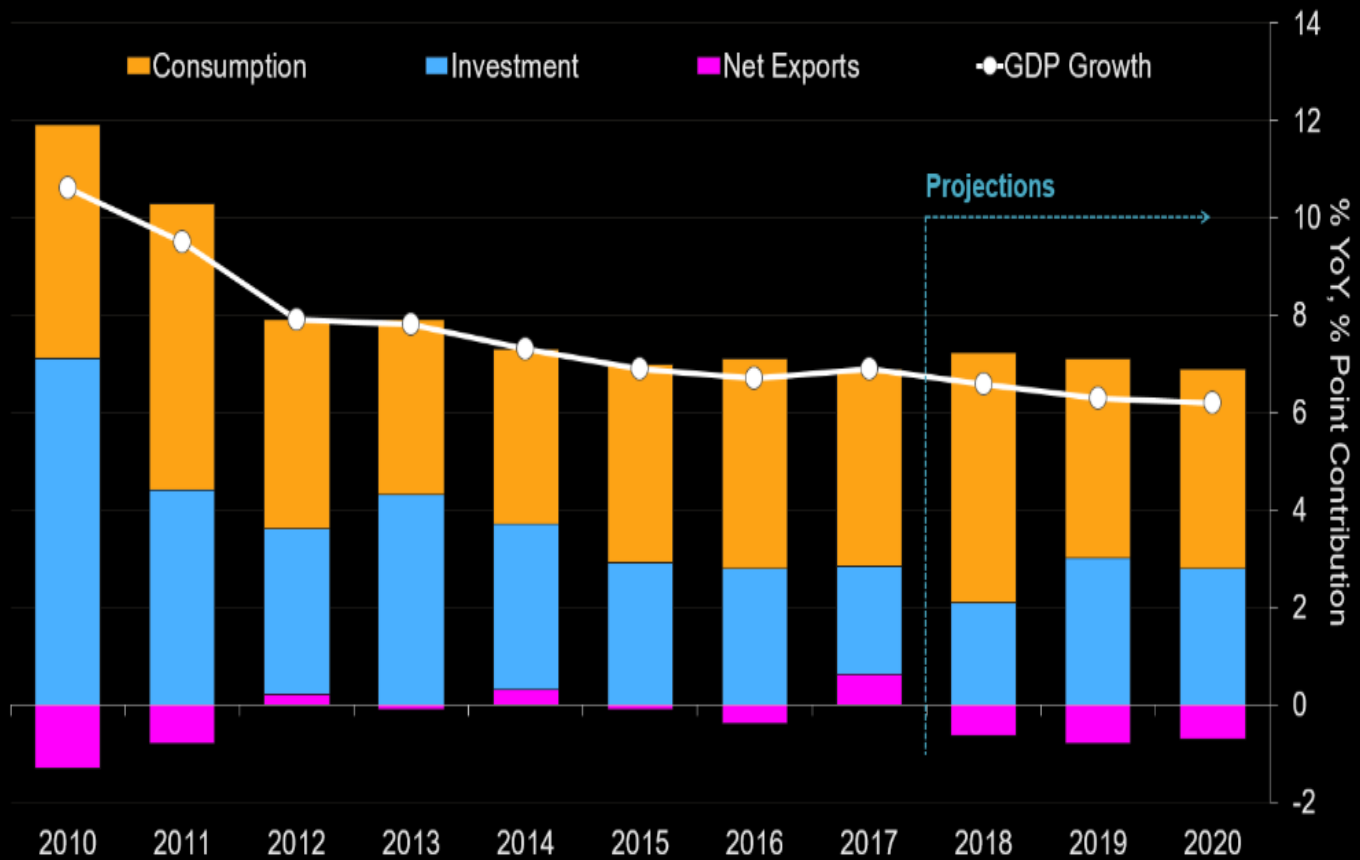
Bloomberg

China Construction Bank



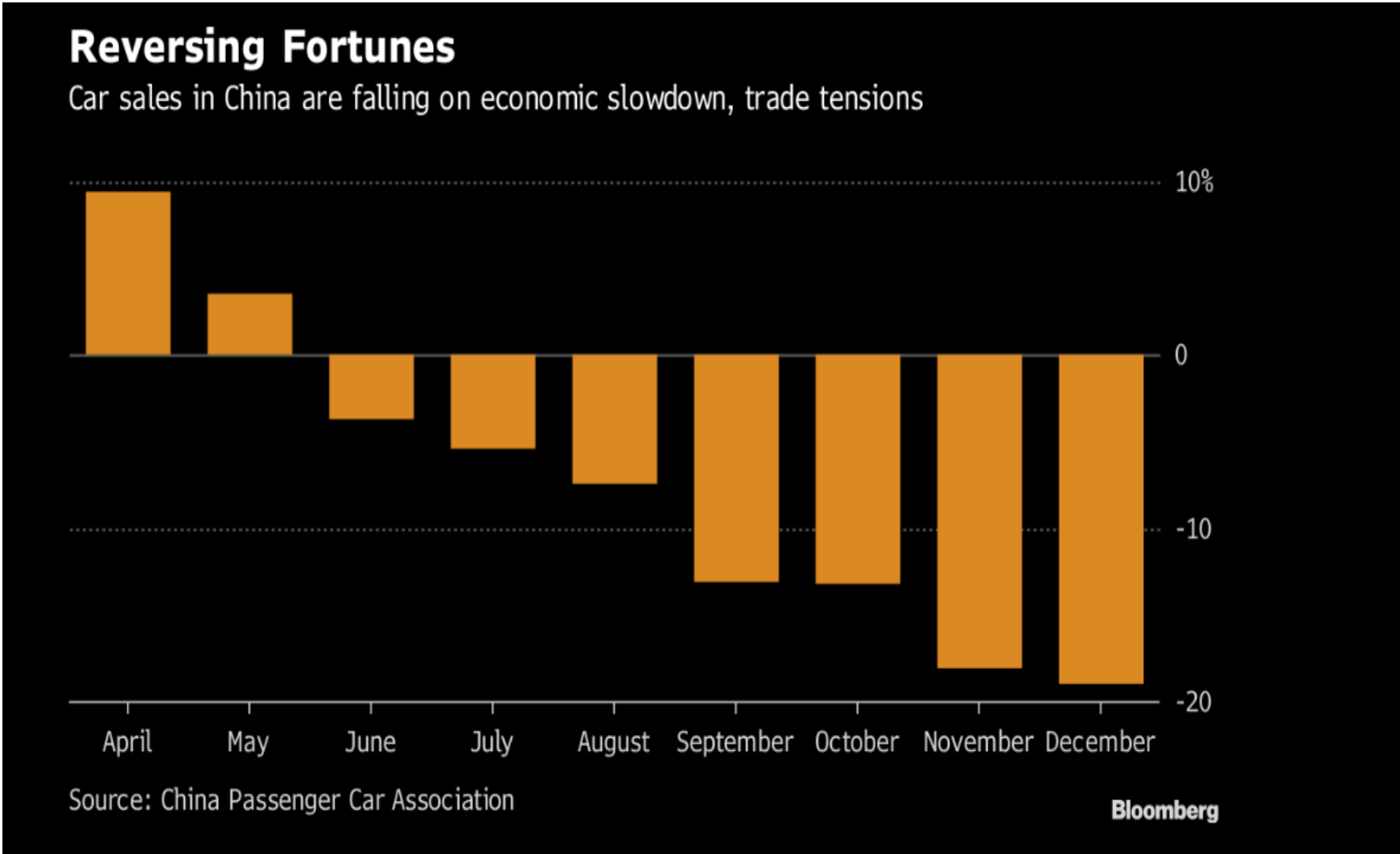
Consumption now the dominant contributor to Chinese Growth

