

## **China Economy Chugging Away**

*The world's second largest economy is chugging away despite mounting worries.*

### **The Great Wall Of Worry**

The Chinese economy is chugging away despite a great and growing wall of worry. Fears of hard landing turned to worry over a growing credit bubble. Political turmoil threatens trade throughout the Asian economic arena. Tepid economic data and a crack-down on leverage have caused volatility in the Chinese based indices which have skewed from each other. Over the course of the last month the mainland Shang Hai index has fallen 9% from it's 1 year low to test support while the Hong Kong based Hang Seng has risen along with other global indices and set new 1 year highs.

On the political front North Korea and trade ties with the US top the list although there are still domestic issues in China, South Korea and elsewhere moving local markets. The North Korean situation will likely be a pain in the world's side for some time to come, trade ties with the US at least seem to be warming up again. Presidents Trump and X Jinping were able to bridge gaps between them and allow a 10 point trade deal to be hammered out. The deal opens up new markets for both nations and helps solidify relations that had been on shaky ground.

On the economic front reports are conflicting but most show growth. Based on PMI and recently released import/export data industrial production and trade are still strong and showing signs of expansion. The official PMI reading for May came in at an expansionary 51.2, unchanged from the previous month. It is better than expected but offset by the Caixin's 49.6, which shows a mild contraction in small to medium size business.

Services PMI and import/export data are showing stronger levels of growth and expansion. Services PMI rose by a half percent to 54.5 where it has been trending for the last 7 months. This shows ongoing expansion within the segment and underscores the ongoing shift within China from an emerging industrial economy to one that is more consistent with the more advanced west. Imports and exports both rose in May, more than expected, in a sign of both domestic and international demand. Exports rose by 8.4% while imports rose at a much stronger 14.8%.

Inflation remains tame on both the consumer and producer level. CPI rose by only 1.2% in the last report, consistent with an expanding economy with only mild upward consumer level price pressure. The PPI came in at a much hotter 6.4% and at levels that would be seen as inflationary in other parts of the world. In terms of Chinese economics this number reveals a slowing of expansion and weakened demand within a hot economy.

### **China's Growing Credit Problem**

The real worry is China's growing credit levels. The country has been financing its growth with debt for decades, that's no secret. It's also no secret that debt levels, both corporate and national, have been excessively high for some time. While many economists think that the debt can be sustained provided the country's growth remains on track and spending remains focused on infrastructure there are concerns it could spark a global financial crisis of a magnitude to put the Housing Bubble, Global Financial Crisis and Great Recession to shame. Moody's downgraded the country's credit rating because of the debt. China's rating was lowered from A1 to Aa3 with stable outlook but is notable because it is the first downgrade in 25 years.

From the Asia Pacific Fund Annual Report;

*Among all the major economies around the world, China is one of the very few that is still growing at a decent pace of 6% or more per annum. Despite the moderating growth from its peak, we don't believe China is entering into an economic hard-landing or debt driven crisis. Social stability in China seems relatively intact, and the government is carefully walking a tightrope between managing growth and pressing ahead with structural reforms.*

The Asia Pacific Fund, Inc is a closed end fund managed by Value Partners, Asia's leading money management firm. The fund is directly managed by Norman Ho and Philip Li who have more than 30 years combined experience investing in China and the Asian economic arena. It is focused on capital appreciation and targets small to medium sized businesses with a value based approach. NAV and share prices have been steadily rising since March of last year and extended their gains over the past month. NAV is up more than 37%, share prices a little more than 50%, with a narrowing discount. The Asia Pacific Fund trades on the New York Stock Exchange under the ticker APB.