Demetri Kofinas: 00:00 Today's episode of Hidden Forces is made possible by listeners like you. For more information about this week's episode or for easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you listen to the show on your Apple podcast app remember, you can give us a review. Each review helps more people find the show and join our amazing community. With that, please enjoy this week's episode.

Demetri Kofinas: 00:48 What's up everybody? My guest today is Leland Miller, Chief Executive Officer of China Beige Book, which runs the largest private data collection operation in the world inside China, interviewing thousands of Chinese firms across every major sector and region. Focusing not just on the growth picture but also key dynamics such as inflation, the jobs market, credit, and shadow finance. Leland, welcome to Hidden Forces.

Leland Miller: 01:20 Thanks for having me.

Demetri Kofinas: 01:21 I'm very excited to have you on, Leland. How are you doing?

Leland Miller: 01:24 Doing well, all things considered. Bunkered down, trying to stay safe.

Demetri Kofinas: 01:29 How long have you been in quarantine? Now, have you been in quarantine on US time or Beijing time?

Leland Miller: 01:35 US time. My team is based in New York. I have actually been out of New York for the last over three weeks, bunkered down outside of New York, self-quarantining with the family. Our team has spread out everywhere, New York, DC, San Francisco, London, Hong Kong, and doing what we need to do remotely.

Demetri Kofinas: 01:56 Yeah. I've been all, I'm based in New York City. That's where our studio is but I've been, I basically been out of the city for more than a month now. It's wild and doing all of these interviews remotely but in some ways, I find that people are actually more available because everyone's in quarantine. I want to discuss China today. Surprise. Surprise. But before we do, I'd love for you to give our listeners a sense of who you are. I want to also know obviously what is China Beige Book, but also how did you get into this business? I mean, were you always a kind of data sleuth, data analyst, someone who was interested in economics? How did you get into this line of work?

Leland Miller: 02:36 Yeah. Not at all. My background is in China. I've been doing the Chinese language through college. I studied Chinese after college in Taiwan, did a language fellowship over there, and also did a master's in Chinese history at Oxford University. I have had my foot in the China world for many years but after I finished grad school, I went to law school. I was at the University of Virginia for a number of years, and from there, went into law at a big law firm where I was doing transactional work out of both New York and Hong Kong.

Leland Miller: 03:09 But while billing these mega law firm hours, I continued to keep active on China. I was working on China issues in DC. I was writing a lot. I was speaking a lot. I was doing advisory work for buy-side funds, even early on, and eventually, I just decided to jump over to something I enjoyed the most. I was counseling a buy-side fund once who was asking me some question about official inflation numbers for month to month.

Leland Miller:	03:39	I said, "Look, none of this matters." They snapped back at me, and they said, "If this doesn't matter, why don't you do something that does matter?" I said, "Ouch." But good point. I went back and thought a lot about that. Part of the process got me together with some other people who are similarly frustrated with the state of the China watching industry. Basically, taking China's numbers, official numbers and telling a story, even though everybody knows they're not the real deal.
Leland Miller:	04:10	I came to this conclusion, this is what I wanted to do. I want to try something big and bold and something that everybody said was impossible, which was to go to China, collect data, because we couldn't trust anyone else's take. Collect big data in China and try to tell the story ourselves. So, back in 2010, 2011, I raised funds for China Beige Book, and we gave it a try. We were told by everybody we couldn't do it, China's a black box. They'll never let you operate; firms won't tell you what's actually going on.
Leland Miller:	04:41	We were not just pleasantly surprised, but we found that we could get just about any type of information we wanted if we asked the right questions. We kept making the survey bigger and bigger and bigger, and we didn't target just things like what growth is like. Although that's a big portion of what we do. But we were tracking inflation metrics, we were tracking the jobs market, and we were tracking the credit environment, which is something that nobody has ever been able to do before, and within credit, we started tracking shadow finance.
Leland Miller:	05:11	This has really gone in some amazing ways that even we didn't think was possible, and we're almost, we've been doing this for almost 10 years. It's quite a lot of fun.
Demetri Kofinas:	05:21	I'm very interested in this what you said about asking the right questions. What do you mean when you say that?
Leland Miller:	05:27	Well, I think one of the major problems with going into China is that the people don't know how to survey in China. I'm going to keep some of this close to a chest because some of these are proprietary secrets here. But I think the major problem was you typically had people who were China experts trying to get data or you had poll takers who didn't know China and there was never the right combination.
Leland Miller:	05:49	So, when we started this, we had several different arms. We had longtime China experts, we had professional poll takers, people who have done international survey taking for their whole career, and we had financial and data analysts who were able to crunch the data. When we put all this together, we figured out the right way to do this, and the right way to do it is to not just use a few firms, and not just concentrate in popular big cities or on the coast or just large firms, the entire purpose behind China Beige Book was doing away with all the other biases that made the rest of the data questionable.
Leland Miller:	06:28	For instance, when you look at the PMIs, the Purchasing Managers indexes, you've got a state PMI, which overly focuses on big firms, and certain geographical locations, and then you've got a private PMI that focuses on smaller firms, often private firms, and the other kinds of geographical locations, and usually one PMI is telling a different story because there's not just one China. There's a lot of different Chinas.