China Growth by Composition



Source: Bloomberg Economics; *Values for 2018 onward are forecasts

Auto Sales recently falling at close to 20% rate year on year



Recent Anecdotal Evidence

- Consumption Tax Revenue fell 62% in Nov and 71% in Dec (Bloomberg)
- Apple Cites Unforeseen Slowdown in China for Guidance Cut (Bloomberg)
- Jaguar cuts 10% of workforce as China sales fall 22% (Bloomberg)
- Hong Kong Property Sales – 58% year on year in Dec (South China Morning Post)
- “Chinese authorities are studying plans to help banks replenish capital...(by issuing) perpetual bonds. Swelling soured loans and a slump in share prices are making it harder for banks to raise money”

If Boom Was Turning to Bust What Might One Expect to Observe?

- Weakness in Domestic Markets
- Weakness in the Markets of Economies Closely Tied to China
- Weakness in Commodity Markets
- Spillovers into Developed Markets

South Korea Kospi



Nikkei



Taiwan SE



TWSE Index (Taiwan Stock Exchange Weighted Index) Crude Oil Daily 20DEC2015-25J

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Australia



ASX 200 Index (S&P/ASX 200) Crude Oil Daily 20DEC2015-25JAN2019

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iShares Emerging Market ETF



If Boom Was Turning to Bust What Might One Expect to Observe?

- **Weakness in Domestic Markets**
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- **Weakness in Commodity Markets**
- **Spillovers into Developed Markets**

