
# How, When, and Why China Will Become the New Financial Capital of the World

By Martin Armstrong

# DISCLAIMER

The information contained in this report is NOT intended for speculation on any financial market referred to within this report. Armstrong Economics, Ltd. makes no such warrantee regarding its opinions or forecasts in reference to the markets or economies discussed in this report. Anyone seeking consultation on economic future trends in a personal nature must do so under written contract.

This is neither a solicitation nor an offer to Buy or Sell any cash or derivative (such as futures, options, swaps, etc.) financial instrument on any of the described underlying markets. No representation is being made that any financial result will or is likely to achieve profits or losses similar to those discussed. The past performance of any trading system or methodology discussed here is not necessarily indicative of future results.

Futures, Options, and Currencies trading all have large potential rewards, but also large potential risk. You must be aware of the risks and be willing to accept them in order to invest in these complex markets. Don't trade with money you can't afford to lose and NEVER trade anything blindly. You must strive to understand the markets and to act upon your conviction when well researched.

Indeed, events can materialize rapidly and thus past performance of any trading system or methodology is not necessarily indicative of future results particularly when you understand we are going through an economic evolution process and that includes the rise and fall of various governments globally on an economic basis.

CFTC Rule 4.41 – Any simulated or hypothetical performance results have certain inherent limitations. While prices may appear within a given trading range, there is no guarantee that there will be enough liquidity (volume) to ensure that such trades could be actually executed. Hypothetical results thus can differ greatly from actual performance records, and do not represent actual trading since such trades have not actually been executed, these results may have under– or over–compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated or hypothetical trading programs in general are also subject to the fact that they are designed with the benefit of hindsight and back testing. Such representations in theory could be altered by Acts of God or Sovereign Debt Defaults.

It should not be assumed that the methods, techniques, or indicators presented in this publication will be profitable or that they will not result in losses since this cannot be a full representation of all considerations and the evolution of economic and market development. Past results of any individual or trading strategy published are not indicative of future returns since all things cannot be considered for discussion purposes. In addition, the indicators, strategies, columns, articles and discussions (collectively, the "Information") are provided for informational and educational purposes only and should not be construed as investment advice or a solicitation for money to manage since money management is not conducted. Therefore, by no means is this publication to be construed as a solicitation of any order to buy or sell. Accordingly, you should not rely solely on the Information in making any investment. Rather, you should use the Information only as a starting point for doing additional independent research in order to allow you to form your own opinion regarding investments. You should always check with your licensed financial advisor and tax advisor to determine the suitability of any such investment.

# Contents

# Preface

Throughout recorded history, the **Financial Capital of The World** has never been in a fixed location. "In the future, everyone will be world-famous for 15 minutes," is one thing Andy Warhol will always be famous for saying. Nevertheless, from an economic standpoint, it is absolutely true. If this were not a true statement, we would all be speaking Babylonian today.

Of course, everywhere that has ever occupied that lofty position also assumes that they will retain that stature indefinitely. No one ever thinks for one moment that there is a clock ticking away that defines their destiny.

A nation does not rise to the top entirely by its own merits. As they say, it takes two to tango. The natural cycle of life of empires, nations, and city states is hallmarked with the abuse of government, official greed, and delusional arrogance. They will typically assume the posture as a government grows of benevolence, authoritarian when it convinces itself it is for the good of the people, and then the final state of madness where it no longer believes what it does is for the people, but the people merely serve the state. Like a human being, we are born in innocence, mature in self-interest, and finally go out far too often with regrets or dementia.

This is one of those moments in history where the balance of financial power will shift from the West to the East. It is not merely the prowess of China that will accomplish this amazing shift, it is the West's turn to collapse from the distortion of economics ushered in by Karl Marx.


ArmstrongEconomics.COM

# The Power Shift of 2032

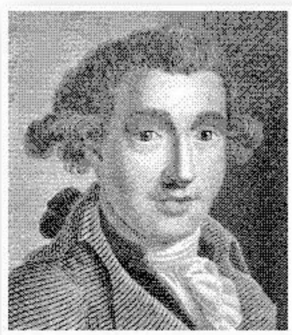
The **Financial Capital of the World** has never been stagnant. The rise of a capital and the decline of another is not due to a competitor merely envisioning how to do a better job. China will rise relative to the West as socialism dies. The process is set in motion by the internal decay of society in the current financial capital as it moves through the cycle of life — it is born, it matures, and then it dies.

The fall of every empire throughout recorded history follows a similar pattern. It begins with extended periods of weakness followed by unsustainable bursts of strength that inevitably are followed by a resumption of the economic decline. These bursts of countertrend recoveries in economies are like the process of dying. They appear weak, and then suddenly there is a rally for a day giving false hope that they will recover only to weaken and then die.

This very same pattern befalls political states of all sizes. The forces that motivated its destruction comes from the internal decay at the hand of corruption which infects its rule of law. The state always rules in its own favor; all liberty, rights, privileges, and immunities die as well. The economic decline of the West is in motion and government is rapidly descending, hurling to its death.

Still, no government simply hands back the scepter of power willingly. Acting in their own self-interest, governments will battle against the loss of power as it begins to slip through the fingers of its clenched fist. Yet, all governments remain in a state of denial until the end. They see the discontent public as criminals and their solution is to stamp them out by grinding them into the dust.

The cycle of all governments may begin with the belief that they are righting all wrongs. The power corrupts them from within. They rapidly move from a



**Thomas Paine**
**(1737–1809)**

## Common Sense

***Some writers have so confounded society with government, as to leave little or no distinction between them; whereas they are not only different, but have different origins. Society is produced by our wants, and government by our wickedness; the former promotes our POSITIVELY by uniting our affections, the latter NEGATIVELY by restraining our vices. The one encourages intercourse, the other creates distinctions. The first a patron, the last a punisher.***

***"These are the times that try men's souls."***

benevolent state for the people into the darkness where the solution is more power. They then transform from benevolent entities to authoritarian and as power continues to slip away. Then they move into dictatorial power which is the final stage of their demise.

The American Revolution followed this pattern quite well. The majority of the people had not yet reached the idea of actually starting a revolution. Many saw the Revolutionists as troublemakers. Then on January 10, 1776, Thomas Paine published his pamphlet *Common Sense*. Paine migrated to the British American colonies in 1774 with the help of Ben Franklin. Paine signed his work anonymously "by an Englishman". It took just three months (one pi cycle) to sell over 100,000 copies to the two million residents of the 13 colonies. Paine won the title Father of the American Revolution, for it was his writing that inspired the people. He astutely identified the problem with government. They always confused the nation with government believing they, and not the people, were all that mattered.

Thomas Paine moved to France where he became deeply involved in the French Revolution. *He wrote Rights of Man* (1791) in defense of the French Revolution. He was tried in absentia in England and found guilty of the crime of seditious libel against Edmund Burke. The British government under William Pitt the Younger was deeply concerned that the French Revolution would infect Britain and all of Thomas Paine's works were banned in Britain. This British token clearly makes the hatred of Paine quite distinct.

Paine's central theme advocated the right of the people to overthrow their various governments under monarchy, which was not very popular among those in power. Paine was even elected to the French National Convention despite the fact he could not speak French.

In December 1793, Paine was arrested and taken to Luxembourg Prison. That is where he wrote *The Age of Reason* (1793–1794). Future President James Monroe used his diplomatic connections and Paine was released in November 1794. He eventually returned to America. However, he had also written against organized religion. Because of that stand, when he died on June 8, 1809, only six people had the courage to attend his funeral.

Even if we look at the French Revolution, the ministers who assumed power were worse than the people they deposed. Then Napoleon succumbed to the cycle and crowned himself emperor as if that were different than "king."

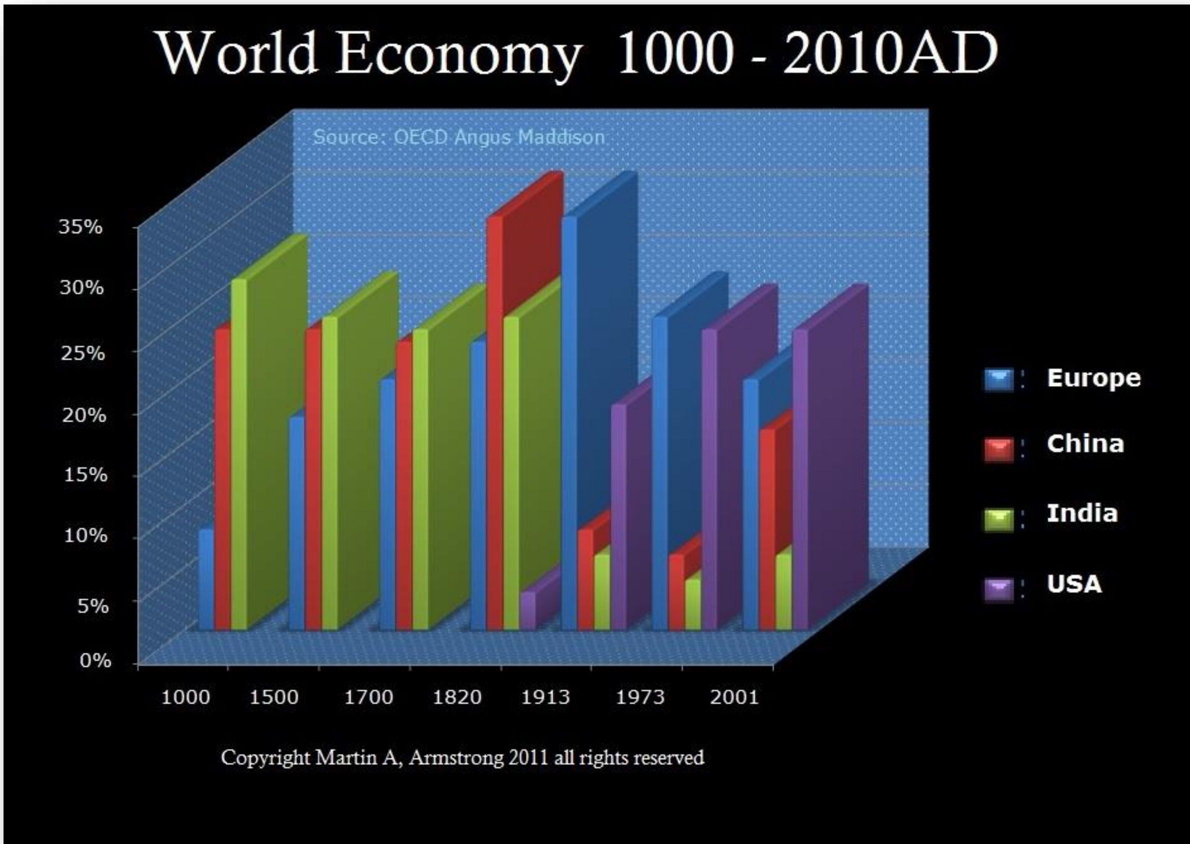
**King Charles I** **(b 1600; 1625-1649)** | **Oliver Cromwell** (b 1599; 1653–1658)

Then of course there is the English Revolution and Civil War (1642–1651). The Puritans managed to behead King Charles I. However, Oliver Cromwell then placed his image on the coinage, wearing a laurel wreath as did the Roman Emperors, and King Charles I but claims the title Lord Protector. This is what gives meaning to the King is Dead, Long Live the King.

When the Puritans gained control after beheading Charles I, their values were instilled on the public. The theatres were closed by an official ordinance since it was considered improper to indulge in any kind of diversions or amusements. In 1647, another and more imperative order was issued. Due to certain infractions of the previous ordinance, the Puritans threatened to imprison and punish all rogues who broke their enactments. The Puritans outlawed kissing wives in public, as well as all sports, and prohibited celebrating Christmas, since to them this was exclusively a time of prayer. Religion has far too often been the excuse for war. There is always an excuse for one group (the majority at the time) to oppress the minority. Hence, the historical and well-known clash between Protestants and Catholics in Northern Ireland.

The American Revolution was supposed to be all about **“We the People.”** Yet politicians came about and by the next generation they were paying themselves and serving in Congress without limit. Laws were then enacted to support the political class all the way to things like Obamacare applied to the people but not to politicians. They even exempted themselves from insider trading in equities. Once they taste power, they refuse to give it back.


As each empire came, its currency presented it as the financial capital of the world. Yet the world was divided into two – East v West. Here are the coins reflecting the empires of the West. Each had its place in the sun; each abused its power, became corrupt, turned against their people, and lost their support. With time, each declined into the memories of recorded history books.

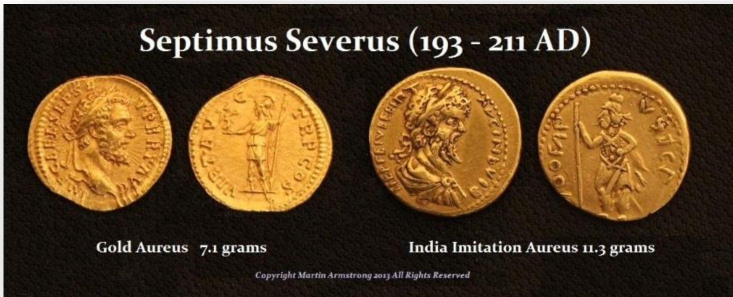



Likewise, the rise of China in the East demonstrated a very important part that so many purposefully overlook. China's monetary system was based upon power — not precious metals. Its coinage had little tangible value for they were made of bronze and then degenerated into iron. Japan began the same way, but with each new emperor, they devalued all outstanding money and issued their own. That led to the distrust of the Japanese monetary system and the people turned to commodities and the coins of China. Japan lost the ability to issue coins for 600 years. It was all about

Qin Dynasty, Shih Huang-ti (246-210 BC)
Ban Liang (1/2 Liang)

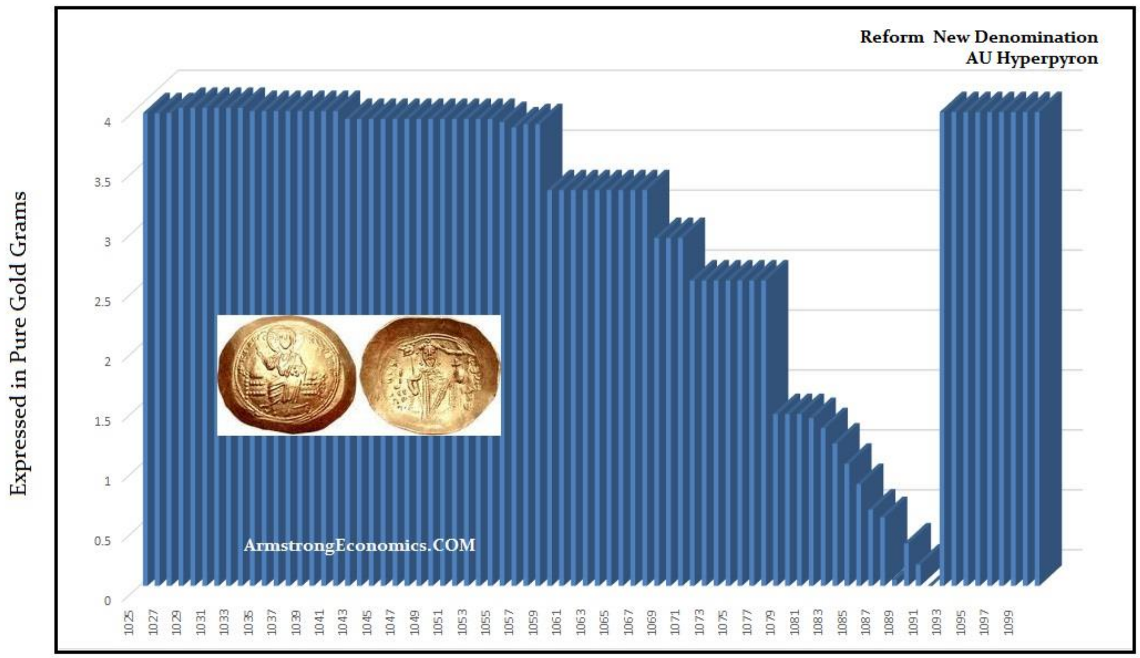
what the people believed. Did they "trust" the coinage enough to use it? Does money need to be gold or something tangible? China proved that idea was just wrong.

So why has our computer been projecting the shift in the **Financial Capital of the World** from the United States to China? The computer is monitoring everything that essentially drives the capital flows around the world. From Babylon, it moved to Athens, then Macedonia took Greece and the rest of the world. Then the Romans took the title from Greece and eventually Rome split into two with the East surviving as the new Byzantine Empire.




## Byzantine Great Monetary Crisis of 1092AD

Gold Content of the Histamenon Nomisma




The debasement of the Gold ***histamenon nomisma*** in Byzantine reflects the fall of the empire. From the start of the debasement to the Great Monetary Crisis of 1092, it was just about one ECM 51.6-year wave down. When Byzantium fell in 1453, the **Financial Capital of the World** moved to India, who all long made a fortune on spices. We find that India imitated Roman coins for more than 100 years. Obviously, they imitated Roman coins because they were worth a premium over the actual metal content.

After a brief time when trade was really cut off with Europe, India lost the title to China for it failed to develop an internal economy to boost its own GDP without reliance on external trade. This is a very critical lesson to understand for boosting one's exports does not create long–term economic growth.

Nevertheless, the wealth of India was legendary. During the medieval days of Europe, pepper was worth more than gold. The spice trade is what brought the wealth to India, which is why Columbus attempted to set sail for India. China then developed a more internal economy than India and surpassed it in wealth. Thus, the **Financial Capital of the World** moved from India to China based upon the fact that latter established an internal economy.

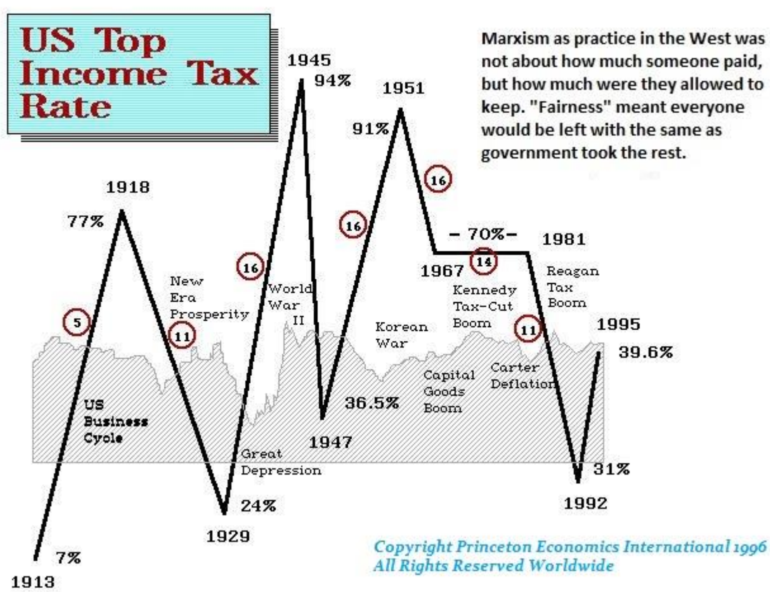
Columbus' discovery of America propelled Spain into the slot of European financial capital surpassing Italy, which was the home of banking in Sienna and trade. The Spanish never bothered to develop a domestic economy and squandered their riches.

Consequently, Spain became a serial defaulter. They defaulted on their debt seven times until they succeeded in converting Spain into a third world country within Europe.

The financial capital within Europe briefly passed to Germany from Spain, but then the Spanish defaulted on their debt and wiped out the German bankers. The capital then moved to Amsterdam followed by Britain only after the marriage of William of Orange to Queen Mary.

The British began engaging in empire building, taking to the high seas. They too went to Asia and managed to take the title from China back to Europe. After World War I and World War II, the British lost that title as the United States of America emerged with 76% of the world's official gold reserves.

So here we are. The United States adopted Marxism when it was very popular at the turn of the 20th Century before anyone saw the horrors of the Russian Revolution in 1917. The USA altered the American Constitution, removing the safeguard of personal liberty which was the prohibition against direct taxation. The introduction of the income tax in 1913 ensured that the United States would descend into socialism. Yet, it did something more. It made everyone account to the government what they earned. They could not imprison someone for not paying, and so the penalty became failure to file taxes. Then they claimed they would only tax the rich followed by the payroll tax for World War II.



Tiberius (14-37AD)

Genuine AU Aureus (7.82 grams) — India Imitation (6.69 grams)

Now the United States is losing that title of the **Financial Capital of the World** as it shifts to China. The decline of the United States is not that dissimilar to that of the fall of Byzantium. India was out to beat Constantinople. Like China, they were making a fortune on trade especially in spices. In fact, Southern India simply used Roman coins and when there was a shortage they would imitate Roman coins, not counterfeit them. Bullion was simply worth more in the form of a Roman coin so the imitations were real gold and on comparable weight. These imitations are known to have appeared at least during the reign of Tiberius (14–37 AD) and appear to have continued until around 240 AD.

**INDIA Kushans - Vima Kadphises**
**(Circa 90-100 AD) AV Dinar (7.88 grams)**

The mere fact that India imitated the Roman coins validates the proposition that Rome was the financial capital of the world. This was like US dollars being used in Russia or China. Actual Indian coins first appeared in northern India around 100 AD in the Kushan Empire. Southern India traded directly with Rome. Before he died in 180 AD, the Roman Emperor Marcus Aurelius sent a diplomat to the emperor of China. World trade and empires existed among those whose currency was dominantly defined where and who was the financial capital of the world.

## The Great Monetary Crisis of 1092

**Alexius I Comnenus**

**(1081 - 1118AD)**

**Pre-reform Histamenon Nomisma** *(Electrum Gold 8 carat 4.24 grams)* | **Pre-reform Histamenon Nomisma** *(Silver 4.02 grams)* | **Post-Reform Hyperpyron** *(Gold, 31 mm, 4.30 grams)*

ArmstrongEconomics.COM

The Great Monetary Crisis of 1092 in Byzantium marked a weakened empire and a desperate attempt to revive its former glory. Interestingly, it would be only 112 years from this event, a half cycle of the 224–year Cycle of Political Change, when the siege and sack of Constantinople occurred in April 1204.

It was 1091 when Constantinople was besieged by the Pechenegs, a semi–nomadic Turkic people from Central Asia. Eventually the Turks took Constantinople or what we now call Turkey. Alexius I Comnenus (1081–1118 AD) defeated the Turks, but this invasion was the main reason for the complete collapse of the gold ***Histamenon Nomisma*** reducing it to a silver.

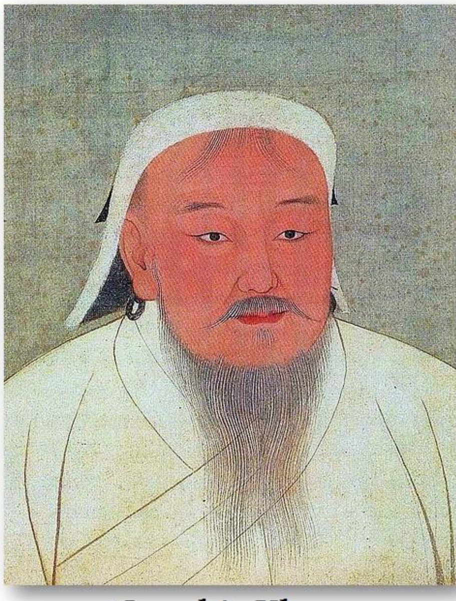
**Michael VIII Palaeologus**

**(1261-1282)**

**AV Hyperpyron Nomisma (25mm, 4.20 grams) Constantinople mint**

ArmstrongEconomics.COM

The Venetians sacked Constantinople in 1204. They retained power there until the city was retaken by the Byzantines on July 25, 1261. During May 1209, the First Parliament of Ravennika was convened by Latin Emperor Henry of Flanders and they set up control of Greece. From that date, it would be 51.6 years when the Byzantines would retake Constantinople from the Latins under Michael VIII Palaecologus (1261–1282). We will see this frequency reappear countless times throughout history.



**Genghis Khan**
(c. 1162 – 1227)

The Mongol conquest of China began as a series of border raids which was perfectly in tune with the Economic Confidence Model. If we only count the border raids that began in 1207 under Genghis Khan and plot that out to 1279 when the Mongol leader Kublai Khan established the Yuan dynasty conquering China, crushing the last Song resistance, it constitutes one 72-year cycle. It was 1271 when Kublai Khan officially proclaimed the dynasty in the traditional Chinese style about one 8.6-year cycle before completing the conquest.

However, if we look closer, China was not one country. It was only during the last 51.6 years that the Mongols began invading the other regions beyond the Xia at the border. In August 1226, Mongol troops approached Wuwei, which was the second-largest city of the Western Xia empire. They surrendered without a fight. In autumn 1226, Genghis took Liangchow and crossed the Helan Shan desert. By November he had laid siege to Lingwu, a mere 18 miles from Yinchuan. It was there where the famous Battle of Yellow River took place when the Mongols destroyed a force of 300,000 Western Xia. Genghis reached Yinchuan in 1227, which is 51.6 years from the fall of the entire country. Genghis Khan laid siege to the city and launched several offensives into Jin to prevent them from sending reinforcements to Western Xia.

Of course, nothing lasts forever and that includes governments. The Yuan Dynasty lasted between 1271–1368, but in reality, at best it survived for only 86 years. The decline was brought about by corruption and high taxes – sound familiar?

The Yuan Dynasty first began to decline during the reign of Buyantu Khan known as Emperor Renzong (1311–1320), when peasant uprisings emerged in southern China. However, despite the warning of the uprisings, corruption of the Yuan court officials continued. Also, power struggles within the ruling class became increasingly serious. For example, during the short period from the beginning of

Külüg Khan's reign, known as Emperor Wuzong of Yuan (1307–1311) in 1307 to the start of reign in 1333, there were eight emperors.


Aurelian (270-275AD) Constructed Defensive Walls Around Rome

During the collapse of Rome's Monetary System, from the capture of Valerian I in 260 AD, there were 15 emperors until Aurelian (270–275 AD) who then built the wall around the city of Rome because of the barbarian attacks. We see the same pattern where there is a raid change in the head of state which undermines confidence.