Leland Miller:	06:53	The purpose of China Beige Book was to make something so big and so comprehensive that we were taking in all the different Chinas at once. We were telling their individual stories across major regions, across major sectors, across dozens of sub sectors, across private firms, and state firms, and every firm size. Then, we were putting the combined story together to tell the real story of what was going on across all of China.
Demetri Kofinas:	07:23	How did you go about approaching these companies like initially? Because I imagine now it's easier, right?
Leland Miller:	07:30	Well, it's not really understood. Some of this is very sophisticated survey taking methods that I don't think people are aware of. But essentially, one of the problems people have is that they usually go straight to the companies and they go in the front door and they ask someone to fill out a survey, and often that person is a party official or a PR official or someone else who's not familiar with the actual lines of business, and then you get information that it's not the real deal. It's not usable information. It's what people or the party or the company want you to be reporting, not what is actually happening at these companies.
Leland Miller:	08:08	We had to find methods to get to the right people at the right companies, and then expand it. It's easy enough to do some survey taking in Beijing or Shanghai or Guangdong, but we had to go to the west and we had to go to the center and we had to go all across China in order to make sure that we weren't telling the story of the coast and not the periphery.
Leland Miller:	08:30	This has taken a lot of time. It took us about two years of on-the-ground work to get this thing up and running. But now it's entirely electronic. We have an enormous interactive database where all the private data information is used and utilized by clients there's like 5 million rows of data, 100,000 different data metrics. It's truly big data. I would say it's probably the only big data that exists outside of a handful of China tech companies and Beijing government.
Demetri Kofinas:	08:57	Another interesting thing you said was the right people. The right people and the right questions, that makes sense, that's interesting because the obvious question for someone like me is what stops the CCP or local government officials from basically, if not directly, indirectly communicating through these companies that they should not be communicating directly or honestly with you. Right? I mean, there's a general understanding in China that what the government wants the government gets, which is that's why I was asking this. That's interesting.
Demetri Kofinas:	09:31	Again, at all times being aware that you have proprietary methods, what can you tell our listeners about how you gather your data? Is your data all surveys for example?
Leland Miller:	09:42	Yes. It is. What we do is we go to over 3300 firms at a time, release data 8 times a year. Although we've moved towards weekly data releases of late, and we go to these thousands of firms and we ask them, how's your business doing? What are you seeing? How much are you paying for capital? How often are you accessing it? What are you doing with your workforces? Are you firing people? Are you hiring people? What are the prices you're paying? What are the input costs that you're paying, the prices you're selling at?

Leland Miller: 10:11 All different kinds of questions, and then we put together a composite picture of a sub-sector, and then from those sub-sectors, we put together a composite picture of the sector. So, manufacturing, services, retail, property, commodities, agriculture, et cetera, and then from that we put together a comprehensive national picture of the entire macro economy. Basically, we build up from many, many pieces of granular information on the ground, and build it up to one advocate picture of what the true China growth and other dynamics are.

Demetri Kofinas: 10:44 One of the problems with China is there's no benchmark. Right? You're not going to compare the accuracy of your data to the official numbers coming out of China. Right? How do you gauge the accuracy of what China Beige Book puts out there?

Leland Miller: 11:00 Yeah. That's actually a very astute point because one of the problems we had when we started this out was people would tell us, okay, we believe that you've got the real picture on China. But if they're announcing fake numbers and markets believe or are willing to believe the fake numbers, then what advantage do we have by using your stuff? It took us a bunch of years to sort of figure out exactly how to navigate this universe.

Leland Miller: 11:26 One thing that I was told very early on by a CEO was that we don't care what China's actual numbers are, we care what markets perception of those numbers are. It got us thinking. The first thing we had to do was understand how our numbers correlated. So, we get our stuff in real time, and even official numbers to extent they're not manipulated but they lack. So, that we were always getting a story several months ahead of what the Chinese data were.

Leland Miller: 11:53 Now, they can manipulate them at any given time, they can smooth it out, but eventually, directionally, they're going to tell a story. We were always on top of that. But I think what we also found out in times like 2013 when there was a credit crisis, 2015 when everyone thought the economy was falling apart that the Chinese don't announce bad news ahead of time. They're not going to tell you things are falling apart ahead of time. It only took a handful of times for clients and for companies and for economies to be totally sideswiped by a China growth panic to see, wait a second, we need a canary in the coal mine.

Leland Miller: 12:30 I think the first real group of companies that came to us as clients were one saying, "We're sick of not having any understanding of where the messaging is failing. We want to know if there's a problem that's right around the corner. We're not going to get that from official data. You can help us with that." I think that started it and from there, we've really been able to get more and more data so that we have correlations to all the major indicators. We just run at two to three to four, sometimes six months ahead of what official data reports.

Leland Miller: 13:02 It's a work in progress but it's something that's been very interesting, and now it's necessary because China's successes and failures dictate global portfolios everywhere.

Demetri Kofinas: 13:12 One of the things that I wanted to ask you about has to do with your use of quarter-to-quarter comparisons in your reports. Is there a reason for that and do you look at year-over-year?

Leland Miller: 13:24 Sure. One of the advantages to having this all in a one giant database is you can run any type of comparisons you'd like, and one of the things that we do when we write out our analysis is we put the quarter-on-quarter figure on there, we put the year-on-year figure there so that the data presented both ways. I think if you, you can't miss the year-on-year perspective particularly because that's the way the Chinese government reports its data. But the quarter-on-quarter is extremely important too because that gives you a sense of how things have changed over the course of a few weeks or months.

Leland Miller: 13:56 In terms of reporting quarterly data or eight times a year data, instead of going into months and weeks and what we found is that when you report data out of China, in particular, but this applies to most monthly data, you get an extraordinary amount of white noise. One of the problems with the PMI, which is released monthly, and this is not just a China issue, this is any PMI released monthly is that people make a lot of very small movements. You can have a movement in one month that goes up a little, the second month up a little, the third month a big drop.

