

What is happening in the global world?

Written by: Colin Thompson

China is synonymous with strong and secure economic growth. Indeed, so entrenched is this sentiment that commentators talk of Chinese exceptionalism; i.e.; that the usual rules of economics do not apply. But rules are rules. And there's concern that China's rapid build up of credit has left it vulnerable to a sharp slowdown. A very fragile China are in deep trouble that will impact globally!

Dragon's Debt. China's solution to the economic and export fallout from the financial crisis was to invest more at home. So it's been consuming a strong cocktail of excess investment fuelled by large debt. It's a heady brew that leaves the country's banks sitting on a high level of bad loans, as signalled last week. And the strains are beginning to show. As China faces this problem/major issues globally while trying to reform its economy, the best outcome is that growth will slow substantially. But there's still time to avoid the worst. China's issues will impact on global economies and effect growth!

UK's Two Directions. Although the number of mortgage approvals fell in April, the average value of each approval rose. The UK housing market is currently experiencing two opposing winds. One is new mortgage regulations, sensibly aimed at ensuring borrowers are better able to afford a future rise in mortgage rates. The other is rising demand, supported by Help to Buy. So far the scheme has helped over 27,000 households buy a home, most of who bought properties valued at £250k or less. Banks lending to many very high borrowing proposals for houses and many overseas buyers just buying for investment and not letting the houses!

A stitch in time. No member of the UK Monetary Policy Committee (MPC) has voted for a rate hike for almost three years (since July 2011). But it looks like that will change before too much longer. In an interview with the Financial Times, MPC member Martin Weale said that if you want to raise rates gradually, then you have to start sooner. He said "we can wait a bit longer" but the implication is he will be voting for a rate hike before the year is out, possibly as early as August. If markets are correct, it will be the first half of next year before a majority of the nine-person committee joins him. Major challenges on bank rate rises will see many house borrowers very worried for the future!

And I'm feeling good. UK firms and households are feeling chirpy. May's GFK consumer confidence index rose to its highest level since 2005. Although consumers are particularly pleased with the UK's economic performance, as well as hopeful about the future, they've yet

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to see a marked improvement in their own finances. Likewise, the CBI growth indicator reported that British firms are experiencing the strongest growth in orders and activity since the survey began in 2003. We already knew the UK economy has a spring in its step. But few of us mind being reminded of our good points all the same. Growth based on UK government and domestic borrowing THEREFORE TROUBLE AHEAD WHEN THE UK BANK RATE RISES!

Do not panic. US output shrank by 1.0% on an annual basis in the first quarter, enough in normal circumstances to have us reaching for the panic button. But there's no need. Firms running down their stocks accounted for a large chunk of the fall and the icy grip of winter on construction activity for most of the rest. Growth of 3.1% in consumer spending was a more accurate reflection of the economy's health. And with the Purchasing Managers' Index hitting a four year high in May, Q1 looks like no more than a blip. Domestic and Government borrowing are very high, so there will be major trouble ahead!

Bubbling along. US house prices increased by 10.3%/y/y in March according to Case Shiller. That's a little slower than the 11%+ rates recorded in the second half of last year but not much. Incomes are rising at a fraction of that rate, so house prices are becoming less affordable by the day. Yet with US long-term interest rates falling to their lowest levels in almost a year and mortgage rates following them, a frothy housing market could be with us for some time yet. Many challenges ahead with a flat housing market in the future! Will we see the same problems as we did in 2008?

Cosy. We're used to reading about the high price of houses. But less attention is paid to the wider costs. London's meteoric house price growth is having an effect on how many people are living in a typical house. The share of households with six or more people rose by a third in the 10 years to 2011. Cosy, as estate agents might say. Estate agents making a fortune again on the back of very high selling prices!

Crossroads. India's economy grew 4.6%/y/y in Q1. Although that's a decent pace of growth by western measures, its low for a country at India's stage of development. India's most powerful economic weapon is a functioning democracy. However, the country has just elected a proven reformist as prime minister with a strong parliamentary majority. India's problems/issues are a mirror image of China's. It's underinvested in infrastructure. That may be about to change. India running into economic trouble the same as China, therefore the impact is a double whammy globally!

Very Fragile China/Very fragile India! Globally, there is trouble on its way `big time`!

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