

INCREASINGLY desperate investors are turning eastwards in search of markets where their wealth might be invested. These days, with the OECD and IMF publishing little but bad news about the global economy in 1993, there is nowhere to hide. Except China. And Hong Kong.

Or so some entrepreneurs imagine. China's growth in the last 12 months was 11%, her market reforms having boosted the economy to the same share of world trade as Britain and France. So, according to the US news magazine *Business Week*, "The biggest payoffs, American investment bankers feel, could be direct investments in Chinese real estate or infrastructure projects" (Dec. 14).

We now issue a serious caution to investors: beware investments in companies that are shifting capital into Hong Kong, whence it is going into mainland China.

The coastal boomtowns where the Communist Party is encouraging the free market - on land leased from the state - are set for a major crash. We predict a weakening in the construction sector next year, followed by a generalised recession in 1996. Why?

EI readers know that we subscribe to the 18-year business cycle, one that is peppered with minor slow-downs but which terminates in a severe recession two years after the end of a land boom. Well, Deng Xiaoping reintroduced the market in 1978. Unless China demonstrates a unique capacity to buck the trends of history - has uncovered the secret that enables her to avoid the major 18-year recessions - round about now we would expect the accumulation of a lot of "hot money" ready to flow into land speculation, followed by a building boom and a termination of growth in 1996.

Is it happening? The Politburo thinks so; Vice-Premier Zhu Rongji is reportedly trying to cool speculation in stocks and real estate. He won't succeed, which means that China is on-time for a major economic crash.

◆ Banks report savings deposits of \$183 billion. Economists reckon

that there is another \$37 billion salted away. The savings rate of 38% of GNP is one of the world's highest. One result: a surge in the growth of credit, and inflation in the coastal towns underestimated at 10%.

◆ China's deregulated sectors are going hell-for-leather for growth. They are pouring enormous sums into capital investments, a substantial proportion of the returns from which are rents from land which the State is not collecting. Although the State owns the land, it has failed to set up a system in which the rents are socialised. That means people and companies are pocketing land-rents: they have been placed in the role of land speculators



"The Politburo is trying to cool speculation in real estate: it won't succeed"

(proving, once again, that ownership rights are not what count, but who reaps the rent).

Guangdong Province is a case in point. Economic growth has been 12.5% in recent years, leaping to 23% in the year to last May. Inward investment is estimated at US\$5 billion. The governor's officials in Guangzhou have set a target of 15 years to catch up with the other Asian tigers. Thirteen years of explosive economic growth encourages them to think they can attain their target without inter-

ruption.

They won't. Watch for a re-run of the adage that "the bigger they are, the harder they fall." The province is now displaying advance signs of the lawlessness which will be used as an excuse, one day, for a political clamp-down. Meanwhile, one of the beneficiaries is Gordon Wu, who has just completed a 76-mile highway between Hong Kong and Guangzhou, the capital of Guangdong. His company will get a half-share of the tolls but, "more importantly, hopes to make a killing out of developing three million square feet of land around 16 of the interchanges," reports *The Guardian* (Dec.29).

◆ People are beginning to pour into shares. Stock markets have been officially designated in Shanghai and Shenzhen, but other cities are jumping the regulatory guns and are issuing unlisted stocks to the public. Prices are soaring. Last October, the average on the Shanghai exchange was 160 times the earnings rate; one company had a ratio of nearly 572:1 in April. This compared with shares in Hong Kong (selling at 12 times earnings) and Wall Street (where 13 is the typical multiple).

◆ The prospect of picking up land-rents (disguised as returns on capital investments - which is what fuelled the Tokyo "bubble") is attracting Serious Money from abroad. Example; a Singapore-Indonesian consortium is working on an industrial park in Fujian province, the first phase (costing \$190m) to be completed next year.

◆ City governments are being lured by the new prosperity into multi-billion-dollar investments, which will stretch the capacity of the construction industry to breaking point. Example: Shanghai's 40m sq. ft. business centre, for which plans are now being designed by Richard Rogers, an

award-winning British architect. He says he has learnt the lessons of London's Docklands. The social lessons of Docklands may now be understood, but the economic dynamics continue to elude the policy-makers in the West. This we know, for example, from president-elect Clinton's appointment of Lloyd Bentsen as Treasury Secretary.

Inevitably, major mistakes - of Docklands proportions - are about to surface. Example: in Haicang - a short drive south along the coast from Xiamen City - the equivalent of £570m has been invested in infrastructure, including a new harbour. But the foreign petrochemical companies have not, so far, materialised.

The mainland crash in '96 will be blamed on Hong Kong. China recovers the British colony in '97. Analysts will fail to explain the mechanism for the mainland debacle, and will assume that the seeds of instability were sown by the current conflict with Governor Chris Patten over reforms to the colony's political system.