Leland Miller: 14:30 For two months, you may have tricked yourself into thinking there was some sort of positive momentum but the real story of the quarter was a more precipitous drop or the reverse of that, two baby dips and a large improvement. It's always good to have frequent data but if you have too much white noise, it won't tell the story and we ran different time periods for this. We settled on the types of periods that were actually proving to us to be forward-looking. We could tell what's happening both in in reality and in Chinese official data, weeks, months, sometimes quarters ahead of what was being announced when we did our data in a certain way, and that's sort of the methodology we settled on.

Demetri Kofinas: 15:06 Well, one of the reasons I asked about that, specifically about quarter-to-quarter versus year-over-year has to do with the incidence of Chinese Lunar New Year during this most recent quarter that you reviewed in your early look brief. How does that factor into the data the fact that I assume that was during a time of year where there would be a lull in economic activity?

Leland Miller: 15:30 Sure. The problem is you cannot make much as you say. You can't make much out of January to February comparisons because sometimes Lunar New Year falls one place, sometimes it falls the other, even Beijing has recognized this in the last couple of years by combining Jan, Feb data in most instances. You're never going to come out with any really important conclusions about jumps and growth or falls and growth between January and February.

Leland Miller: 15:54 The most effective way to looking at Q1 is by looking at a quarterly figure. That doesn't mean you can't break apart the figure. For instance, when we were looking at what was happening in China as coronavirus was spreading, we broke it apart and we were reporting weekly updates. Here's the share of firms that were reporting back to work by sector, by sub-sector, by state versus private, and here are the results that they were telling us in terms of output, and sales, and sales prices.

Leland Miller: 16:22 You can present certain data but you can never oversell January to February data as being something major. The most effective way of looking at this is from a quarterly lens. But so long as you understand that, you can break it down into smaller time periods, but this is something that Q1 operates just very different than most other quarters.

Demetri Kofinas: 16:39 All right. Let's get into what your report shows for Q1. Q1 is the quarter where China began to enact its lockdowns, right? Did it begin at all in December? When did this start?

Leland Miller: 16:54 It really started in January. You had reports of something fishy happening in Wuhan and a couple other places in December, arguably even November but nobody knew what this was. I mean, you've seen epidemics in the past where you've seen swine flu, you've seen diseases wiping out the chickens, you've seen all kinds of things that were just a very small micro China story. They were tragic but they weren't global issues, and so very few people were paying attention to them before January.

Leland Miller: 17:21 I think January is when this became a bigger issue. The Chinese government started to treat it more seriously. You had potential contagion problems simply because on Chinese Lunar New Year you have everyone traveling everywhere, and so the potential the spread of the virus became a bigger issue, and then when people didn't go back to work after Lunar New Year that was when I think the entire world took serious notice of this. It's a Q1 story for China, even though you had some issues before it.

Demetri Kofinas: 17:50 Well, there are multiple aspects of your report obviously, and right now I'm looking at both the key economic indicators for Q1 but I'm also looking at the credit shadow finance monitor report. Let's go through the economic, the sort of real economy to begin with. What have we seen based on your numbers in terms of economic contraction in the first quarter in China?

Leland Miller: 18:12 Yeah. Well, the thing that jumped out from the very beginning, when I say that, we started reporting numbers in mid-February. That was almost a month, at least, two to three weeks before anybody else was putting out any type of numbers on this whatsoever, and the depth of contraction, the breadth of weakness was really eye-popping. These are the worst numbers we've ever seen and there's never been anything close.

Leland Miller: 18:34 Every sector was in severe contraction. Every region we track was in severe contraction. Every sub-sector I think except maybe one or two were in severe contraction. Every headline metric we saw was showing severe weakness. This wasn't something we'd ever seen before and what was interesting is that it was less surprising to look at the data in February when you were looking at all these firms and locked down, forced shutdowns of certain sectors like property and, of course, manufacturing factory is being shut down.

Leland Miller: 19:03 You don't expect the numbers to be anything other than terrible during February. What really became interesting is that when we moved into mid-March and the Chinese government started pushing people back to work, and started advertising the idea that firms were reopening at this torrid pace, and that workforces were back and that things were getting up and running and lights were being turned on, we were reporting all through that period and what we thought was fascinating is that even as firms we're going back to work and we saw that by our closure rate falling and firms reporting being back to work, in whole or in part, the data kept getting worse.

Leland Miller:	19:40	The output was not going up. Firms were still reporting very bad data, and so the idea of a recovery that people had a V-shaped recovery in March into April, it became very clear very early on that this was never going to happen. Firms were just getting their bearings even when they're reopening, they weren't returning to any types of growth, and March data were much, much weaker than people thought. We saw them from the very beginning in March.
Leland Miller:	20:05	There was less surprise when some of these weak numbers came out even from China's government because it's what we had been seeing all the way through the quarter and getting worse, if anything, not getting better even as we got into mid-March.
Demetri Kofinas:	20:16	Does that mean that a good number of people were not going back to work? Does it also mean that firms in order to appease workers or enact safety measures limited the amount of time and productivity? Is that partly what it is? Is it a reflection of the productivity hit that you get when you have to run a factory with safety and NPIs as non-pharmaceutical interventions as being a core aspect of your operations?
Leland Miller:	20:44	Well, no question that was part of it but the problem was that going back to work didn't mean what people thought it meant. You had these headlines, China's getting back to work, on the road to recovery. Well, what is back to mean? Well, you would have labor forces forced back to work. You had police escorts bringing buses of migrant workers from the countryside into factories and the Rust Belt in order to get factories up and running. You had executives slowly returning from working remotely. You had lights going on. You had factories, conveyor belts turning on, but you didn't have anything happening.
Leland Miller:	21:18	Output wasn't happening, you weren't seeing any of the internal metrics getting better, firms themselves reporting to us that their workforces were coming back and their lights were going on but they weren't doing anything. I think that's what people were missing early on. They were obsessed with the idea of getting back to work without realizing that getting back to work doesn't mean anything if you're not doing anything when you get there.
Demetri Kofinas:	21:38	Well, that kind of leads into a question that I had, which really has to do with like what kind of… I mean are we under playing or under estimating the psychological barrier to interaction, whether inside or outside of the workplace that people in China will have especially in Hubei Province where it was the epicenter of all of this and the dampening effect that this could have in Q2 in terms of Q2 output?
Leland Miller:	22:05	Yes. I mean I think that it's not surprising if you think about it. But look, these conditions that they will be returning to and that those of us in the US will be returning to at some point are not the status quo ante, this is not what we saw before. If you're around somebody on your factory line or in a store when you're trying to buy something and someone starts coughing, you're going to run for the door.
Leland Miller:	22:26	I mean I was in a pharmacy the other day and someone walked by me and started coughing. I almost did a cartwheel in the other direction. I was getting away from him so fast.