During this period of 26 years, the corruption in the Yuan Dynasty became severe as subordinate officials were commonly appointed on the basis of bribery rather than merit. Once government falls into corruption, the rule of law then collapses to protect the state. The land was seized and gradually concentrated in the hands of Mongolian aristocrats and a select group of powerful Han landlords. This only inspired the peasant rebellions. Then a fiscal crisis in the Yuan court erupted due to the lavish lifestyles of the political ruling class as we see in America with Hillary renting a beach house for $100,000 a month or in Russia where it was discovered the leaders lived it up high begin walls. Then the final stage enters. The Mongolian army became corrupt and gradually disintegrated. This is similar to how Roman armies would rebel after not being paid and ransack Roman cities because they supported a rival general who was seeking to usurp power. It is **ALWAYS** the same pattern.

During the reign of the last emperor, the real power of the Yuan regime fell into the hands of his ministers. Toghun Temür (1320–1370), Emperor Shun, was the 11th and last emperor of the Yuan Dynasty (1260–1368). He ascended to the throne in 1333 when he was just 13–years–old. He was preoccupied with sex and is remembered for favoring group sex in the palace. He even constructed a stage where he could enjoy performances.

There had been conflicts with respect to the succession of the previous emperor upon his death in 1332. General Bayan broke with El Temür and supported Toghon Temür who would be the last emperor of the Yuan Dynasty.

In 1335, Bayan succeeded in annihilating El Temür's sons and family. Bayan began concentrating official positions of power into his grasp. He was extremely prejudiced in politics and looked down upon the Chinese. He abolished the imperial examination system that ensured people were qualified for positions. His dislike of the Han Chinese led to him convincing the emperor to slaughter all Han Chinese with the surname Zhang, Wang, Liu, Li, and Zhao. He claimed this would prevent a rebellion but it had the opposite effect.

In 1339, Bayan became grand chancellor akin to the Prime Minister and usurped all power. In 1340, his nephew Toqto expressed his concern to his father about the harshness of his uncle Bayan's authoritarian rule. He feared, correctly, that he would bring destruction to the dynasty.

Bayan plunged the state administration into chaos. The corrupted imperial envoys he dispatched managed to plunder local officials, who in turn imposed heavy taxes on the people to satisfy the corruption.

Wu Zhifang, a Confucian scholar in the court, expressed his deep concern that Toqto should take action against Bayan. Once he did, Bayan's support was built upon fear and it quickly turned against him as his power evaporated.

**Toghun Temür 元顺帝妥欢贴睦尔**
**(Born 1320; Reign 1333-1368)**
*11th & Last Emperor of the Yuan Dynasty*

Nevertheless, it was perhaps Murphy's Law – what ever can go wrong, will go wrong all at the same time. During the late 1340's, frequent droughts, high inflation, and famines devastated the population. High taxation added to the discontent and a large-scale peasant uprising unfolded. In 1367, the troops formed by the people against the Mongols were led by Zhu Yuanzhang who captured the Yuan capital Dadu, which was modern Beijing. The emperor fled to Ying Chang which was southwest of Dalinuoer in inner Mongolia today. He later died of diarrhea in 1370.

The Yuan Dynasty was simply destroyed by the peasants' uprising. In 1351, the assembling of a resistance army among the Chinese began. After defeating the Mongols, a new dynasty, the Ming Dynasty (1368–1644), displaced the Yuan Dynasty.

**Wanli Emperor ( 萬曆)**
**(born 1563; Reign 1572-1620)**
***14th Emperor of Ming Dynasty***

Nonetheless, while the Yuan Dynasty peaked with the 11th emperor, the Ming Dynasty peaked with the 13th Emperor and began its protracted decline. If we plotted his reign as we would a market, it appears much like a Panic Cycle.

During the first ten years his reign, Wanli rule saw the economy and military power prosper, reaching its most formidable point in Ming Dynasty history under the guidance of his adviser Zhang Juzheng. When Wanli began to act freely drunk with power after Zhang's death, he reversed many of Zhang's administrative improvements.

Then in 1584, Wanli issued an edict confiscating all of Zhang's personal wealth and purging his family members. This led to distrust of his character and within two years conflicts began to emerge with his vassals throughout the country. Wanli then decided to not hold any council for 20 years and shut them out of any means to object. This simply began the decline and fall of the Ming Dynasty, which would come to a complete end in just 51.6 years — 1636.

A rebellion broke out in 1634 once again due to high taxes. In 1640, masses of Chinese peasants who were starving and unable to pay their taxes no longer lived in fear of the frequently defeated Chinese army. They joined the rebellion and began to form into huge bands of rebels. The emperor found himself without support. On April 24, 1644, Beijing fell to a rebel army without much resistance.

It was 1636 when the Qing dynasty came to power formed by the Han people who claimed the mandate of Heaven had passed to them. This was the last imperial dynasty of China. It ruled China from 1644 to 1912 when the birth of the **Republic of China** was formed thereby ending the monarchy**.** Today, the Forbidden City where the last emperor resides is a tourist attraction.

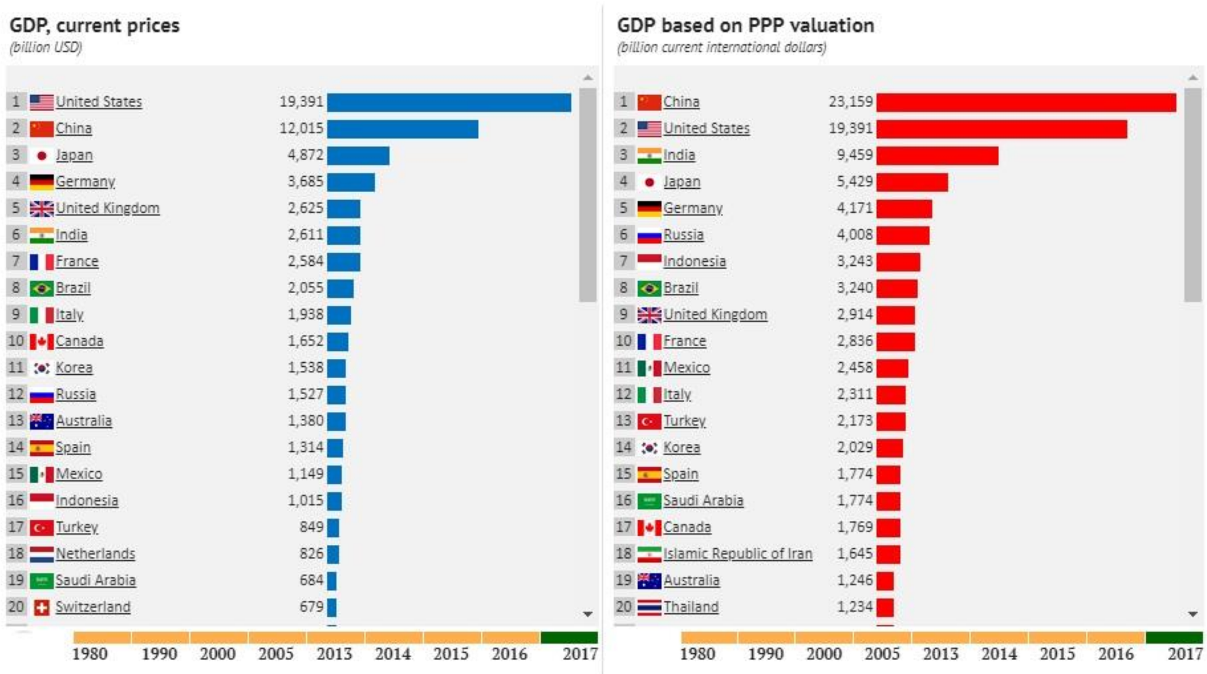
In 1917 during the Russian Revolution, the same unrest spread to China and led to the next revolution and the birth of the **People's Republic of China.**

Note 202 BC is the rise of the Han Dynasty, which is the same year that Rome defeated Hannibal. The parallel correlations are remarkable, which have led some to theorize that there are some periods where humans just rebel around the world collectively for different reasons.

# China Moves to Second Largest Economy in the World

Many people ask why will China surpass the West. They clearly do not know their Asian history. China had been one of the world's largest and most advanced economies prior to the 19th century. China has passed Europe as the second largest economy in the world. In 2017, it actually passed even the United States economy on a purchasing parity basis. So, what does that mean?

Comparing the GDP of one nation to another's can be very misleading. The higher the taxation rates, the greater the proportion GDP is consumed by government which lowers the standard of living. Naturally, government wants to pretend it is taxing the rich and giving it to the poor to better their standard of living. The data argues otherwise. Even before income tax was applied to everyone under the Democrats for World War II. Back then, the wife stayed home and took care of the kids and the house for that was really a form of retirement — the kids in turn took care of their aging parents. Post-income tax, women may think they are more independent for now they can have a career but they lost the ability to stay home and raise the kids. It now takes two salaries to do what one did back in the 1930s.




*Source World Bank*

When we look at what is called the PPP valuation of Gross Domestic Product, China is already **NUMBER ONE!** So, what is this PPP valuation? When we look at an economy, we must consider a number of factors because the culture and taxation are different. Remember, the higher the tax rate, the lower the standard of living and economic growth. Then there is the debt factor.

Costs for everything vary among countries, which means that the missing element in GDP is the standard of living. Taxes play a key role in the standard of living because they apply to everything. Cars, phones, financial services, back massages, etc. exist in all countries but at different prices. If the same smart phone costs $1,000 in the U.S. but only $400 in China, then China's GDP is not exactly reflecting the standard of living. The same can be said within a country. Real estate is significantly high in New York City compared to New Orleans. Internationally, the same thing happens.

If everything is 40% less in China for the consumer, then the GDP of China is being understated by 40% if we simply measure it in gross dollars. Then there is the currency factor. The lower the currency, the lower the GDP when measured in dollars. Obviously, there can be serious problems when we measure economies at market exchange rates. In general, less developed countries have lower prices, which means their GDP gets systematically understated. I had friends in

Europe who retired to Spain for the prices were so much cheaper that they could afford a villa, pool, and a maid for less than what a flat would cost them in London.

Economists have attempted to come up with a way to reflect the standard of living aspect that is lost in the standard GDP calculation. They have created what is known as an adjustment called **Purchasing Power Parity** (PPP), which tries to portray relative prices for comparison. This is by no means a perfect solution. It still must account for things like product quality, which can be hard to measure if not impossible as it introduces subjectivity. Nevertheless, the theory is interesting and takes a stab at a more accurate picture of how much a country really produces. On this level China has already surpassed the United States, but what does that mean?


Still, reflecting GDP through the looking glass of PPP may provide a look at production on a relative value basis, but it still does not reflect debt, savings, and investment. This illustrates the problem as we focus on trade in merchandise but ignore the net capital formation and movement. There are cases where the people do not trust the government and export their money as fast as possible. Then there is the classic person who wins the lottery and far too often ends up bankrupt for they lack the management skills and will rapidly spend every penny only to wake up shocked after it’s all gone.

The debt to GDP ratio is also interesting, yet misleading. In 2008, China's total debt was about 141% of its Gross Domestic Product. By mid-2017 that number had risen to 256%. Countries that take on such a vast amount of debt in such a short period normally face quite a hard landing. This is why everyone is deeply concerned that China has entered a debt bubble.

The total public debt in the US is at about 106% with intra-governmental holdings standing at $5.35 trillion, giving a combined total public debt of $19.19 trillion. US GDP for the previous 12 months was approximately $18.15 trillion for a total debt to GDP ratio of approximately 106%. The problem when looking at the total debt for the USA is that it stands at $73 trillion or over 350% of GDP. Now that sounds really crazy. However, the government debt in total stands at $23.5 trillion, consumer debt at just $15.7 trillion, and the big number is business debt at $33.2 trillion. Now look at the complexity. Here American business is highly international. Therefore, the debt may be raised domestically, but investment and production are offshore. Obviously, that really distorts everything.

China's public debt stands at 46% of GDP but its total debt picture stands at 250%. The public debt ratio to GDP reached at 180% for Greece and France is at 96.5%. China has a very low public debt to GDP and its economy has surpassed all of the EU in total nominal terms.

Still, we have to pick up the rug and look a litter deeper. China's central bank injected cash in the financial system to support growth and thus stimulate the domestic economy.

However, commentators were dead wrong in classifying China's stimulation as a Western Marxism style of Quantitative Easing. The policies of China were a completely different approach that cannot be classified in the same breath as Quantitative Easing. Analogies with the West, or even Japan, are not useful for explaining complex financial matters since they only confuse people. Any comparison is just outright misleading. Chinese monetary policy works in a rather different manner and applying the Western term to China overstates the degree of easing that the central bank actually carried out.


**People's Bank of China (PBOC)**

As always, the talking heads just keep talking and seem to always miss the central point. The QE policies of America, Japan, and Europe bought government debt thinking that they would be buying in the bonds from domestic holders and therefore the liquid money supply would increase and stimulate the economy. There were two fatal mistakes with the entire QE process: 1) it was assumed the banks held the bonds and thus if they had cash, they would lend it out; and 2) while the Fed only bought federal government debt, the Bank of Japan (BOJ) bought the bulk of government bonds while the European Central Bank (ECB) bought federal debt of all member states. The ECB stumbled into a major crisis of simply placing the member states on life support. The worst credit worthy member states saw their interest rates drop below the USA all because of the ECB bids. The Federal Reserve's mistake was the assumption that the bonds were held by Americans. Foreigners sold their long-term maturity issues and swapped to five years or less. The money never entered the US economy.

Back in 2008, I was asked by a member of the House Banking Committee about the entire mechanism of QE. I explained that buying government debt did not stimulate the local economy for much of the debt was held externally and was in fact the reserve currency of the world. I further explained that the original design of the Federal Reserve was to "stimulate" the economy by purchasing corporate paper in times of a contraction when banks were unwilling to lend.


Eventually, the Fed came to its senses and at the FOMC meeting. They finally sought to provide additional policy stimulus by expanding the holdings including large-scale purchases of fixed-rate, mortgage-backed securities (MBS) guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. The purchases were intended to lower longer-term interest rates and contribute to an overall easing of financial conditions. The trading desk at the Federal Reserve Bank of New York began to buy the MBS from its counterparties for open market operators who were primary dealers. The MBS purchase program was announced in November 2008 and the FOMC expanded the size of the program in early 2009. In total, $1.25 trillion in MBS paper was purchased between January 2009 and March 2010.

Buying the MBS was domestic focused and managed to repair where the damage had been intensified — real estate. The stock market bottomed on March 2, 2009, confirming that this change in policy would be successful.


Now, why is Europe still in the midst of a banking crisis and the ECB is the only central bank that can actually go bankrupt? Besides the fact that each member state retained its central bank, the ECB exists only as long as the euro exists. It represents the European project to federalize Europe in an attempt to create the United States of Europe. However, they refused to integrate credit and debt.

The ECB never bought in the mortgage backed debt that was the problem on the member banks' books. Its stimulus was restricted to government debt. The Fed began buying the MBS in 2009, and it took the ECB until March 10, 2016, to announce it would add a corporate sector purchase program (CSPP) to the asset purchase program (APP) known as Quantitative Easing. Therefore, it took the ECB 8.6 years before it would consider buying anything other than government debt.

Now looking at China, we can see that its approach was again completely different from the Fed or the ECB. The **People's Bank of China** looked to acquire assets directly from commercial banks, just as the Federal Reserve did in buying mortgage-backed securities. Another has likened it to Europe's "long-term refinancing operations," reporting that the central bank will lend directly to banks, taking local government bonds as collateral.

Applying Western QE analogy to the **People's Bank of China** does not fit. True, the use of quantitative tools has long been the norm for China's monetary policy. The government still sets a money supply target every year with targets of even 12% M2 growth and regulators rely on lending quotas to influence the behavior of banks. In addition, the central bank also adjusts the required reserve ratio which determines how much cash is available to banks for lending more frequently than it does interest rates.


The "unconventional" policy in China has been its pledged supplementary lending to the China Development Bank. Here, the **People's Bank of China** provides financing which in turn was lent into the economy on infrastructure spending. The Chinese central bank has regularly used similar forms of relending over previous years so this is not a new policy unique to QE. The central bank expanded the lending, but it did not change its previous financial policy. China's monetary policy has been focused on the quantitative nature of tools rather than trying to establish targets based upon price levels.


The second problem with the QE comparison is that it exaggerates the extent of China's monetary stimulus. The loosening of monetary policy was intended to **replace cash** that had left China through Bitcoin and other clever schemes as the Chinese invested around the world. **People's Bank of China** recognized the **capital flight** impact which has been ignored by Western central banks that still look at their economies from a myopic domestic perspective. China was not simply pumping extra money into the economy as the ECB and Fed QE actions using the Quantity of Money Theory.

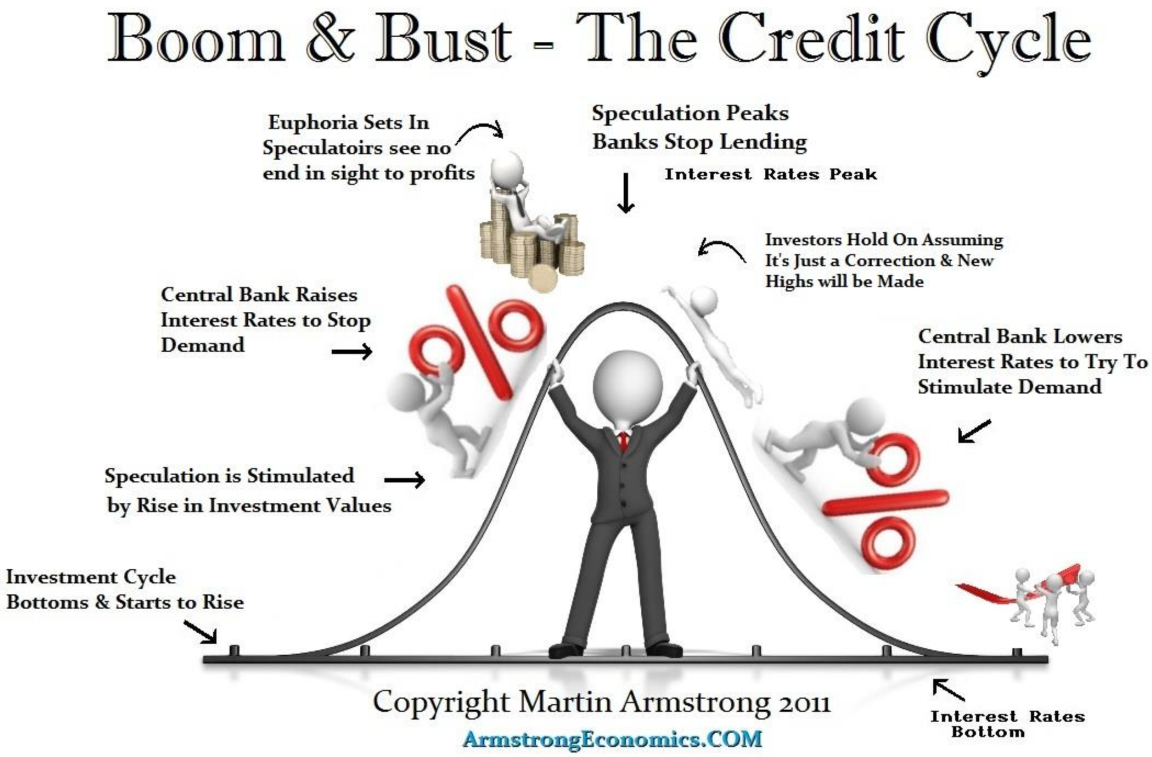
# Capital Flow Analyisis


*It is always a question of Capital Flows*
*Domestically between Investment Sectors*
*& Internationally between Nations and Regions*

Whatever your thoughts and fears about the latest tariff tension, we live in a world dominated by capital flows, not trade flows. Global trade matters, but capital matters more. On April 3, 2014, Bloomberg News reported that the **People's Bank of China** will "closely monitor" new global and domestic economic and financial development, as well as changes in international capital flows according to a statement on monetary policy committee meeting posted on **PBOC** website. A close analysis of the net capital flows reveals that the number one source of money pouring into emerging markets was not coming from the USA, but from China.

The People's Bank of China has adopted our approach to forecasting capital flows, which is strikingly different from the Fed or the ECB who have both ignored international impacts. In the past, the **PBOC** relied on foreign exchange inflows to generate money supply growth. As I have explained, if a foreigner buys a domestic fixed asset like real estate, they are actually importing money which increases the domestic money supply. The **PBOC** understood our analysis and applied it. Yuan was freely created to facilitate buying up dollars being imported. When capital flows reversed and capital began to migrate out of China, then the **PBOC** created new money through alternative channels.

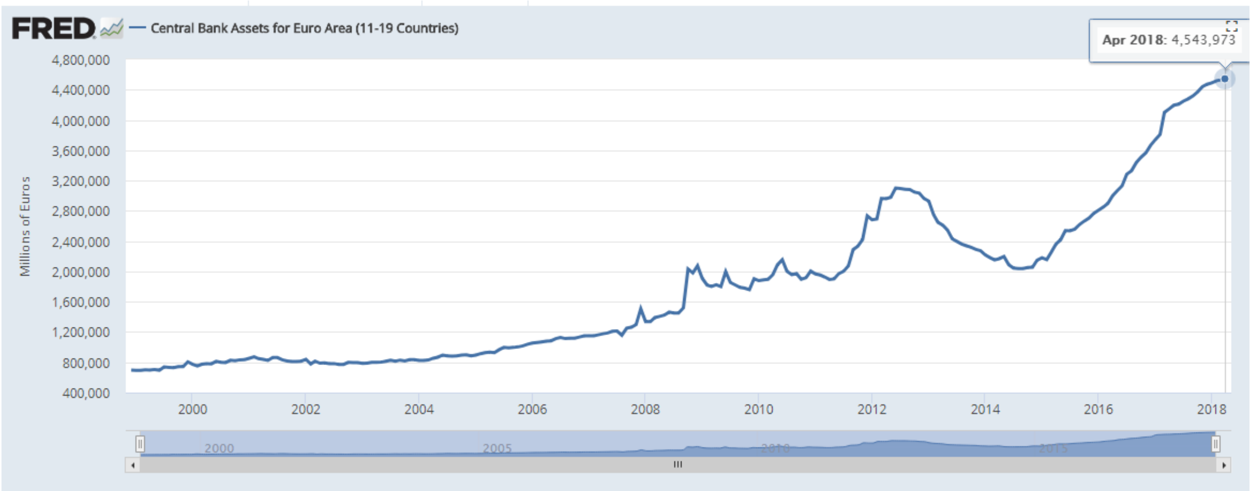
China also has no need for QE. The Bank of Japan and the European Central Bank, among others, have turned to Quantitative Easing because conventional monetary policies simply ran out of room on lowering interest rates to stimulate in theory demand, which has never worked anyhow.




Interest rates in Japan and Europe moved to virtually to zero and even negative in Europe. Their central banks have lost all control of their economies and are beyond coming up with new ways to lower funding costs and spur banks to make loans. China, on the other hand, maintained more conventional policy and was not temped by the insanity of moving to zero to negative interest rates.

The Bank of Japan's holdings of government debt rose to a record in the fourth quarter of 2017 under its quantitative easing The BOJ held a record 449 trillion yen ($4.24 trillion) in government debt at the end of 2017 which was an increase of 6.8% from the same period a year earlier. The BOJ held 41.1% of **ALL** government debt (JGB) which is a historical record. Insurance companies and pensions were the second-largest holders, accounting for 21.6% of all bonds outstanding. Back in July 2017, the BOJ announced it would buy JGBs with no limitation.

In Europe, the total national debt in the Eurozone amounts to about €13 trillion. The balance sheet of the ECB shows they own €4.5 trillion in assets of which €2.5 trillion was government bonds. In Europe, "covered bonds" are sold by banks and backed by pools of mortgages that date back to 18th century Prussia.

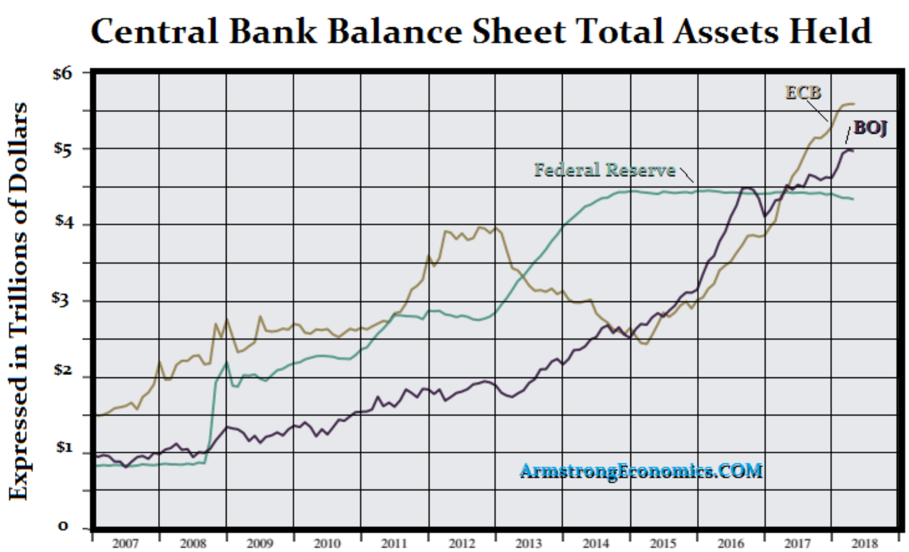



Covered bonds have been an important way European banks maintain a source of funding for mortgage lending. The ECB previously announced that they would buy covered bonds back in May 2009 in hopes that the banks would revive lending, which did not happen as expected. By the start of 2017, the ECB owned 27% of the covered bond market.

The governments of the Eurozone are now addicted to borrowing with the ECB becoming the new permanent buyer. This is why long-term yields on risky European debt are below that of risk-free US Treasuries. The ECB has destroyed the bond markets in Europe and created an unprecedented bubble. Yields on risky European bonds have been driven below the yields of long-dated US securities simply by the QE program of the ECB.

