The US and China in the Global Financial Crisis

Our Chinese friends, including government officials, now often joke that the US is increasingly becoming the "socialist" king of developed economies with its ever greater government "interference", while China is increasingly becoming "capitalist" to deal with issues of revaluation, unemployment and A and B share headaches. It makes one wonder what the new economic paradigm will look like ten or twenty years downstream. In any case, one thing is clear, and that is the deep interdependence of the US and China – a relationship that may portend more for the world's economic future than nearly anything else one can name.

China has depended on exports for growth to a much greater degree than other countries. So when a global recession hits, China gets hit disproportionately. The current slowing of the US economy has already caused many small and medium-sized export-oriented Chinese manufacturers, located mainly in the Pearl River Delta, to close their doors, putting thousands out of work. And the fear of social disruption due to labor unrest is always a red flag for China's leaders.

Conversely, it is China's buying power – i.e. import power - that has been the engine of the global economy for the last decade. If China's infrastructure growth slows up, the US (and the world) will slow up accordingly, or quite possibly seize up. If we think the sub-prime crunch is bad, imagine what would happen if China's economy suddenly stopped expanding! Boeing, for one, might well be joining the car companies on Congress's doorstep.

So, last week, Beijing announced its 4 trillion yuan ($586 billion) stimulus package, the largest in the country's history. It was a strong move to try to keep the world economy from getting even worse. Beijing also sharply increased export tax rebates for over 3000 products in an attempt to re-stimulate exports, and she will loosen credit, cut taxes and embark on a massive infrastructure spending program to boost internal market demand and create jobs. With these moves, China sends the message that it recognizes its role and importance in the global scheme of things, and it was not going to miss the chance to point this out to everyone.

Most important, China will protect its own interests, which include protecting its largest export market, the US, and its largest investment, US Treasury bonds. China's export value to the US last year was US$232 billion, more than twice the value to its number two export target, Japan. And in September this year, China surpassed Japan to become the largest holder of US government bonds, at a whopping value of US$585 billion. China desperately needs a strong America to protect these values.

Forecasters believe that China's growth will slow from 11.9% last year to under 10% this year. Most of the impact is being felt in the low end, export sectors, like toys and tee shirts. However, in a number of high end marketplaces like nuclear power, wind power, high speed railways, and aircraft, China is really humming along. For example, China is starting a jumbo aircraft development program. The aircraft will be designed and assembled in Shanghai, but parts will be sourced globally, which is the same model adopted by the two dominant commercial aircraft groups, Boeing and Airbus. And, at the recent Zhuhai Air Show, which we attended, the Commercial Aircraft Corporation of China (COMAC) signed a 5 billion yuan (US$ 735 million) contract to sell 25 ARJ21-700 regional jets to GE Commercial Aviation Services (GECAS) – a huge step for China's homegrown aircraft business. Related to this, Boeing just announced that it will expand its composite materials JV in Tianjin by 60%, as it sees demand for light-weight materials picking up substantially. So, from alloy steels for landing gear to traffic control systems to avionics, China's growth is critically important. And it's the same in other industries. Just ask GE, for example.

The Yuan-to-USD revaluation has made US exports much more attractive. SCI has seen its sales of capital equipment continue strong – turbine bearings, diesel engine crankshafts, coal crushers. In fact, this is a perspective on the financial crisis that you don't normally hear. The *productive* economy, as opposed to the *financial* economy, has been doing fine, at least so far as US-China business is concerned. To take another example, the power industry, China continues to build hundreds of new, sophisticated power plants to support growing internal electricity demand, and is investing heavily in wind and hydro power and alternative energy development. It is highly likely that this expansion will continue, even if the rate slows a little. We really believe that China's market demand for high-end foreign products related to energy saving, new energy, new materials and environmental protection, etc. is real and is big.

The current financial crisis is huge and we don't know how it will end. But the powerful US-China economic dynamic needs to be a key consideration.

For more information about us, please take a look at our full approach and advantages on our website at www.s-c-i.com, or call Shiqiang Gu at 610-828-8061, or Dr. Timothy Weckesser at 610-828-8060. We look forward to hearing from you.