Demetri Kofinas:	22:36	Do you wear a mask? Do you wear a mask when you go out?
Leland Miller:	22:38	I have a mask. It's a crappy mask. I do wear gloves. I've got someone, hopefully, sending me a few masks I can give to my family, but we have been more and more protective of this simply because doing as much work in Asia and in China, we don't see this as odd as I think most American see the idea of masks. I remember early on in January, I was walking to the airport and either you'd see someone with a mask on, particularly if they're from Asia and people would recoil, even though that was the-
Demetri Kofinas:	23:05	What's funny that's-
Leland Miller:	23:06	… that was the sensible thing to be doing.
Demetri Kofinas:	23:07	Not just the sensible thing but when I see someone wearing a mask, I think, "Oh, this person is far more responsible. I have far less to worry about."
Leland Miller:	23:15	Right.
Demetri Kofinas:	23:16	It isn't even that I have less to worry about because they're wearing a mask, and therefore, I'm less likely to get an infection from whatever they may or may not have but the fact it's sort of a way of signaling, "Hey, I'm extra careful." You're right. That is entirely something that we're not used to here.
Leland Miller:	23:31	The West is going to have to learn this lesson. I think that whatever the road to recovery is in the United States and Canada and Europe and elsewhere, part of it is going to have to be walking around with the mask for the next several months because this is the new reality. We have to make sure that we're not contagious and other people are not giving us something simply by passing by and having particles passed between us.
Leland Miller:	23:55	This is the new reality. I don't think people have thought this through and there are no answers yet. But, yes, a mask is going to start becoming a common feature in the weeks and months ahead.
Demetri Kofinas:	24:05	Well, one of the things that we've talked about, not to get too far off track here, but it's almost like everything is COVID-19 these days. Something I've talked about on this show and in other interviews that I've done is that I think the narrative in the US does not serve us very well because it suggests or it's gotten people thinking that we have to just go through this short lockdown period and once we flatten the curve then we're done. But that's not actually what's going to happen, and people are going to have to learn how to live with this virus.
Demetri Kofinas:	24:34	There's no clear evidence that we're not going to have a second wave for example. In fact, some of the studies I've looked at suggest that the flatter the curve based on mitigation measures and quarantine and things like this, NPIs, the more you can flatten it in the initial phase, the more it peaks later on and that the area under the distribution tends to be pretty much statistically identical, not identical but that the difference is not that great between cities that enact draconian quarantines and those that don't in the long run.
Demetri Kofinas:	25:09	I think there's a concern about a political crisis in the United States when they go to lift the quarantine in some of these cities like New York, and the numbers

start going up and people start to panic because they've got different ideas in their head but to this point about a second wave, what are we seeing and what are you seeing with your data and your surveys in terms of this second wave?

Demetri Kofinas: 25:33 Where I've already started seeing there have been reports coming out in mainstream US media outlets, I saw a videotape posted online of someone in a Chinese city collapsing. Once, again, these are videos that were circulating commonly months ago. What are you seeing in terms of re-infections or rather increase again and prevalence of the virus now that the quarantine has been lifted?

Leland Miller: 25:55 Yeah. It's too early to know. I mean the second wave can mean a lot of things. It can mean letting up on draconian measures, and then seeing social distancing go away, and so you get more infections. It can mean allowing more people to travel to China. You see what's happening on the Russian border, they're actually putting new cities into lockdown because people are traveling into China and re-spreading it. There are serious questions about whether you have immunity once you get it. We could be seeing a first wave now, people could be relaxed, it could either be because of the weather or because of some temporary immunity.

Leland Miller: 26:29 Then, you could see a reinfection wave hit again a few weeks or months from now. There's just so many questions about this. This is what has made economic strategy so difficult around it. We don't know the medical aspects of this. We don't know whether this is going to be a 6-month story, a 3-month story, an 18-month story, and there's going to be a lot of trial and error here. I think the lessons we learn from so far is that no one has been able to control this so far.

Leland Miller: 26:55 You look at Singapore, which is a success story. Singapore as we speak is going back into lockdown because of some sort of second wave. That's also probably going to happen other places as they ease up on the original lockdowns. So, enormous number of questions right now that's made the job for policy makers trying to figure out an economic recovery path, out of this, nearly impossible.

Demetri Kofinas: 27:19 Here's a question for you, and I'm going to ask it in a few different ways during the course of this conversation because I think it's very important. Because on the one hand, there are obviously many difficulties in gathering credible data in real time that tells a backward-looking picture about the Chinese economy. That's challenging enough, right? It's even harder to make projections about how the economy is going to look.

Demetri Kofinas: 27:44 One of my questions is, how do you incorporate the virus, the impact of the virus and the impact of the monitoring and mitigation measures that will continue to be taken going forward? How do you incorporate that into your economic forecast for China?