The global financial system may appear to be riddled with anomalies, distortions, and erroneous prices, but all of those labels assume it is the madness of crowds and crazy speculation rather than the government being the source of this bubble. Mario Draghi has created the worst financial nightmare perhaps in modern history since governments began borrowing way back during the 12th century. These anomalies are not driven by a free market, but one that is based entirely on the manipulation of a central bank gone absolutely mad. Anyone in the private sector would be arrested for such shenanigans.


The ECB, under Mario Draghi, has purchased around $2.6 trillion in securities since his Quantitative Easing began in March 2015. He wrongly assumed that this would stimulate the economy. He is trapped and has no way out, which is why he has come out and said that the ECB will reinvest when the bonds they hold mature. There will be no end to this madness and he has single-handedly wiped out the bond markets. There is no free-market remaining. How will governments sell their debt in the future?




When we look at the numbers and plot the Quantitative Easing policies of the Fed, ECB, and BOJ, it becomes baffling as to why the dollar bears even exist. All they do is bash the dollar and the Fed without ever looking externally. We can see that the Fed ended its Quantitative Easing and announced that it would not replace bonds as they matured. The ECB and BOJ have continued to the extreme point that they have wiped out their bond markets. The Fed's balance sheet is less than 25% of GDP with the ECB balance sheet standing at nearly 40% of GDP. The real crazy number comes from Japan where the BOJ balance sheet stands at about 94% of GDP.

In Scandinavia, the Swedish National Bank launched its QE program back in February 2015 announcing it too would join this unprecedented experiment in buying up government debt. They purchased nearly $1.2 billion USD joining Japan's Abenomics. The Swiss National Bank actually had the largest balance sheet relative to the size of the economy of the entire group. They came very close to owning 100% of Switzerland's GDP. Interestingly, they were fighting the rise of the franc and invested a total of 12% of its reserves into foreign equities. By contrast, the US Federal Reserve's holdings only equaled about 20% of GDP, while the European Central Bank's assets were worth 30% of GDP and climbing with no end in sight. The bank has said that it will not buy more than 70% of any issue of government debt.

Therefore, when we compare the monetary policy of **PBOC** to the at the Fed, ECB, BOE, or BOJ (not to mention Switzerland and Sweden) there seems to be no real comparison. Many have asked why does China bother with relending when across the board easing would be more effective in stimulating the financial sector? They fail to see the answer lies in the very question.

Unlike Western central banks that have turned to unconventional tools that have never been tested historically, China uses its relending for targeted purposes. PBOC approaches this from a practical perspective, perhaps because they sent their staff around the world to work on dealing desks at banks in hopes of bringing home the expertise that the Western central banks lack. The PBOC have avoided pouring cash on the fires burning in the economy when debt levels are already too high. Moreover, Western central banks just bought in debt in hopes that the banks would lend out the cash to restart the economy, but they never did. The PBOC has turned to relending operations simply because their staff worked in banks and understand that the faith put in them by Western central bankers is misplaced. They just do not trust financial markets to allocate credit to the areas that policymakers want it to go. The West just pours cash on the fire hoping to rebalance the economy because they themselves are clueless.


The PBOC understands fully that in a contraction, banking sector liquidity is the first casualty of the decline. If the central bank accepts local government bonds as collateral, its objective will be to persuade banks to buy the bonds in the first place. In this way, the PBOC can direct the money into specific sectors. It is at least a step in the right direction, but it still needs refinement.

The monetary policy approaching the PBOC has created its own problems. For as the economy grows and becomes far more complex, the quantitative tools under traditional Keynesianism are increasingly becoming old fashioned. They can work when a financial system is largely closed because they fail to comprehend, no less monitor, the international capital flows and the impact that has on the domestic economy.

# Interest Rates & their Failure as a Monetary Tool

As an economy matures, the capital account expands and actually opens the bond markets which displace the banks as lenders. Some will argue that this confirms the fact that central banks should focus on the interest rates or the price of money in the future. But central banks cannot control the long–term, at best they can control the short–term only.

Therefore, as the economy matures, is it possible for a central bank to target lending to particular recipients? How are the decisions made? Is this introducing just human opinion? Will human judgment then determine central planning instincts? The process rapidly becomes a management nightmare.

Nonetheless, China has made plenty of progress over the past several years in freeing up its financial system. It continues to move toward a free market system. The central bank is, little by little, shifting to a price–based monetary policy (i.e. interest rates). However, targeted lending has been a safeguard in the economy that is still adapting to the free markets and the structural changes unfold gradually with time.

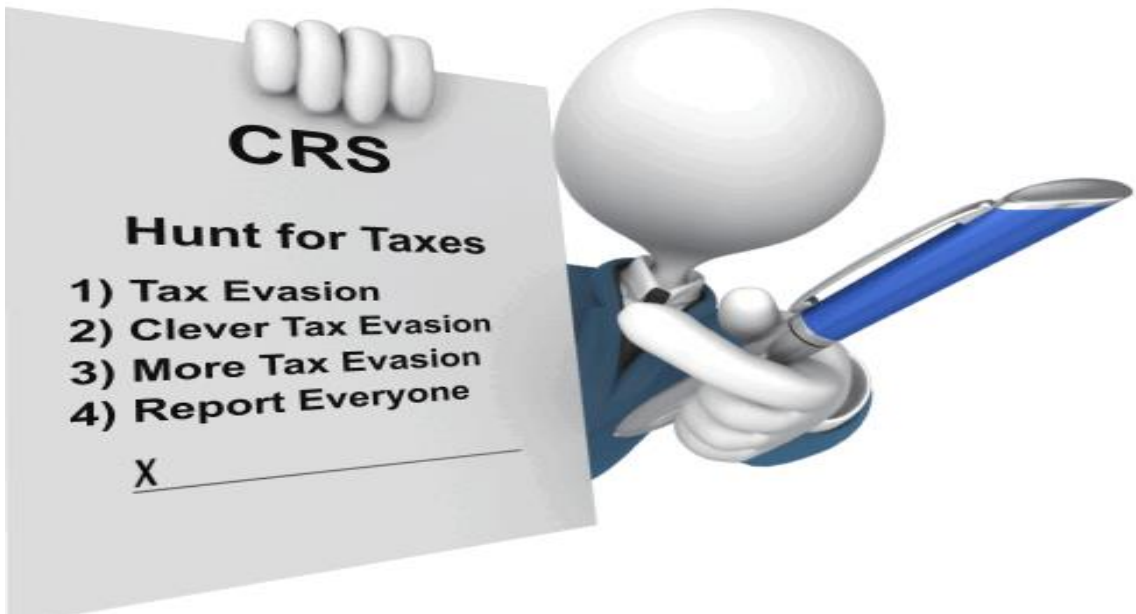
The argument that China should move away from targeted lending to manipulating the interest rate is simply declaring this is what the West has done. Nobody seems to review the progress to see if such a policy has ever worked. What is absolutely certain is that trying the manipulate demand by raising and lowering interest rates has **NEVER** prevented a bubble or a bust. So, why will the West continue a policy that has **NEVER** prevented a recession or a bubble even once?


Back in 1997 when the Asian Currency Crisis hit, I was invited to China. I met with the PBOC and was shocked that everyone had real live experience. I was then taken to a secret facility which was a military installation. It had huge satellites on the roof and inside there were about 300 people downloading everything they found interesting from the internet.

I was totally amazed that they were monitoring absolutely everything in the economy. I was shown 249 varieties of tea that they kept track of. I began to help them understand capitalism. They were amazed that one tea would be selling at twice the price in one area compared to another. What impressed me was the fact that they did not interfere, rather they just studied how everything was working.

That was extremely important for that philosophy is why the PBOC has succeeded where others have failed. They are not following the Marxist–Keynesian policies. They have adopted capital flow analysis.

China did not follow the West in QE in an untested experiment. They have not followed the West in adopting bail–ins. However, China did sign the **Common Reporting Standard (CRS)** which is an information standard for the automatic exchange of tax and financial information on a global level. It was put together




by the Organization for Economic Co-operation and Development (OECD) back in 2014. Its purpose was to hunt down tax evasion primarily for the European Union. They took the concept from the US Foreign Account Tax Compliance Act (FATCA), which imposed liabilities on foreign institutions if they did not report what Americans were doing outside the country.

The legal basis of the CRS is the **Convention on Mutual Administrative Assistance in Tax Matters.** As of 2016, 83 countries had signed an agreement to implement it. First reporting took place in September 2017. The **CRS** has many loopholes for countries have to sign the agreement. This has omitted the United States as well as most developing countries. Note that countries that are included are China, Singapore, Switzerland, most tax havens, and of course Australian/New Zealand as well as Canada.

**As of 2018, the signing nations are:**

Albania, Andorra, Antigua and Barbuda, Aruba, Australia, Austria, The Bahamas, Bahrain, Belize, Brazil, Brunei Darussalam, Canada, Chile, China, Cook Islands, Costa Rica, Dominica, Ghana, Grenada, Hong Kong (China), Indonesia, Israel, Japan, Kuwait, Lebanon, Marshall Islands, Macao (China), Malaysia, Mauritius, Monaco, Nauru, New Zealand, Pakistan, Panama, Qatar, Russia, Saint Kitts and Nevis, Samoa, Saint Lucia, Saint Vincent and the Grenadines, Saudi Arabia, Singapore, Sint Maarten, Switzerland, Turkey, United Arab Emirates, Uruguay, Vanuatu

# China's Debt to GDP Ratio


The question about China's debt to GDP ratio ranks up there with the developed economies such as the U.S., the U.K., and Italy reaching 250%. This scared a lot of people. The problem is that China is still a middle–income country with a purchasing power parity adjusted GDP per capita of just $15,400, which is scarcely a quarter of the U.S. level. The debt level with such a low income has some people worrying about a crash based on debt at such a relatively low income level. The prevailing view is that this debt level will make it more difficult for China to pay for its climb toward a developed economy. But is this real or just Western criticism of the pot calling the kettle black?

## Who's Borrowing & Who's Lending?

With real estate booming in China, many have simply looked at China and pronounced it is the same as the U.S. before the housing market collapse in 2007. The comparison is very superficial. In the USA, the fall began with a directive from the Clinton Administration who said that they wanted banks to lend more so that everyone had a home. American households are relatively lightly leveraged.

Then there is the comparison to Greece. Yet, China is not Greece going into its sovereign debt crisis. The 180% debt to GDP in Greece was government debt exclusively, whereas in China the government debt to GDP stands at about 46%. This means that government debt is low. Indeed, it is much lower than Europe as a whole or the USA.

Obviously, we have to dig a bit deeper. The bulk of the borrowing is actually primarily appearing on corporate balance sheets. Chinese corporate debt was 163% GDP in mid–2017, according to the Bank for International Settlements. Banks are the main enablers. The **PBOC**, the central bank, aims to have the bond market play a larger role in financing debt, reasoning that credit is allocated more efficiently in transparent, liquid markets than behind closed doors with loan officers.

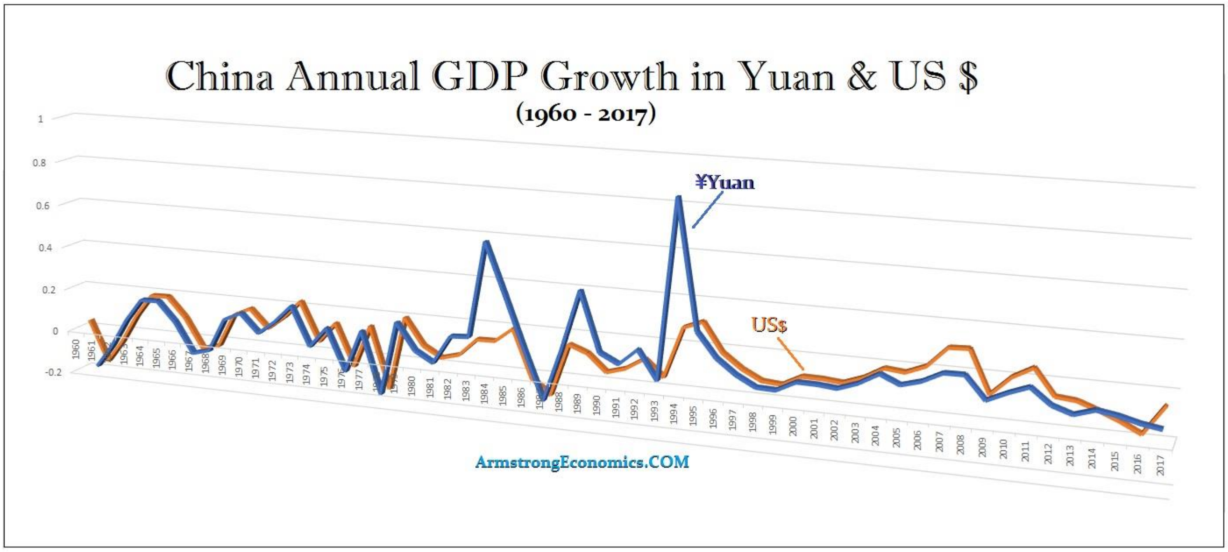
When we dig even deeper, we discover there is also arbitrage going on. Before 2015, it was cheaper to borrow in dollars in Hong Kong and take the money back to China and make 50% or more on the interest rate differential. This had the adverse effect of making it appear that corporate debt was rising rapidly and that China was doing better on trade than it really was. This is because of the accounting system tracking the movement of money rather than goods.

# Asia Monthly Prime Rate

| Country | Last | | Previous | Highest | Lowest | |
|---|---|---|---|---|---|---|
| Sri Lanka | 11.55 | Mar/18 | 11.43 | 23.2 | 6 | % |
| India | 9.45 | Apr/18 | 9.45 | 20 | 8 | % |
| Thailand | 7.00 | Apr/18 | 7 | 16.5 | 5.75 | % |
| Philippines | 5.84 | Mar/18 | 5.35 | 39.73 | 5.09 | % |
| Singapore | 5.33 | Apr/18 | 5.33 | 14.98 | 5.28 | % |
| Bahrain | 5.22 | Feb/18 | 5.04 | 9.3 | 4.72 | % |
| Hong Kong | 5.00 | Apr/18 | 5 | 19.61 | 5 | % |
| Malaysia | 4.86 | Mar/18 | 4.79 | 13.53 | 4.44 | % |
| Kuwait | 4.75 | Dec/17 | 4.74 | 9.1 | 4.34 | % |
| China | 4.35 | Apr/18 | 4.35 | 12.06 | 4.35 | % |
| South Korea | 3.67 | Mar/18 | 3.68 | 17.01 | 3.23 | % |
| Israel | 3.53 | Feb/18 | 3.49 | 1486 | 3.39 | % |
| Taiwan | 2.63 | Mar/18 | 2.63 | 16.5 | 2.56 | % |
| Japan | 1.00 | Mar/18 | 1 | 9.9 | 0.9 | % |

## The Warning Siren is Sounding

While interest rates have begun to rise in US dollars since the last quarter of 2015, rates have tended to flatten out with Hong Kong now above that of China. Nevertheless, history warns that a sudden sharp rise in debt without comparable economic gains traditionally does not end very well. Generally, credit to GDP ratio booms that increase by more than 30% in less than five years have ended with an economic decline and some version of a financial crisis. China's debt to GDP ratio has risen over 50% during the last five years.



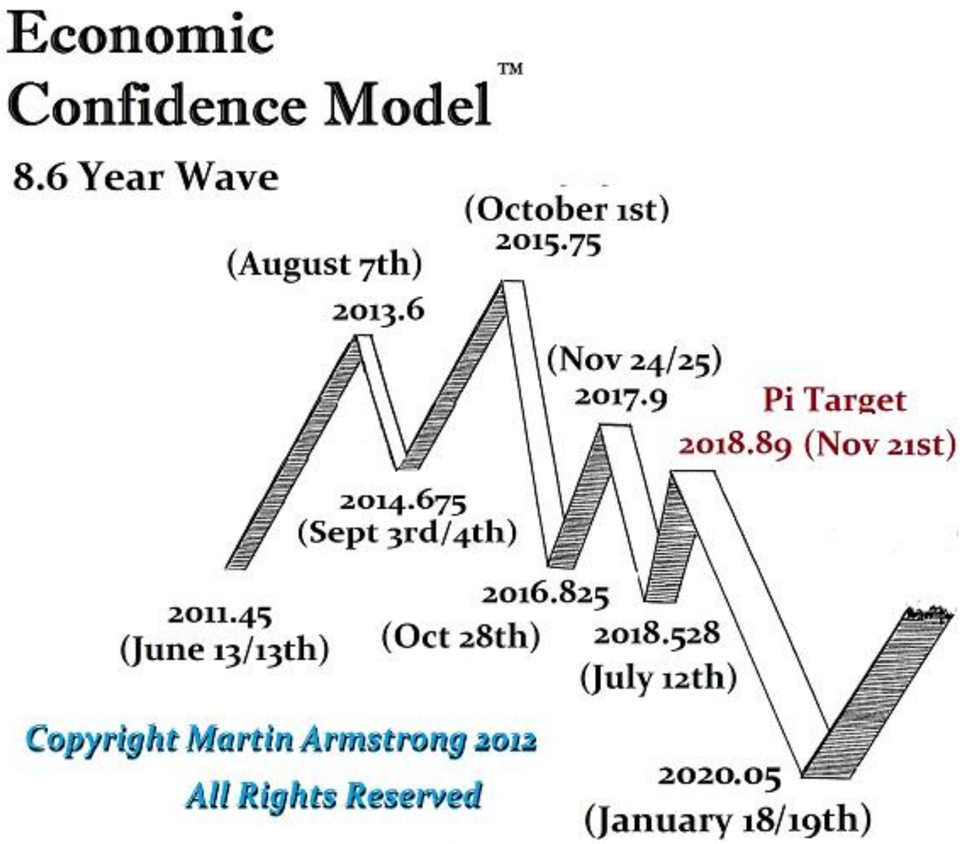

While GDP growth is typically reflected in US dollars so one can compare one country to another, this distorts reality for the rise and fall of a currency may create currency inflation or deflation, but it does not truly reflect the domestic economic conditions. When we plot annual GDP growth for China from 1960 to 2017, we can see that at times the disparity between the currency and domestic growth can create some serious divergences.

Politicians never understand the implications of currency relative to trade no less GDP growth. Far too often, we end up in trade wars because of currency fluctuations rather than actual changes in trade flows.


We can see that the recent decline in the dollar makes it look like GDP growth is turning up in China when in fact it has been flat to declining. To think that politicians then make decisions based upon erroneous fluctuations in currency becomes really quite alarming.

The entire protectionism movement during the Great Depression was cause by the 1931 Sovereign Debt

Crisis which drove the dollar substantially higher and politicians responded with protectionism.




What is clear is that GDP growth in China is moderating and turning down. As interest rates rise, China becomes vulnerable to a debt crisis. China is the second-largest economy in the world and the biggest trading nation in the world. China is also the third-largest bond market thanks to Bank of Japan, and the ECB is destroying their local bond markets by artificially manipulating interest rates. That is a scandal far worse than the LIBOR scandal after which banks were fined.

A meltdown in the debt markets in China would have global repercussions beyond the scope of what anyone is imagining. Far too many emerging markets have depended upon China. Between China backing off and the US raising interest rates mixed with emerging markets issued dollar denominated debt. This cauldron mixed concoction is unmistakably a disaster more so for outside China than inside. Countries with the closest trade ties are the most at risk. South Korea, Malaysia, and Vietnam each have exports to China valued at more than 10% of their GDP. Then the main commodity export-based economies such as South

Africa and Chile are in for some very hard times. Overall, the economic decline will take China down into 2020.05.

The trade issues that Trump has taken up with China are clearly being influenced by taxes, capital flows, and currency. China is NOT stupid. Its banks have some of the best balance sheets in the top 10. However, China fully understands that the German economic model will fail in the end just as it has with Britain, Spain, and the Dutch before them. Nations that build their economies on trade and empire building have failed faster because they do not develop a domestic consumer economy.

China understands this lesson from history. They are less concerned about a trade war that meets the press headlines. Any financial crisis in China that hits the spending power of China's middle class will really disrupt international politics. The vast Chinese consumer market, second only to the United States, would devastate US economic growth for American corporations are expanding into China because of that very marketplace.

China made a strategic shift to a more consumer-driven economy and that is why American corporations, such as Apple Inc. and name brand cloths, began to look at China as a significant marketplace for sales and a potential growth market into the years ahead. China has expanded into computers significantly where Intel Corp's sales have risen from 13% in 2008 to 25% by 2017.

## Shadow Banking

The Chinese government understands that a decline in the yuan can adversely make it appear they are doing better in trade and they comprehend that this will cause trade friction. The government is not actively trying to depreciate the yuan for trade. Conversions of yuan are already subject to a quota or currency controls in an effort to curb capital outflows.

Bitcoin was the escape method for capital fleeing China. China's major bitcoin exchanges halted or otherwise updated their bitcoin trading services back in 2017. They were the shadow banking means to export money. The Chinese were buying Bitcoin and then selling it in North America and they circumvented the currency controls. The People's Bank of China delivered "informal guidance" that began to take notice of the capital flight through Bitcoin exchanges. The central bank called in the big exchanges in their offices for a discussion.

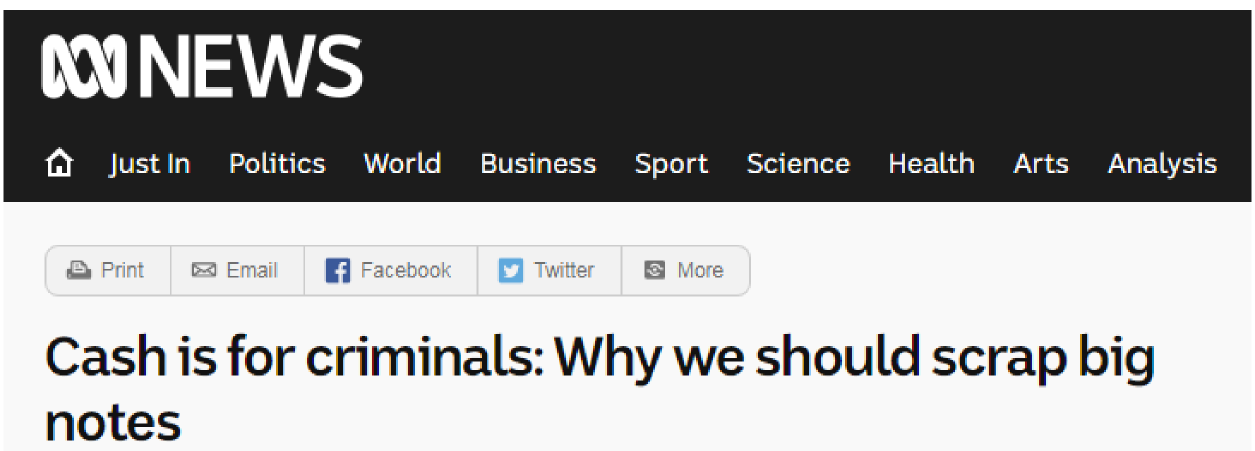

The Chinese government continues to look at new regulations to control cryptocurrencies and capital outflows which weaken the currency. This has been a major roadblock to the expectations of so many that Bitcoin would go to $10,000 and paper currencies would be dead. The idea that cryptocurrencies are not centralized and can change the world monetary system is complete sophistry. Government will not standby idle and watch their power be taken from them. They can easily declare that Bitcoin is for "criminals" and is the means for international money laundering.

Governor of the People's Bank of China, Zhou Xiaochuan, came out and said in March 2018 at a press conference that authorities were not rushing to issue a national digital currency. He also made it clear that no government recognizes Bitcoin as a legitimate payment method for taxes. If it is not "legal tender" for taxes, then you can be forced to liquidate and then incur taxes on that transaction to pay a tax.

Zhou expressed the PBOCs position rather to the point: ***"We do not currently recognize Bitcoin and other digital currencies as a tool like paper money, coins and credit cards for retail payments. The banking system does not accept it."***

In early 2017, China was the biggest and most influential market for Bitcoin worldwide as the bulk of both mining and trading was conducted in the People's Republic as a means to export capital. Therefore, Bitcoin was in reality a tool to circumvent the capital controls. For a long time, China was the country where the largest percentage of Bitcoin miners were located. China accounted for about 70% of the Bitcoin network. In addition, China's mining pools are also the most dominant. This dominance is explained by the fact that electricity in China is comparatively inexpensive. China's government subsidizes the price of electricity to its citizens so it was profitable to run energy intensive operations from China.

The claim that initially the Chinese citizens gravitated toward acquiring and storing Bitcoin as a hedge against inflation was rather nonsense. It was always a means to circumvent the currency to escape from government currency controls. However, with the increasingly hostile regulatory climate, the Chinese dominance on Bitcoin and the wider cryptocurrency market is diminishing. Since the government has recognized that Bitcoin was just an avenue to circumvent currency controls, their actions against Bitcoin have shown that the idea of cryptocurrency replacing the world monetary system is nonsense and the new regulatory approach has impacted the viability of Bitcoin.




Moreover, trading on exchanges and ICOs are currently prohibited, and the **PBOC** has been making mining more difficult by restricting access to reliable energy sources. Bitcoin is simply reduced to an asset class from a viable currency. Governments can make it illegal to accept Bitcoin. In Australia, the slogan is already "Cash is for Criminals". Bitcoin can easily go in the same direction when governments are deprived of taxes and/or Bitcoin is used to launder money from one place to another.

Bitcoin is not being shut down, but there was concern that the capital flight must be stopped. BTCC is the only exchange to explain the changes in a message posted to its website: "BTCC will [suspend loans and borrowing services] from 12th January, 2017."

Effectively, loan-based trading services were no longer available using Bitcoin. The news spread quickly about the changes on social media. Margin trading services had always been in the grey area given the longstanding lack of legal clarity that allowed the exchange to blossom in the first place. The additional liquidity for Bitcoin that came from China began to decline. There is little doubt that the Chinese Bitcoin market was impacted by regulators moving forward.


The very reasons Bitcoin soared was its ability to be used to export money from China. Governments around the globe are hunting cash for taxes as this poster in London shows – they are watching. The very idea that cryptocurrencies will somehow change the world and bring down the financial system are is a delusion of people who understand nothing.

