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Getting China Right

Skepticism about the Chinese economy remains widespread

We continue to believe that getting the Chinese story right is the most important job of the next five to ten years. There are few investment questions that don't lead back to China, whether we are projecting energy growth, trade across the Pacific or technology trends, China cannot be ignored.

While we are optimistic at this point about the future of China, we need to test our ideas constantly to avoid stepping into a trap. Here are some legitimate questions that require thoughtful answers:

- Is the Chinese real estate market entering a bubble stage?
- Can we trust the government statistics coming from Beijing?
- Will Chinese growth come at the expense of economic health in the USA?

Our quick answers to these are: No, No, and No.

Real Estate: Real estate bubbles result from easy access to credit such as the "liar loans" here during most of the 2000's. Here are a couple of numbers that suggest that Chinese real estate is far from the bubble state: 1) from 2002 through 2009, only 34% of the cash put into real estate came from mortgages and 2) banks still require 20% down on first homes in China and 40% down on second or investor owned apartments.

There are 4 to 5 million people moving to urban centers in China each year. They need to be housed and for now sales are running higher than completions. We think a residential real estate bubble is possible in China, but not now.

Office construction is a different story. There's no doubt it is over done and the process for approvals is driven more by politics than economics. However, over 80% of the market is residential and that's where we are focused.

We just printed a 59 page report on the Chinese real estate and construction industries. It came from our newest research source in Beijing, a group I will be visiting with next week on a trip to Hong Kong. I'll let you know what I learn.

Government Stats: We're pretty sure that Beijing is no better at measuring its economy than any other government and is probably worse. Happily, there are other sources of information and one reason for my trip to Hong Kong is to meet with GaveKal Research and others to gain some more confidence in these sources.

The primary numbers we need to watch relate to migration inside China. Right now 15 to 20 million people a year leave the \$300 per capita world of the farm and villages and move to the \$3,500 per capita world of manufacturing and construction. There seems to be another 10 years left in this process. If it slows or stops, the Chinese growth story is over.

Is China a threat to the US? The answer is “no” if we are looking at the total economy. But there is no doubt that Chinese labor is hurting low skilled workers in this country and other advanced regions of the world. If the US economy fails to grow as it has in the past we think this will be a totally self-inflicted condition, not a result of Chinese competition.

When you hear that China will rule the economic future, keep in mind the same predictions about Japan in the 1980's. The US can compete if it chooses to.

As I did last summer from Shanghai I hope to be sending some pictures and thoughts from Hong Kong. I'll be attending two investment conferences as well as meeting the team at GaveKal. It should be an intense educational experience and one that will help us make the right decisions over the next few years.

If we get China wrong, it won't be for lack of trying.

Best regards,



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