Brent Crude



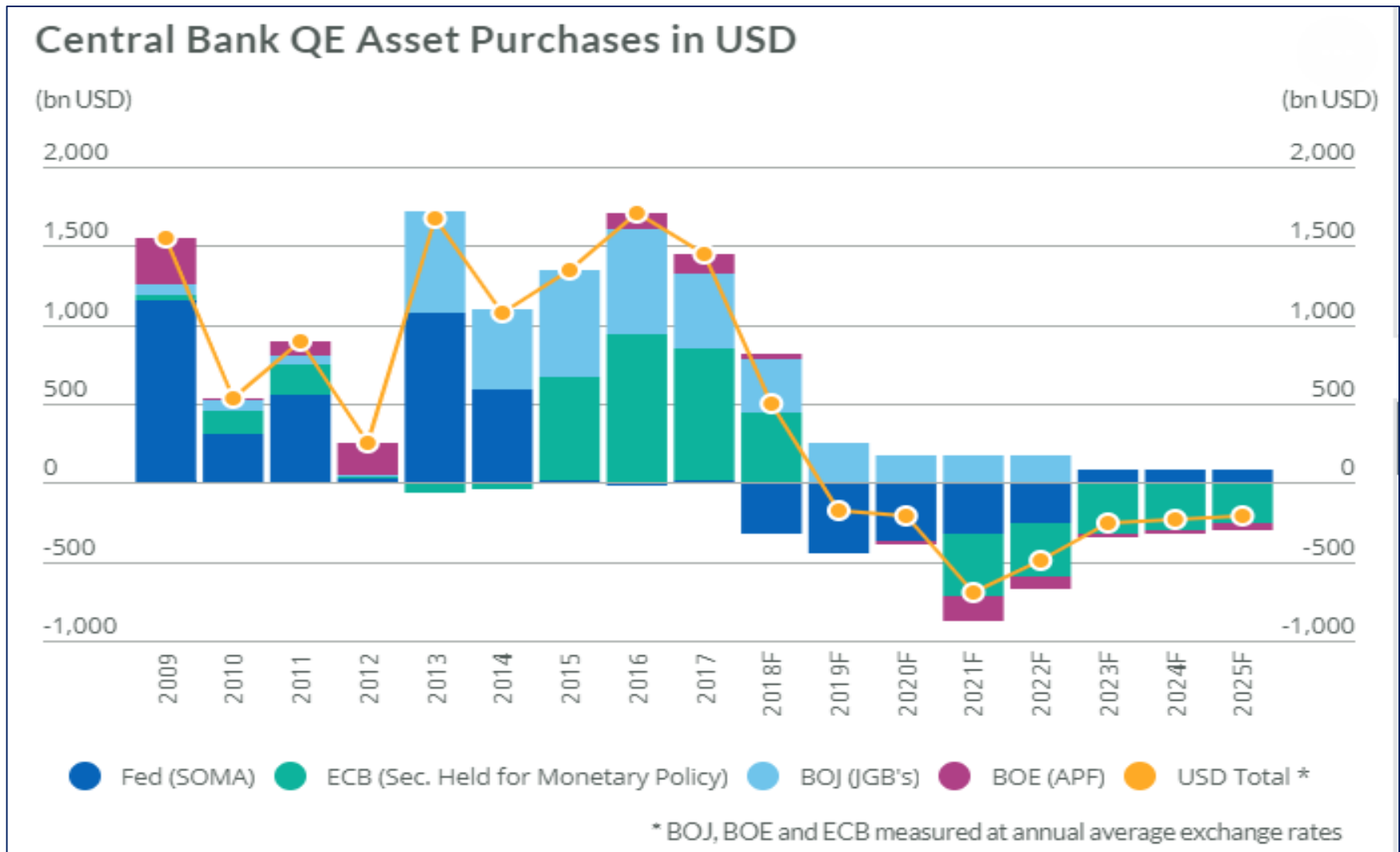
LME Industrial Metal Index



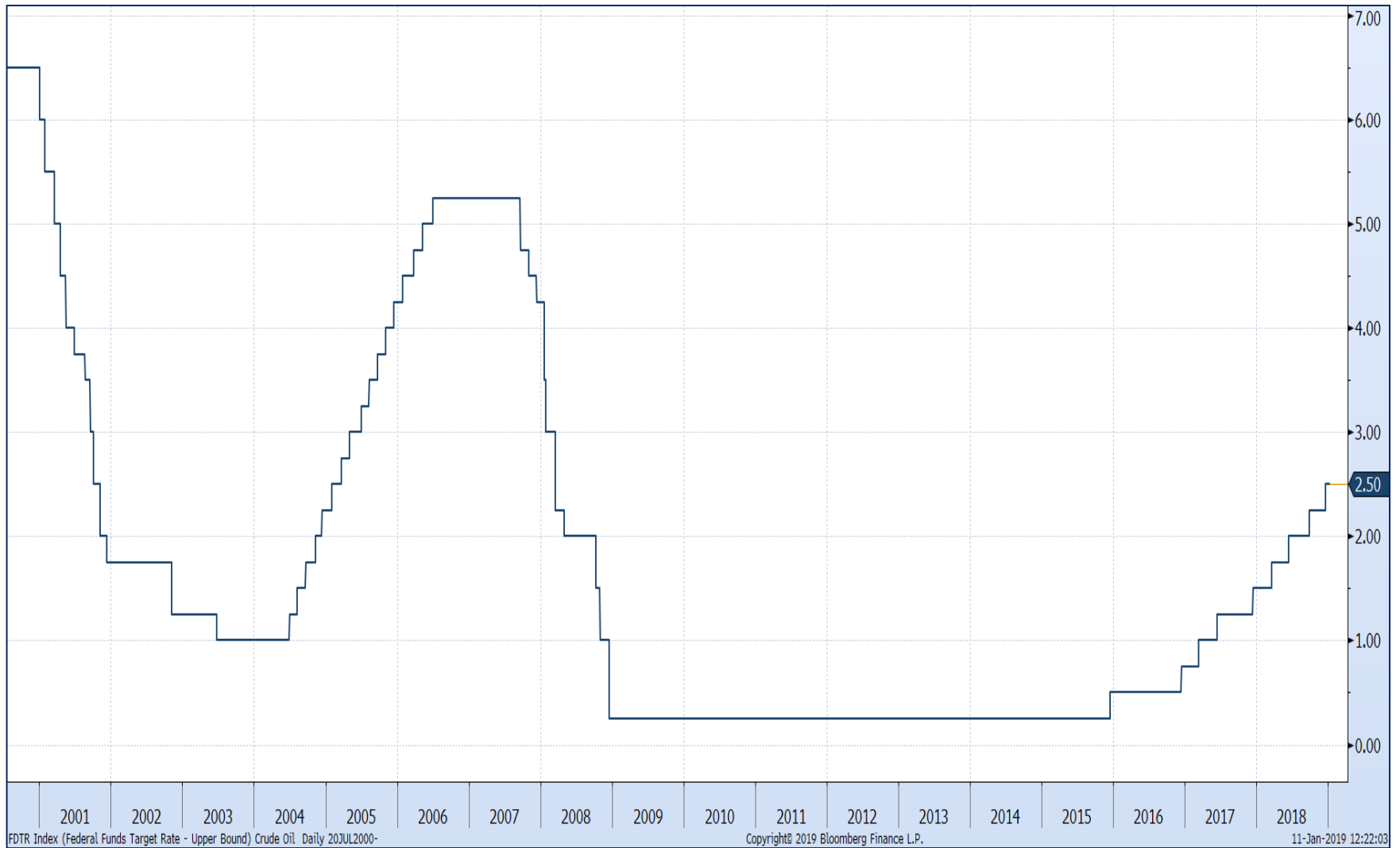
If China's Economy was imploding what might one expect to observe?

- **Weakness in Domestic Markets**
- **Weakness in the Markets of Economies Closely Tied to China**
- **Weakness in Commodity Markets**
- **Spillovers into Developed Equity and Bond Markets**