The abundance of credit in Bitcoin was all to move money out of China. It was not because it was a great new invention that would change the future. The change sought was merely to circumvent government and nothing more. Make no mistake, Bitcoin was the cornerstone of shadow loans in China. That has begun the process of coming to an end.


The policies used by central banks to control economic growth have been simply to raise or lower interest rates, which is the theory of managing **DEMAND**. With inflation under control and growth uncertain, the **PBOC** has left the benchmark loan rate on hold at 4.35%. Repo rates are used to guide interbank borrowing costs, but have edged only slightly higher. If we measure new credit being generated as a percentage of GDP, it clearly shows that new lending is no longer providing stimulus to economic growth and has become more neutral. This infers that the speculative boom is indeed slowing down.

The Chinese economy has been growing of late at 6.8% year–on–year in the March quarter of 2018. This is steady, but not an improvement on the previous two quarters. Growth has been supported primarily by solid consumption, property investment, and exports. GDP Annual Growth Rate in China averaged 9.63% from 1989 until 2018, so it is turning down. It did reach an all–time high of 15.40% during the first quarter of 1993 and a record low of 3.80% in the fourth quarter of 1990.

Don't mistake the PBOC's inaction on rates as a sign that it's giving up on the private debt problem. The central bank has rolled out regulations targeting bad behavior by banks. A quarterly balance sheet review punishes those that operate outside the lines on assets or liabilities. This supervision has worked in slowing any bank's lending on risky ventures. The PBOC also understands why banks fail. They lend long–term yet rely on unstable short–term funding.

China, unlike the West, has taken a very proactive role in working to manage bad loans. Banks are being strong-armed into swapping loan claims for equity stakes. Small banks are being merged into bigger ones and gaining a capital infusion along the way. A review of 2016 financial statements of 41 banks found 576 billion yuan ($83 billion at the end of 2016) in bad loan write-offs, down from 117 billion yuan in 2013. This is a policy already in place for the deleveraging agenda in the economy.

## Managing Demand with Interest Rates

Containing a debt bubble does have a risk. Most central banks raise rates to stop the bubble and then rapidly drop rates to try to create the soft landing. No central bank has ever been able to master that management technique to date. The risks are always that they lag behind the business cycle, making the theory of managing **DEMAND** just a delusional dream.

Any meaningful steps to limit leverage necessarily involves slower loan growth. When that happens, markets fall and growth drops even faster. In December, for example, deleveraging fears pushed the 10-year government yield above 4% and the benchmark CSI 300-equity index sold off 3% in one day. The risk is that steps to deleverage trigger the hard landing they're meant to avoid.

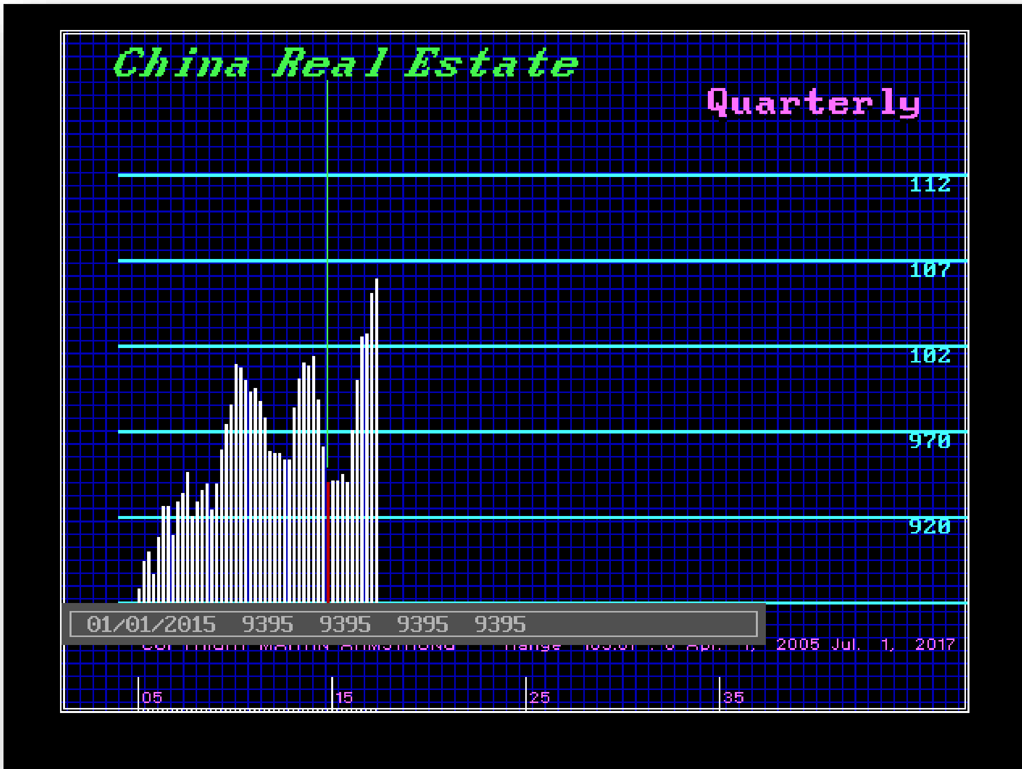
The more efficient way to manage the business cycle is simply by regulation on altering the required collateral for loans rather that the indirect method of raising interest rates. The traditional tool of raising rates to stop a bubble in one sector adversely impacts all sectors. It is in this manner that the economic growth of a nation is sent into a tailspin.

For example, to stop a real estate boom in Toronto during the 1980s, the Bank of Canada kept raising interest rates to stop the speculation. They had the adverse impact of bankrupting farmers in the West who were already on their knees because commodity prices were at rock bottom.

Not everyone in the economy is in the same position. Attempts to manage **DEMAND** in one sector does **NOT** justify raising interest rate for the entire nation. If you want to stop lending into the stock market, you need to be able to isolate that impact. Call money rates for stock speculation can be raised to double for the rest of the economy without bankrupting people in other sectors of the economy.

# China's Property Boom

The real estate boom in China has baffled just about every analyst on the face of the Earth. Beijing and Shanghai are now well known for their ballooning condo/home prices with double-digit gains that have blown the minds of everyone to be surpassed only by Bitcoin. China is worried about the real estate boom and they have perhaps listened too much to the classic Western analysis. This has prompted China to develop more regulatory tightening. Nevertheless, the risk factors involved could decide the fate of China's property boom and will be found well beyond the confines of Beijing and Shanghai. As I have warned countless times, capital investment in real estate follows one golden rule. The first area to boom is **ALWAYS** the core city. Then it spreads outward to the immediate surrounding suburbs. After that, the bubble spreads to other cities. The key to watch at that moment is what is taking place back where it began in the core. The first area to rise is also the first to decline. When you see that decline unfold in the core, it will spread to the outer regions so comprehend nothing lasts forever.




A closer look at our index and the available economic data of ten cities reveals the differences in how the trend unfolds and then spreads. While some look at population growth, income gains, and the ratio between house prices and pay, the Chinese market has been strikingly different from a Western real estate boom/bust cycle. Our index does NOT show a steady bubble type of pattern as portrayed in the headlines of the Western media. There has been a cycle and the last low came during the first quarter 2015. When we correlate the real estate with the currency, we begin to see that the hidden driving force has not been typical **speculation**, but **preservation**.

The main driving force in China that has sent capital running into property has been the desire to get off the grid. President Xi Jinping reiterated that "houses are built to be lived in, not for speculation." It has been the very same motivation behind the Bitcoin evolution in China. Both served as a means to get money out of the banking system. Real estate has been used by those unwilling to send money overseas and Bitcoin has been used by those who do want their money offshore.

Shanghai, China

The government has been monitoring some 70 regional real estate markets very closely on the basis of their national or regional relevance, how the economic factors perform could indicate which are more at risk from a sudden reversal of property-market fortunes.

Using this criteria, Shanghai and Beijing have lower population growth, moderate increases in wages and elevated home prices. This is seen as being far more vulnerable to a real estate crash. For that reason, the government has put in place the strictest curbs on who can own property and how it is financed. These two mega cities, both with more than 20 million inhabitants, are also planning to place a maximum cap on their population capacity. They are curbing urban sprawl, traffic congestion, and air pollution.

Beijing, China

With a proportionately bigger influx of new residents and top-notch wage growth, Guangzhou, which is near the coast in Southern Guangdong Province in China, where the climate is a bit warmer, has seen the lowest year/year growth. Shenzhen, also in Guangdong Province on the southern coast of China, has seen the highest growth rate in property values. The Guangdong Province forms one of the largest urban agglomerations on the planet. There is less space for building new properties so they have faced less pressure on the housing speculation front.


Guangzhou, China

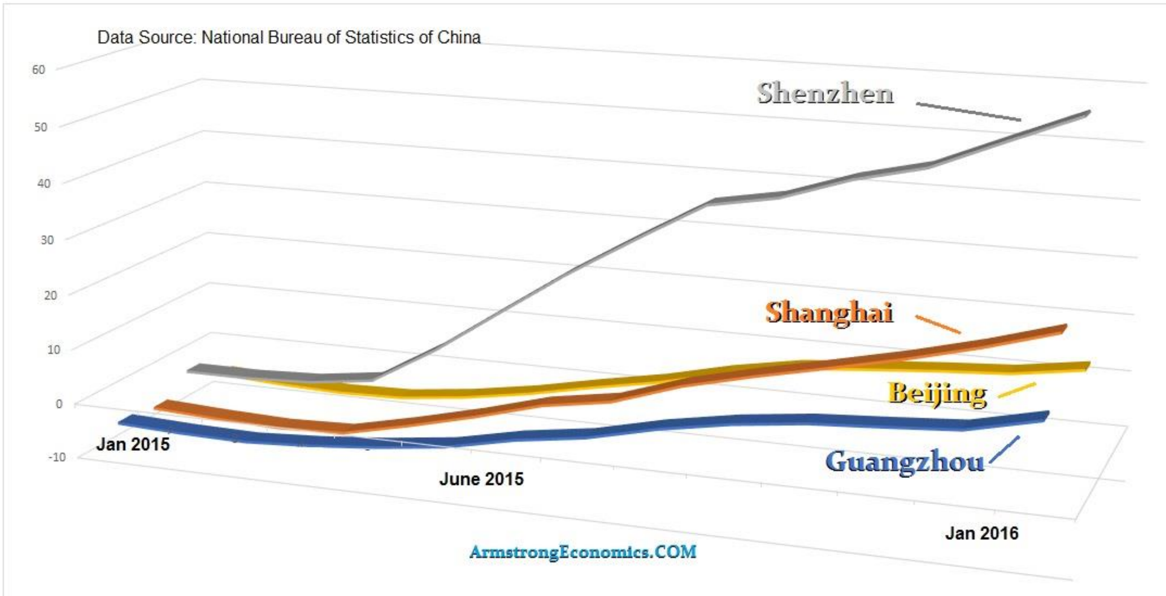
Smaller cities can also display dangerous fundamentals. Haikou, the capital of tropical Hainan island south of Hong Kong–– China's Honolulu –– displays meager wage gains and lower population growth. The real estate has still boomed here as well and has topped the table for credit expansion.

This beautiful city with its palm trees offers a different climate. This has been a vacation target so the investors come from outside the city illustrating that the cycle is not so easily defined in a plain vanilla economic manner. Haikou has been the subject of a housing cycle much like Hong Kong. It went through a bubble that burst back in the 1990s. Haikou has seen real estate loans jump to more than 100% of its 2016 economic output because it is a vacation spot.


Shenzhen, China


Haikou, China

Chinese Real Estate By City (Year/Year)




When we compare these four major cities, we can easily see that the strongest advances in property values have been experienced in Shenzhen. This is the home of the second largest stock exchange in China. Its market capitalization of its listed companies stands around US$2.2 trillion at the end of 2015. Shenzhen is actually the 8th largest stock exchange in the world and 4th largest in Asia.


Shenzhen Stock Exchange

The Shenzhen exchange opened the ChiNext board (Chinese: 创业板), which is a NASDAQ-type exchange where high-growth, high-tech start-ups are listed. This opened up on October 23, 2009. This is the high-flying area for new companies and it is understandable that this area has been posting the highest gains in real estate values. Naturally, Beijing and Shanghai were the core markets. They have tended to peak in the first quarter of 2018 and that means we should be mindful that the peripheral markets will start to cool off in the second-half of 2018 going into the low of the **Economic Confidence Model** which tracks the global business cycle due to bottom in 2020.

**Wenzhou, China**

When we look further afield, we see other small cities that have little population inflow, flat income growth, yet nevertheless home prices have risen. The traditional analysis places these regions at a greater risk. That type of analysis is just not correct. Most of the top ten cities have seen a significant rise in property loans. This has been in both categories of mortgages and developers' debt.

The one exception among the city review has been Wenzhou, which is on the coast north of Hong Kong yet south of Shanghai. This is home to small and medium-sized businesses that make various goods for export. Credit expansion in the coastal city has not been aggressive. It did go through a real estate bubble that burst back in 2012. It is much more restrained than its peers, showing that it may have drawn some lessons from its own property bust in 2012.

The major concern has been that the Chinese household debt has increased with the housing bubble. Some see this as a problem that could result in an economic slowdown as real estate peaks and interest rates rise. But most of the analysis in the West concerning the Chinese real estate bubble is carried out very superficially. They make basic assumptions based upon property elsewhere.

The **PBOC** is far more sophisticated than other central banks. They respect that there are differences in people, sectors, and regions. The West uses a one–size–fits–all policy. The lending rates on property in China are distinguished between first–time buyers and people buying a second home. A first–time buyer can get a 30–year mortgage while a second–home buyer can get a 25–year mortgage. The West needs to take notes from China rather than pretending to tell them how to run things.

In Britain, for example, the Exchequer George Osborne created a real estate crash in London that has never been seen before with such a magnitude. Housing sales crashed 40% in the first three months. Essentially, Osborne created a **ONE–WAY–MARKET** of sellers, with nobody in their right mind as a willing a buyer unless you are actually looking for a home at a cheap price. You paid a higher tax rate if you owned property and was leasing it out. We see similar punitive actions in Canada, Australia, and New Zealand.

Chancellor of the Exchequer George Osborne's (2010-2016)
Proud of his "shock tax" Higher Property Taxes on Rental Property

Australia made it a criminal act for a foreigner to own property and not disclose it. Politicians thought that if they could create a real estate crash, they would make housing more affordable. That is like saying the stock market is too high, so let's create a crash so people can but it cheaper.

In Vancouver, they outright imposed a 15% tax on buying a home if you were not Canadian. Talk about protectionism and discrimination. The benchmark price of a home in Metro Vancouver stood at $998,700 in June 2017. Though prices dipped for a while after the introduction of the tax, they started bouncing back in early 2017 and shifted as those who could not afford a detached house switched to condos. The foreign people buying were paying cash. They slowed down but did not stop. The buyers are Chinese willing to pay the tax because they are trying to get money out of China.

The entire idea that they would make houses more affordable never worked. The sharp advance switched from housing to condos, which now stands at $600,700, and they rose 17.6% above year-ago levels. Domestic homebuyers appear to have given up on trying to purchase a detached house (benchmark price: $1,587,900) and are now just buying up the condo market.

Under the leadership of a new prime minister whose campaign was also against foreign property buyers, New Zealand lawmakers moved to introduce a disincentive to foreigners seeking to buy New Zealand residential property as an investment. The PM is moving to raise the threshold at which tax will not need to be paid by such investors on any capital gains to five years or longer from two years. Now, they have to own it longer. Once again, she is oblivious to why people are buying property in the first place.

**Jacinda Kate Laurell Ardern**
***New Zealand's 40th Prime Minister***

From Britain, Canada, Australia, and New Zealand, both conservative and labour politicians simply are ignorant of how markets even function. The economy will move into recession when property values decline because people will curtail their spending. When property values rise, people spend more freely simply because they "feel" richer.

In China, the central bank's benchmark lending rate for loans longer than 5 years has stood at 4.9%, which is typically used to set floating-rate mortgages. The average mortgage interest rate for first-home buyers in 35 major cities has been about 5.43%. Nevertheless, as we entered into 2018, the Chinese property market has begun to show signs of fatigue as the cooling measures and higher borrowing costs start to weigh on real estate investment.

The mortgage interest rate for first-home buyers has been increased by 5-10 percent over the central bank's long-term benchmark rate. Banks in the northern Chinese province of Hebei, where property values soared almost 25% in 2017, have raised mortgage interest rates for first and second-home buyers trying to stem the rally. Meanwhile, the interest rate for second-home buyers in the province was raised by 20% over the benchmark rate. There is a very clear distinction between first and second home buyers in China.

The greatest risk in all real estate bubbles has historically been the leverage. Prices rise in proportion to the leverage available, but they then crash when the spigot is turned off. Debt is by no means the only warning. As developers and households become more leveraged, the risk is that a price downturn doesn't remain contained within the property market. The greater risk tends to be the developers for they typically never see the cycle peaking and are building right into the high. They cannot service their business loans and prices start to crash as excess supply then hits the market.

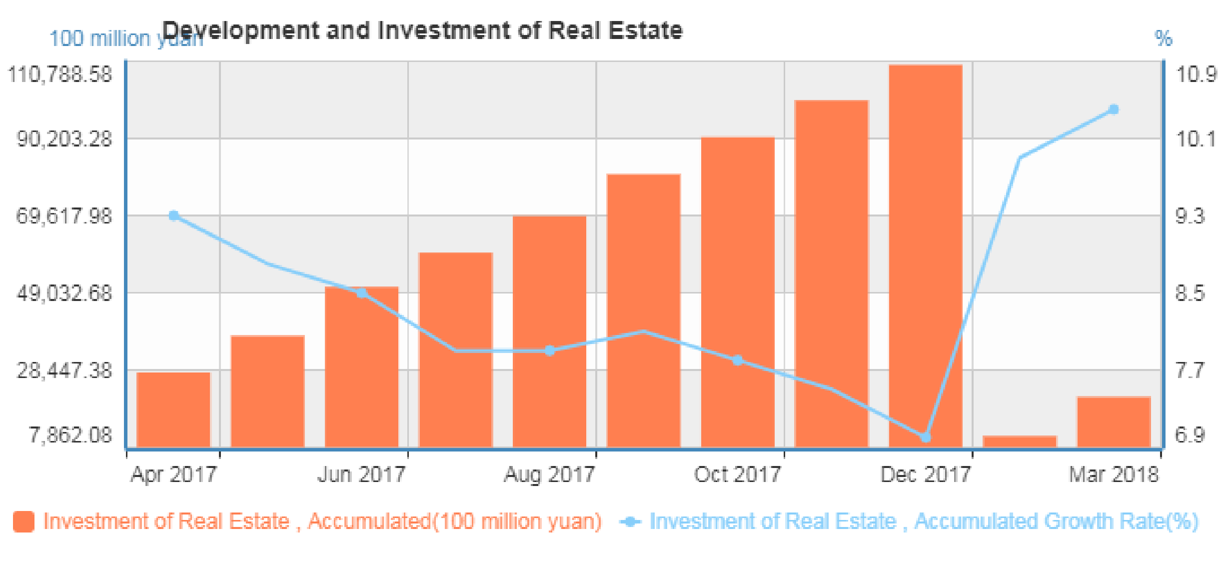
# All Bubbles Are Not the Same

Every nation has its cultural roots. Americans are looked upon as more prudish. Janet Jackson's breast popped out at the Super Bowl and they held Senate hearings. The Attorney General Ashcroft put a tarp around the statue of Justice because her breasts were bare. Vice President Pence has done the same thing. In Europe, statues of naked people fill the fountains all over the continent and nobody gets upset. If American politicians had their way, they would cover them all. Obviously, America has been shaped by the fact the pilgrims were Puritans who where religious fanatics. When they ruled Britain under Oliver Cromwell, they made it a felony for men to kiss their wives in public.

If we are going to look at China's real estate with an open mind, we must understand their culture as well. Briefly, land ownership rights in China are important to understand. After the People's Republic of China was established in 1949, the government imposed several waves of confiscation of land, including that of "counter-revolutionaries," land formerly owned by the Kuo Minh

Tang government, property of large landlords, foreign capitalists, and subsequently most urban residential property and rural agricultural land. Despite the Marxist theory that was used to justify these confiscations, and that holds that all land is ultimately owned by the state, individuals and families, especially in rural areas, were acquiring land rights as early as the mid-1950s. Kate Xiao Zhou wrote a classic piece on the subject, *How the Farmers Changed China: Power of the People* (1996). As mentioned, the advent of ***baochan daohu***, turned agricultural production over to individual households. This policy began in the mid-1950s and has proceeded at a steady pace since the late 1970s. Unlike the Russians who clung to ideology, China quickly realized that growing food was not its management specialty.

Therefore, we tend for find the same trend emerge in Eastern Europe after the fall of Communism there as well. Suddenly, people could own a home that they were not allowed to own previously. Therefore, owning a home became, not a luxury, but a political statement and a necessity. It was not rooted in get rich quick schemes.




In China, it has been easy to get mortgages from Chinese banks because of this cultural distinction. The conditions have also been rather simple. First, you should have a job and your salary should be double your monthly repayment. Secondly, you need to buy a house or some other fixed assets which can be sold easily. Finally, you should have a source of repayment and then you also need a pledge.

As for interest, the policy of the interest rates is set by the People's Bank of China unlike that in the West. There are some conditions that the down payment should not be funded with off-market loans. Nevertheless, banks are free to add a premium to the base rate set by the PBOC.


Many have been circumventing the loan qualifications which tend to make it more like a US real estate bubble of 2007. Home prices have risen so high in some big cities that buyers were seeking consumer loans to fund their down payments. The outstanding individual mortgage loans rose almost 31% by the end of 2017 from the year before compared to 20.1 trillion yuan, according to the PBOC.

Nevertheless, with the PBOC clamping down on consumer loans being used for real estate, new loans have become much tighter to fend off what the government still fears is a growing credit and housing bubble. The greatest concern is that the bulk of the debt to GDP level is 250%+ and private, which does compose a high level of property loans. Yet, all bubbles are not the same. Consequently, we have seen prices actually decline into 2018. The last surge up in real estate peaked during the final quarter of 2017, making it an 11-quarter run up since the first quarter 2015.

Traditionally in economics, a so-called "bubble" is any deviation of an asset's market price from its intrinsic value. Whether this definition is even half-true is very debatable. Nonetheless, such deviations are believed to be driven by a range of **irrationally exuberant** and **speculative behaviors**. These interpretations assume it is really an investment type bubble rather than a flight of capital seeking safety from an external source.

Some see these asset bubbles as being driven exclusively by people who become overly confident in their views of the future. Others call it rampant optimism, bandwagon effects, herd mentality, or just a misplaced faith in one's personal genius as an investor. All of these theories are confined to investment bubbles and they do not look at capital fleeing from other regions for external events. Property in London soared, especially after France went after the rich. People left the homes vacant in Paris and took up residence in London. In Vancouver, the property boom was driven by Chinese looking to get capital out of China. In both cases, the local rise in property was not driven by a local investment bubble.


Therefore, analyzing whether the Chinese property market represents a **"bubble"** of epic proportions hinges completely upon the nature of the **demand**. Are we looking at **capital flight** or **irrationally exuberance**? Does the country's sky–high property prices truly reflect genuine, realistic views on the future which includes culture, investment expectations, and not the least of which is also inflation? Are prices simply speculative purchases driven solely by the **irrationally exuberance** with the expectation that house prices can go nowhere but up?

So far, objective research indicates that consumption driven purchases in major markets have been robust, and were indeed driven by wage inflation and urbanization. The **irrationally exuberance** was clearly in the rise of China as a whole and the assumption that tomorrow will be better than today. That instilled an underlying confidence in the economy and the future, which is not present at all in Europe and to a much lesser degree in the United States. Even after China's growth rate fell below 7%, the fundamental demand for property still does remain strong from a cultural perspective. It will take a major crash in property values as witnessed in the United States before we see that cultural attitude begin to change. Property was simply confiscated. The idea of private ownership has been the view of necessity, not luxury.

It took the 2007–2009 crash in the United States to convince the youth that renting was better than buying. The American youth saw the American dream was not all that it was cracked up to be. In China, ownership was simply banned. People want to do what they were forbidden to do for decades.

