

# How Big is China's Economy?

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**“Your past is important because it brought you to where you are, but as important as your past is, it is not nearly as important as the way you see your future.” Dr. Tony Campolo**

The International Monetary Fund recently made a surprising forecast on its website in April, 2011. For the first time, the international organization has set a date for the moment when the “Age of America” will end and the U.S. economy will be overtaken by that of China. According to their latest forecast, China's economy will surpass that of America in real terms in 2016.

This raises enormous questions about what the international security system is going to look like. Both the U.S. dollar and the giant Treasury market have been propped up by privileged status. They continue to operate on the assumption that it will always remain the global benchmark of money. If the U.S. dollar ceases to be the world's sole reserve currency, what would be the alternative?

There is disagreement among economists regarding how the two countries are compared in real terms. Exchange rates quickly change and most agree that China's exchange rates are phony. China artificially undervalues its currency, the Renminbi, through massive intervention in the markets. Another way to look at a comparison would be using “purchasing power parities.” That compares what people earn and spend in real terms in their domestic economies. Under PPP, the Chinese economy will expand from \$11.2 trillion this year to \$19 trillion in 2016. Meanwhile, the size of the U.S. economy will rise from \$16.2 trillion to \$18.8 trillion. That would take America's share of the world output down to 17.7 percent, and China's share would reach 18 percent. Just 10 years ago, the U.S. economy was three times the size of China's.

Naturally, all forecasts are fallible. Time and chance happen to them all. If the great Chinese juggernaut blows a tire, as a growing number fear it might, it could delay things several years. The eventual outcome is scarcely in doubt however.

We have lived in a world dominated by the U.S. for so long, that there is no longer anyone alive who remembers anything else. America overtook Great Britain as the world's leading economic power in the 1890's and never looked back. Both the U.S. and Great Britain live under very similar rules of constitutional government. They operate with respect for civil liberties and the rights of property. China has none of those. The Age of China will feel very different.

For decades, China has successfully pursued economic policies aimed at national expansion and power. Meanwhile, the U.S. has embraced either free trade or, for want of a better term, economic appeasement. We have traded jobs for profit. The jobs have moved to China, leading to erosion of the middle class in America. What will the rise of China mean for defense and international affairs? From a beleaguered economy, the U.S. is now spending gigantic sums to try to maintain its place in the world's eyes.

America is not alone. Much of the world has tremendous amounts of their resources invested in the current economic system. A dramatic change in the world's reserve currency will not be a

sudden thing. It certainly will not be attached to economist's comparisons between U.S. and China. America's longstanding relations with other nations, fostered through monetary and physical aid over many decades, provides a counter balance to any perceived economic superiority by China in the future. In contrast, spending sprees and rising debt will not work for the U.S. or the markets in the long term.

What does this mean to the individual investor? It probably isn't necessary to start hoarding gold bullion for fear of the U.S. dollar collapsing. However, it does indicate that there are excellent opportunities for investment in Asian markets. Investors do have to carry out due diligence, as business practices and regulatory oversight are far different than what we are accustomed to in the U.S. markets. TPI has carefully analyzed investments in this area of the world and includes them as an asset allocation in well diversified portfolios. TPI will continue to monitor economic and political changes both in the U.S. and abroad that affect our client's portfolios.