Global Quantitative Tightening (was) Underway



FED Funds Target Rate



S&P 500



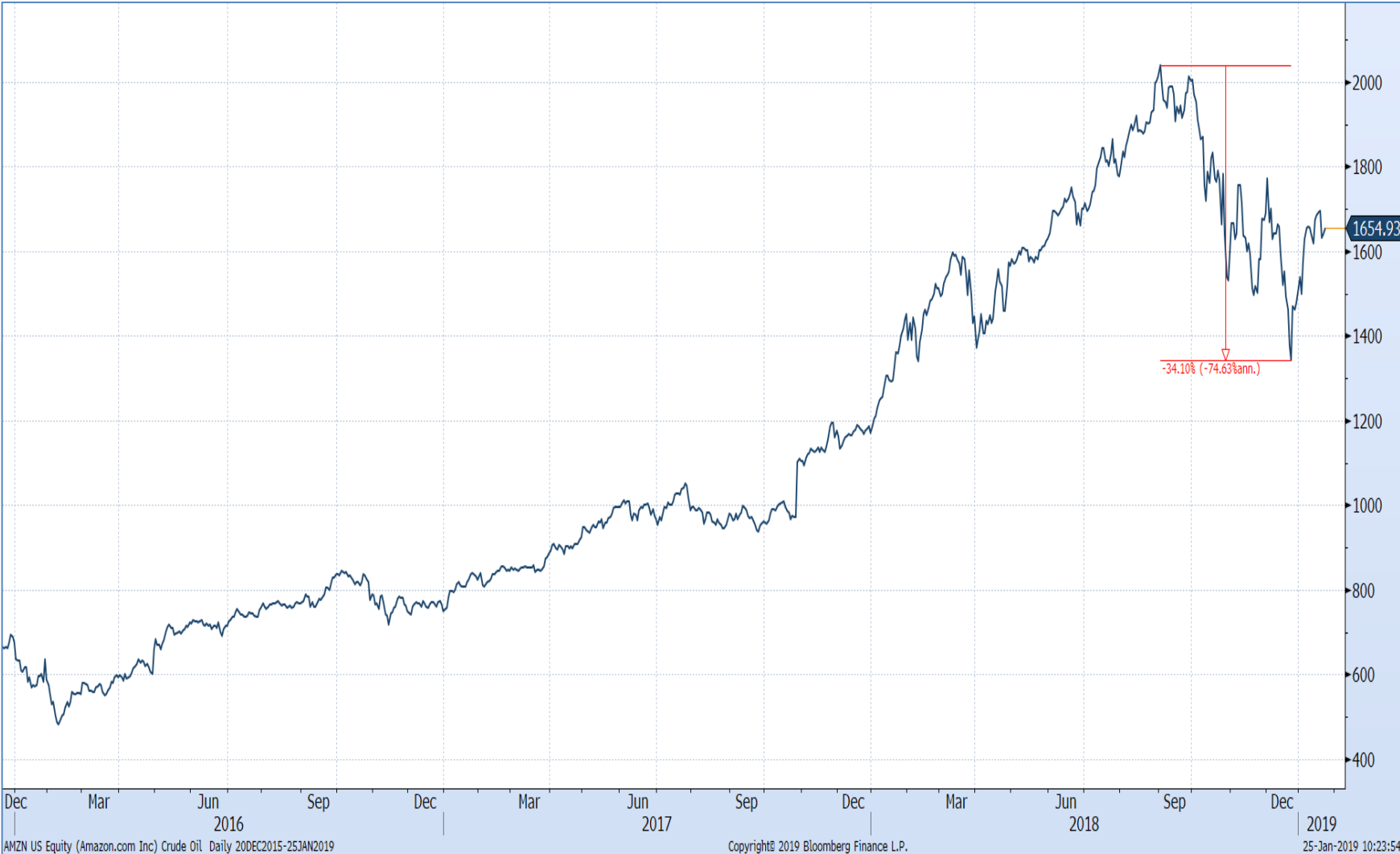
Eurostoxx 600



Apple – Bell weather Stocks Crushed



Amazon



FED Backs Off

- 1) *POWELL: MKTS SEEM TO BE PRICING IN PESSIMISM ON GROWTH, TRADE
- 2) *POWELL SAYS FED CHAIRS HAVE MET WITH PRESIDENTS IN THE PAST
- 3) *POWELL SAYS NOT APPROPRIATE TO TURN DOWN A TRUMP INVITATION
- 4) The Fly: Fed's Powell commented on the FOMC minutes
- 5) The Fly: Fed Chairman Powell: there's the "patient" word again
- 6) *POWELL SAYS NOT HAD AN INVITATION YET TO MEET TRUMP
- 7) *POWELL SAYS FED DOESN'T TAKE POLITICAL FACTORS INTO ACCOUNT
- 8) *POWELL SAYS FED VERY FOCUSED ON ITS JOB, IGNORES POLITICS
- 9) ✓ Mohamed A. El-Erian: At The Economics Club of Washington DC, #Fed Chair Jero...
- 10) *POWELL SAYS HE DOESN'T LOBBY FED COLLEAGUES OVER POLICY
- 11) *POWELL SAYS DIVERSITY OF VIEWS ON FED LEADS TO BETTER DECISIONS
- 12) *POWELL: FED WAITING, WATCHING AND CAN BE PATIENT, FLEXIBLE
- 13) The Fly: Powell says Fed can be 'patient and flexible' on interest rates
- 14) The Fly: Powell says financial markets signaling downside risk concerns
- 15) *POWELL SAYS FED IS IN A PLACE WHERE IT CAN BE PATIENT, FLEXIBLE
- 16) *POWELL SAYS FED HAS THE ABILITY TO BE PATIENT ON RATES
- 17) *POWELL: FED CAN WATCH PATIENTLY AND CAREFULLY
- 18) Reuters Top News: RT @ReutersBiz: Fed Chair Powell speaks at Economic Club o.
- 19) *POWELL: FINANCIAL MARKETS EXPRESSING CONCERN ON DOWNSIDE RISKS
- 20) *POWELL: LABOR MARKET VERY STRONG BY SO MANY MEASURES
- 21) *POWELL: 2018 WAS VERY GOOD YEAR FOR U.S. ECONOMY

Invesco US Senior Leveraged Loan ETF



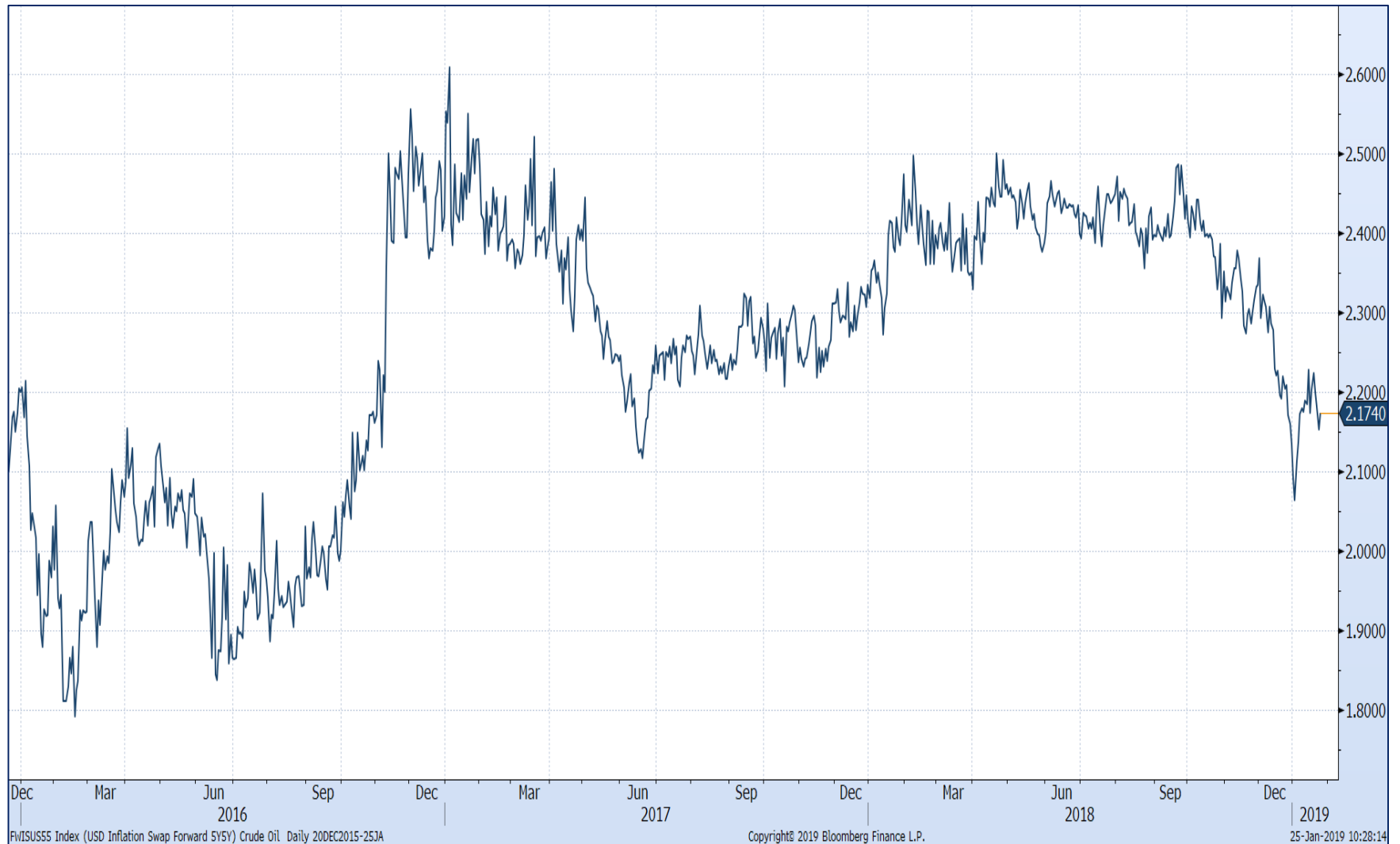
SPDR High Yield ETF (JNK)