# Residential Mortgages as % of GDP

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|
| Austria | 17.2 | 19.9 | 21.7 | 23.2 | 23.3 | 24.7 | 25.7 | 27.2 | 27.2 |
| Belgium | 28.8 | 30.0 | 32.5 | 34.9 | 36.6 | 38.6 | 43.4 | 44.2 | 45.3 |
| Bulgaria | | | | | 8.8 | 10.4 | 10.5 | 10.1 | 8.9 |
| Croatia | 7.3 | 8.5 | 10.5 | 12.9 | 14.7 | 15.6 | 17.0 | 18.3 | 18.7 |
| Cyprus | 9.1 | 10.8 | 27.7 | 33.7 | 39.8 | 45.3 | 56.4 | 62.5 | 64.4 |
| Czech Republic | 2.7 | 4.0 | 5.6 | 6.7 | 9.5 | 9.4 | 11.2 | 11.7 | 12.1 |
| Denmark | 81.9 | 85.6 | 93.2 | 98.7 | 104.4 | 106.9 | 116.6 | 114.5 | 114.8 |
| Estonia | 10.9 | 15.4 | 23.3 | 31.6 | 34.6 | 37.6 | 43.2 | 40.6 | 35.9 |
| Finland | 23.8 | 26.2 | 29.5 | 32.0 | 33.3 | 34.9 | 39.7 | 41.0 | 41.5 |
| France | 23.3 | 25.3 | 28.1 | 30.9 | 33.2 | 35.1 | 37.7 | 39.8 | 40.9 |
| Germany | 52.1 | 51.0 | 50.5 | 49.5 | 46.0 | 44.7 | 46.6 | 44.7 | 43.1 |
| Greece | 15.0 | 17.6 | 22.8 | 26.2 | 29.8 | 32.1 | 33.9 | 35.6 | 37.7 |
| Hungary | 7.7 | 9.3 | 11.7 | 15.1 | 17.2 | 20.9 | 24.1 | 25.2 | 21.9 |
| Ireland | 41.2 | 49.9 | 58.8 | 67.5 | 71.4 | 79.6 | 88.0 | 63.2 | 59.5 |
| Italy | 11.1 | 12.8 | 14.6 | 15.8 | 16.5 | 16.2 | 17.8 | 21.9 | 22.4 |
| Latvia | 6.6 | 11.2 | 18.1 | 26.9 | 29.6 | 29.5 | 36.5 | 36.4 | 29.7 |
| Lithuania | | 6.9 | 10.8 | 12.4 | 16.7 | 18.5 | 22.4 | 21.4 | 18.8 |
| Luxembourg | 32.0 | 33.7 | 35.6 | 36.0 | 39.9 | 42.3 | 47.1 | 47.0 | 48.0 |
| Malta | 21.5 | 25.8 | 29.6 | 32.9 | 35.0 | 36.2 | 40.0 | 40.4 | 42.0 |
| Netherlands | 79.0 | 82.7 | 88.0 | 88.3 | 89.7 | 92.6 | 99.7 | 100.1 | 100.6 |
| Poland | 4.5 | 4.7 | 6.0 | 8.3 | 11.7 | 14.2 | 16.8 | 18.8 | 19.1 |
| Portugal | 45.4 | 46.7 | 50.1 | 55.3 | 57.6 | 58.8 | 63.1 | 63.6 | 64.7 |
| Romania | | | 1.0 | 2.2 | 3.4 | 4.0 | 4.7 | 5.3 | 5.7 |
| Slovak Republic | 4.7 | 6.3 | 7.8 | 11.5 | 12.1 | 13.0 | 14.8 | 16.1 | 17.6 |
| Slovenia | 1.0 | 2.9 | 4.7 | 6.2 | 7.6 | 9.0 | 10.9 | 13.4 | 14.0 |
| Spain | 38.9 | 44.7 | 51.1 | 56.7 | 59.8 | 60.4 | 62.9 | 62.9 | 62.0 |
| Sweden | 5.5 | 53.3 | 56.4 | 61.3 | 61.1 | 58.5 | 77.0 | 79.2 | 76.2 |
| United Kingdom | 63.9 | 67.3 | 72.7 | 78.0 | 74.8 | 67.5 | 83.7 | 79.3 | 80.0 |
| Norway | 48.6 | 53.1 | 54.6 | 55.0 | 59.7 | 49.7 | 68.3 | 65.7 | 64.3 |
| Turkey | 0.1 | 0.1 | 0.4 | 1.5 | 2.3 | 2.6 | 3.3 | 3.8 | 4.6 |
| Russian Federation | | | 0.2 | 0.6 | 1.5 | 1.9 | 2.4 | 2.3 | 2.5 |
| United States | 57.0 | 49.0 | 58.2 | 57.8 | 63.4 | 72.9 | 70.6 | 70.9 | 75.5 |

Source: European Mortgage Federation

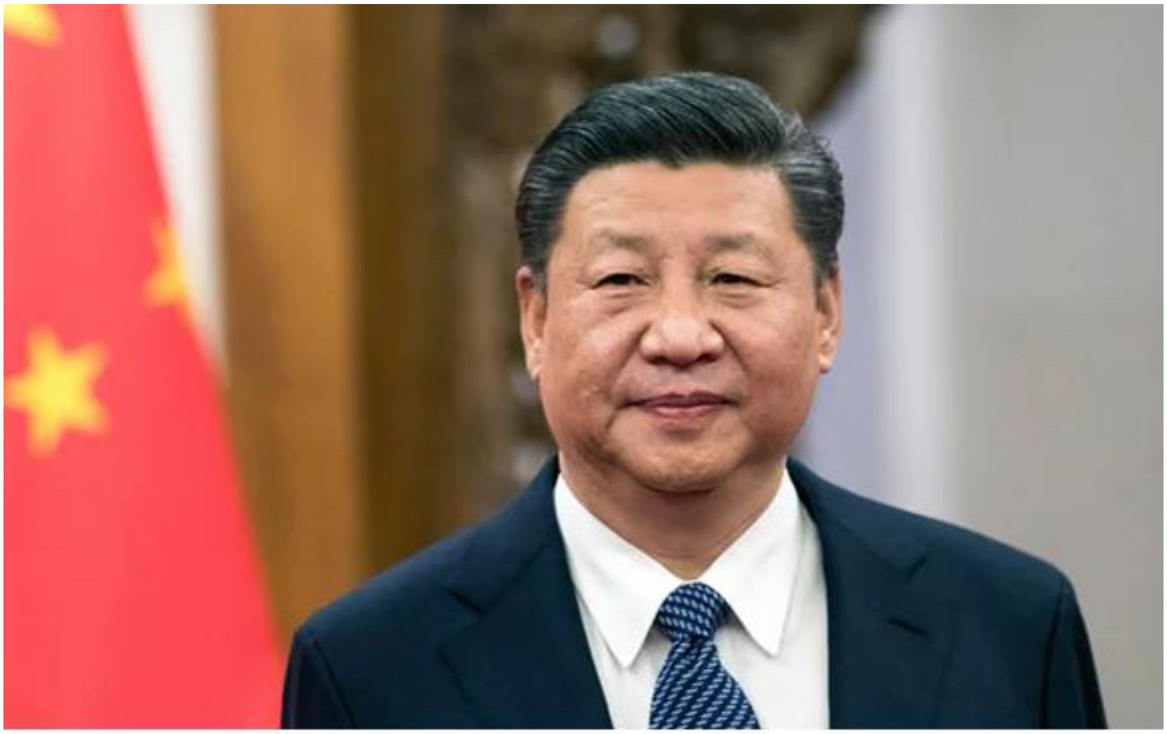
ArmstrongEconomics.COM

While many have bought a second home to benefit on the boom, they still had to made the required down payment. They have borrowed from family and friends, used credit cards and consumer loans to meet the down payment requirements. Therefore, even assuming there is some level of a housing bubble in China, it is substantially different from the housing bubble that plagued the U.S. and Europe. The residential mortgage debt remains relatively low. Chinese residential mortgage debt was 15% of GDP as of 2009, compared to 70.6% in the United States and even worse in Britain at 83.7%. The USA was even below Sweden and Netherlands. Because of the high down payments, people are not likely to just walk away from a mortgage. That is also culturally unacceptable in Asia.

Since we have seen people using consumer loans to meet the down payments, this means defaults are more likely outside of the mortgage market. Western banks have not run into China's lending of real estate as Europeans were doing in the USA into 2007 eager to invest in mortgage backed securities. In the case of China, the mortgage market is local. China's outstanding household debt stands at 44.4% of China's GDP, which is far less that the ratios in Europe (87%), Britain (79%), or in the United States (62%).

So once again, the underlying facts just do not support the same outcome. China is not one huge real estate bubble just because everyone saw that in the West during 2007-2009. Yes, there will be a crash. However, this will be far more moderate than what we have seen in the West.

The crucial difference between the US real estate crash was the simple fact it was funded by zero-down-payment loans. That is just not the case in China. There was also no property tax on real estate in China. This meant that real estate became truly a place to park money.



# Xi Jinping Dictator for Life

Most in the West reacted harshly to the Communist party of China's statement that they were removing the expression that the president and vice president of the People's Republic of China "shall serve no more than two consecutive terms," despite that being part of the country's constitution. Many in the West called this a grab for power, tyranny, and a political bombshell.

After all the claims that this was tyranny and a blow to Democracy, when we look closely at the politics of the West, the first thing you notice is that we too have no "democracy" and the governments formed are purely "republics" and nothing like a government by the people and for the people.

Even when they created the new European Union with a central Parliament in Brussels, they deliberately removed any right to vote for anyone on the European Commission or the head of the European Union. The only place where the people could vote was for members of Parliament which cannot overrule the commission. The commission need not follow anything proposed by parliament. It is just a dog and pony show to pretend there is a right to vote.

## Unelected Troika

**Christine Lagarde** Head of IMF — **Jean-Claude Juncker** EU President — **Mario Draghi** Head of ECB

Today, the West has fake democracies, for the people vote only on representatives and have no vote on key issues that affect their lives from taxes to immigration and war. None of the members of the notorious Troika in Europe that dictates the economy has to stand for election. So exactly where is the democratic process?

We live under Republican governments that masquerade as Democracies and are as evil as the Roman Republic in its heyday. The propaganda against Julius Caesar (100–44 BC) has survived to this day and has wrongly colored our ideas of him and what was at stake. Caesar stood against the corrupt politicians and when he crossed the Rubicon, they fled to Asia while the people rejoiced and opened the city gates to him. Everyone expected Caesar to abolish all debts that were being exploited from the people – a situation not so different from today. The corrupt senators were the bankers to a large extent.

Today, governments are no more democracies than they were during the Roman Republic. Historically, ever single **REPUBLIC** throughout history has turned against the people and has been dominated by corruption led by an oligarchy. All the outrage over Xi Jinping becoming dictator for life is so ironic when we have pretend elected politicians for life, no different than Saddam Hussein who was also elected in fake elections.

John McCain is trying to block things from his death bed. He even wants to block Trump from speaking at his funeral. That's how much he personally hates Trump. Even from his death bed, he just does not stop.

The most beneficial form of government has always been a benevolent dictator. Why? There seems to be two major categories of people who like to rule the world. There is the most common type like the Clintons who are just lining their pockets. They even stole furniture from the While House when they left. Within about two weeks of the publication of the Washington Post article that the Clintons declared they were taking $190,000 worth of things they called "gifts" from the White House, public criticism escalated. The Clintons announced that they would pay the government nearly $86,000 for items that were actually government property. A few days after that, they also returned about $48,000 worth of furniture including two sofas, a chair, and an ottoman from Mr. Mittman who said he donated them to the White House, not the Clintons. The Clintons had to return back to the government $134,000 out of the $190,000 the Clinton's had declared as gifts.

The second type of person is someone who wants to be remembered. These are the Donald Trump and Ronald Regan types. They even put up a bronze statue of Reagan in Budapest, Hungary. They are not doing it for money, they want the recognition to be remembered forever. We even see the same distinctions between Roman Emperors. People like Caligula (37–41 AD), Commodus (177–192 AD), and Caracalla (198–217 AD) squandered state assets and were in it for themselves. This is contrasted by people such as Marcus Aurelius (161–180 AD) or Julian II (355–360 AD). So, does it really matter if Xi Jinping is a dictator for life? **No**. He seems to be ruling China for the betterment of the nation rather than lining his pockets like the Clintons. We have career politicians in the West. What's the difference?

# Why China is Not Communist

The historical review of the political course of events in China is a long one. We have seen numerous governments rise in the West, but for China, it has an amazing historical continuity that extends back on par with the Roman Empire. China's history extends back to the first real strong dynasty where we can draw the line that defines China as a major single nation — the Qin Dynasty 221–206 BC. Of course, there have been cycles within that history. It was the Qin Dynasty who built the Chinese Wall to keep others out. China has never invaded sent its troops off to invade other countries since the time of the Mongol invasion.

The history of China reveals a nation that has been invaded and plagued by civil war. In fact, cyclically, China also moved into a civil war period at the same time frame as in the United States, 1851–1864, known as the **Taiping Rebellion**. We also see in 1900 the famous **Boxer Rebellion** where foreign nationals were murdered.

**Puyi (溥儀) (1906 – 1967) the Last Emperor**

*Last Emperor of China & 12th Ruler of the Qing dynasty forced to abdicate on February 12th, 1912 to the Republic of China Then in 1932 the Japanese made him "Emperor" of Manchukuo ruling until 1945 and the end of the war. The People's Republic of China was established in 1949 and Puyi was imprisoned as a war criminal for 10 years*

We see rebellion again with the outbreak of the **Xinhai Revolution** on October 10, 1911. This was the early stages that would create the **Republic of China**, which was born on January 1, 1912, and the last Emperor was forced to abdicate on February 12, 1912. He was the 12th emperor of the Qing Dynasty. He was sent to prison when the **Republic of China** was overthrown by the Communist Revolution and the establishment of the **People's Republic of China**.

**Sun Yat-sen**
(1866 - 1925)

The revolutionary leader Sun Yat-sen (1866–1925) was elected Provisional President and founded the Provisional Government of the **Republic of China**. To preserve national unity, Sun ceded the presidency to military strongman Yuan Shikai (1859–1916), who established the Beiyang government. As so often the case throughout history, people who rise up against monarchs typically then try to become the monarch. This was the case here and after a failed attempt to install himself as Emperor of China, Yuan died in 1916. He left behind a power vacuum which resulted in China being divided into several warlord fiefdoms and rival governments.

**Yuan Shikai**
(1859 - 1916)

China was only nominally reunified again after a typical 12-year cycle in 1928 by the Nanjing-based government which was headed by Generalissimo Chiang Kai-shek (1887–1975). After the Northern Expedition, they governed the country as a one-party state under the Kuomintang, and was subsequently given international recognition as the legitimate representative of China.

**Deng Xiaoping**
(1904 – 1997)

While 1931 was the infamous Sovereign Debt Crisis with most countries defaulting on their national debts permanently, this year also marked the Japanese invasion of Manchuria in China.

Major political change unfolded in 1933 with Franklin D. Roosevelt and the nonviolent **"New Deal."** That same year, the same economic pressures brought Adolf Hitler to power. When we look at China, we also see the rise of Mao Zedong (1893–1976) who led the famous Chinese Communists on their Long March to Shaanxi. Following the Japanese surrender to the United States on September 2, 1945, this set the stage for the resurgence of civil war in China once again. There was a surge of communist sentiment that seemed to appear withy the end of both World War I in Germany and Russia, and World War II in China. Though only nominally democratic, the Nationalist Government of Chiang Kai-shek continued to receive U.S. support both as its former war ally and as the sole option for preventing Communist control of China. By 1949, the Communists defeated Chiang Kai-Shek who fled to Taiwan and the new **People's Republic of China** emerged.

**Mao Zedong**
(1893-1976)

Mao actually feared Deng Xiaoping (1904–1997) and his reformist economic ideas that if they implemented them, it would lead to a restoration of capitalism and end the **Chinese Revolution**. For this and other reasons, Mao launched the

**Cultural Revolution** in 1966, during which Deng fell out of favor and was forced to retire from all his positions.

Public Trial of the Gang of Four

The **Cultural Revolution** fell into the hands of a radical leftist political group known as the **Gang of Four**, which was actually led by Mao's wife Jiang Qing. The members were Zhang Chunqiao, Wang Hongwen, Yao Wenyuan, and Jiang Qing. This **Gang of Four** competed for power within the party. They saw Deng as their greatest challenge to power and threat.

The **Gang of Four** convinced Mao Zedong to launch what became known as the **Cultural Revolution** in order to reassert his authority over the Chinese government. They believed that Communist leaders, like Deng, wanted to take the nation back to capitalism. Mao called on the nation's youth to purge the "impure" elements of Chinese society and revive the revolutionary spirit that had led to victory in the civil war and the birth of the People's Republic of China. The **Cultural Revolution** continued in various phases until Mao's death in 1976, and its violent legacy infected Chinese politics and society for decades to come.

Beginning in late 1975, Deng was asked to draw up a series of self–criticisms. Although he admitted to having taken an ″inappropriate ideological perspective″ while dealing with state and party affairs, he was reluctant to admit that his policies were wrong in substance. This antagonized the **Gang of Four** and they persuaded Mao in their own favor. Mao refused to accept Deng's self–criticisms and asked the party's Central Committee to ″discuss Deng's mistakes thoroughly″.

Based upon his beliefs and positions, Deng was by no means a Marxist revolutionary any more than the present leaders. Deng Xiaoping was truly a nationalist who wanted to see China restored to its former glory where it would be finally respected among world nations once again. He participated in the Communist Revolution as a means to overthrow the corrupt bureaucracy.

When Mao died on September 9th, 1976, a purge unfolded terminating the extreme leftist **Gang of Four** the following month, October 1976, carried out by the Chairman of the Communist Party, Hua Guofeng (1921–2008). On the evening of October 6, 1976, each member of the **Gang of Four** was informed to attend an emergency session of the Politburo. The session was to take place in the Great Hall of the People in Beijing. As several important issues were to be discussed, all Politburo members were required to attend the session.

Sometime between 7:55 PM and 8:30 PM on that day, the members of **Gang of Four** came to the Great Hall of People. One by one, they were apprehended by military personnel as soon as they passed through the doors into the entrance lobby. All was done in superb efficiency. Without any gunfire, the members of **Gang of Four** and some of their associates were captured. They did not even have a chance to cry for "help."

The **Gang of Four** stood public trial. On January 25, 1983, both Jiang and Zhang death penalty sentences were commuted to life imprisonment. It was reported that Jiang showed no repentance and yelled, "Kill me! Why you do not kill me?" Eventually, facing life in prison, on May 14, 1992, Jiang committed suicide in a hospital after being released on medical grounds.

**Hua Guofeng**
(1921–2008)

**Mao Mausoleum**

Deng's reformist nationalism gradually emerged where many had agreed behind the curtain. Then on July 22nd, 1977, Deng was restored to the posts of Vice Chairman of the Central Committee, Vice Chairman of the Military Commission, and Chief of the General Staff of the People's Liberation Army. This was the start of his comeback.

It was therefore Deng who repudiated the Cultural Revolution and in 1977 he managed to launch what became known as the **"Beijing Spring,"** which allowed open criticism of the excesses and suffering that had occurred during the period of the Cultural Revolution.

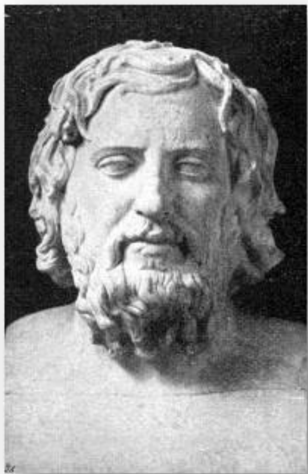
In February 1978, the party met to approve a new state constitution presided over by Hua. Yet Hua was a weak leader who simply continued a loyalty to Maoism which the leadership was questioning after the Cultural Revolution. Later that year at the 3rd Plenary Session of the 11th Central Committee of the Communist Party, the Central Committee from December 18 to December 22, 1978 was planning change.

Finally, Hua's downfall arrived in 1980–81, when the party's official verdict was that he had done good work by removing the Gang of Four, but afterwards committed "serious errors." Hua could not defeat a leadership challenge by Deng Xiaoping who saw reform as necessary to restore the dignity of China among world nations. Clearly, the party saw a much more enlightened policy for the future, which has produced the powerhouse of China today. Deng ousted Hua by removing him from the leadership position in 1980. Yet, in contrast to previous leadership changes, Deng allowed Hua to retain membership in the Central Committee and quietly retire rather than bloodshed which was normal up to that point in history.

Deng has supplanted Hua who was Mao Zedong's designated successor as the "paramount leader" of the Communist Party of China and the People's Republic of China. Deng created his own group of reformists known as the "Eight Elders," and the meetings were held typically in his personal home.

In 1982, the Central Committee of the Communist Party released a document entitled ***On the Various Historical Issues since the Founding of the People's Republic of China***. Mao retained his status as a "great Marxist, proletarian revolutionary" and it further said that his "accomplishments must be considered before his mistakes," yet it acknowledged that "Mao mistakenly began the Cultural Revolution" blaming the **Gang of Four**.

It is abundantly clear that Deng Xiaoping saw that Marxism had failed. Advancement comes from human nature – not central planning. By 1984, Deng was dramatically freeing society. He was on the road to modernizing China. There is no doubt that China is by no possible means COMMUNIST or Marxist. They may have retained the name Communist Party, but they have renounced Communism is everything by name.



Xenophōn of Athens
(c. 430 – 354 BC)

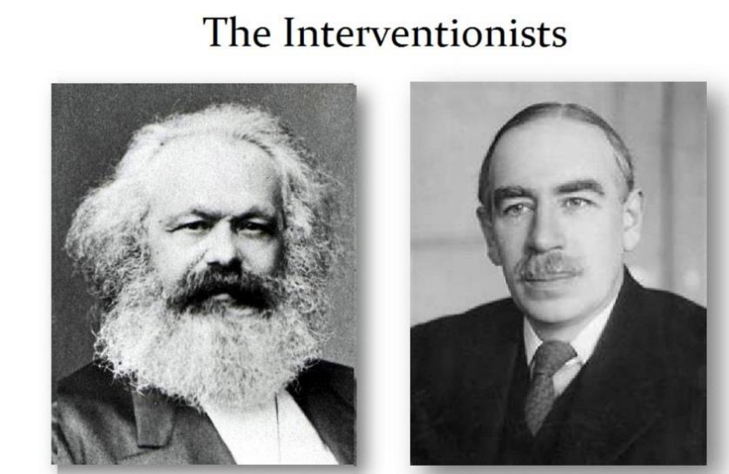
# The Economic Confidence Model

The very world in which we live is a vibrant pulsating environment full of life in all its many dynamic forms. From ancient times, mankind has respected that there exists a cycle to all things. The Roman Temple of Janus had two doorways that were left open in time of war to remind them that the fortunes of war could run both ways. They respected the cycles of fortune, which could bring good as well as bad times. As Janus was pictured with two faces, one looking back and the other forward, time itself may only be a dimension with multiple layers.

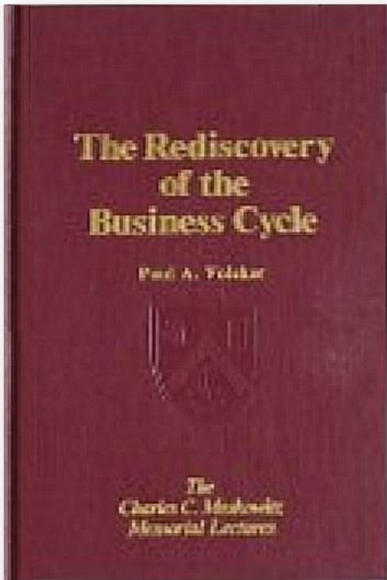
As superstition faded and scientific investigation has replaced it, we have advanced in just about every field except that of economics; a subject that only began as a formal course in 1902 at Cambridge University. Previously, any discussion had been limited to the confines of moral philosophy. Adam Smith (1723–1790) did not consider himself an economist, but a moral philosopher. His teacher, Francis Hutcheson (1694–1746), translated (plagiarized) a book written by Xenophon (c. 430 – 354 BC) entitled ***Oikonomikos*** meaning to regulate the household from which we get the modern word – **ECONOMICS**.

With the passage of time in science, economics has suffered greatly under the yoke of moral philosophy. Instead of exploring its true nature, we assumed as a species the arrogance of a demigod with government possessing the ability to manipulate and shape our economy, and thus society, into anything it desired. Karl Marx (1818–1883) introduced the original idea that government should take the power to eliminate the humanity of the people and create a commune-type society without private ownership void of religion. John Maynard Keynes (1883–1946) took that position that government had a role and devised the framework where it could manage the economy by managing the demand of the consumer.

Marx & Keynes advocated the Age of government intervention. With this foundation of power resting in the hands of government, the Age of New Economics was born. No longer would we explore the innerworkings of the economy as did Adam Smith. No, we would tame it and control it. Suddenly, the business cycle would exist no more.




Karl Heinrich Marx (1818-1883) | John Maynard Keynes (1883-1946)




**Rediscovery of the Business Cycle**
***by Paul A. Volcker 1978***

Paul Volcker former chairman of the Federal Reserve back in 1978 delivered a speech on this very topic. He explained the failure of the Age of New Economics:

*"The Rediscovery of the Business Cycle – is a sign of the times. Not much more than a decade ago, in what now seems a more innocent age, the 'New Economics' had become orthodoxy. Its basic tenet, repeated in similar words in speech after speech, in article after article, was described by one of its leaders as 'the conviction that business cycles were not inevitable, that government policy could and should keep the economy close to a path of steady real growth at a constant target rate of unemployment."*

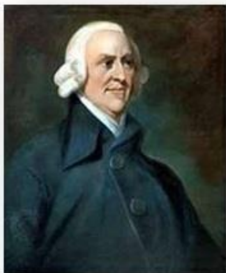
**"God doesn't play with dice" with the Universe**
**Albert Einstein (1879-1955)**

Just before his death in 1946, Keynes told Henry Clay, a professor of Social Economics and Adviser to the Bank of England that he hoped that Adam Smith's **"Invisible Hand"** would help Britain out of the economic hole it is in. ***"I find myself more and more relying for a solution of our problems on the invisible hand which I tried to eject from economic thinking twenty years ago."***

Even when I was in high school, I would go to Physics class and be told that nothing was random and that there were laws that government how everything functioned. Then I would go to Economics class and be told that the business cycle was not inevitable, it was just a random walk like a drunk staggering through a park, so do not waste your time in trying to forecast something that cannot be. Albert Einstein put it best, "God doesn't play with dice" with the universe. There is nothing that is random except our belief in our own ability to control and manipulate something we do not even understand.


What if there is a golden key that opens the door to knowledge of the interworking of nature herself? Perhaps we have overlooked one of the most important building blocks upon which the entire universe is constructed? If we could understand and dissect such building blocks within our political–social–economy, just perhaps this would open a door to not merely comprehend how our social structure functions, but we may then be able to see how the future is set in motion not by random chaos, but by a structured order neatly sequenced like a line of dominos. Tip one over and it sets off a chain reaction like a contagion because despite our arrogance, we are all really connected meaning not even one country can prevent a global depression like the 1930s because the source of such events is not within the control of a single government.

In every other field, man has observed to learn how things function. In mainstream economics, we have assumed the power to regulate the economy yet in truth we may only be the tail that is trying to wag the dog. Karl Marx dealt a death–blow to economics. The quest to discover how it worked, which was the hallmark of Adam Smith and even David Ricardo, came to an end. No longer did economic look for discoveries, explanations, and answer, we knew it all and possessed the power to alter the future. We began the gods of finance.



