

**THE RISE AND FALL OF THE MIDDLE KINGDOM'S ECONOMY:  
WHEN (AND HOW) WILL IT,  
LIKE THE MYTHOLOGICAL PHOENIX,  
RISE FROM ITS ASHES ?**

The People's Republic of China (PRC) mesmerised the attention of the industrialised world when two factors came to the fore, those two factors, propelling the Middle Kingdom into the international limelight.

Those two factors were:

1. The PRC had embarked on a programme, leading to the production of good-quality goods, specifically aimed at the export market, those goods, being comparable, in many respects, to similar products, manufactured in developed countries that had, for some time, obtained a well-deserved, international reputation for excellence; and,
2. PRC industrialists had graduated with honours from '*The School of Hard Knocks*' where they had learned, in a very short period of time, how to improve the quality of their manufactured products and, at the same time, how to achieve production-efficiency, making their finished products more cost-effective than those of their rival, Asian producers.

As a result of the aforementioned factors and many other positive attributes with regard to the PRC's manufacturing industry, multinational conglomerates, especially those, internationally known corporate leviathans, flocked to the PRC in order to enter into contracts with manufacturers for the production of goods that would adorn shops in The United States of America and in Europe, those goods, bearing USA or other countries' brand names, but having been manufactured, in part or in their entirety, in the PRC.

As a direct consequence, for some years, the PRC was known as the world's tailor shop, the largest producer in the world of condoms, of microwave ovens, of household electrical goods, such as washing machines, toasters, frying pans, fish steamers, of personal computers, of printers, and not forgetting those world-favourite electronic devices, such as iPhones that bear the brand name of '*Apple*'.

So powerful became the economy of the PRC that the '*word*' on the street was that, within a couple of decades, this country, with its human population of about 1.30 billion people, would overtake the economy of The United States of America.

When the PRC replaced Japan – which was, then, the second-largest economy of the world – in the Number Two Slot, many people thought that the writing was on the wall: Watch out, Mr and Mrs America, here comes the PRC!

Of late, however, the tide has turned in respect of the PRC's economy and, today, questions are being asked as to how this huge country will be able to extricate itself out of its present economic predicament.

Due to the many demands of PRC workers, over the past decade or so, their wages have risen to such an extent, and in such a relatively short time period, that the manufacture of certain goods has become more expensive, all things considered, than producing similar goods in Europe and/or in the US.

Many multinationals have been forced to downsize operations in the PRC – or pack up and move to other climes – in order that their goods become cost-effective, once again.

As mentioned in previous **TARGET** () reports, the strength of the renminbi vis-à-vis the US dollar, the British pound, the euro, the South African rand, etc, resulted, as far as US and European multinationals were concerned, in profit margins, being squeezed, making shifting production bases out of the PRC and back to the US and/or parts of Europe, especially Eastern Europe, a very necessary requirement in order for the multinationals to remain competitive on the world stage.

When The People's Bank of China (), the de facto Central Bank of the PRC, determined to devalue the renminbi in terms of the US dollar by 1.90 percent, it was another blow for many international companies that had established bases of operations in the Middle Kingdom.

That was, yet, another very valid reason for international conglomerates to move out of the PRC in favour of a return to the US and/or Europe.

### **'The Reports Of My Death Have Been Greatly Exaggerated'**

Mark Twain (Samuel Langhorne Clemens), the famous US author, is credited with having stated that 'The reports of my death have been greatly exaggerated'.

A similar statement could, today, be uttered in reaction to pundits' numerous warnings that The United States of America is on the downward slope, headed straight to economic oblivion.

But the most-recent economic statistics in respect of the US economy do not appear to bear out such a prognostication and, in fact, the opposite appears to be the case: The US economy is going from strength to strength.

Until early last year, it had been strongly suggested that the PRC would overtake the US economy within a couple of decades – if not quicker than that period of time.

Then, this year, the PRC's economy began to slide down the slippery slope – and, by all accounts, it continues to slide.

Now, very few people would care to suggest that the PRC's economy was on the road to overtaking the largest economy of the world, or even, for that matter, get close enough to see its dust.

The key indices of equity markets, around the world, have been in retreat over the past month or so, mainly because of the fear that the world's second-largest economy will have a deleterious effect on the economies of many countries, from the US, to Europe, to South Africa, to the Middle East.

There is some truth to this suggestion, too – unless the PRC Government can pull the fat out of the fire.

Thus far, the PRC's economists appear to have been suggesting the employment of superficially cosmetic concepts in order to turn the economy round, but the artificiality of these concepts has been of little avail.

And the key indices of the PRC's two equity markets continue to plumb to lower and lower levels, wiping out trillions of renminbi from the market values of many a blue chip.

Just about every day, now, one department of the PRC Government orders its '*Propaganda Ministry*' – the Xin Hua News Agency – to release the Government's latest plan of action in order to stop the rot on equity markets.