Markit CDX North America Investment Grade CDS



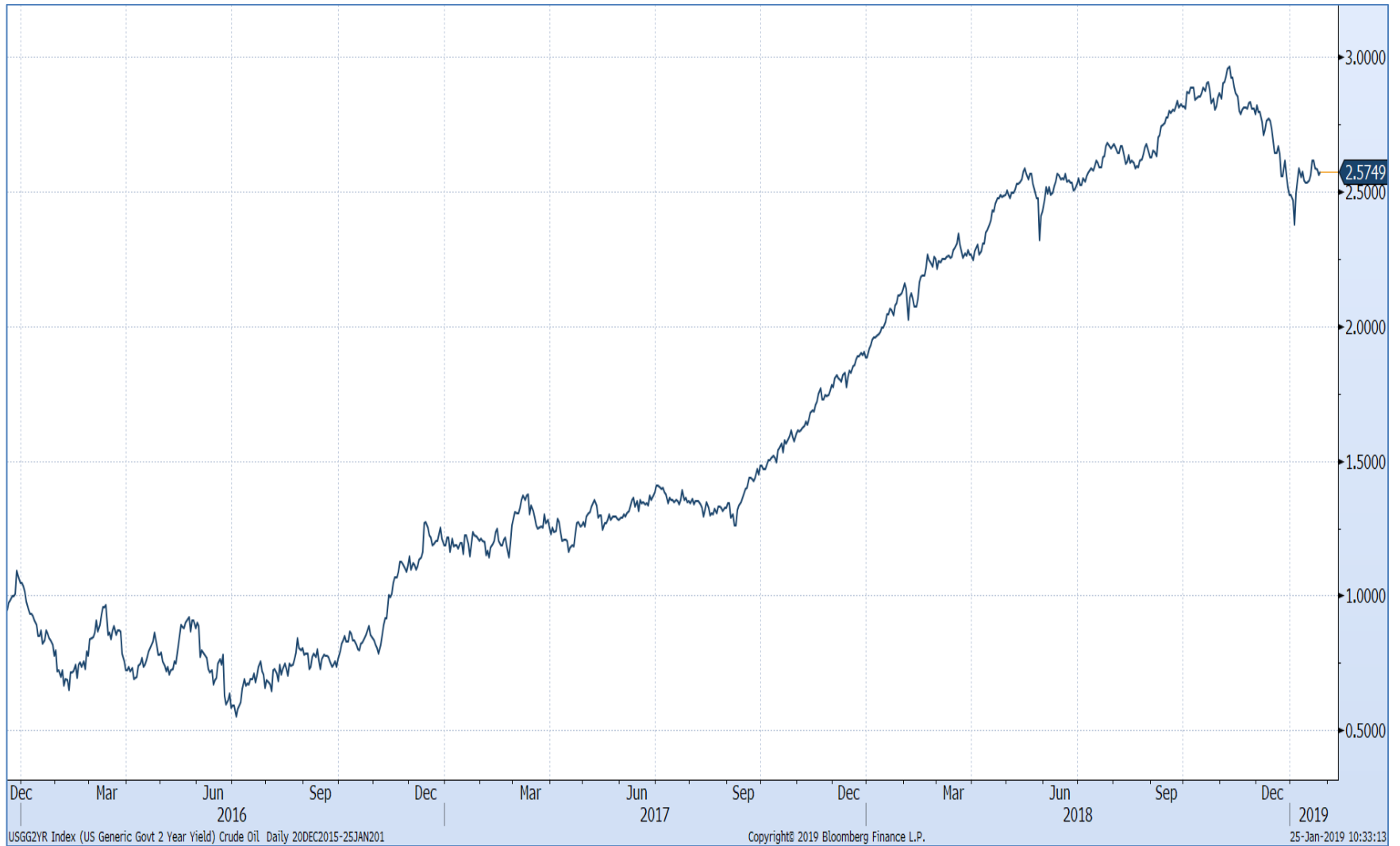
US 5yr, 5yr Inflation Swap Rate – gauge of future inflation expectations