Adam Smith (1723-1790)

*"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."*

Adam Smith; Wealth of Nations 1776, Book I, Chapter II, Of the Principle which gives occasion to the Division of Labour

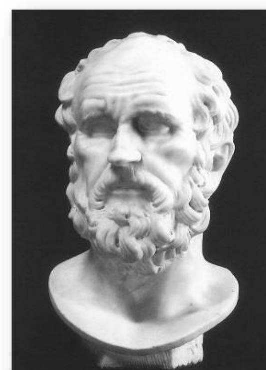
Adam Smith began his exploration into what made society function and he discovered the extreme complexity, yet the extreme simplicity of it all. This became known as his ***Invisible Hand***. We do not obey the dictates of a central government which communism and socialism held because it was power handed to government in a scepter. Instead, we all pursue our own self-interest. Smith wrote, ***"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."***

Centralized control of the economy by governments has completely failed because government is also composed of individuals who will also act in only their own self-interest. Republics always disintegrate into corruption for once a government imposes taxes and regulations, it then inspires oligarchies to lobby, bribe and manipulate government for exceptions. Another great mind from history, Thrasymachus (c. 459–400BC) saw this aspect of Smith's ***Invisible Hand***.

> *"[T]he different forms of government make laws democratical, aristocratical, tyrannical, with a view to their several interests; and these laws, which are made by them for their own interests, are the justice which they deliver to their subjects, and him who transgresses them they punish as a breaker of the law, and unjust. And that is what I mean when I say that in all states there is the same principle of justice, which is the interest of the government; and as the government must be supposed to have power, the only reasonable conclusion is, that everywhere there is one principle of justice, which is the interest of the stronger." (Plato 380 BC)*

Justice is always dealt in the self-interest of government. The history books are littered with those who have suffered political persecutions. It is the ultimate corruption of government to use its power against anyone who dare to challenge its will. Take Edward Snowden, who exposed that government was spying on everyone in the country. He had to flee to Russia for political asylum for government called him a traitor. But if we truly have a government of the people and by the people, then the sovereignty of the nation rests with the people, not government. Therefore, it is impossible for Snowden to be a traitor when he informed the people that it was those in power who were acting illegally.

Another great mind from history also observed this problem that government has always evolved in its own self-interest governed by Smith's ***Invisible Hand*** to see itself as the sovereign and the people as mere economic slaves. Thomas Paine (1737–1809) in his *Common Sense* which inspired the American Revolution explained that governments ***"have so confounded society with government, as to leave little or no distinction between them ..."*** This is obviously the result of their own self-interest.



Thrasymachus (Θρασύμαχος)
(ca. 459-400 BC)

Therefore, the ever-present ***Invisible Hand*** is an interesting effect that is greater than the sum of its parts. The concept as set forth by Adam Smith in his *Wealth of Nations* in 1776 is that each and every one of us in pursuing our own self-interest creates the economy, which includes those within power. The entrepreneur sees an opportunity, perhaps a town without a baker. By observing that opportunity, he steps in to fill that void for personal gain. He then hires others to help and in so doing he may hire a young individual who then learns the idea of creating a business and applies what he learned elsewhere. The baker had no intention to create an economy or to provide a training school that will teach others. Nonetheless, in pursuing our own self-interest, we combine to create a synergy that is greater than the sum of the parts. This becomes the ***Invisible Hand.***

Nikolai Dmyitriyevkh Kondratieff
(1892 - 1938)

It is this collective ***synergy*** that creates society as a whole and forms the base upon which we construct our world. This is what communism destroyed and replaced it with government central planning. However, because government is made of bureaucrats who usually have not experienced the private sector no less thought much about it, they cannot see the opportunities and innovation that only the individual is capable of providing.

The bureaucrats eventually destroy the economy for they expand it by growing like any business. When the government consumes more than 10% of the total productive capacity of a nation, the decline begins. Yet this process is by no means confined to governments. The very same pattern emerges in large corporations, which is why they also eventually wither and die.

RCA was one of the high–flyers during the first half of the 20th century. It declined and became a subsidiary of General Electric. Standard Oil of the Rockefellers became one of the largest corporations ever. It ended in 1911.

This is also why big corporations typically get rid of the creative genius (Steve Jobs) and replace them with their own version of bureaucrats. In the process, the corporation loses the very thing that gave it birth – that ability to innovate. To remain competitive, the big corporation then buys fresh starting companies because they lack the ability to innovate and must purchase new developments.

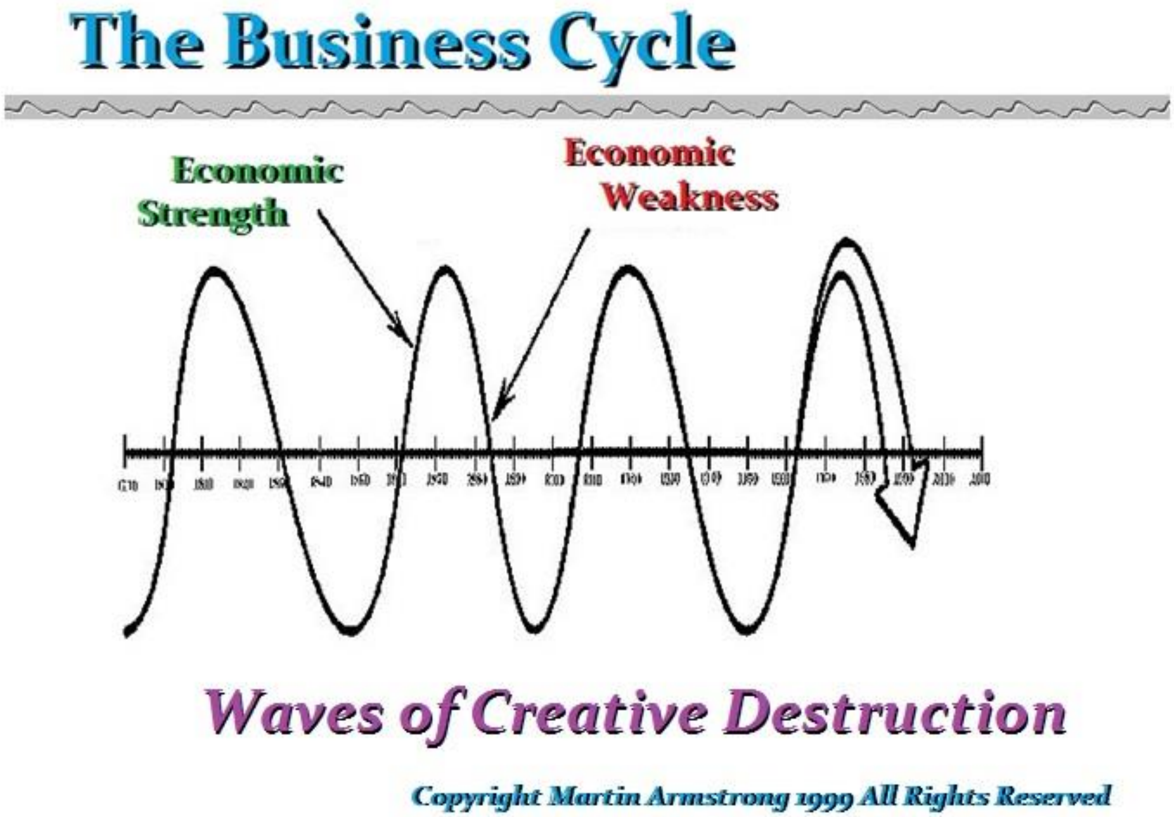

Throughout the course of time and circumstance, some have stumbled upon this building block design and contemplated the waves within **Time**. Some have caught a glimpse of the effects of this secret building block out of the corner of their eye and giving it a name such as the ***Business Cycle***. Nikolai Kondratieff (1892–1938) explore the concept that the economy moves through a cyclical process. He was certainly not the first to explore this phenomenon. There were many other before him who were just so famous.

Joseph Alois Schumpeter (1883–1950) is best known for his theory of "***Creative Destruction***" in which he argues that there is an economic force of obliteration where the old makes way for the entrepreneurial new. This groundbreaking analysis made him an early champion of free markets. Schumpeter wrote:

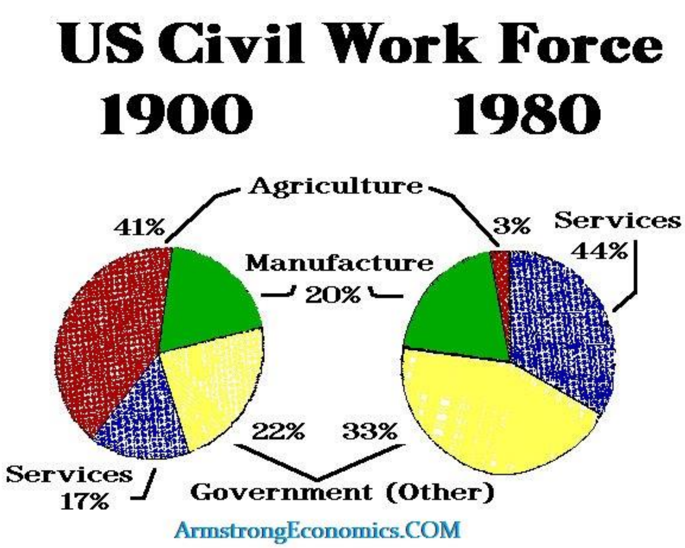
Joseph Alois Schumpeter
(1883 - 1950)

***"Analyzing business cycles means neither more nor less than analyzing the economic process of the capitalist era. … Cycles are not like tonsils, separate things that might be treated by themselves, but are, like the best of the heart, of the essence of the organism that displays them." (1939, 5)***

Schumpeter sought to explain the ***Business Cycle*** and how they function not just why they exist. His theory of ***Creative Destruction*** is a keen observation. When the automobile first appeared, those whose industry is threatened by this new invention begin their decline and fall. The wagon and buggy makers are replaced by a machine and the horses are no longer needed.




Schumpeter saw the ***Business Cycle*** driven by innovation. The combustion engine created automobiles, but it also was used for tractors. Suddenly, we have a wave of new creation of the auto industry, but at the expense of the wagon makers and the introduction of the tractor and other farm equipment resulted in the reduction of employment. Agriculture had employed 41% of the civil work force in 1900 and by 1980 it accounted for just 3%. These are the waves of ***Creative Destruction*** as the internet is doing currently and the introduction of robots.



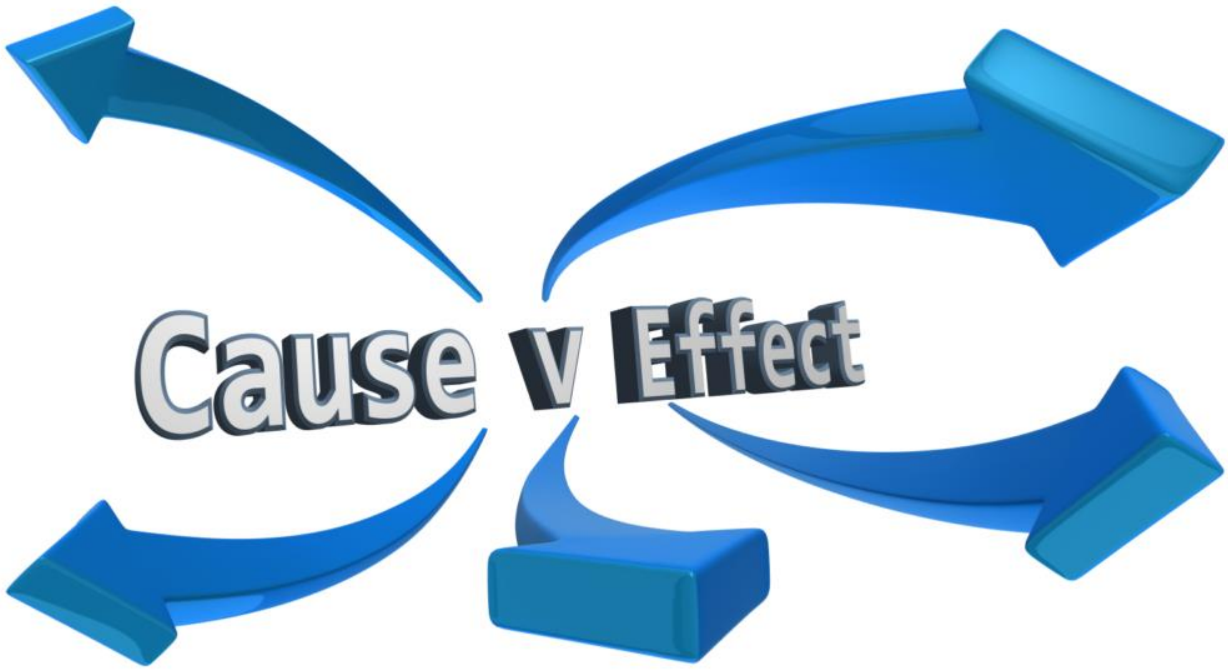
LISTING OF YEARS IN WHICH PANICS TOOK PLACE

INTERNATIONALLY

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1683 | | | | | | | |
| 1711 | 1720 | 1731 | 1745 | 1763 | 1772 | 1783 | 1792 |
| 1814 | 1818 | 1825 | 1857 | 1866 | 1869 | 1871 | 1872 |
| | 1873 | 1884 | 1890 | 1893 | 1895 | 1896 | 1899 |
| 1901 | 1903 | 1907 | | | | | |

When I was actually trying to see for myself if there was some definitive way that I could measure and predict the ***Business Cycle***, I came across a list of panics in an old newspaper in the Firestone Library at Princeton University. It covered the span of 224 years between 1683 and 1907. There were 26 events. So, I did the first extremely simple calculation of 224 years divided by 26 events to ascertain what the average cycle would be. This produced 8.6153846. I did not think much about it. It just seemed that there was on average a financial panic every 8.6–year interval. I thought that was very nice. However, I began to back–test to see what it would look like.

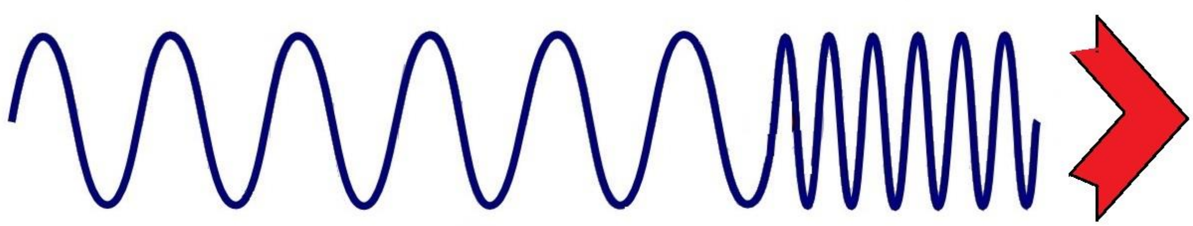
I began to apply my knowledge from Physics in comprehending how there was the process of wave motion. I had always also loved the ocean. Some say because I am a Scorpio and thus a water sign, I am drawn to water. Not sure if that really applies to every water sign, but it did to me. I had often gone to the beach and noticed that every wave was different. I would count how many small waves there were between big waves. There was a rhythm.




I understood that there was a major difference in research between studying just an "effect" as distinguish from the "cause." We try to reduce everything to a single cause and effect. That is a fool's game. There are people who have never smoked who get cancer and others who have smoked intensely and never develop cancer. That mere existence proves the statement is false. It turns out if you have the cancer gene, you will get cancer even if you do not smoke and if you do, it may accelerate the process. This is why a doctor today covertly asks you about your family history was there cancer, heart attacks, stokes, or whatever. Most illnesses are genetic which are distinct from such contagions like plagues and influenzas.

In many respects, the global economy is like an onion. There are layers upon layers that need to be peeled back to investigate what lies beneath. We must get down to the tangible root upon which the entire universe is constructed before we can capture that glimpse of how the world really functions.

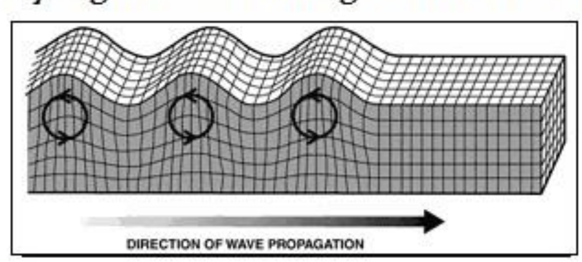
At this core level there is one law of absolute certainty that **ENERGY** can neither be created nor destroyed. It is the essence of everything. It is the grand law of the universe upon which everything is constructed including we ourselves. We can alter the form of **ENERGY** like a tree by burning it. Nonetheless, the wood is merely transformed into gas, smoke, and residue – it is not utterly destroyed. The **ENERGY** contained within anything was created from the very beginning of life. It certainly explains how something can always exist without end. In effect, there is an infinite past and an infinite future as well. Consequently, we are faced with the question that since **ENERGY** flows changing form continually through our three-dimensional world (SPACE), does it also flow through the fourth dimension of **TIME** changing its form, but never its nature? Since **ENERGY** can be invisible like sound and much of the electromagnetic wave emitted by the sun, then can it flow on a grand scale through **TIME** affecting trends and generations by collectively? If so, then can it also be tracked, measures, and forecast?



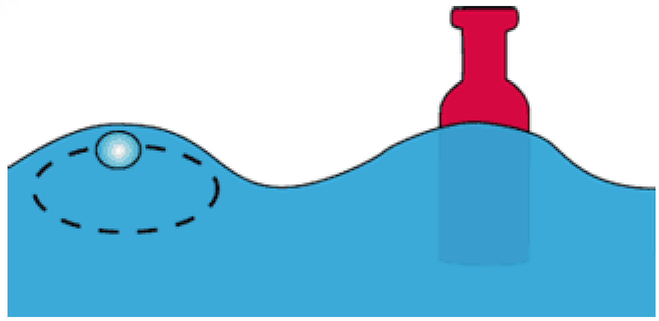
How **ENERGY** moves is a fascinating subject that most people seem to overlook. We have heard of "***sound waves***" and "***sonic booms***" and we may have felt the awesome force of an earthquake moving through the very ground beneath our feet. In both cases, this is **ENERGY** moving through a medium be it the air, in the case of sound, or the planet in the case of an earthquake. In the case of sound, stand on a corner of a street and close your eyes. You can hear a car coming as the sound gets louder. It is moving away from you as the sound fades.

**Seismology** is the study of earthquakes and seismic waves that move through and around the earth. There are different formations of waves. Yet what are they to begin with? This is once again **ENERGY** moving through the Earth is the formation of wave

Rayleigh waves through Earth's crust



Go to the beach and you will see the waves in the ocean traveling through the water. However, look closely at the motion of the water. If you place a bottle that floats just beyond where the waves begin to break before crashing into the shoreline, you will notice that it will rise and fall in a circular pattern as the **ENERGY** (wave) passes through the water around it, yet it does not travel with the wave.

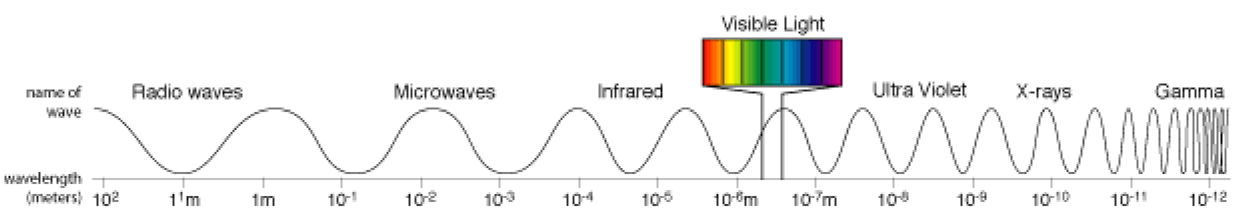


What you are observing is that **ENERGY** is passing through the medium of the water. It is not the water that is moving but the **ENERGY** that is moving through the water. This is because what is actually taking place is that **ENERGY** is passing through the water just as sound passes through the air. It does not move the medium through which it is moving. If you put your finger in an electrical socket, the electricity will move through your body which becomes the medium (conductor) but your flesh does not move with the electrical current because it is the medium through which the electricity simply moves.

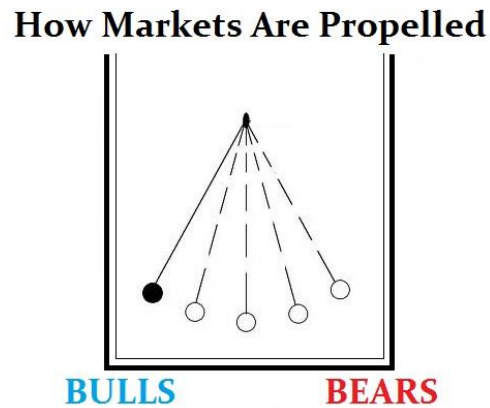
In economics, **ENERGY** passes through even groups of people and animals creating panics or stampedes. We are impacted by others around us and react because of them. This we will refer to as a contagion. It is the wave motion through the society that impacts our emotions to buy, sell, or pause.

Our emotions are complex, which also cannot be reduced to a single cause and effect. Why did you fall in love? Can you reduce that to a single cause? Why do we just like some people when we meet them and others cannot stand or trust? The complexity behind human emotion cannot be simply explained. Hence, the boom and bust cycle cannot also be reduce to a single cause.

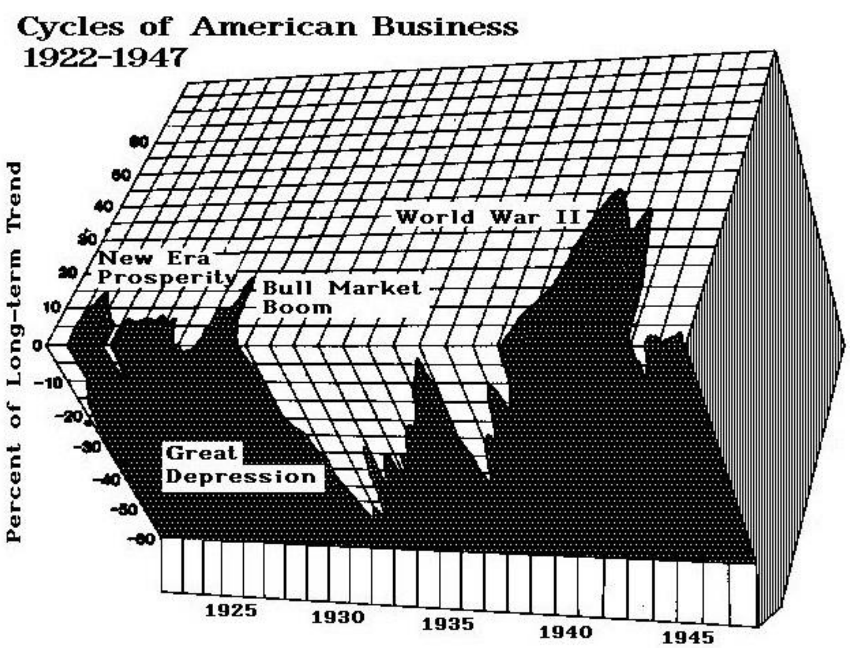
Everything around us pulsates. The sun is a thermodynamic system. It does not put out a steady constant flow of heat. The sun beats as does your heart. It is this cyclical beat that is the essence of all life for this is how **ENERGY** moves. Even light is not constant for it too travels in wave formations. Even when we monitor our brain, there are wave patterns. We are officially declared dead when there is no brainwave remaining.




In this sense, the wave structure can become complex whereby it becomes an electromagnetic wave combining two forms of **ENERGY**. Understanding this structure has allowed us to harness light itself, not just in laser form, but to be able to create TV, radio, x–rays, or to cook with a microwave all by altering the frequency between the peaks and valleys of the cyclical wave structure.



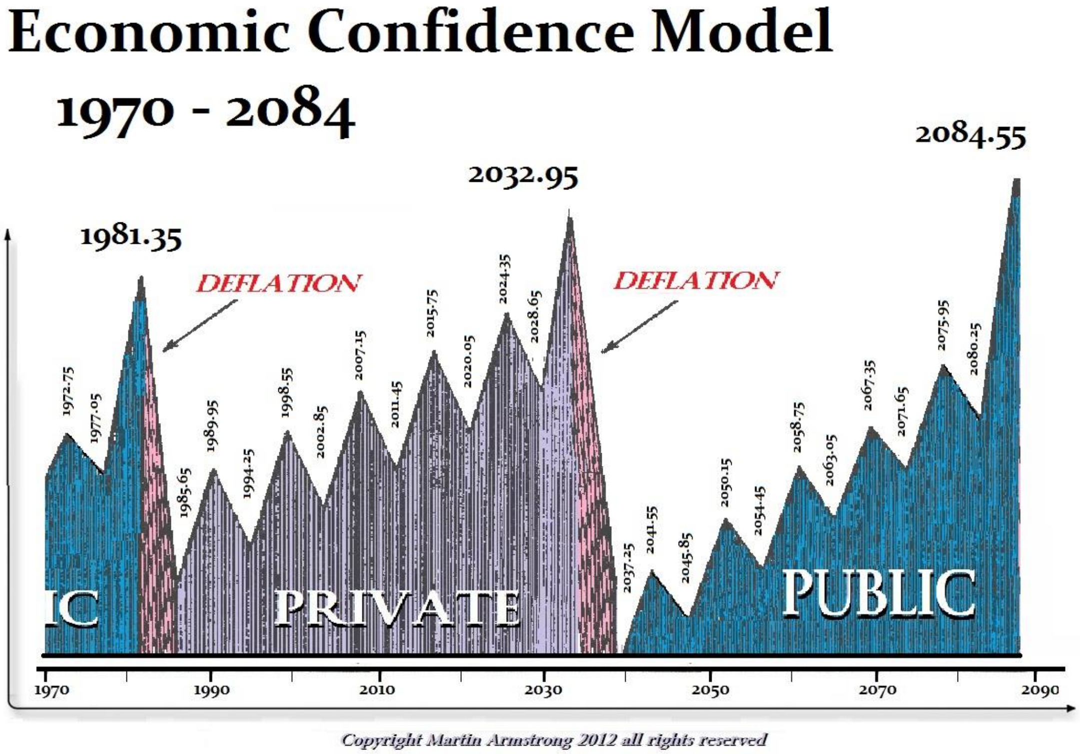






We all realize in our political–social–economy, there are booms and busts that are inherent within the ***Business Cycle***. However, these are the "effects" we call panics which are by no means the "cause" of the event. Government always tries to launch an investigation to hang someone for causing the event as if it can be reduced to a single person or company. There is something that must be at and extreme between two opposites and moving to one extreme provided the ENERGY to swing back in the opposite direction.

