Lincolnshire COUNTY COUNCIL
Working for a better future

:
Regulatory and Other Committee

Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	**Pensions Committee**
Date:	**08 October 2015**
Subject:	**Independent Advisor's Report**

Summary:

This report provides a market commentary by the Committee's Independent Advisor on the current state of global investment markets.

Recommendation(s):

That the Committee note the report.

Background

INVESTMENT COMMENTARY

October 2015

China – the key to future global growth?

Global equity markets fell sharply in August, as members will recall. Admittedly, thin markets at the peak of the holiday season exacerbated the fall, which extended to over 10% at one stage late in the month. What “spooked” markets was a crisis of confidence about China’s rate of economic growth. Overlaid on top of this was anxiety surrounding market expectations that the US Federal Reserve would raise short term US interest rates at its September meeting.

China’s economic evolution.

China’s significance to economic events around the world for the past twenty years or so has been based on several things: its sheer size (a population of about 1.4 billion – the US by comparison is about 325 million and the EU about 500 million) and its high rate of economic growth, over 10% per annum at one stage. Together with Russia, India and Brazil (thus forming the “BRICS”), it was responsible for boosting global economic growth to well over 5% per annum and materially increasing levels of international trade. China became the export “power house” of the world, responsible for producing many of the everyday items that we, in the

West, consume in our everyday lives. It thus exerted a significant influence both over global economic events and over global stock markets because of the economic linkages. Think of the importance of China to companies like Microsoft, Apple, McDonalds, Mercedes Benz, Airbus, Bayer and many more.

So what has changed? The key is population growth, which has now ceased. This is a direct result of the “one child” policy introduced by the Chinese authorities over thirty years’ ago. The population has peaked and will now slowly decline. At the same time, China’s enormous concentration on infrastructure spending (roads, railways, power stations, new cities etc) is peaking, thus reducing demand for raw materials (and hence raw material prices such as copper and iron ore) from places like Australia and South Africa. The huge movement of population from the rural areas into the cities and into manufacturing employment will continue but at a slowing rate.

Markets well understood what this process entailed. The Chinese economic growth which, according to official figures, was running in 2014 at around 7% per annum was likely to fall each year to around, say, 4% in the early 2020’s. Most commentators are convinced that the Chinese authorities manipulate their economic statistics; the figures are amazingly smooth compared to comparatives in other countries. Observers of the data usually track other statistics which are more reliable, e.g. electricity consumption or railway passenger miles, to deduce what they believe is a more accurate estimate. Some such estimates suggest growth of the Chinese economy in 2015 is already as low as 4%. That seems to me unlikely. All economies, as they expand and grow wealthier, increase their consumption of services as a proportion of the total; services are more difficult to measure accurately. The true growth rate is almost certainly less than 7% but more than 4% this year.

What is not in doubt, however, is that the Chinese economic growth rate is currently falling (but positive), led down by a contraction in manufacturing output and hence exports.

Implications for global economic growth.

Underlying the anxieties surrounding the Chinese economy are deep seated fears about the health of the other emerging economies – principally Asia (excluding China) and South America but not forgetting Africa. Their economies are also suffering; what differentiates them from China is demographics. Their populations continue to grow at rates much higher than in Europe and the USA, both of which are largely dependent on immigration to increase numbers.

So global economic growth in 2015 will probably fall to around 3%. Partly this is due to economic certainty in many of these countries, especially South America, about the likely rise in US interest rates and the continued strengthening of the US dollar.

Is this reduction to 3% per annum permanent? Hopefully not, but world growth will not return to the high levels seen in the mid 2000’s, when Chinese growth was around 10% per annum. It is not easy at present (absent population growth) to see

what will get world growth back to say 5% and hence give a significant upwards impetus to global trade – which would certainly increase stock market confidence.

End of the bull market in equities?

Hopefully not. Global markets have risen a long way since the low points following the "Lehman" crisis of 2008/9. They have had setbacks, notably in 2011. Markets never rise without suffering any reversals. The setback in August this year of say 10% from peak levels is not untypical. Global growth remains strongly positive and the US, the UK and Europe are growing in 2015, the first two at rates above 2%. So, I doubt the bull market is over.

The Federal Reserves' decision not to increase US interest rates at its meeting on17th September was, by innuendo, blamed on the uncertainty about the health of the Chinese economy, notwithstanding that a rise was warranted by purely domestic US considerations. Stock markets do not like such uncertainty – will the Federal Reserve increase interest rates in December – or wait until 2016? So, is a strong rebound in equities likely? Probably not.

Peter Jones
24th September 2015

Consultation

a) Policy Proofing Actions Required

n/a

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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