US 10Yr Yield



US 2Yr Yield – Peaked



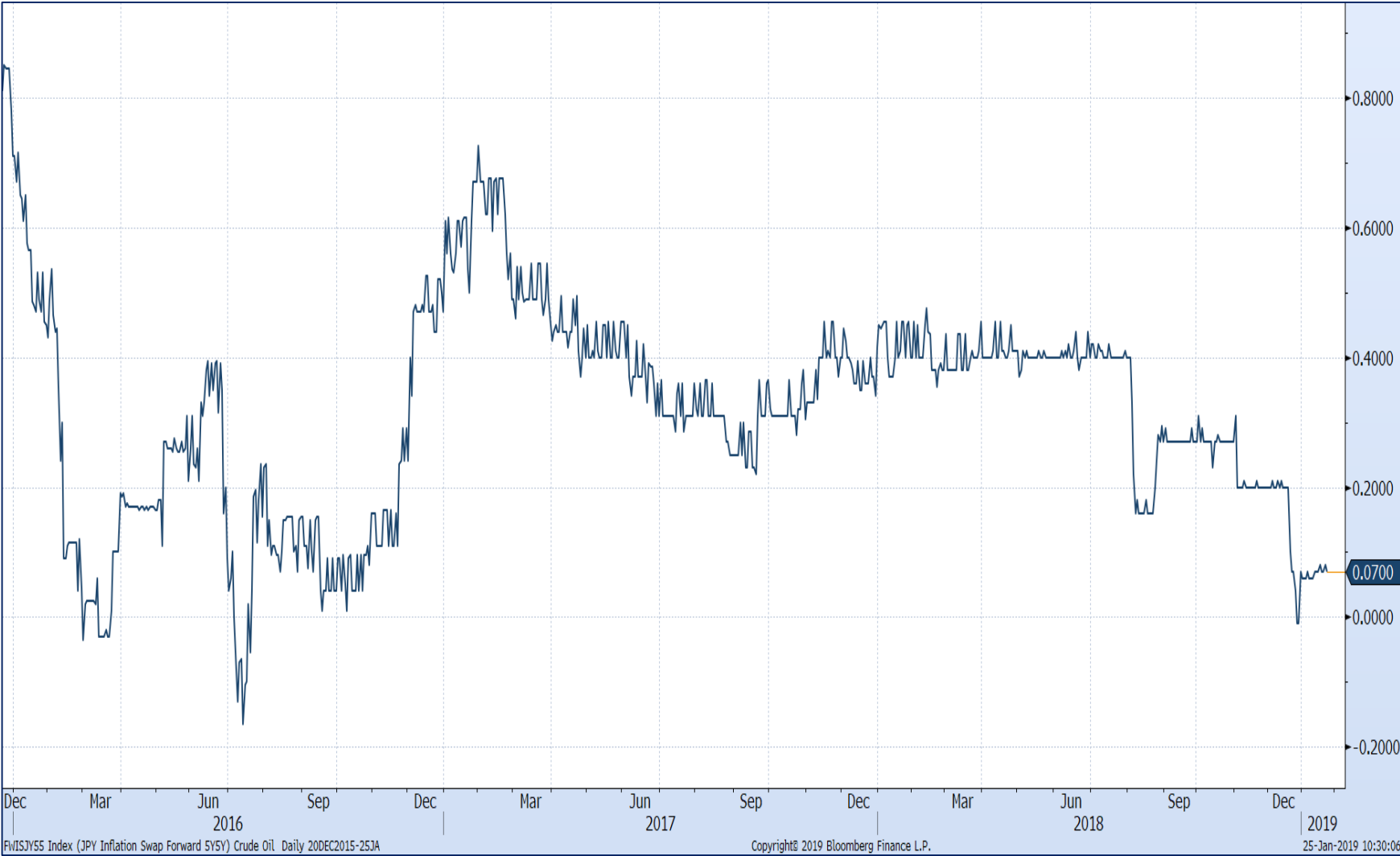
Eurozone 5yr, 5yr Inflation Swap Rate



Ger 10Yr Yield



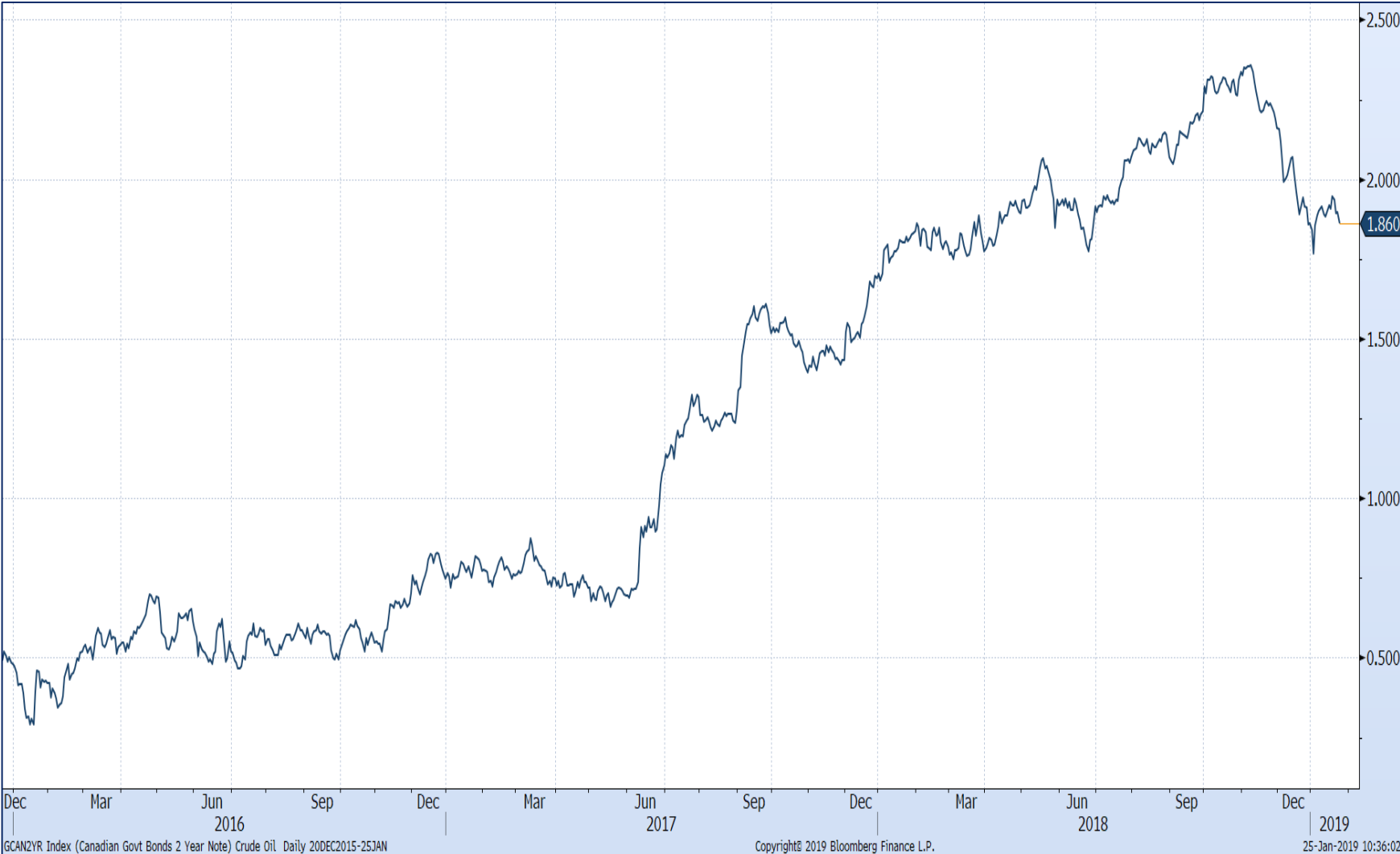
Japan 5yr, 5yr Inflation Swap Rate



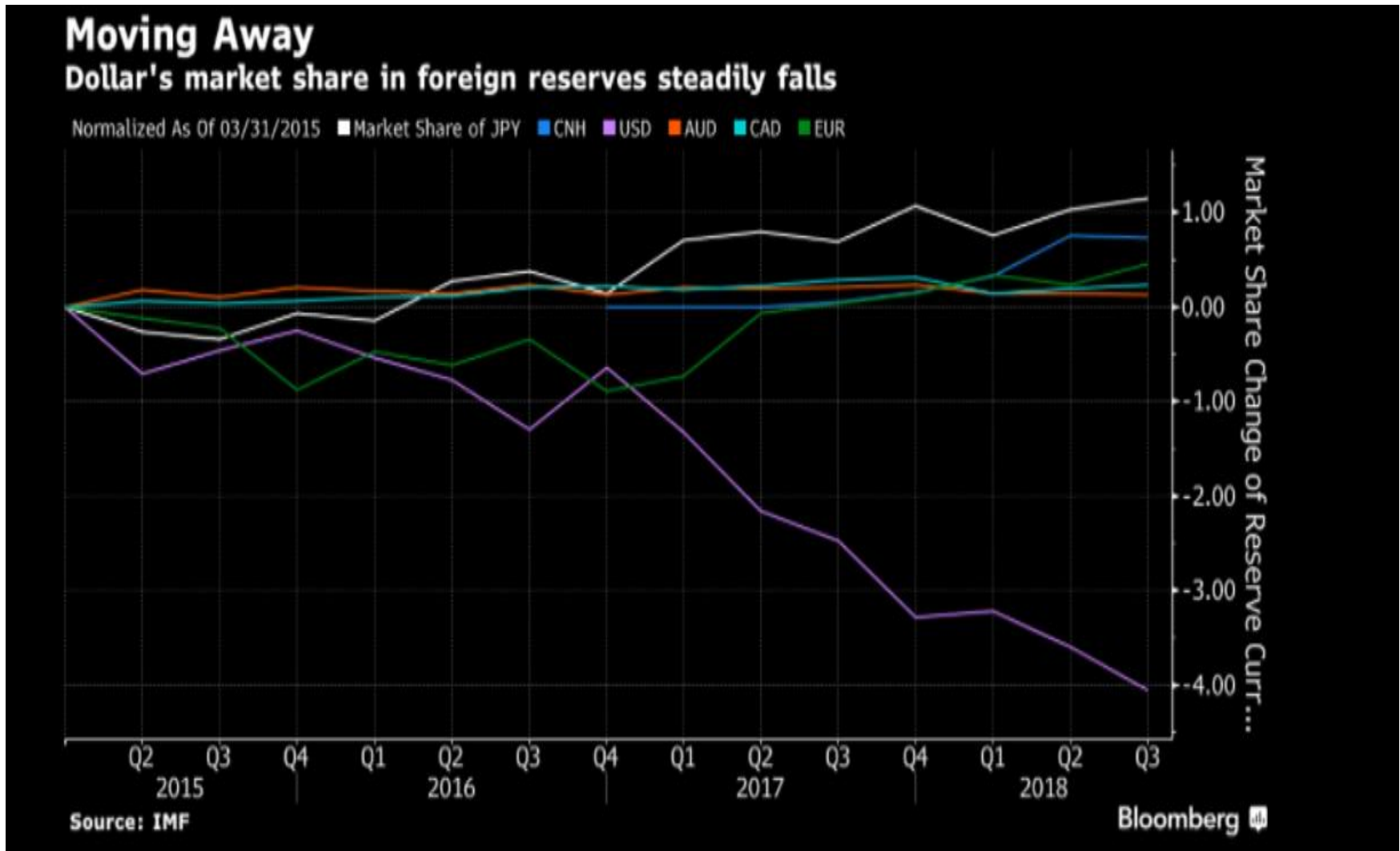
Australia 3Yr Yield



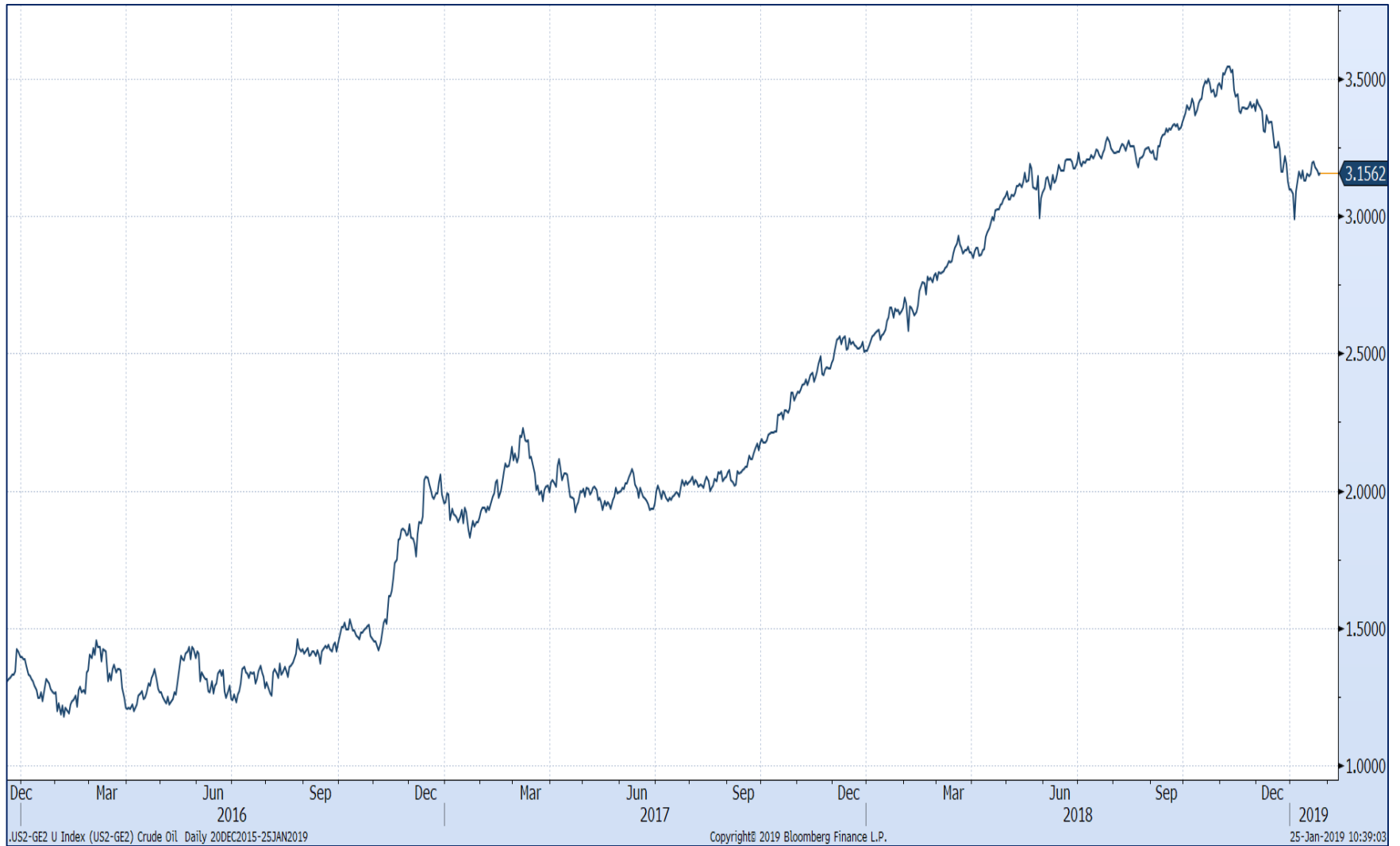