The fascinating driving engine behind the ***Business Cycle*** is that the majority must always be WRONG for they are the very ENERGY that propels the cycle. It can be illustrated simply as a pendulum with the bulls on one side and the bears on the other. This is the ***Last Frontier*** remaining in economics. It is time to understand that it is our emotions that drive the ***Business Cycle***. Are we confidence in the future or scared of the dawn? It is always a matter of what we believe will happen, which is why traders for decades have said – buy the rumor but sell the news. We act on anticipation of events. We do not wait until the last second.



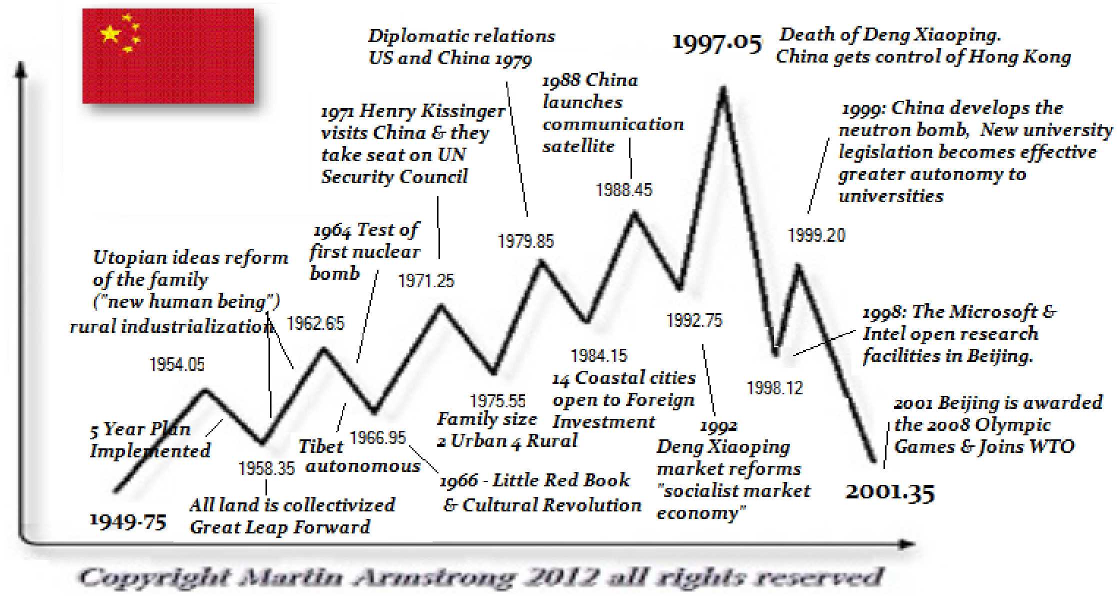

# China from a Cyclical Perspective

When we look into the details of China and how it has performed relative to the **Economic Confidence Model (ECM)** plotted from the Communist Revolution, a striking result begins to emerge. The iron grip of Marxism did not last even a full cycle, which is why our model had been projecting that China would take the title of Financial Capital of the World.

What is striking is that China only made it half-way through a 51.6-year wave reaching the third wave in 1971 when Henry Kissinger secretly traveled to China under the directions of Richard Nixon. The outstanding event opened China to the world economy at the precise moment that in 1971 Nixon closed the gold window on August 15th that year ending Bretton Woods fixed exchange rate system.

# The Economic Confidence Model

## China Post-Communist Revolution






ArmstrongEconomics.COM

Plotting the **ECM** for each nation from its historical backdrop gives us the cyclical rhythm of every country. Here is the plot of the **ECM** for China from the birth of the People's Republic of China in 1949. Communism/Marxism did not last beyond 25.8 years. It was the extreme view of the **Gang of Four** which sought like Stalin to force their view upon the nation. They took the Marxist doctrine all the way and moved to outlaw even religion. The fact that they were put on trial was a significant event which demonstrated that the philosophy of Deng Xiaoping (1904–1997) is what saved China compared to Russia.

Communists Enter Beijing
October 1st, 1949

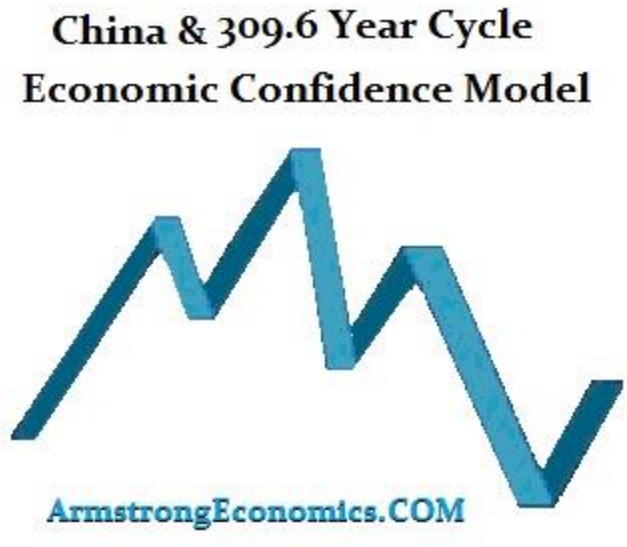
When Joseph Stalin (1878–1953) died, the politicians maintained the system because it was all about personal power. Following the death of Mao in 1976, there was a full-scale purge of the extreme left that had oppressed the people. Deng saw that economically Communism was suppressing the country and he was never a Marxist supporter to begin with. Because of that internal conflict within the Communist Party, China retained the name, but saw the opportunity to compete on the world stage of economics.

The purge of Marxism in China came about just three waves into to a 51.6-year wave which was 25.8 years. Deng Xiaoping saved the nation and he died right with the peak of the wave in 1997. By the end of the wave in 2001, China had joined the World Trade Organization and Beijing won the bid for the 2008 Olympics.

When we look at the 72-year cycle, we can see that from the fall of the monarchy in 1912, we arrive at 1984 when Deng Xiaoping reduced all the controls on private businesses starting the great economic boom that would propel China to the top of the world economies.


We find that in 1917, Sun Yat-sen set up a rival government in Guangzhou as the Nationalists seized power. We can see that **72 years** from this new government brings us to **Tiananmen Square** in 1989 and the start of the new age of Chinese controlled capitalism.

It was also about 51.6 years from Chiang Kai-shek move to establish the National Government he began toward in 1927 that we reach the beginning of economic reforms in 1979.



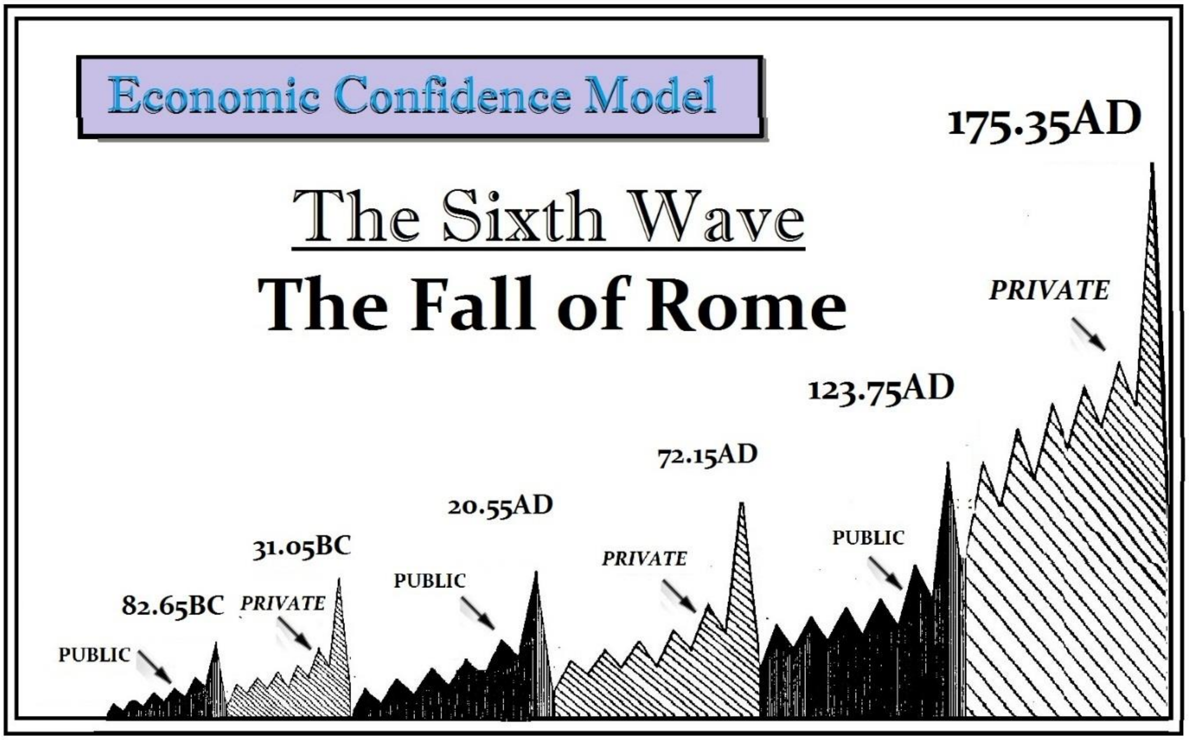

| |
|---|
| 1766 |
| 1456.4 |
| 1146.8 |
| 837.2 |
| 527.6 |
| 218 |
| 91.6 |
| 401.2 |
| 710.8 |
| 1020.4 |
| 1330 |
| 1639.6 |
| 1949.2 |
| 2258.8 |

When we look at the history of China and run this through the long-term models, we see what emerges rapidly in the 8.6-year cycle frequency but the fractal structure with 309.6-year cycles quickly come to the surface. From 1766 BC, the 12th wave thereafter brought us directly to 1949 and the birth of the People's Republic of China.

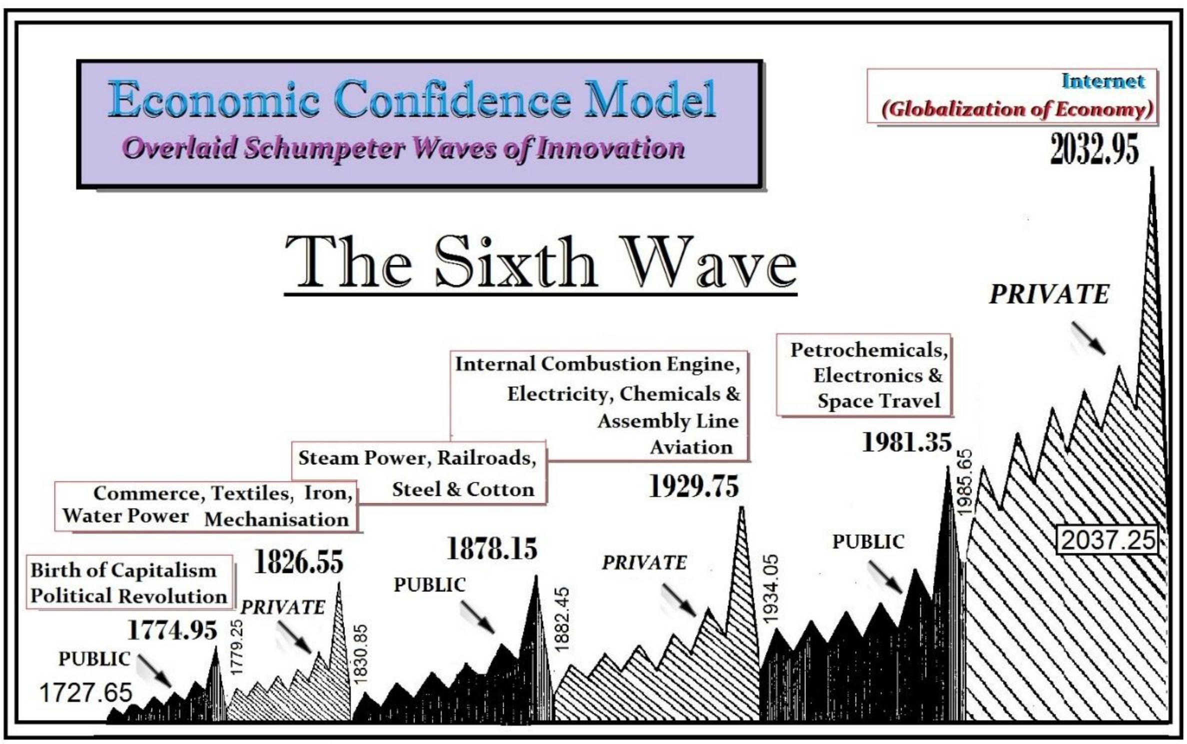
While political biased views will paint the Communist Revolution as a great evil, it was obviously made up of various revolutionary forces that shared one goal – the elimination of the bureaucracy – not simply a monarchy. As Deng Xiaoping proved, the revolutionaries were by no means all sold on Marxism. Therefore, the true communist regime was short-lived, 25.8 years, and therefore marks truly a transformation of China from a monarchy under a corrupt bureaucratic rule to one of economic freedom that will shake the foundation of the world.

Understanding how cycles function moving between two extremes, allows us to comprehend that the if it were not for the Communist Revolution in China, then we would not also have the resurgence in the economy today. You must always move to one extreme to provide the incentive to move to the opposite.

From a broader perspective, the change in trend will eventually arrive in 2258/2259. Between here and there will be an interesting ride. However, to ascertain the potential for the rise of China, we must also understand the reasons for the fall of the West.


Economic Confidence Model
175.35AD
The Sixth Wave
The Fall of Rome
PRIVATE
123.75AD
72.15AD
20.55AD
31.05BC
PUBLIC
PRIVATE
PUBLIC
82.65BC
PRIVATE
PUBLIC




Economic Confidence Model
Overlaid Schumpeter Waves of Innovation
Internet
(Globalization of Economy)
2032.95
The Sixth Wave
PRIVATE
Internal Combustion Engine,
Electricity, Chemicals &
Assembly Line
Aviation
Petrochemicals,
Electronics &
Space Travel
1981.35
1985.65
Steam Power, Railroads,
Steel & Cotton
1929.75
Commerce, Textiles, Iron,
Water Power Mechanisation
2037.25
Birth of Capitalism
Political Revolution
1826.55
1878.15
PRIVATE
PUBLIC
PUBLIC
1934.05
PRIVATE
1882.45
1774.95
1779.25
1830.85
PUBLIC
1727.65

The year 1989 marked the end of Communism in Russia and China. It was the culmination of Marx's failed theory that government could manage the economy to eliminate the ***Business Cycle***. To do so, he advocated altering human nature. The year 2015 market the peak in Western political structures and August that year China devalued the yuan because of its rise against other Asian currencies. Ever since, we have been in a downward spiral driven by the failures of Socialism advocated by Marx as the West tried to be just a little-bit pregnant with Marx's philosophy – the New Economics.

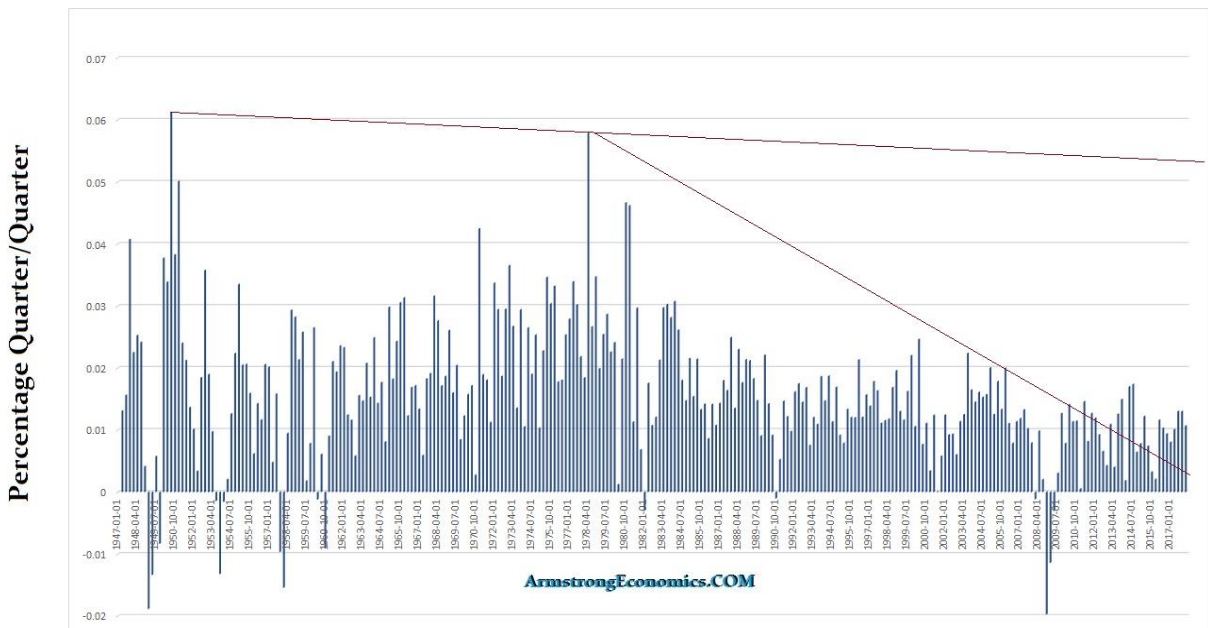
Effectively, what China and Russia experienced was the collapse of centralized planning. The West has a social structure with pension promises that are collapsing. Governments simply expected that the population would always increase and therefore a new crop of people would always appear to tax to pay for the last crop. But the continued rise in taxes has demoralized families marking it too costly to have as many children as they once had during the previous century. Then the youth watched their parents' homes collapse in value and with it the American dream. So many do not want a home, children, or even marriage. In Japan, they call the Celibacy Syndrome for the youth are not even dating no less having children.

Then we have the madness of Mario Draghi who has taken interest rates to negative levels in Europe in a desperate hope of stimulating the economy. He has singlehandedly wiped out pensions and retired people who had counted on making interest income from the savings to live on. Pension funds needed 8% to survive. Draghi has manipulated interest rates in Europe to such insane levels where 10-year bonds of Italy are paying 1.8% compared to USA rates of 3.1% It is not the private sector buying at these level, it is the central bank of Europe known as the ECB.

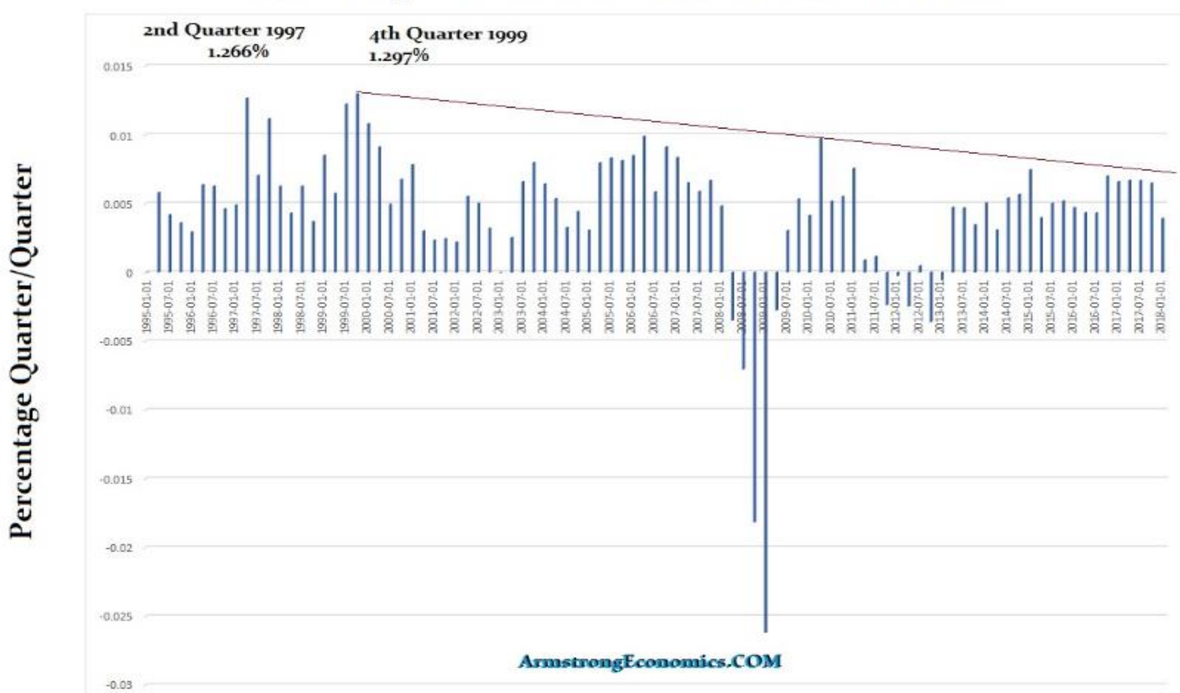
When we look at the growth rate of the Eurozone since 1995, we can easily see that there has been zero economic benefit for the growth rate has fallen consistently below 1% per quarter since the peak back in 1999. We are looking at a 21 year decline staring us in the face. Europe will not simply ask the question if forming this new government in Brussels has actually been positive or negative. By the time this decline completes, the EU may no longer exist. There has been no economic benefit when the growth rate declined.

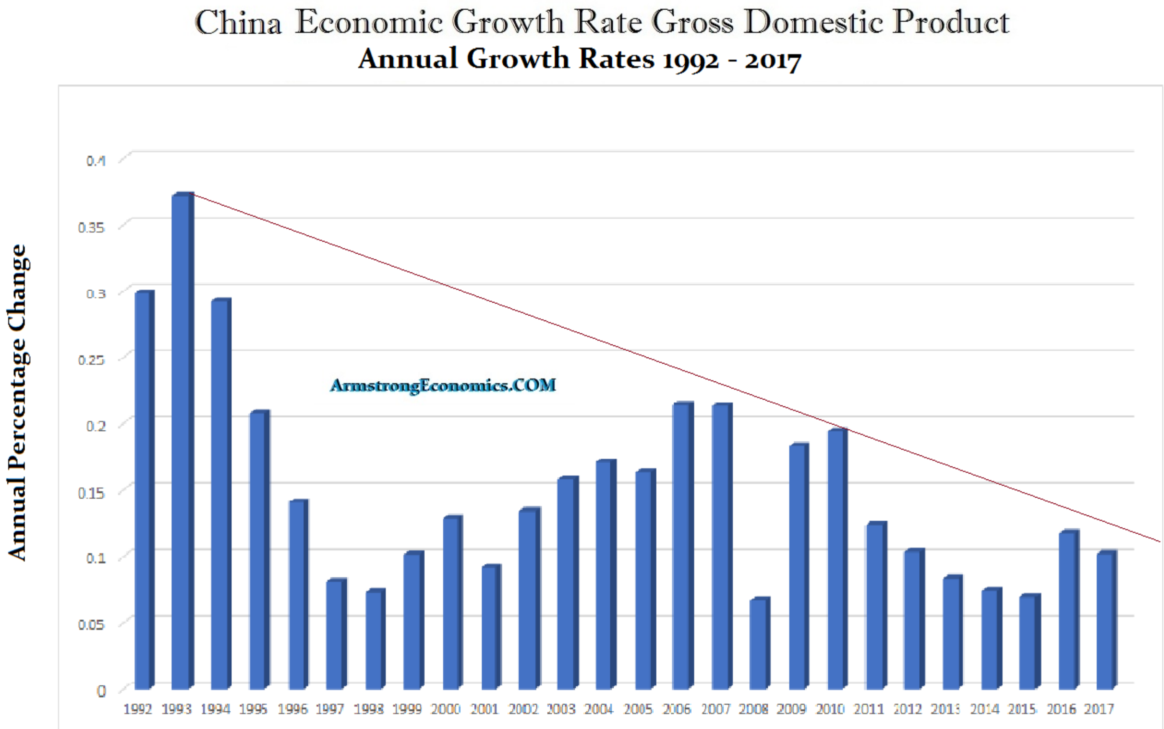
When we compare the GDP quarterly growth rates of the Eurozone to the United States, we see the stark difference besides the propaganda as in BREXIT that Britain will suffer by leaving the EU. Focusing on the 2008 low, you will notice that there were four consecutive quarter declines in the EU whereas in the USA, we see one single spike quarterly low. Post-2008, not a single quarter in the Eurozone produced a growth of even 1% whereby the USA has produced such return 50% of the time.

## United States Economic Growth Rate Gross Domestic Product
### Quarterly Growth Rates 1947 - 1st Quarter 2018



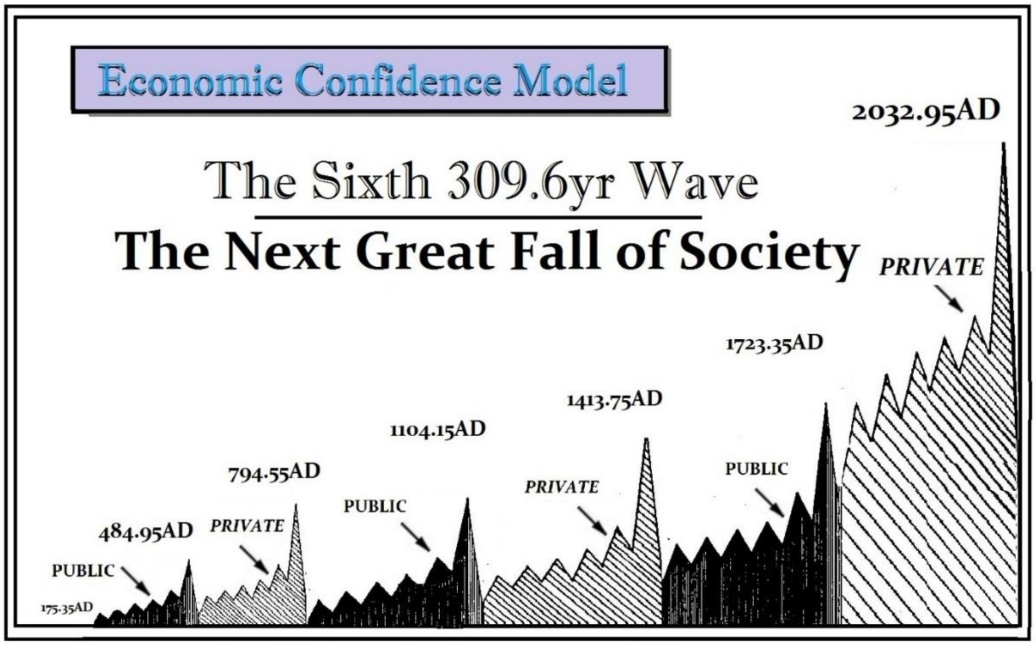

## Eurozone Economic Growth Rate Gross Domestic Product
### Quarterly Growth Rates 1995 - 1st Quarter 2018






Therefore, the rise of China is by no means solely on the back of their accomplishments. The critical key factor here is that China, unlike Germany, has realized that it **must** develop a domestic economy to survive. It cannot depend entirely upon trade. Indeed, even trade has begun to shift as China's exports are now greater to other nations than the United States. We can see that the rate of growth from zero is always the greatest. The rate of annual GDP growth has been declining, but this is demonstrating that China is maturing as a major economy.

