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Business

# China tries to boost its economy, as long trade fight looms with Trump

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China is redoubling efforts to protect its slowing economy from the effects of a trade war with the United States, providing fresh ammunition for President Trump's claim that Washington enjoys the upper hand in the deepening commercial conflict.

The modest slowdown stands in contrast to the surging U.S. economy, which boasts an unemployment rate near half-century lows.

The president in recent weeks has brushed off Chinese calls for negotiations over the trade dispute, labeling Beijing's offers as inadequate and saying the time is not yet right to deal.

The Chinese moves to boost growth are seen at the White House as evidence that the president's hard-nosed approach will pay dividends if the administration keeps its nerve and Chinese officials come to recognize the cost of their refusal to change course.



"President Trump's team estimates there's more analytical work to be done in Beijing about the long-term damage this could cause," said Michael Pillsbury, director of the center on Chinese strategy at the Hudson Institute and an occasional White House adviser.

Chinese officials, meanwhile, appear to be chafing under Washington's inflexible approach. Foreign Minister Wang Yi on Monday clashed in Beijing with visiting Secretary of State Mike Pompeo, accusing the United States of "constantly escalating trade friction toward China."

The diplomatic tensions follow several months of dueling trade actions. Starting in May, Trump imposed two major rounds of tariffs affecting roughly half the $505 billion in Chinese goods the United States imports each year. China fired back with import levies designed to cause the president and his Republican allies political pain by hitting his supporters, especially in the farm belt.

Even as Trump administration officials take credit for Beijing's distress, economists say China's biggest problem is debt, not tariffs.

Since the 2008 financial crisis, China has cut by one-third its dependence on trade to drive growth. Instead, it's relied on easy credit. Beijing doubled the size of its economy over the past decade — but it needed to quadruple its banking system, adding $29 trillion worth of new loans, to do so, according to a study by Logan Wright and Dan Rosen of the Rhodium Group.

"The most important levers really driving the economy are credit growth rather than exports," said Wright.

The Chinese central bank, the People's Bank of China, on Sunday reduced the amount of money that banks must hold in reserve for the fourth time in 2018, freeing up $174 billion for new loans. Along with tax cuts Beijing announced earlier this year, the move is designed to shield the Chinese economy from tariff pain.

China grew at an annual rate of 6.7 percent in the second quarter and is on track to meet the government's full-year growth target. But in recent weeks several signs of economic weakness have emerged, including the worst new export orders data in two years, lagging consumer spending and rising corporate bond defaults.

"The trade war has certainly worsened an already difficult situation that the Chinese government was facing," said Eswar Prasad, an economics professor at Cornell University and a former head of the International Monetary Fund's China unit.

Chinese authorities are gambling that the government can stimulate growth without tipping the heavily indebted financial system into crisis, economists said.

Easing monetary policy puts China out of sync with the Federal Reserve, which is expected to continue raising its benchmark rate several times next year, and will erode the effect of Trump's tariffs by effectively discounting the price of Chinese exports to the United States, said Wright, Rhodium's director of China markets research.

The Chinese yuan already has lost nearly 10 percent of its value against the dollar since mid-April.

By spurring growth, however, the People's Bank of China is delaying efforts to wean the $14 trillion economy from its dangerous addiction to debt. Chinese authorities since 2016 have cut the rate of growth in credit by half, but the stockpile of outstanding debt continues to swell.

“It’s more proof that growth is slowing and China is worried,” said Stephanie Segal, a former U.S. Treasury Department official now at the Center for Strategic and International Studies.

Trump in recent weeks has pointed to the year-long drop in the Chinese stock market and the slowing of the economy as signs that the United States is winning the trade war. “They are under pressure to make a deal with us,” the president tweeted last month, referring to Chinese officials. “Our markets are surging, theirs are collapsing.”

Indeed, the Shanghai composite has lost 23 percent of its value this year. Vice President Pence, in a speech last week at the Hudson Institute, said American investment was responsible for much of China’s economic development over the past several decades, and he accused Beijing of unfair trade practices.

Trump’s campaign to compel China to change its system of state subsidies and limits on foreign involvement was “in large part” responsible for the Chinese stock market decline, Pence said.

But the Chinese stock market is driven more by financial speculation than by developments in the real economy. The current economic slowdown, though perhaps somewhat quicker than expected, was planned by Chinese officials.

After borrowing heavily to rescue the economy during the 2008 crisis, China confronts a debt bill topping 240 percent of its economic output. Under President Xi Jinping, banks have funneled too much new credit to inefficient state-owned enterprises rather than to the private sector, meaning China is getting less bang for every buck of new lending.

It now takes more than three times as much new debt to produce a given amount of output as it did a decade ago, according to a January study from the IMF.

“International experience suggests that such rapid credit growth is not sustainable and is typically associated with a financial crisis and/or a sharp growth slowdown,” the IMF warned after examining 43 historical examples of countries that had binged on credit.

To put the economy on sound footing, Chinese officials realize that they need to “deleverage,” or cut debt. That will inevitably slow the pace of growth.

“What’s hitting the Chinese economy the most is deleveraging,” said David Loevinger, managing director for emerging markets at TCW, an asset management firm. “Trade is a head wind to growth, but it’s not as fierce as the deleveraging head wind.”

Trump vowed last month to impose levies on all Chinese imports if Beijing refuses to abandon trade practices he considers predatory, including a requirement that U.S. companies surrender trade secrets in return for access to the Chinese market, and the theft of intellectual property from American companies.

But Xi has dug in his heels, pledging to boost domestic industries, increase exports and pour billions of dollars into infrastructure projects.

Chinese authorities aimed to project calm Monday as they moved to stimulate the economy. “Although some economic indicators eased slightly in August, the fundamentals of the Chinese economy remain unchanged and it remains on the track of fast and stable growth,” said an editorial in the state-owned China Daily newspaper.

Investors, though, appeared startled Monday, with the Shanghai composite falling nearly 4 percent, its biggest drop since June.

The market plunge defied China’s year-long campaign to maintain public confidence as Trump’s threats mount, said Elizabeth Economy, director for Asia studies at the Council on Foreign Relations.

Officials insist that Trump’s tariffs will have a “negligible” impact on the economy next year as China prioritizes other export markets, particularly Europe.

But “there is no way to read this move as other than a sign of weakness in the Chinese economy,” said Economy, referring to the central bank’s action. “That’s precisely the message the government is trying to avoid.”

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