

# David Stockman: China's Real Economic Figures Are Scary

**WASHINGTON** – Serious international economic and business media in the past used to quote official Chinese economic statistics indicating vigorous growth followed by even higher growth without any comments. But now something has changed.

## **Cooking the books**

Without saying so directly, the same media imply that the Chinese Government makes up its numbers. A recent WSJ story –even though not prominently placed– pointed out that it is hard to believe that the Chinese economy really grew at a 6.9% rate when all the indicators about manufacturing, consumption, exports and imports are significantly down.

Yes, official statistics released by the Chinese Government do not add up. Or, to put it differently, if you read between the lines, the truth is that Chinese authorities routinely and willfully cook their books in order to prove that their worn out investment-led growth model still works wonders.

True enough, Beijing conceded a while back that the country is experiencing an economic slow down. But they added that it is not a major one, while the Government has everything under control.

## **5% or less**

Well, several economists and forecasting firms believe instead that China's official GDP growth numbers are inflated by at least 2%, may be even more. Which is to say that the Middle Kingdom is growing, but at 5%, not at 6.9%. Besides, the slower growth numbers hide even deeper troubles, since growth is financed by massive amounts of debt.

## **End of an era**

So, here is the thing: the Chinese economic miracle is over. What we see now is a (semi-desperate) political leadership that is trying to keep the wheels turning via some more debt-financed growth.

The implications of China's loss of momentum are enormous. From Australia to Brazil, from Chile to Zambia, emerging economies that were doing well because of the China-driven commodities boom are now suffering, some (like Brazil) in a major way. Likewise, Germany and others will export fewer high technology products to China.

## **Not under control**

The Beijing cooked up notion (bought by many in the West) that the smart and wise Communist Party planners have all under control, while they steer the country away from investment-led growth to consumer-led growth, is a fantasy. China is in deep trouble, and we should be concerned.

## **In-depth analysis**

For a deeper and detailed analysis of China's real economy, and what the end of its incredible growth era means for the rest of the world, I strongly recommend that you read a piece titled "*Red Swan Descending*" (reproduced below) by David Stockman, (Budget Director under Ronald Reagan). He wrote this on October 20 in his Contra Corner [www.davidstockmanscontracorner.com](http://www.davidstockmanscontracorner.com)

## ***Red Swan Descending* (by David Stockman)**

*"The proverbial peddlers of Florida swampland can now move over. They can't hold a candle to the red suzerains of Beijing.*

*The latter had drawn a line in the sand at 7.0% GDP growth. Conveniently enough, the "consensus" estimate of so-*

called street economists was pegged at 6.8% for Q3, thereby giving authorities one thin decimal point through which to thread a “beat” at 6.9%.

By golly they did it!

Even then, China’s Ministry of Truth had to fiddle down the GDP deflator to negative 0.5% (for the second time this year) in order to hit the bull’s eye. And that’s exactly the point.

No real world \$10 trillion economy plagued with all of the turmoil evident in China’s whipsawing trade data or its volatile real estate development sector or its faltering rust belt and commodity-based industries can possibly deliver absolutely stable GDP numbers to the exact decimal point quarter after quarter.

In fact, the odds that these reports represent anything other than propaganda are so overwhelmingly high that they perforce raise another more important question. Why does Wall Street and its servile financial press not issue a loud collective guffaw when they are released?

But no, the Wall Street Journal took it all very seriously, noting both the “beat” and China’s claim that the “miss” wasn’t a miss at all:

**The better-than-expected result**—a Wall Street Journal survey of 13 economists forecast a median 6.8% gain—is likely to renew debate over the accuracy of China’s growth statistics.....Speaking at an event to promote entrepreneurship in Beijing on Monday, Premier Li Keqiang said **“even though it was 6.9%, it is still a growth rate of around 7%.”**

Right. China’s #2 communist boss is out promoting the “enterprenurial spirit” while emitting central planning propaganda to the decimal point.

**You might find the irony exceptionally rich, but there is a larger message. Namely, the true size of China's economy is unknowable to the nearest trillion or even several trillions. But that does not prevent most of Wall Street from taking seriously each and every word of China's self-evidently clueless statist rulers spouting growth rates to the decimal point.** [Bold added]

In truth, Wall Street has become so intellectually addled from its addiction to central bank enabled gambling that it no longer has a clue about what really matters. That's why the next crash will come as an even greater surprise than the Lehman meltdown, and will be far more brutal and uncontrollable, as well.

Yet the evidence that a China-led crash is on its way is hiding in plain sight. And what is being blithely ignored is not merely the blatant inconsistencies in its economic numbers—such as the fact that electricity consumption has grown at only a 1.3% rate over the past year—or that its commerce with the outside world has shrunk drastically, with imports down by 23% and exports off by 3-6% in recent months.

