
ON GLOBAL GROWTH: U.S. TAX REFORM TO CHINESE DELEVERAGING

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On last week's podcast, we had the pleasure of speaking with Peter Boockvar, chief market analyst at macroeconomic consulting firm the Lindsey Group, and Leland Miller, CEO of China Beige Book, one of the premier China market watchers. Our conversation touched on a number of important issues for the global economy—from both a U.S. perspective but also from an Asian outlook, as much of global [gross domestic product \(GDP\)](#) growth is coming from China.

On the U.S. economic front, Boockvar thinks we are running a 2% growth economy and does not see any signs that productivity growth is increasing to offset a structural decline from the labor force caused by demographic changes. Boockvar hopes that incentives for capital spending from a tax reform package can get productivity growth higher.

Boockvar also talked about pressures he sees on [valuations](#). He questioned whether historically high profit margins are sustainable. If we get tax reform and higher economic growth rates, this could lead to higher interest rates and a higher interest expense for companies. Boockvar credits a good amount of profit margin expansion to low interest rate expenses.

Boockvar believes [monetary policy](#) does not change ultimate economic outcomes but rather just changes the time frame. We pulled forward GDP growth and stock market returns, but he thinks over the next five to 10 years we could see a choppy period without much return.

Boockvar pointed out that over the last 13 [rate hike](#) cycles since world war II, 10 of them put us into [recession](#). As we look ahead to who becomes Fed Chair next year, there is increased talk that Trump is speaking to Kevin Warsh, who is much more hawkish than Fed Chair Janet Yellen. Boockvar believes Trump wants to "keep the party going" longer and is less likely to put in place a more hawkish member like Warsh.

China Beige Book: Bringing Robust Data for China

On China, Miller's firm started independently gathering data on China in 2010 to help overcome the lack of trust in Chinese data. His firm cut China into 8 economic regions, 7 separate sectors, and 34 separate subsectors. The firm goes beyond GDP and tracks a number of jobs markets, credit markets, shadow-credit markets, and inflation. He describes this as a ground-up, panoramic view of the Chinese economy.

Miller's data currently supports the narrative coming out of China today predicting high-level growth, and he tips his hat to Chinese leadership for their accomplishments. A year and half ago, there were China contagion fears and a crisis environment. The

improvements we see in manufacturing, labor markets, and the general economy are very much shown in Miller's data.

Where China Beige Book breaks from consensus is the view for the future. Miller does not see deleveraging in China. He sees slower growth in [leverage](#)—what you might call deleveraging with China growth characteristics. He sees corporates and the real economy borrowing more (despite some watchers who say deleveraging is happening) making the Chinese economic performance all the more commendable. If Chinese leadership does put forward a deleveraging campaign in 2018, that could become much more painful for both China's economy but also the global economy that relies on China.

On China's Currency

There are many [bearish](#) China watchers who believe the buildup in leverage and bad loans in China are going to force the government to devalue the yuan. On other hand, there are those who believe China is rotating toward a consumer-oriented economy and will promote a strong currency to help keep import costs and inflation down. Miller believes this second scenario is more likely. He does not believe a major currency devaluation would solve anything for China, and it would counter the country's long-term goals of shifting to a consumer economy.

Looking Past 2017's Goldilocks Scenario

Miller believes 2017 was a perfect storm of exogenous events going well for China, many of which will not continue into 2018. We had a weak U.S. dollar and no trade tensions or Trump tariffs, central banks kept monetary policy spigots open and there were no worries over political fighting in the South China Sea. There was also support in the domestic economy from Chinese monetary policy and fiscal policy. Yet Chinese leaders know they also must undertake a long-term rebalancing of the economy. Miller believes investors have become too complacent over Chinese growth going into 2018, particularly regarding the demand for commodities.

This conversation touched on a number of important issues across the global economy, and I am very thankful to both Peter Bockvar and Leland Miller for joining me on our program. To listen to the full discussion, you can go [here](#).

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DEFINITIONS

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Monetary policy: Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Rate Hike: refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Recession: two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemployment.

Bear market: A sustained downturn in market prices, increasing the chances of negative portfolio returns.