The more artificial are these plans perceived to be, the less credence are they given.

Eventually, something will definitely happen and the PRC's economy will, inevitably, rise from the ashes of

the walloping that it has received at the hands of investors of publicly listed companies, listed on the country's equity markets.

A healthy PRC economy, today, is of extreme importance to the world for a number of reasons, one of which, no doubt, is that it is the largest, single holder of US debt.

The PRC has, over the past 15 years, accumulated a veritable mountain of foreign reserves. This mountain includes several trillion (US) dollars' worth of US Treasury debt.

Impressive?

Perhaps not.

What is the Government of the PRC going to do with this huge investment?

It is definitely not '*liquid*'.

But it must be, definitely, '*illiquid*'.

Last Monday, it was officially announced that, during the month of August, The People's Bank of China had been intervening on foreign-exchange markets in order to try to defend the falling value of the renminbi.

The Central Bank admitted that its foreign currency reserves had been depleted by nearly \$US94 billion – about 2.60 percent – to \$US3.56 trillion, during the 31 days of August.

It was the largest monthly fall in the PRC's foreign-currency reserves on record.

But, to try to sell a goodly part of the US Treasury Bills, held by the PRC, could well cause immeasurable problems on equity as well as foreign-exchange markets, resulting in weakening the US dollar vis-à-vis other '*hard*' currencies.

This would be counter-productive to the aims and aspirations of The People's Bank of China.

A weaker US dollar would, also, make US-manufactured products cheaper on the markets of the world and this, in effect, would be yet another blow to the economy of the PRC.

This is because, with the massive size and strength of the US economy, along with its vast production ability, the PRC would find itself unable to sell its goods on world markets at a reasonable profit, swamped as its manufacturers would be by the cheaper, US-made, similar products.

This could lead to a further – and faster – deterioration of the overall economy of the country.

Domestic problems and widespread discontent are certain to follow and, close on the heels, political unrest is quite likely.

This would be the worst kind of scenario for the PRC and everybody in the Western World would feel the backlash, almost immediately.

### **How To Sustain Economic Growth For The PRC**

With the economies of many nations of the world, being clearly sluggish, to be polite – with the exception of The United States of America – the biggest problem for the economists of the PRC is, naturally, to find the correct path, going forward.

Attempting to become solely dependent on its domestic market is not, really, an option, today, because, among other things, material, domestic-led growth of the economy is not easy to achieve and, in addition, it

would be slow in producing the desired results.

Meanwhile, at least 10 percent of the existing, 1.30 billion, resident Chinese people, those citizens, numbering about 130 million people, being too old to be productive to any great extent, will continue to age, causing the Government to dig deeply into its coffers in order to meet its financial commitments to the rapidly growing ageing population.

To attempt to resort to undervaluing the renminbi would be met with immediate, stentorian outbursts from the governments of the Western World, with the US Congress, being among the loudest voices to cry *'foul'*.

Clearly, the PRC Government is unlikely to be able to wrestle successfully with its current economic problems and may be forced, by circumstance, to turn to friends for assistance.

One of those friends is quite likely to be The United States of America!

Like it or lump it, The United States of America, the largest, single economy of the world, today, remains the best solution to ameliorate the problems, confronting the PRC Government of today, and, if the present, powers-that-be in Beijing can be sufficiently humble, swallowing their pride, at least surreptitiously, it is a given that President Barack Hussein Obama would be quite willing to spread the red carpet on the driveway, leading to The White House.

Nothing would please the US Government more than being able to get closer to the PRC Government in spite of the fact that it is not, yet, a democratic nation and that the two countries do not see eye-to-eye on a number of matters in Asia and elsewhere.

The main reason that the US Government would like to take tea with the PRC is because, inter alia, it would be a win-win situation for both parties and, in addition, the two biggest economies of the world could work together in their mutual interests and, by so doing, encourage economic growth, internationally, a growth that would be unparalleled in history.

With the trade barriers in Europe, having been substantially reduced and are continuing to be even further reduced, and with the US Government, intent on encouraging the concept of freer trade in the Pacific – East Asia, South Asia, Southeast Asia and Oceania – on the assumption that the final draft of the rules, relating to Pacific trade, are considered fair to all participants, the economic problems of today could well be relegated to the history books.

From the point of view of the PRC Government, however, the key to a successful series of negotiations with the US Government must, first, be that due consideration has to be given to its citizens, rather than favouring industrial behemoths, wherever it might be domiciled.

This would, no doubt, also be true with regard to the signatories of any forthcoming Pacific trade pact: The citizens, always, come first.

Easier said than done.

One matter that the PRC may find it a bitter pill, difficult to swallow, is that it would have to accept the fact that The United States of America, not the British Empire, as in days of yore, rules the waves.

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