Leland Miller: 28:01 Well, one way is we collect data on it. For instance, what we're doing for April is we're going to have an entirely new discreet survey out in the field asking people about supply chain questions, about possible COVID-19 relapse questions, asking about credit conditions, and how the economic stimulus in the aftermath is happening. I mean, we know that they're pumping an enormous amount of money in the economy, everybody who's seen this is but who's being prioritized --

Demetri Kofinas: 28:27

So, what do we know about their stimulus efforts? Because for me, when I've tried to study China, it's almost like I had written out some questions for you and I had scratched them all out before I came in here because I was like, "I'm asking these questions from a Westerners perspective, and the way that the Chinese economy expands credit and the way that credit circulates is totally different than how we think about it here." What are they doing? Is it in any way unusual or even significantly greater than what we've seen in past economic downturns?

Leland Miller: 28:59

Absolutely. This is unprecedented. I spent a lot of my time explaining the nuances of China's non-commercial financial system and how it differs from Western commercial financial systems, and how the West allows risk-taking and it's not backstop by the state and allows firms to fail and all these other things. This is not a time in which any of that applies. I think what you're seeing for the US Fed right now is the same type of approach that China's looking at and everyone else is looking at, which is this is such a massive all-encompassing issue.

Leland Miller: 29:32

It's a supply shock, couple with the demand shock. The likes of which we've never really seen before. That you have to throw everything at this. So, looking at the China example, they are trying to backstop everything. I mean the biggest threat to the party has always been social unrest. Social unrest comes from people who don't have jobs. They don't want to lay off workers, they don't want firms go out of business. But you can't backstop everything, and even if you could, you can't do it all at once.

Leland Miller: 29:59

One of the big questions for us is, what are they prioritizing? How fast are they getting this stimulus out? What are they not doing? One thing we are seeing is we're seeing more stimulus early on going to the usual suspects, manufacturing firms, larger firms, state firms, coastal firms, the bread baskets, the traditional bread baskets of growth. That doesn't mean everybody else isn't going to get it, it just means that those guys are getting priority.

Leland Miller: 30:24

Another thing that we've seen is that the credit numbers in the first quarter are actually somewhat deceptive because they're lower than one would think and that's because of the physical disruptions to the credit market. So, people could not go out and get the loans they needed. They cannot issue bonds because the economy was in lockdown. Banks were closed, people couldn't travel places.

Demetri Kofinas: 30:46

Well, the banks couldn't be opened remotely. Why is that something… That would seem to be one of those things that wouldn't need to be impacted by the lockdown or at the margin, sure, but why would banks be enabled to extend credit during a lockdown?

Leland Miller: 30:58

No. Some can. Some can but the entire Chinese economy, it wasn't in a place… No economy on earths in the place where you just call up your banker, and then every loan to be extended automatically. The US is trying to do that right now with the small business loans but it's not that this stuff isn't happening, it's an enormous logistical nightmare. You've got millions of firms in China trying to access credit, you've got consumers who need to be paid, who need credit too. It's a logistical nightmare.

Leland Miller: 31:24 What I think you're seeing right now is you're seeing the levels of credit high and will continue to get higher as we go along simply as they run through the priority line. It does a queue for credit and they're going to try to give everybody everything they can. But interestingly, the one thing they have not done yet but we're watching this closely is go to the old playbook of heavy infrastructure stimulus.

Leland Miller: 31:47 So, back in 2016, you saw an awful, you saw a real scare in mid-2015. You saw a total China market panic in early 2016, and one of the ways China recovered from that was building lots of things. Many of these were bridges to nowhere, others were apartment complexes it wouldn't be lived in, others were productive things. But basically, just building, building, building and this is something that China has done a lot of after that happened. I think they saw that as a necessary evil because it was in the run-up to the party congress where Xi Jinping was cementing his rule and there were some political strength to the economy that was needed for political reasons.

Leland Miller: 32:29 After that was done, I think a lot of people in Beijing, a lot of influential people in Beijing said, "This is it. We're not going to try to do this anymore. We will stimulate the economy but we're not going to do it the old-school way of just building things." Amazingly, that was what we saw in our data, and 2019, which was a much weaker year than 2018, you actually saw stimulus because you always see stimulus in China, but you didn't see it going into transportation, construction or any of these sectors where they're just building.

Leland Miller: 32:57 What you saw is broader credit provision to firms. So, they would stop firms from going out of business, small, medium sized enterprises who typically couldn't get credit, they were given credit. Private firms who couldn't get as much credit as state firms, they were given credit. Agricultural firms, they were given credit. There was stimulus, there was more credit provided, but you didn't see a resort to the old playbook of just building things, which is what scares a lot of people in Beijing about the non-performing loans and the debt to GDP ratio.

Leland Miller: 33:28 It scares people in Beijing a lot more than it does in the West in terms of views of China's economy. They're much more cognizant of their problems in China than they are outside of China.

Demetri Kofinas: 33:37 Well, they've stimulated that sector so much that they've actually had to go abroad to find places to build stuff.

Leland Miller: 33:43 That's right and they know that, and so this, until coronavirus took hold, I think their play book had moved away from this. They thought it was a danger to the party to continue to rely on this lever. But I think what's interesting now is there are conversations going on in Beijing, how much do we have to fall back into this? Because the story of China's growth is no longer a story of domestic resiliency.

Leland Miller: 34:06 Q1 was terrible. There were severe contraction and they are recovering from that contraction in Q2. But the problem is the rest of the world is shutting down. All of China's trading partners are shutting down one by one. The US and Europe, of course, at the top of the list so there's no global demand. Export orders are falling off a cliff, which means that the original recovery story they thought they could tell back in January or even February, they can't tell anymore, which means that not only are the parties growth targets way, way, way out of the line of possibility.