**Instead, the evidence that China is a slow-motion train wreck lies in the very consistency of its Beijing-cooked numbers.** Apparently, no one has told its credit-happy rulers that printing precise amounts of new GDP quarter after quarter by issuing credit at double the rate of nominal income growth will eventually result in the mother of all deflationary collapses.

Stated differently, if the pattern of debt versus GDP shown below is pursued long enough, the world's greatest open air construction site will fall silent. Everything which can be built will have been delivered; any cash flow which can be encumbered with more debt will have been levered-up; any pretense that financial institutions are solvent will have

given way too soaring defaults; and the Wall Street delusion that the primitive central planners of red capitalism had an iron grip on China's runaway expansion will have been revealed as a snare and delusion.

Accordingly, the only thing that really counted in yesterday's release was that credit is still growing at nearly 12% or at 2X the 6.2% gain in nominal GDP. And as is also evident in the chart, this massive and aberrational debt versus income gap has been underway as far back as the eye can see.

Indeed, it goes all the way back to Mr. Deng's moment of enlightenment 25 years ago. That's when he discovered a printing press in the basement of the PBOC and concluded that communist party power might better be preserved by running these presses red-hot than by Mao's failed dictum that power descends from the white-hot barrel of a gun.

**In any event, why in the world would anyone in their right mind think this crucial chart can be extended toward the right axis much longer. Assume 10 more years of 12% credit growth, for example, and China will have \$90 trillion of total debt or 50% more than the already staggering amount carried by the US economy. [Bold added]**

At the same time and given that China's nominal GDP growth is descending in Gartman fashion from the upper left to the lower right, assume the very best outcome for nominal income. That is, posit that somehow China manages to achieve ten more years of this quarters' 6% nominal growth. So doing, you get a mere \$17 trillion of GDP.

Everywhere and always, however, **a 5X total leverage ratio** on an economy is a recipe for crushing deflation. In fact, it has never happened before in modern times except for Japan after 1990; and Japan at least had some semblance of functioning markets separate from the state and the rule of commercial law, contracts and bankruptcy.

*By contrast, when China fully plunges into its inexorable deflationary spiral the rulers of red capitalism will have no choice except to resort to Mao's preferred instruments of rule—paddy wagons and machine guns—in order to quell an outraged citizenry. After all, Mr. Deng told China's newly ascendant capitalists that it is glorious to be rich, but did not explain that printing press prosperity ultimately results in a crack-up boom.*

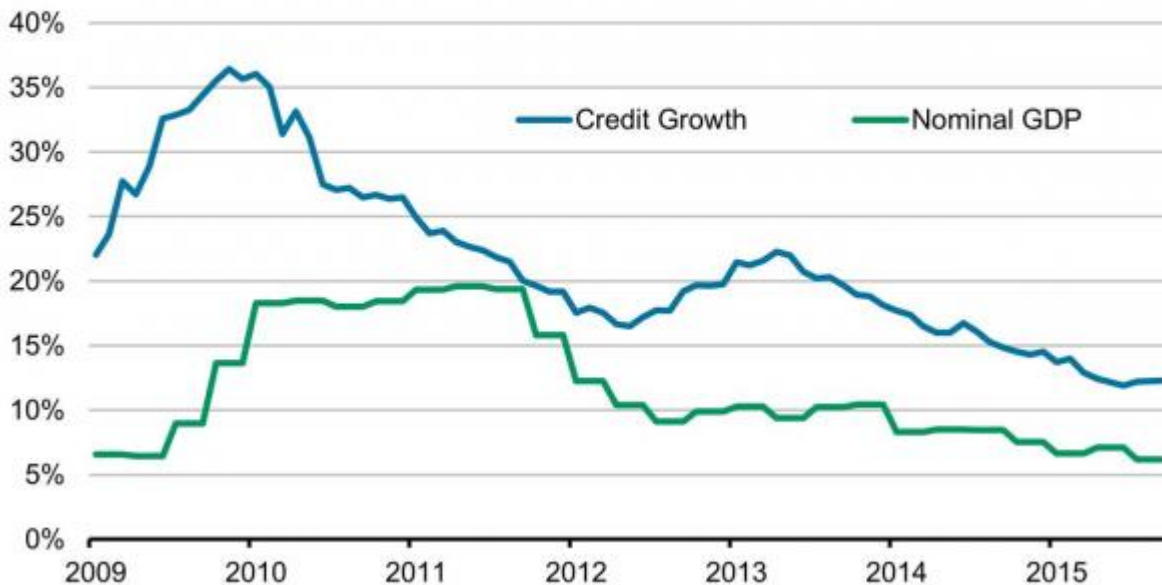
*Stated differently, the recent 18-month rise and then overnight collapse of \$5 trillion of phony market cap in the Chinese stock market gave rise to utter panic and mindless expediency in Beijing, including a de facto bailout of billionaires. China's red rulers apparently feared that the 90 million angry stock market speculators would be no match for its 70 million party cadres—especially since most of the latter were foremost among the former.*