Spain rose quickly to the top becoming the Financial Capital of Europe after the discovery of America. But Spain never developed a domestic economy. The French were imported to unload ships. Spain focused only upon what was coming in on the next ship. Eventually, because it borrowed and could not even wait for the next ship to arrive, they ended up becoming serial defaulter on their national debt driving the country into third-world status. China is very smart. Germany pushed for the single currency so it could sell more cars without the currency risk. Germany's taxes are too high and this stagnates its domestic economy development. China is surpassing everyone for it understands the export model fails in the end.

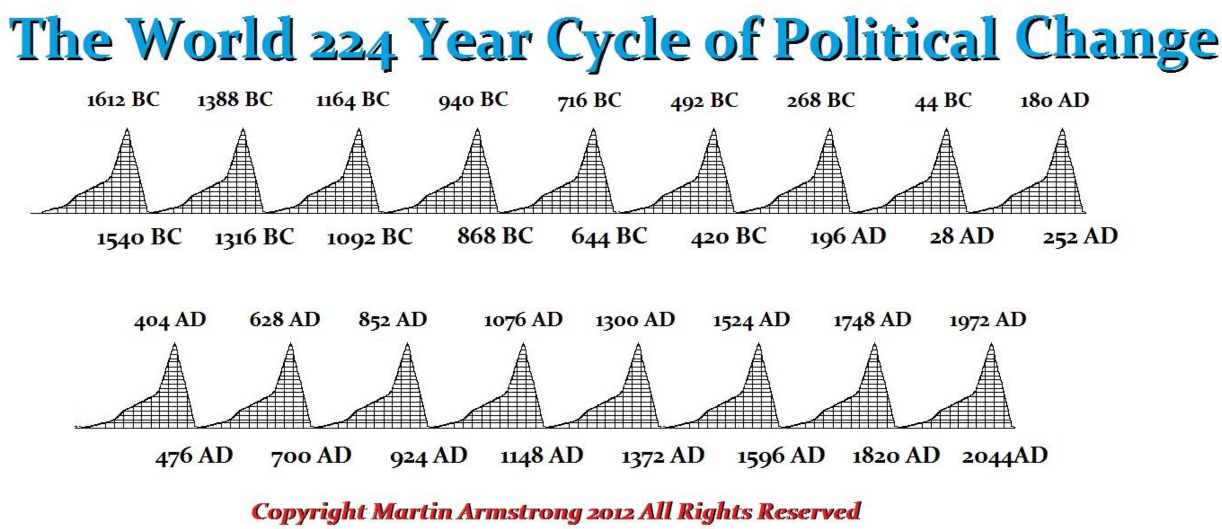





Consequently, the rise of China is intricately linked to the simultaneous decline of the West. The tax burden of a government that on average consumes 33–50% of GDP will be their demise. This is why economic growth continues to decline in the West in a steady progression.

Marcus Aurelius Antoninus
(b 121; 161-180AD)

The **Economic Confidence Model** has reach the Sixth Wave even on the 309.6–year cycle. As we can see, 2032 in the end of a very important sequence and this is akin to the fall of Rome. Indeed, we can see that this sequence begins in 175 AD which was the peak in Rome under Marcus Aureus (161–180 AD). Therefore, 2032 will be a very major shift. It is not the end of the world in Biblical terms (hopefully), but a profound economic shift which is the collapse in Socialism/Marxist theory. China has already learned that lesson the hard way. It is now time for the West to learn the same lesson and stop robbing others to live on their money transforming them into economic slaves.




## China & The 224 Year Cycle of Political Change

When we calibrate the 224-year Cycle of Political Change to China specifically, we see that China has also conformed to the frequency. In 1919, Sun Yat-sen reorganized the party that in 1928 was led to victory by Chiang Kai-shek. It is interesting that the takeover of China by the Communist party influenced by Karl Marx comes on the 224-Year Cycle of Political Change, i.e. Mongols in 1279 (1279 – 1503 – 1727 – 1951). We can see a wealth of cyclical trends back and forth warning that 2021 could be a very important year in China.

Our computer model has been perhaps the most amazing thing ever discovered in economics and holds the meaning of life. We are on a journey of knowledge. Some of us learn from our mistakes and advance, while others accept no blame and prefer to blame others for their failure. It is this second group that is incapable of advancing for they fail to even understand that life is a journey to gain knowledge.

What has been so astonishing about our computer model is that truth is revealed **ONLY** when we eliminate human bias. The computer has illustrated that we are incapable of forecasting the future because we are also emotionally tied up by what we believe. We can see the future clearly **ONLY** by eliminating human opinion. This is what looking at the cyclical pulse of a nation reveals.


# The Chinese Yuan

Since the beginning of the economic reform process in 1979, the Chinese yuan, or renminbi (RMB) meaning "people's money," was devalued on many occasions until 1994 when the two-tier foreign exchange system was ended. While the official rate of yuan had been maintained constant over seven years following 1998, the pressure on the revaluation of yuan intensified. After years of speculation and hearsay, China finally revalued the RMB by 2.1% in July 2005.

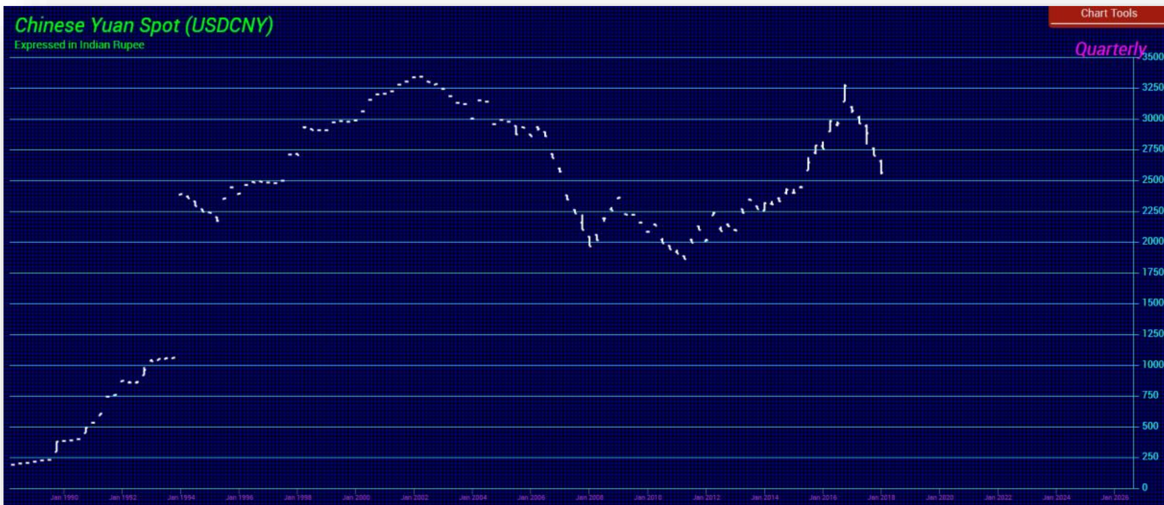
Then in August 2015, China devalued the renminbi, by about 2% against the U.S. dollar on Tuesday the 11th. It stunned the financial market when it devalued again the very next day on Wednesday 12th. It was the biggest one-day move since the renminbi (yuan) was officially de–pegged from the U.S. dollar back in 2005. The yuan maintains a close relationship with the dollar and trades 2% in each direction from a midpoint selected by China. Today, that midpoint went from 6.11 yuan per U.S. dollar to 6.22.


**People's Bank of China, 1949 Issue**

Because of trade, there will always be arguments as to how and to what extent the official rate of the yuan should be further revalued. However, due to a de facto real appreciation of the yuan relative to its neighbor countries in Asia since 1994, the competitiveness of China's exports has been reduced to the point that some production has moved to peripheral countries with cheaper labor. It would be therefore very difficult for the Chinese authorities to allow the yuan to revalue considerably higher in the near future. Clearly, any evaluation higher would only induce further deflation and reduce the competitiveness of China's exports and the growth of GDP. From a trade perspective, jobs leave not merely because labor is cheaper elsewhere. Taxation plays a much greater role in the competitiveness of the production of any country.

While Western politicians had a field day with China's devaluation of the yuan in August 2015, China's central bank devalued the country's currency on

Tuesday, August 11, 2015, by about 2% against the U.S. dollar. It was the biggest one-day move since the currency was officially de-pegged from the U.S. dollar in 2005. Still, the currency maintained a close relationship with the dollar trading 2% in each direction from a midpoint selected by China.




Despite the claims of a currency war, China wanted its currency to steadily rise for political reasons and a show of strength. However, this was also seen as a means to keep capital from flowing out of China. China's domestic and international goals therefore did align with a stronger yuan.

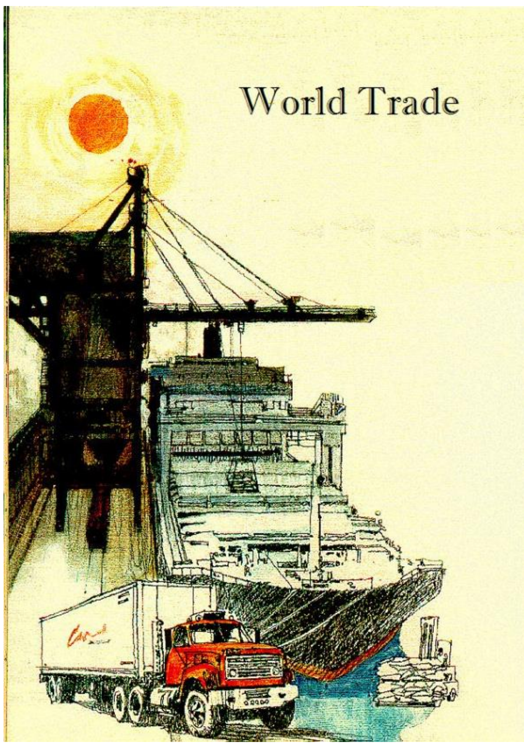
The answer to why China's government devalued its currency on Tuesday August 11 and again on the 12, had much more to do with the dynamics of global currency markets than a sudden urge to help Chinese exporters make their goods cheaper on the world market. It is true that the currency was closely linked to the greenback, but that was only because China still managed the exchange rate within a range against the dollar. When the U.S. dollar rises rapidly against world currencies, the strong dollar actually had an adverse impact upon China relative of the rest of Asia.

China's August 2015 devaluation against the dollar was driven by the rise in the dollar on world markets that was creating deflation within China and aiding the outflow of business and production from China into peripheral economies.

## 2015 China Balance of Trade in Billions of US$

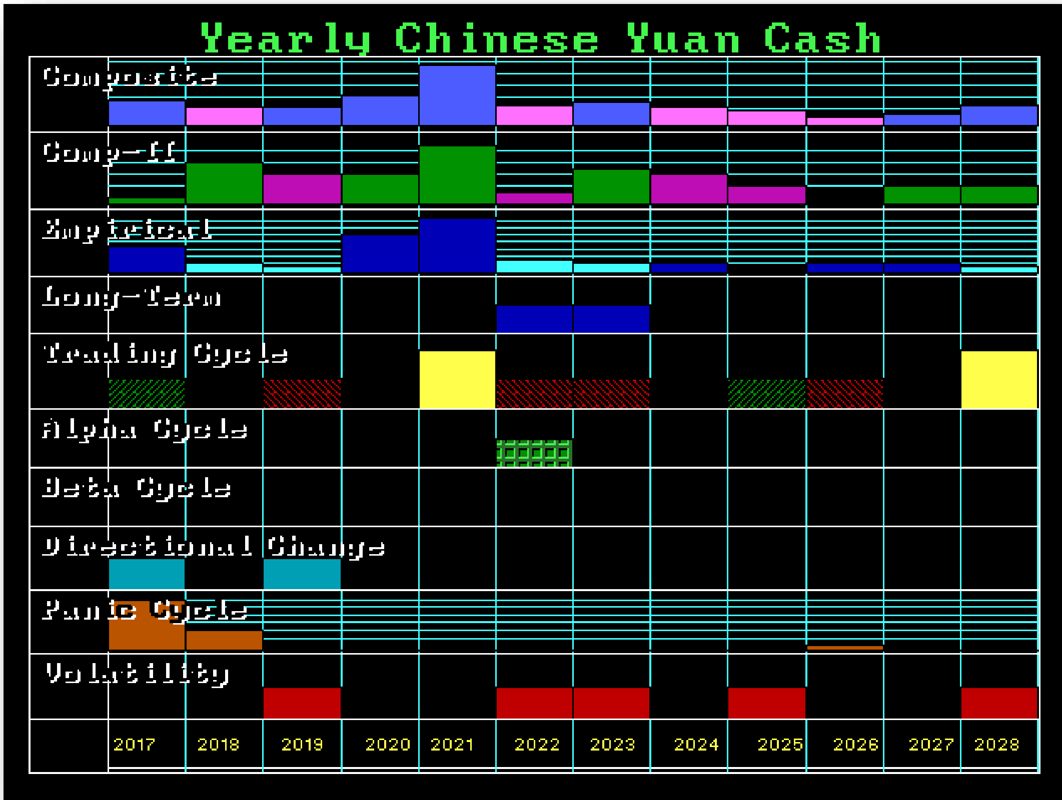
| Rank | Region | Total trade | Exports | Imports | Trade balance |
|---|---|---|---|---|---|
| | Total | 3,953.00 | 2,273.50 | 1,679.60 | 593.9 |
| 1 | Asia | 2,094.40 | 1,140.10 | 954.3 | 185.8 |
| 2 | Europe | 696.3 | 403.2 | 293.1 | 110.2 |
| 3 | North Am | 613.1 | 439 | 174.1 | 264.9 |
| 4 | Latin Am | 235.9 | 132.1 | 103.8 | 28.3 |
| 5 | Africa | 178.8 | 108.5 | 70.3 | 38.3 |
| 6 | Oceanic R | 133.4 | 50.5 | 82.9 | -32.4 |






China wanted the yuan to steadily rise against trade-weighted partners as it was rising to be the largest economy in Asia. That understood, to maintain a steady appreciation in the fact of dollar surges upwards, China was forced to devalue against the dollar to try to maintain a balance against its other trading partners. When we look at the actual balance of trade for China in 2015, we can quickly see that trade with the USA is less than 50% coming in at 44.6%

This constant focus upon the USA trading partner to the exclusion of the rest of the world is a serious and common mistake. The 2015 devaluation was by no means a "competitive devaluation" of the renminbi against the United States dollar. The United States is no longer the majority of China's world trade position.



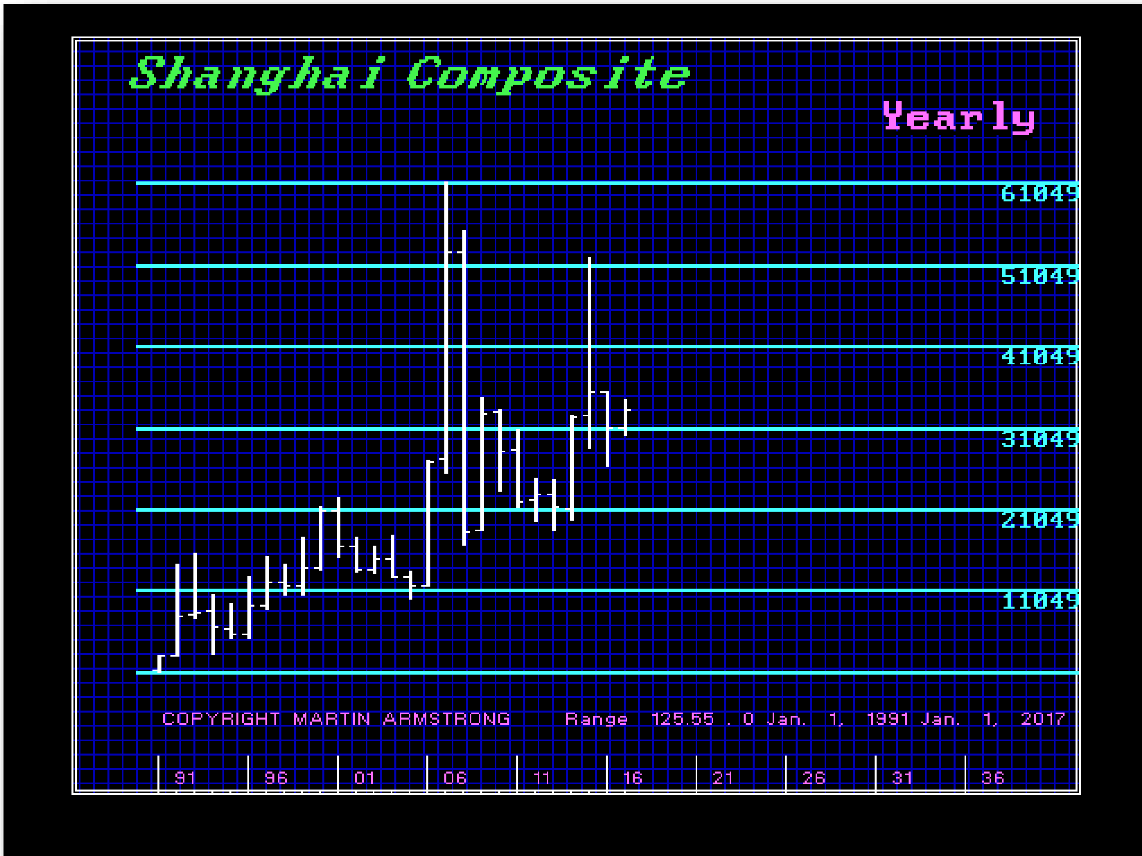

On the yearly level in Chinese Yuan Cash, the last important low for the dollar was established during 2014 at 60402, which was down 20 years from the high made back during 1994 at 87409 against the yuan. There was a three-year reaction rally into 2016 aided by the 2015 devaluation. Right now, the dollar is trading below last year's low of 64350 here in 2018. The dollar declined against the yuan falling into the week of March 26, 2018, dropping to 62420. We have a Double Weekly Bullish Reversal at 63600 and a weekly closing above that will signal the dollar is rising near-term. A monthly closing above 63600 will also signal that the 15-month decline has come to a pause. A monthly closing above 66240 will confirm that the dollar rally has begun.

Overall, the yuan has really been in a long-term bearish trend against the dollar going into 1994. That was followed by a 19-year decline into the lowest yearly closing in 2013. Then 2014 made a slightly new intraday low and was an outside reversal to the upside. That sparked the 2015 devaluation and a close for 2018 above 64940 will signal that the dollar will rally once again. Keep in mind that 2021 is a **VERY MAJOR** target for this is also **72 years** from 1949.


An annual closing back above 72935 will confirm that we will see at least a retest of the 1994 high of 87409. When we look ahead into 2021, the projected target resistance stands at the 81865 level and then we can see that we have a major turning point. If the dollar has **NOT** exceeded that area by that time, then the 1994 high will stand and this also would be a signal that China will eventually emerge as the **Financial Capital of the World** post–2032.

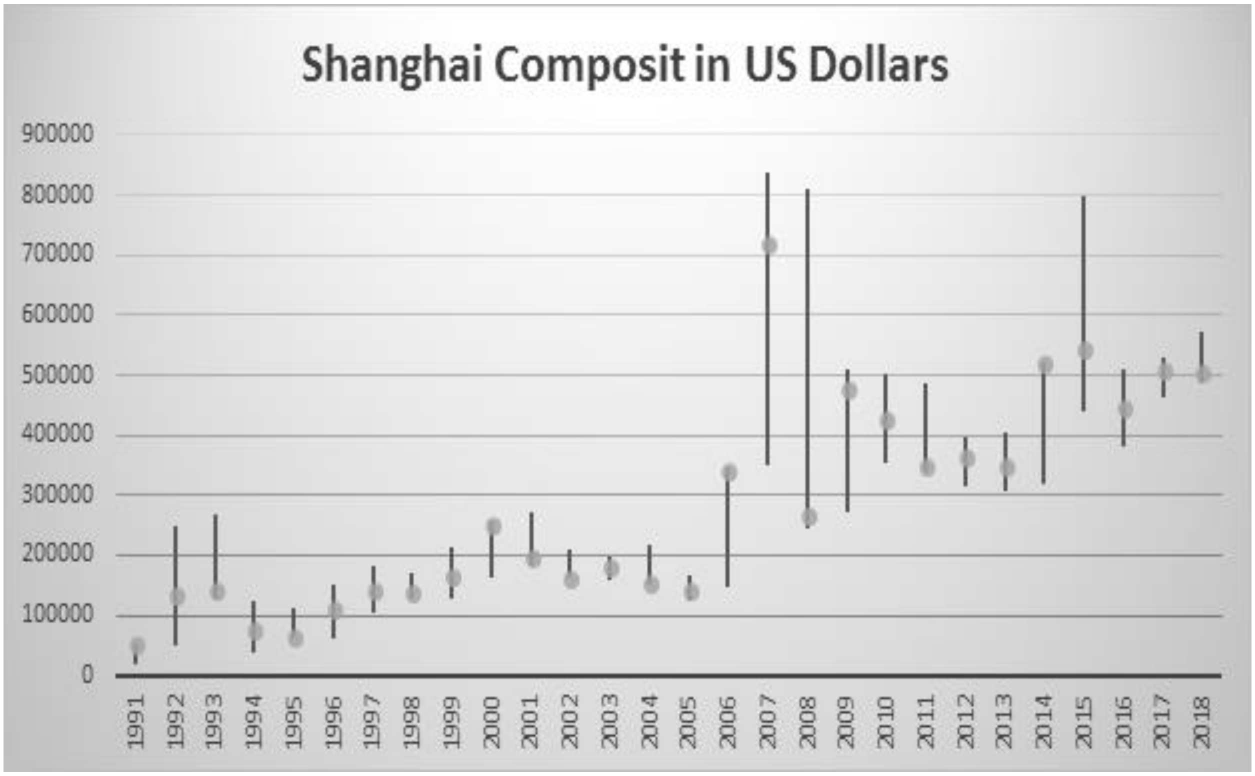
Beyond 2021, we see turning points shaping up as 2023, 2026, and then 2032. When we overlay our **Bifurcation Models**, we also come up with 2018, 2026, and 2032 as the major targets. We still see 2021 as a target as well, but 2032 is where the model indicate we will see the chaotic turning point and this confirms the **Economic Confidence Model** and the Sixth Wave also being 2032.

Bringing together all the pieces of the puzzle, it is very clear that the next major turning points will be in 2021. We are likely to see a major high for the US dollar at that point in time. If we achieve that target and 2018 closes above 64940, at the very least, this will warn that such a dollar rally is in motion, primarily the result of European chaos. Since we have penetrated the low of 2017, which was 64350, then a rally that closes 2018 **ABOVE** the high of 2017 (69600) will indicate a technical outside reversal to the upside, as was the case in 2014, which should take the dollar higher into 2021.




# The Shanghai Composite

On the yearly level in the Shanghai Composite, the last important low was established during 2008 at 1664925, which was down from during 2007. That one-year correction has held with that forming the major low. For the past nine years, the market has been in a consolidation pattern holding support yet remaining below strategic resistance. Therefore, while the US share market has exploded since 2008, the Shanghai market has consolidated. Currently, the market is trading neutral within last year's trading range of 3450495 to 3016531. Overall, the market has been in a long-term bearish trend.




When we look at the Shanghai Composite expressed in US dollars, we have seen why the 2008 low held and why we have seen a consolidation for the last nine years. As the dollar declined against the yuan, it is clearly demonstrating in dollar terms that this market attempted to make a new high in 2015 as a result of the currency devaluation.

Dissecting the longer term yearly level, we see that 2018 is a Directional Change and we should see a turning point in 2019. Thereafter, the turning points appear to be shaping up for 2022/2023, 2024, and then 2027. Normally, each one produces the opposite of the previous event.

A yearly Bullish Reversal stand at 5522780. An annual closing above that will signal a breakout to new highs thereafter. The Yearly Bearish Reversal lies at 2541525. Therefore, we do not see any risk of a collapse without an annual closing beneath that level and we closed 2017 at 3307172.

The Monthly Bearish Reversal lies at 2217680 and a monthly closing beneath that will signal a retest of the 1985000 level down to major support at 1849500. Likewise, a monthly closing above 3538700 will signal the breakout to the upside.

# Conclusion

There is no question that the **Financial Capital of the World** is shifting to China. The critical aspect for China will be to develop its domestic economy and turn inward. The success of such a status depends entirely upon the development of its domestic consumer economy. Rome lasted for a very long time because of that very reason.

It would do China well to abandon the Western economic system altogether and avoid creating sovereign debt that only competes with the private sector. Rome neither had a central bank nor a national debt. It funded itself by the production of new coinage. It is not "inflationary" for a government to fund itself by the creation of money provided it keeps that cost under 15% of GDP.

The rise of China is coming at the expense of the decline of the West by its own mismanagement. The theory that it was less inflationary to borrow than to print was a day when the debt itself was not yet collateral for loans in a formal marketplace. Today, debt is collateral and can be borrowed on and used as cash that simply pays interest. China will displace the West for 309.6 years if it also rejects the idea of creating perpetual debt that is never paid off and resists constantly raising taxes. There should be no federal income taxes and any tax paid should be confined to local taxes for infrastructure. These are the lessons history teaches if we care to listen.