Leland Miller: 34:38 Although they haven't admitted that quite yet but the idea of how do we spur growth in the absence of demand, well, we don't know how much of this demand is going to be taken offline and for how long, what are we going to need to do that we didn't think we'd need to do before? That's why we're watching our real estate construction data so closely because this has not been an option for them for a long time, but it may become an option later in the year when they realize that they're going to have a very difficult time not being in a contraction . . .

Demetri Kofinas: 35:07 Jesus.

Leland Miller: 35:07 … all through the first half of the year.

Demetri Kofinas: 35:09 Jesus. That's the second leg of the story. Right? I mean the virus we talked about and we'll continue to talk about, which is the uncertainty around the virus. The mitigation efforts needed domestically to animate the supply side of this equation but on the demand side, China has always relied on an export market. Right? They have talked about wanting to transition to a consumer led economy, but they have not been able to do that effectively.

Demetri Kofinas: 35:35 Now, they depend on foreign consumers, as they're coming back online because they got this virus late, they're depending on the rest of the world to be available to demand the goods that they can supply. But as we're seeing, the rest of the world is going into lockdown. What happens in China? You're saying that inevitably or it increases the likelihood, perhaps a better way of putting it, that you're going to see them roll back to break their previous commitments and try and stimulate their manufacturing sector further. So, are you seeing that in the loan uptake figures? What sectors have been taking the most amount of credit early on so far?

Leland Miller: 36:15 We're not seeing it yet. We are seeing more loan uptake in manufacturing and we are seeing it from larger and state firms. That's not surprising. But I think that the reason the numbers aren't higher is simply the disruptions to the credit market. They haven't gotten things back. I think as the next few months, as we look into the next few months, I think the credit numbers are going to continue to go up and up and up and up and up.

Leland Miller: 36:38 There's this idea that China is resisting the ways of the West right now and they're going to try to do it a lot more gently, they're not going to be able to do it gently. There is no solution to this problem, and even if there was, the Chinese way is to throw an enormous amount of credit at it. You're going to see a lot more credit going in the economy, you're going to see a discussion about backtracking in the heavy infrastructure stimulus, and you're going to see some very, very difficult decisions being made over who gets the available credit and who gets left out. Because no matter how generous they want to be, and no matter how much they want to support everybody, they're not going to be able to.

Leland Miller: 37:13 It will be impossible. They cannot backstop everyone and everything. There are going to be losers in this, and those losers are going to do very poorly over the next year. This is the decision tree that's being worked out in Beijing right now, who are the losers going to be? This is tough.

Demetri Kofinas: 37:28 I have another question here, which is how is China going to get the dollars it needs to import the raw materials it needs in order to ramp up this export machine? How is that going to work in the current environment? Because US Central Bank has not set up swap lines. They set up swap facilities with many countries including many new emerging market economies, has not done that with the People's Bank of China. What's going to happen there?

Leland Miller: 37:53 Well, I have a somewhat different opinion than others. I mean, yes, the Fed doesn't have a swap line with the PBOC and, yes, there would be severe political pushback from the idea of exporting dollars to our adversary, China, but the Fed also doesn't have a swap line with other banks of allies. I don't think we have it with Korea for instance.

Leland Miller: 38:13 The idea that if things got really bad, and we're talking about some of these, the idea that this is going to be a Great Depression, services are dead for the next six months, unemployment, it just goes on and on and on and businesses can't get back to work in any meaningful way. I think a lot of things that were not possible before will become possible. You've already seen that with the type of programs the Fed has released in the last few weeks.

Leland Miller: 38:38 I think that there's just no level they won't go eventually in order to stabilize or save the economy. I think that includes extending swap lines to the PBOC eventually. I think that means extraordinary types of fiscal monetary policy in both the US and China and everywhere else.

Demetri Kofinas: 38:56 But what would be the reason for doing that? Would it be because they'd be concerned that they would begin to flood the market with US Treasury Securities in order to raise the dollars they need? Would it be because they would be concerned that the absence of Chinese manufactured goods would spike inflation at the same time as Americans needed to keep consumer prices low because they're expanding the money supply and expanding fiscal stimulus? I mean, what would be the logic there that the Fed would do that?

Leland Miller: 39:24 These are the issues that people are talking about but the reality is, at the end of the day when things get really bad, the world floods into safety, and safety is the US dollar and now there is an issue, of course, with a lot of Chinese companies having taken out dollar denominated loans, there is a vulnerability there. It is nowhere near what it was a number of years ago when China was extremely vulnerable on this.

Leland Miller: 39:45 But look, you have in a world where the dollar is strong and appreciating, you need to have dollars yourselves. I think that if the PBOC wasn't able to get access to dollars, you have a major problem, they would circle back on the rest of the global economy, would hit emerging markets, and then it would hit everyone else. So, I think the idea is that the dollar is the flight to safety. I think if we're going into something truly horrific, then there will have to be access to the dollar from just about every one of the major players. I think if there was a restriction on that for too long, it would cause a rupture in the system.