Analysts have already identified the weak link, when pressure is applied to the system: "If China strikes back too hard, Hong Kong land prices could tumble and new investment could flow elsewhere" (*Business Week*, Dec.21).

The upcoming economic crisis in Hong Kong is being induced, in major part, by China's cash-rich state-owned enterprises. According to one estimate, Chinese companies invested HK\$15 billion (£1.25 billion) in HK property last year. Although land is held under lease, property owners are able to derive a great part of their returns from land-rents. Amoy Properties paid HK\$900m (US\$116.4m) for Standard Chartered's HQ in Hong Kong last month, confirming the

upward trend in the price of prime sites.

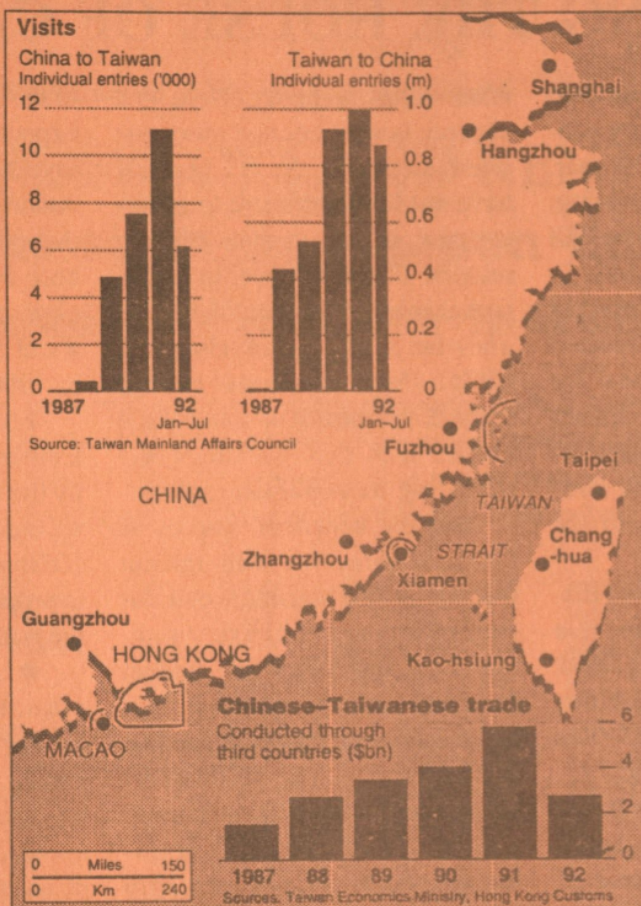
The emerging property crisis in HK will rebound onto the mainland, where the Politburo will have to deal with its first capitalist-style crisis. The governors of the key market-based provinces - Guangdong, Shanghai, Tianjin and Shandong - were elevated onto the Politburo last October, in what was a defeat of the communist reactionaries. When their economies suddenly start to unravel, they will come under tremendous pressure from party diehards to explain why the "miracle" of the market was going up in bankruptcies.

The impact on Chinese investors and consumers will be serious: many mainland companies are now tied by share-holdings into the fate of HK companies. The result may be a ferocious clamp-down in the newly-recovered cash-rich territory. China's Basic Law agreement with Britain is based on the philosophy of "convergence" of the two economies. China will swamp the island oasis, because

her political system is not sufficiently sophisticated to deal with the economic crisis. This will be matched by a tightening of social controls on the mainland, in response to a domestic crisis that will recall Tianenmen Square.

From there, the shockwaves will be felt throughout the Pacific Rim. Example: Taiwan investors are going to suffer severely. They are pouring billions of dollars onto the mainland, attracted, in part, by relatively lower land costs. (The *Financial Times* graphically summarised the new relationship: see map). They will try to pull their money back, only to find themselves trapped by an unyielding system.

Thus will accumulate the elements of a geopolitical crisis that will affect both



world trade and international relations. Don't expect the United States to bail out China; Bill Clinton has already drawn attention to China's \$15 billion trade surplus with the US - the second largest of any country - and he wants to create a pattern of trade that favours the creation of domestic jobs. Strategically - from the point of view of US employment prospects - few tears will be spilt in the White House over an economic contraction in China.

CONCLUSION: Other economic commentators are drawing attention to the "satisfactory" economic growth in China. This is encouraging adventurism in investment intentions which will end in tears. Investors now adjusting their portfolios for medium-term growth should question the general assumption of a major shift in advantage to the Pacific Rim. What looks like the Best Bet today is going to turn sour within a few years, and the financial infrastructure does not afford the protection that is to be found, say, in the United States.