*Yet what will happen when China's hideously inflated real estate and land values succumb to the deflationary wringer? And hideous is not too strong a word: in many urban areas housing prices have reached 15-30X the median income.*

***Well, there are 65 million drastically over-priced, empty apartments in China because its rulers told speculators and the rising middle class that housing prices could never fall—that they were the next best thing to a piggy bank. Accordingly, the last phase of China's madcap construction boom is likely to be a manic spurt of prison building to accommodate the millions of irate citizens who are destined to experience China's turbo-charged version of 1929. [Bold added]***

## Debt Fueled, But Not Much Growth

China's economy is slowing, but it isn't deleveraging, as credit growth continues to expand faster than nominal GDP.



Source: CEIC, People's Bank of China, National Bureau of Statistics | THE WALL STREET JOURNAL.

*The other number in the Q3 release that has been drastically misinterpreted is the reported 10.6% growth of fixed asset investment. Needless to say, this was described as "disappointing" when it is actually a screaming symptom of China's terminally deformed economy. If it had any hope of avoiding a crash landing, fixed investment in its fantastically overbuilt public facilities and industrial capacity would be sharply negative, not still growing in double digits.*

*Owing to the cardinal error embodied in Wall Street's self-serving rendition of Keynesian economics, however, China's fatal dependence on erecting economic white elephants and what amount to public pyramids in the form of unused airports, train stations, highways and bridges, is given hardly a passing nod. That's because it is assumed that some way or another China will make the transition to a services and consumption based economy just like the good old shop-till-they-drop US of A.*

***Let's see. When China finally stops its borrowing binge, these***

*putative shoppers will need to finance their purchases out of current incomes. Yet is not the overwhelming share of household income in China currently earned from the supply chain for fixed asset investment and construction and from the export of cheap goods to already saturated and debt-besotted DM markets? [Bold added]*

*Just consider the fantastical reality that China's 2 billion ton cement industry produced more in three years than did the US industry during the entire 20th century. When they finally stop building roads, apartments and factories, therefore, it is not just the cement kilns which will shutdown, but a whole network of gravel haulers, chemical plants, cement truck fleets, construction equipment suppliers, work site service vendors and much more reaching deep into the interstices of China's hothouse economy. [Bold added]*

*Likewise, when rebar and other construction steel demand collapses and the rest of the world throws up barriers to China's surging steel exports, as it surely will and is already doing, the ricochet effects on China massively overbuilt 1.1 billion ton steel industry will be far-reaching. The incomes of coal barons and blast furnaces workers alike have already taken a pasting, and the downward spiral is just getting started.*

*And wait until China's newly minted auto dealer lots become backed-up with unsold cars as far as the eye can see. Then its 25 million unit auto industry will tumble into a depression unlike anything since 1929 when Detroit's production plunged from 6 million cars/year to less than 2 million.*

*All of those suddenly unemployed auto, steel, rubber, glass, upholstery etc. workers did, in fact, economically "drop". But it wasn't from an excess of shopping!*

*In short, the affliction of Keynesian economics brought many*



ills to the modern world, but repeal of Say's Law was not among them. You can have a one-time credit party, but when it inevitably ends, consumption spending defaults to that which can be financed from current incomes. Consumption is the consequence of production and income, not its cause.

Yet crack-up booms eventually destroy the bloated and unsustainable incomes generated in the raw materials, capital goods and consumer durable sectors during the boom phase. Accordingly, even the red suzerains of Beijing can not get from here to there. The phantom incomes that resulted from paving nearly half of the Asian continent occupied by 20% of the world's population must inevitably shrink, meaning that China's consumption and service spending will falter, too.

**Stated differently, China's red capitalism is the new black swan.** There is nothing rational, stable or sustainable about it. Moreover, the consequence of its pending collapse will be literally earth shattering.

That's because in recent years it has accounted for a lot more than the one-third of global GDP growth conventionally cited. The latter is just a measure of border-to-border economic statistics.

But the second and third order effects are equally large. From the bowels of Australia's iron ore mines to the top of Dubai's pointless 100 story office towers, the entire warp and woof of the global economy has been distorted and bloated by the central bank money printing spree of the last two decades, led by the red credit machines of Beijing. Everywhere economies have succumbed to over-building, over-consumption, over-financialization and endless dangerous, unstable speculation.

So forget the cleanest dirty shirt meme or the preposterous Wall Street nostrum that the US economy has been "decoupled" from the rest of the world. That's unadulterated hogwash, and

*its means that the stock market and risk assets are heading for a thundering crash."*