Demetri Kofinas:	40:16	Here's another question for you. If China's going to go the route of stimulating its manufacturing engine but the rest of the world isn't really available to purchase the outstanding supply in a traditionally commercial way, will we begin to see China engaged in more of these favors abroad like they've been doing recently like they gave masks and PPE to countries like Greece, and Italy as part of their, I don't know how you call it, a trade diplomacy, foreign policy, because the Chinese economy and the Chinese political system are much more connected than let's say the US is.
Demetri Kofinas:	40:52	So, maybe this is a way of kind of asking you, also, how coronavirus and how this entire situation could be an impetus for a narrative shift by the CCP to explain, not just its poor growth numbers now, not just its poor growth numbers going back quarters as a result of mistakes that the party has made, not on account of the virus and i.e. take advantage of this crisis but also take advantage of this crisis to further geopolitical ambitions of the party.
Leland Miller:	41:25	Yeah. Well, the economic side, what we have counseled them to do for years is take advantage of a slowing global environment, and to allow their growth targets to go away, to accept slower healthier growth. The Chinese economy is not growing. Let's just take COVID out of the picture entirely.
Leland Miller:	41:42	The Chinese economy is not growing at 6%. It was probably growing about half that. But they had to advertise it was growing at 6% because the deal the party has made with its people is that we will continue to grow the economy at this pace and that's why you should trust us as your one party and trust us with your leadership. It's been outdated for a while. They should take advantage of this to say, "Look, what we're here to do is make China stronger, not faster growing in an unsustainable way and we were going to buckle down and accept lower rates of growth, most of which was foisted on us by circumstances outside of control, where there's a trade war or a global manufacturing recession or a coronavirus pandemic."
Leland Miller:	42:23	That's what they should do but they haven't done that yet. The jury's out on that. In terms of the geopolitical side, this is what they've been doing for years and years and years. People are seeing the mass go out and they're thinking this is some new play book. It just used to be briefcases a dollar bills before. This is always this kind of China's influence diplomacy. They're always trying to do things in order to achieve soft power goals.
Leland Miller:	42:47	They're going to have to be a little bit more aggressive about it because it's a tougher environment out there. But I think this isn't so much a paradigm shift as its forcing China to do things that before it would rather have done that under-the-radar, away from the public view. Now, it's forcing them to be much more public about this type of thing because quite frankly, people are mad at China because they lied about the coronavirus pandemic spread early on. They wouldn't let the CDC in. They wouldn't let the WHO in a meaningful way and this thing spread.
Leland Miller:	43:17	There's a lot of people angry about China, and in the aftermath, they tried to secure global leadership of this thing by saying, "We cured it in China. It was probably done by the US military anyway." It really backfired. I mean this was just absolute incompetent diplomatic management. As a result, they're sort of clawing back from where they were before and trying to act like a responsible

party, which I certainly applaud. But this is nothing new. It's just more difficult circumstances forcing to light things that the party has done for years and years and years and years.

Demetri Kofinas: 43:51 Well, they just issued some new meat guidelines, meat like diet guidelines and they reclassified dogs as pets not livestock. So, either they are trying to signal --

Leland Miller: 44:05 I was happy to see that.

Demetri Kofinas: 44:05 Yeah. Exactly. Yeah. As a dog lover I'm happy to see that. So, either they're signaling that this has not come from our bio weapons facility in Wuhan or that this is not the US military doing it. One way or the other, it certainly doesn't bode well for the theory that the US military has done this. But going back to this thing about growth, you kind of made mention of it. It's sort of like a double-edged sword because in some ways growth is not good for China if it's not the right kind of growth.

Demetri Kofinas: 44:37 They've had the wrong kind of growth for a while. This is the dance I think that a lot of foreigners or people from the outside world looking and trying to understand this, and it also makes it difficult because I had written here, "Best case, worst case, base case scenarios for China GDP." But that kind of misses the point, doesn't it? Because the best case scenario for China isn't that it gets the highest level of growth, the best case scenario for China is that it gets the highest level of growth in the direction of what kind of growth that it wants, even if that growth is less growth then it would get.

Demetri Kofinas: 45:09 The worst case scenario would be tons of growth in the wrong direction. Right?

Leland Miller: 45:14 Yes. Exactly right.

Demetri Kofinas: 45:16 How do you think about that? In that context, what are the best worst and base cases for China's economy going forward?

Leland Miller: 45:23 The best case is, and this is not going to happen anytime soon, is that the Chinese economy actually de-leverages instead of just announcing it de-leveraging campaign, which our data show was not actually de-leveraging. It was a few years of slower additional leveraging but to de-leverage to the point where your growth can outpace your debt load because that's the real problem. When you have the other dynamic, it means that you're cutting down on productivity and you're in the process of creating a zombie economy, which is what China is on the path towards right now.

Leland Miller: 45:52 So, what they do not want to do as you said is grow fast because they can't support that other than with more and more and more credit. We have spent years trying to get people away from GDP growth as a measure and not just in China, for everyone. But look, GDP and here's the real problem, is a measure of aggregate growth. It's not productive growth, which means if you want to hit a certain target, you can hit any target you want by building a bridge, tearing it down, building the same bridge again, tearing it down, building it a third time, tearing it down, and go on and on and on and on to hit 8%, 6%, 9% growth.

Leland Miller: 46:31 Now, your productivity has just fallen off a cliff. Your waste of resources is legendary, but you can still hit your growth numbers. I think that's the problem that people have fallen into for so long. One, looking at GDP as a sensible measure of anything, and second, lauding the Chinese government for high growth levels, when it's actually been very counterproductive to the idea where China will create a sustainable growth model and become a true global leader in the future because what they're doing right now is only done through enormous levels of non-performing loans, non-productivity.

Leland Miller: 47:06 It's not sustainable, and what it's doing is forcing them to push good money after bad. In a non-commercial financial system, one of the reasons you don't just have the thing fall over in a domino effect, it's because you can swoosh huge amounts of capital for one financial system to the other to plug holes, to make problems go away. But what that means is you're always chasing good money after bad. You're always lowering your level of productivity compared to what you'd be doing if you just let the bad actors fail.

