CHINA NEWS

Slackening Growth Pressures Beijing

Obama Administration Calls on China to Disclose Intervention in Currency Markets

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What do China's weak GDP figures mean for the U.S. economy? Silvercrest Asset Management chief strategist Patrick Chovanec explains. Photo: Getty.

BEIJING—China's economic growth slowed to its weakest pace in 18 months, putting pressure on China's leaders to allow the yuan to fall as a way to help troubled exporters and boost growth, and setting up a potential fight with the U.S. on trade and currency policy.

Beijing released its disappointing growth figures hours after the U.S. blasted China for its recent currency moves, calling the decline in the yuan "unprecedented" and pressing Beijing to disclose its market intervention more regularly.

The Treasury Department, in its semiannual report on currencies released Tuesday, said the weakening of the yuan would "raise particularly serious concerns" if it signals a retreat from Beijing's publicly stated policy of scaling back intervention to let market forces play a bigger role.

The report stopped short of labeling China a currency manipulator, a move U.S. administrations have avoided for the past two decades. But the warning marked the Obama administration's latest attempt to keep Chinese officials from

slipping on their currency commitments despite slower growth in the world's second-largest economy.

China's 7.4% year-on-year growth for the year's first quarter was below the 7.7% level seen in the fourth quarter of 2013, and slightly below the target of "about 7.5%" set by China's leadership for all of 2014.

In only one other quarter since the global financial crisis of 2009—the three months ending Sept. 30, 2012—did China miss the annual target, and that slowdown prompted Beijing to ease credit significantly in an effort to boost growth.

The rate, however, was slightly above economists' expectations, so Beijing may feel it has less need to prevent the yuan from rising. Many analysts expect China to allow the currency to begin appreciating again later in the year.

Since Feb. 17, when the yuan started heading downward, the yuan has weakened 2.5% against the dollar.

A main point of contention over the yuan's level against the dollar is whether China's currency, which in recent years has strengthened, has risen to its natural strength or has further room to rise, as the U.S. contends.

American manufacturers have complained that China's artificially weak yuan gives the country an advantage in trade. And U.S. lawmakers have backed legislation targeting overseas currency manipulation and asked the Obama administration in recent months to include currency rules in trade negotiations.

Beijing had allowed the yuan to appreciate for years before shifting toward a recent bout of depreciation. This year's shift has been "quite unusual," said Nicholas Lardy, a China expert at the Peterson Institute for International Economics.

The U.S. administration had previously touted its efforts to persuade China to allow the currency to appreciate and want to make sure China isn't ignoring the recent weakness. Chinese officials and have said the yuan's weakness is a temporary move designed to halt hot-money bets on the strengthening of the currency.

Reduced momentum in investment and consumption—key drivers of the economy—were behind the moderately weaker quarterly growth.

China also released a slew of other economic statistics on Wednesday that suggested continuing weakness. Industrial production grew 8.8% in March, below analyst expectations of 9.0%. This compares with 8.6% year-on-year growth in January and February, combined to limit distortions from the Lunar New Year holiday, according to the National Bureau of Statistics.

The purchasing managers' index, another indicator of the health of the manufacturing sector released earlier this month, also showed some weakness.

Fixed asset investment, covering areas such as machinery, land and buildings, grew 17.6% in the first quarter, compared with 17.9% year on year in January-February, which analysts attributed in part to problems in the housing sector.

Retail sales, meanwhile, posted 12.2% year-on-year growth for March in line with the consensus, a modest increase over the 11.8% year-on-year rise seen in January and February. An anti-extravagance campaign introduced last year to stem corruption continues to impede spending, although tepid government support for e-commerce could goose consumers into opening their wallets.

A strengthening yuan cuts in different ways for Chinese growth. On the one hand a weaker yuan makes Chinese exports cheaper in dollar terms and gives Chinese manufacturers an edge. On the other hand, a stronger yuan makes imports cheaper in yuan terms and can boost consumer spending somewhat. It also helps China make progress in its goal of remaking its economy so it depends more on domestic consumption and less on exports.

Over the years, Chinese officials have tended to put concerns about short-term growth ahead of longer-term restructuring.

China tightly controls the value of the yuan and uses its massive foreign reserves to buy or sell yuan as a way to guide its direction. In the first quarter, those reserves jumped by $129 billion, hitting an all-time high of $3.95 trillion. The increase, analysts say, reflected the central bank intervention to drive down the yuan's value against the dollar.

David Loevinger, a former U.S. Treasury official who is now an analyst at investment firm TCW Group Inc., said U.S. complaints may have limited impact in China, which is focusing first on growth. Senior Chinese officials believe that unless they can keep GDP growth above a certain level—somewhere between 7% and 7.5%—unemployment may rise to unacceptable levels. "Complaints from the U.S. are going to increasingly fall on deaf ears, given the appreciation [of the yuan] in past few years and the adjustment in China's current account," a broad measure of a country's trade and financial flows.

One additional bit of leverage the U.S. may have this year is that China hosts the Asia Pacific Economic Cooperation Forum this November. Beijing tends to take such assignments seriously and tries to clear away disputes that could mar the event—and that could include a fight over currency and trade policy. Indeed, a number of foreign and Chinese officials are lobbying Beijing to put free trade at the center of the APEC agenda.

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The latest currency report underscored the continued friction among the world's leading economies almost five years into a weak global recovery. Emerging economies have complained that the Federal Reserve's bond-buying program, known as quantitative easing, initially put downward pressure on the dollar and sent a flood of capital their way.

As the U.S. sees economic growth accelerating slowly, the Fed is paring back its easy-money policies—and generating more complaints overseas.

"The tough words in the report signal an escalation in currency tensions among the major advanced and emerging market economies," said Cornell University economist Eswar Prasad, a former head of the International Monetary Fund's China division. "The U.S. has started pulling back on quantitative easing but other countries including China and Japan are continuing to rely on monetary policy and currency depreciation to buffer short-term growth."

The report said disclosing intervention in the currency market more regularly would help "to increase the credibility of its monetary policy framework and to promote exchange-rate and financial-market transparency."

The report maintained its criticism of some European policies as the euro zone faces slow growth and a persistent risk of deflation, or falling prices. Six months ago, the Treasury report employed unusually sharp language in criticizing Germany's economic policies and blamed the "anemic pace of domestic demand growth" for dragging down its neighbors and the rest of the global economy. This month's report registered the same concerns but in less strident language.

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As with Europe, the U.S. said it was "imperative" for Japan to focus on an increase in domestic demand.

Finance Ministry officials in Japan said they concurred with the U.S. Treasury's assessment of the issues facing Japanese policy makers.

"Prime Minister Shinzo Abe's economic policy is exactly aimed at fostering domestic demand-led growth," said a senior government official.

The report said South Korea should limit won intervention to exceptional circumstances. South Korea's Embassy didn't respond to a request for comment.

—Eric Morath, Liyan Qi, Lingling Wei and Mitsuru Obe contributed to this article.

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