

Hello Everyone,

Look at this recent headline:

Does A Sudden Surge In SO2 Levels Suggest A Huge Surge In Cremations Across China?

Apparently, rising sulfur dioxide levels can be attributed to burning bodies. It can also be the result of burning trash.

Of course, we wouldn't have headlines like this if China would just come clean about the situation.

But, since they won't, people tend to look for alternative ways to get to the truth. I get that. I'm trying to do the same. But since I don't know much about SO2 and cremations, I'll stick to finance.

Today's missive tries to connect China's GDP ...to trade tariffs... to the coronavirus. I'll let you decide if it's a stretch.

Signed, Your Hopes-China-Is-As-Concerned-About-Controlling-The-Virus-As-They-Are-About-Controlling-The-Narrative Financial Advisor,

Greg

KKOB 02.10.2020 China and Coronavirus

Part 2

Bob: So, Greg, apparently your segment on Chinese banking and the coronavirus hit a chord last Friday. Therefore, you want to stay on that theme again today, right?

Greg: I do. I'll say this...you have a very informed (and opinionated) audience. So, let's go a little deeper into the China-coronavirus situation...and its potential economic impact.

First, I think everyone knows China continually reports 5-7% annual GDP growth rates. Meanwhile, we report 2-3%. And while China's emergence is hard to argue, it may not be as great as they say. Here's why.

Bob, let's say the Chinese decided to build a giant statue of Mao in downtown Shanghai. And around this statue they decided to

put fountains, a park, a museum, and a massive underground parking lot.

Oh, and they are going to tear down some apartment buildings in the area to make room for this mega-project; which means they'll relocate people to new apartments in the suburbs.

Now, as they do all this construction, does that contribute to their GDP? Sure. Think of the concrete, steel, lumber, glass, and labor needed to pull this off. All that increases their GDP number. But, let me ask you this, "Is this productive use of resources? Does this kind of project lead to long-term wealth creation?"

Bob: Well, no. It might be impressive, but ultimately you spent a lot of money on a statue. And there was no benefit in building new apartments when the old apartments were serving their purpose. This is really all just "make-work".

Greg: Right. Well, China has done a whole bunch of this "make-work" with ghost cities that have never been occupied, factories that weren't needed, and ill-conceived public works projects which made local officials rich without providing much benefit to the population.

And now the Chinese must deal with the coronavirus. 400 million are now in lockdown and can't work. This is the kind of unexpected shock that amplifies past mistakes. Had they instead encouraged a more free-market/efficient system, they would have savings from their economic miracle to fall back on. Instead, they have massive amounts of bad debt.

All of which leads to this question.

Bob, if you were a Chinese business owner, what is more important to you, paying your creditors back...the guys who loaned you money...or keeping your shareholders happy?

Bob: I would say paying my creditors back. If I don't pay my loans, they could take my business. I can always tell my shareholders things will turn around someday, but not if my business is in foreclosure.

Greg: I agree. So, this the connection I want your intrepid listeners to make. China has many structural problems, because communism by its very nature is corrupt and inefficient.

Even before the coronavirus outbreak, China's stock market had gone nowhere for 10 years. Let me repeat that. China's Shanghai Composite Index is where it was in April of 2010. Shareholders aren't happy, but at least loan payments were being made, or restructured, or assumed by the government.

Now, coronavirus, could make billions in loan repayments nearly impossible.

So, what can China do? Well, last week China dropped tariffs on over 1700 American products by anywhere from 10%-50%. They say it's a goodwill gesture in trade talks with the US, but my guess is they are bracing for an economic shock...and they need soybeans, oil, pork, and consumer goods.

Bob: I can see that, but I don't think we should cheer this news. This would mean the virus is more widespread than they are letting on. And to think a Chinese recession (or depression) wouldn't affect the rest of the world isn't reasonable.

Greg: Agreed. With that said, it's not panic time. We are still early in this game. Six weeks ago, no one had heard of coronavirus.

But our goal as investors is finding truth, because you'll make better decisions based on facts. We know China won't be truthful, so we follow the money instead.

So far, banking is holding up. That's good news. The tariff reduction announcement, however, hints the situation is worse than they say. In short, the jury is still out.

Bob: Great report. How do people reach you?

Greg: My number is 250-3754. Or go to my website at zanettifinancial.com.

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