Leland Miller: 47:34 The bankrupt firms go bankrupt, the trust products that should be not returning anything go-

Demetri Kofinas: 47:40 We can't even do that here look. Leland --

Leland Miller: 47:42 Hey, look, [laughter 00:47:44]-

Demetri Kofinas: 47:45 This is crazy. Right? We're not even doing that here. It's not going to happen there, right?

Leland Miller: 47:51 It's not going to happen there. It's not going to happen anywhere, but the difference is that during a time, at least, most of the world was pretending to understand that up until now. Now, we sort of thrown in the towel. Europe is throwing in the towel. Japan is certainly throwing the towel. China will throw the towel; it already has no matter what it says. But they have for years been ignoring this problem, which means they're at a much worse starting point than anybody else is except arguably Japan.

Demetri Kofinas: 48:15 Or maybe they're in a better starting point because we're all moving in that direction. You may need to start doing this from the US.

Leland Miller: 48:23 Anything's possible.

Demetri Kofinas: 48:25 You might have to do US Beige Book.

Leland Miller: 48:26 Look, here's your new paradigm. It is that there is no longer a failure allowed, bankruptcies are allowed, the government backstops everything and we're going to see how long that goes until the system implodes. So, there's your new paradigm.

Demetri Kofinas: 48:38 Yeah. No. In all seriousness, that is a concern. Right? Now, we're kind of digressing a little bit and we'll get back in. But this is kind of the problem with the debt fueled growth model that we've had in the US. Again, this is something we've talked about in the show before, with rising levels of wealth, inequality the only way you can sustain that is to debt financing, and the only way that you can sustain debt financing and that dynamic is by lowering interest rates. But if you lower interest rates, you eventually divest savers of the capacity to save.

You move them out to become speculators, and so everyone moves into the stock market.

Demetri Kofinas: 49:12 Then, the value of the stock market becomes the health and the wealth of your savers. Then, you become invested in the appreciation of the market, and the entire government then begins to buy the index. Right? Then, you basically, ultimately, all roads lead to Rome. It's the same thing.

Demetri Kofinas: 49:30 It means government owns more and more of the economy. This is the place that we're going. It's ironic that we've been having conversations about China moving towards a consumer led growth model when we here are moving in their direction. So, anyway, to bring it back again to what we were talking about. Maybe instead of asking you for a pie-in-the-sky, crazy, best-case scenarios, what do you think is going to happen? What is your kind of base case? What do you foresee given everything including the challenges of having to navigate this, what might be a start and stop, stop and go model of containment mitigation with this virus, not just in China but also in the demand countries that it depends on for its export-led growth model?

Leland Miller: 50:22 Well, for a number of years we said that the future of China is going towards 1% or 2% growth at the most, and I think that the difference between what's happened with COVID is it simply just bed this process up. It's getting closer to the point where we're going to get lower rates faster. Look, what I was describing before was that the Chinese economy is based around avoiding failure, avoiding bankruptcy, avoiding, backstopping everyone and everything.

Leland Miller: 50:50 What that's meant is that productivity has fallen and that the economy is basically stagnating over time. That means that getting positive growth at all in the next decade from now is going to be very, very difficult. COVID sped that up. The problem here is that I think that that's happening around the rest of the world too. China's is just farther ahead on the curve on this.

Leland Miller: 51:09 I think that the idea that China will be growing at anywhere near the rates it has been is quite ludicrous. I think the idea that they're going to be able to grow at half the rates they've been claiming is quite unlikely. I think we're looking at an extraordinarily low growth model coming out of China, at which point, it's going to make it harder for the party to operate. It's making it harder for the party to backstop everything.

Leland Miller: 51:31 They have some real headaches going through. China can get out the other side. They can come out the other side but the longer they wait to restructure the system, and to stop relying on bad debt, and stop relying on investment led model, the harder it's going to be.

Demetri Kofinas: 51:45 Leland, I'm going to move us into the overtime. I want to pick your brain a bit on the geopolitical dimensions of this because I feel that as we move along the horizontal axis of time, more and more of these conversations that have been happening or discussed in economic terms are going to really become political. I want to talk about that. I also want to talk about the real estate market in China. I'm fascinated to learn how this has been impacted.

Demetri Kofinas: 52:12 Also, to this point about geopolitics, Japan has been incentivizing. This came out today I think at the news. We're recording this on Friday, April 10th, 2020. They are incentivizing domestic companies as part of their bailout package to move their operations out of China. This also I think is an interesting phenomenon. For regular listeners, you know the drill. If you're new to the program or if you haven't subscribed yet to our audio file autodidact or super nerd tears, head over to patreon.com/hiddenforces or scroll down to the summary section of this week's episode page and click on the link that sends you to the Hidden Forces Patreon account where you can continue to listen to my conversation with Leland, including gaining access to the transcript of today's conversation, as well as this week's 22-page rundown, which includes all of the research information that I compiled to prepare for this episode.

Demetri Kofinas: 53:14 Also, don't forget, if you haven't integrated the Patreon RSS feed into your podcast application that you use to listen to the regular episode, you need to do that. Overtimes are downloaded directly to your phone. You'll be able to listen to them just like you listen to the regular episodes. Leland, it was awesome talking with you. Stick around and we're going to continue the rest of our conversation in the overtime.

Leland Miller: 53:37 Will do.

Demetri Kofinas: 53:39 Today's episode of Hidden Forces was recorded in New York City. For more information about this week's episode or if you want easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you want access to overtime segments, episode transcripts, and show rundowns, full of links, and detailed information related to each and every episode, check out our premium subscription, available through the Hidden Forces website or through our Patreon page at patreon.com/hiddenforces.

Demetri Kofinas: 54:16 Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at hiddenforces.io. Join the conversation at Facebook, Twitter, and Instagram @hiddenforcespod or send me an email. As always, thanks for listening. We'll see you next week.