

## THE MORE THINGS CHANGE, THE MORE THEY STAY THE SAME

WEB BUZZ 2009.08.03

One of the seeming bright spots in the world economy has been China. Their latest GDP number was a positive 8%. With their exports, which is what they live on, being down some 20% and their middle class still relatively small, we wondered where all this growth was coming from. In that regard, several articles came to our attention that make us think that the next bubble we wondered about is probably happening right now before our very eyes but, rather than at home, it is happening far, far away.

The major article, which appeared recently in *The Financial Times* of London, was by Stephen Roach, former chief economist at Morgan Stanley and now chairman of their China subsidiary. The title of the piece is "I've been an optimist on China. But I'm starting to worry." The article can be found [here](#).

Stephen Roach's view on the unsustainable global economic model, in our mind, is legendary. He was the only Wall Street economist we know of to understand and predict the mess that we are currently facing. In simple terms, China produces and exports and the U.S. borrows and imports. That just cannot go on forever, and, of course, it hasn't. His solution calls for China to become more of a consumer (their savings rate is currently 40%) and the U.S. to become more of an exporter. What have China and the U.S. done in the way of policy response to the recession to address this problem? China has implemented a stimulus plan to the tune of \$585 billion. This was done by asking the banks to lend the money and they have done so. Their loans have been used for more investment rather than to stimulate consumption, which moves their economy in the wrong direction. The U.S., on the other hand, has stimulated consumption, which, again, takes us in the wrong direction.

The world-wide recession has also caused the natives to become restless. Note the riots taking place in northwest China and the tea parties taking place here at home. Now what does this all mean? First of all, we are not solving the disconnect that led to our problems; just the opposite. Second, in our mind the recovery that seems to be about to take place will be tentative and fraught with danger.

Stephen Roach's article "I've been an optimist on China. But I'm starting to worry." in *The Financial Times*: [http://www.ft.com/cms/s/0/42d38b2c-7bd6-11de-9772-00144feabdc0.html?nclick\\_check=1](http://www.ft.com/cms/s/0/42d38b2c-7bd6-11de-9772-00144feabdc0.html?nclick_check=1)