

THE CHINA SYNDROME



No one has a kind word to say about Tony Blair these days. The Chinese press have just slammed him for his latest lecture visit: less interesting than a local newspaper column; more expensive than buying ownership of the whole paper.

At one level, Blair is merely the latest hooker on the international celebrity circuit. At another, he's just boring. Clients want more of his body for the money they pay. Perhaps this will all change once he converts to Catholicism. Having more to confess than most, it would at least liven up proceedings. Freed from office, and anxious for penance, Blair might begin to talk honestly about the mess he and his mate, Dubya, have taken the world into. China would have been a good place to start, for they are now pivotal in the choice of crisis that comes next.

It is China's economic growth that stops the current US housing crisis from turning into a complete economic meltdown. At the same time, it is China's rate of growth that makes the next global crisis unavoidable.

Bush's management of the US economy has been disastrous. He has turned Clinton's final year surplus of \$236 billion into a \$7 trillion budget deficit. It may be the last budget surplus the US sees in a long, long time. Bush has redistributed wealth to the wealthy, sunk American into an Iraq war costing \$600 billion (and rising), cut services to the poor, and given away money that the country didn't have.

This was only possible while there was cheap credit inside the economy and willing buyers of US foreign debt outside. China has been the main buyer of US debt. With 70% of the US economy based on consumption, much of China's own growth has been in supplying the goods the US no longer produces for itself. In return, China used its cash surpluses to buy up US government debt. It was like a credit card that you never had to pay off; a Never Never Land in which the US deficit could just rise and rise.

This worked until the collapse of the US sub-prime housing market. Up to then, most of the internal credit within the US was provided by banks and pension funds; believing that the economy could be driven on ever rising housing prices. What a sea of tears they now swim in.

Major corporations queue alongside banks (large and small) to announce record losses and bad debt write off. Conventionally, the answer would have been to cut interest rates to give the economy a boost. But, with the dollar falling like a stone in the international exchange markets, the danger is that the currency itself would cease to be worth holding...even for the Chinese.

As if this weren't bad enough, other aspects of the China Syndrome are starting to kick in with their own complications. The International Energy Agency has just reported that the growth rate of Chinese and Indian demand for oil imports will lead to an oil supply 'crunch' by 2015.

What does this mean? At the moment China takes up almost 80% of all of the extra oil the world

produces. By 2015 it will probably take 200%. This means it will take big slices of oil consumption that other countries currently buy. Hold on to your hats for the price consequences.

With oil prices set to cross \$100 a barrel, Americans are set for a tough winter. Gas prices could rise by over 50% in the next few months and the average home heating bill is set to double this winter. Oil price rises will also feed into the general price of goods and push US headline inflation up to 5%. To control this, the Fed will want to raise interest rates, not cut them.

Then you have the matter of food consumption. As China grows, so too do the food demands of its citizens. The country has become a net importer for the first time in its history. The effect (in combination with extreme weather conditions) has been to drive up global food prices.

Some dairy prices have risen by 200%. The cost of wheat has doubled. Pork prices have gone up 50%. So, both fuel and food are bringing their own inflationary pressures into economies that are otherwise stagnant.

The Bush plan to get out of oil dependency by shifting to bio-fuels only adds to US confusion. To deliver his 20% target of bioethanol production by 2017, Bush will require 40% of US corn crops to be used for fuel rather than food. This, too, will accelerate the rise in food prices and inflation. Americans will feel it in the shopping trolley as much as the petrol tank.

So here is the trap. If the Fed raises interest rates to tackle commodity price inflation it will turn today's crisis into a full blown recession. If it cuts interest rates (to boost the economy) inflation will rise, the dollar will fall even further, and China (along with everyone else) will decide that holding monopoly money is a safer bet than holding dollars. Then the shit really hits the fan.

All this, and more, is what Blair should have been telling the Chinese to think about. All this, and more, is what Gordon Brown should be thinking about too, before pledging undying loyalty to the Bush bandwagon.

One way or another, the brown stuff is going to be all over the place. Britain has already been hit by the knock-on consequences of the US mortgage and credit collapse. Whether you are in a UK pension fund, an insurance scheme, a bank or the government itself, the smart move is to cash in your dollar assets now. Put the money somewhere else if you want to keep it.

This is the one clear message that neither Brown nor Blair have the courage to voice.

When Hurricane Katrina hit Florida, the UK insurance industry picked up big chunks of the costs. When the US sub-prime market collapsed, the UK housing market was thrown into crisis too. If China decides to shift its foreign currency holdings away from the dollar, if it ends the line of everlasting credit, everyone else with assets in dollars will be left holding confetti.

Don't say we haven't been warned.