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China's slowing economy could complicate relationship with U.S.

By Zachary A. Goldfarb, Published: August 10

The Chinese economy on Friday showed worrisome signs of slowing down, a development that not only threatens global economic growth but also may complicate the relationship between China and the United States.

China reported that its exports, a critical driver of economy activity, grew by only 1 percent in July, far below the 11 percent rate seen in the prior month. It was the latest evidence that the world's second-largest economy is losing steam, a problem for U.S. businesses that sell their goods and services to China.

But China's response to its slowdown, which comes ahead of a rare change in power, could also create new tension with the United States, where the presidential campaign is focused on the economy.

China is turning to policies that may benefit its economy at the expense of the United States'. This year, for instance, China has surprised a wide range of observers by allowing its currency to lose value relative to the dollar, which makes its exports cheaper than America's. And there are prominent calls inside the country for the renminbi to fall further.

"The economic slowdowns and the political circumstances in both countries could lead to trade tensions erupting once again," said Eswar S. Prasad, an international trade expert at Cornell University.

Driving China's slowdown are several factors — most notably, the financial crisis and recession in Europe, which is sapping demand for China's goods. Also contributing is a slow recovery in the United States and a significant decline in residential real estate investment in China.

Exports are critical to China's economy, accounting for more than a quarter of economic activity, compared with a little more than a tenth in the United States. To maintain overall growth rates, China has hoped to keep exports growing at about 10 percent per year, and for much of this year it has succeeded.

That's why the news that Chinese exports had dropped so much caused worry on Friday, and it was only one of several troubling signs. Another indicator Friday showed bank lending declining, a signal that businesses and consumers are planning to spend less money, while on Thursday factory production failed to meet expectations. Many expect overall Chinese economic growth to suffer, too.

Chinese leaders are under pressure to take steps to help the economy as a rare change in power looms. This fall, the Communist Party will choose a new general secretary and officials through the government.

“They cannot afford, during a period of political transition and political turmoil, to suggest any loss of economic control,” Prasad said.

China and the United States are the twin engines of global growth, and both need each other to take steps to keep economic activity going.

China has a number of tools at its disposal to stimulate economic growth — some harmful to the United States, others potentially neutral or helpful. China routinely subsidizes companies that locate there, reducing the competitiveness of U.S. businesses. More favorable programs include China’s effort to boost government spending and lower interest rates to increase lending.

One of the most politically contentious is China’s management of its currency, which U.S. leaders, as well as independent economists and the International Monetary Fund, have long criticized as artificially low.

In response to heavy lobbying, China has since 2011 allowed its currency to become as much as 8 percent more valuable relative to the dollar, after inflation, building on prior progress. That has modestly leveled the playing field.

The IMF now says that the Chinese currency remains “moderately undervalued.” Nonetheless, China has allowed its currency to depreciate lately as growth has slowed. This year, the renminbi depreciated by 2 percent, after inflation.

“China will be less forthcoming in terms of currency appreciation,” said Cheng Li, a China scholar at Brookings.

Earlier this month, the state-backed China Securities Journal noted that “depreciation . . . will be beneficial by enhancing exports” and said the currency should fall by an “appropriate” amount, according to the Financial Times.

China’s trade advantage over the United States has continued to widen in recent months. On Thursday, the U.S. reported that its trade deficit — how much more the country exports than imports — narrowed, a positive for economic growth. But it widened with China.

Others note China has not overreacted to its slowdown. So far, its currency’s decline relative to the dollar has been modest this year. Chinese leaders also don’t appear to be backing off other commitments to open up markets.

Another currency indicator, which is used by many economists to take into account a broader swath of global trade, shows the Chinese currency appreciating slightly this year, but still at a significantly slower pace than in recent years.

It’s also possible the United States might take steps that could aggravate relations with China.

When the Federal Reserve embarked on another aggressive campaign to lower interest rates in late 2010, China howled, saying it would devalue the dollar and help U.S. exports. And indeed, the dollar did come down some, and exports boomed.

But the dollar has since rebounded, likely as investors have sought security in U.S. Treasury bonds.

China might signal similar concern this September, if the Fed launches a round of so-called quantitative easing to jolt growth.

Republican candidate Mitt Romney has lashed out at President Obama for refusing to declare China a “currency manipulator,” a Treasury Department designation that could lead to tariffs. Romney has vowed to do so, a move favored by many labor unions.

Obama officials have questioned the usefulness of the label and suggested it would cause a trade war. They point out that China has made a lot of progress in allowing its currency to appreciate over the past several years.