Canada 2Yr Yield



Trump undermines USD



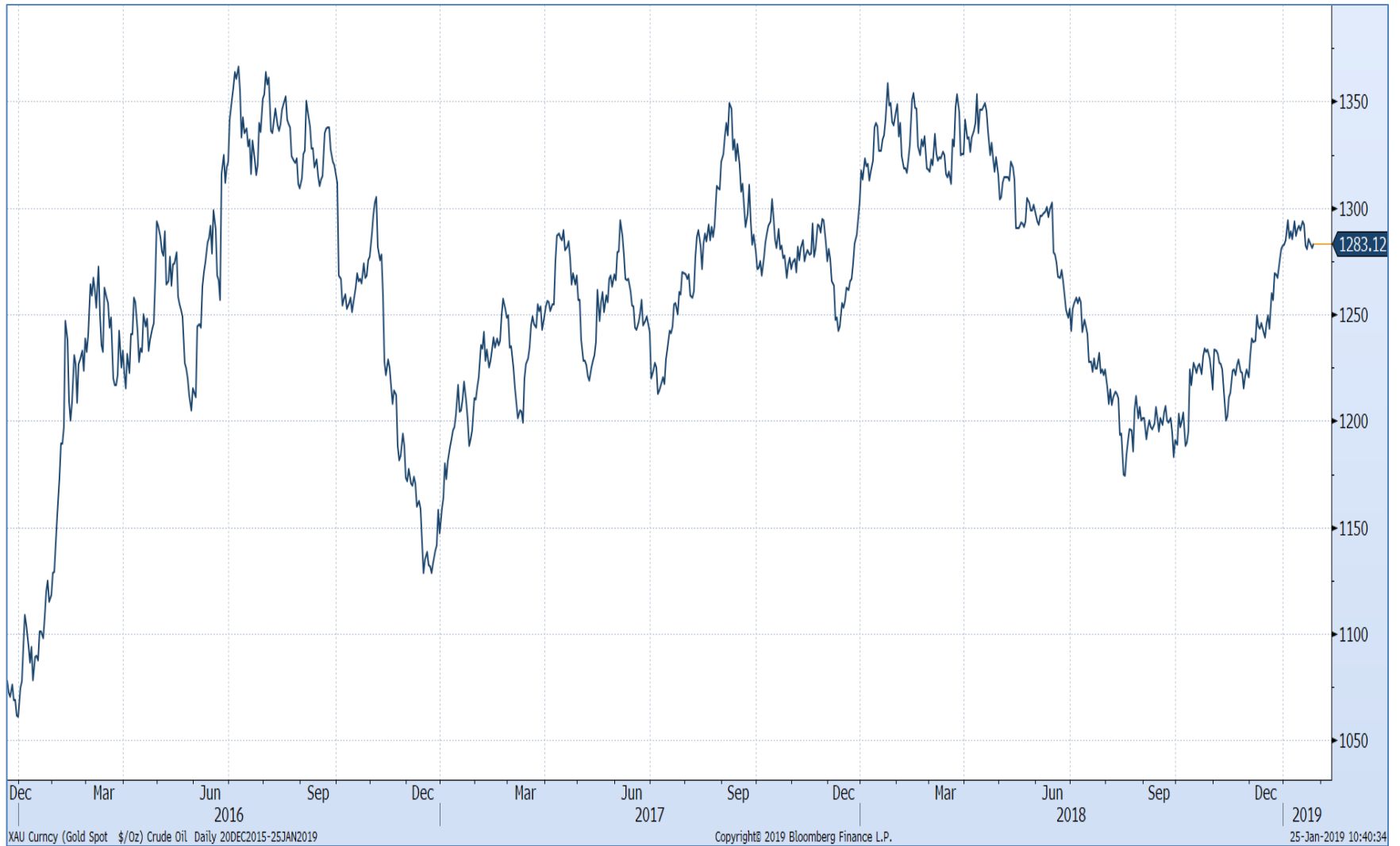
US 2Yr – Ger 2Yr



Bloomberg USD Index



Gold



Silver



Capacity for Global Policy to Respond is Constrained

	Central Bank Target Rate	Government Budget Surplus / Deficit
US	2.50%	-4.3%
Eurozone*	0.00%	-1.0%
China	2.38%	-3.7%
Japan*	-0.10%	-2.6%
UK	0.75%	-1.8%
India*	4.00%	-4.0%
Brazil*	6.50%	-7.1%
South Korea	1.75%	1.6%
Canada	1.75%	-0.4%
Australia*	1.50%	0.5%

Source: Bloomberg. * Historic Low

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Capacity for Global Policy Co-ordination is Reduced



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