Global Economic Outlook and Sino-U.S. Economic Relations

By

Zhen Binxi
Senior Research Fellow
China Institute of International Studies

I. Global Economic Outlook

The U.S. sub-prime mortgage crisis has put a sharp brake on the robust growth of the world economy. As the Wall Street financial storm has quickly escalated into a global financial crisis, the full-scale recession in the developed world has dragged the emerging markets into economic downturn as well. The adverse feedback loop between the financial sector and the real economy has plunged the world into the worst recession since the Great Depression in the 1930s.

According to the IMF, global economic activity is projected to contract by 1.3% in 2009. This represents by far the deepest global recession since the Great Depression. The GDP growth in the developed world will fall from 0.9% in 2008 to -3.8% in 2009, while the growth in emerging and developing countries will decrease from 6.1% to 1.6%, well below their trend. Among the developed economies, the U.S., Euro area and Japan will continue a deep decline in economic activity, with GDP growth rates respectively from 1.1%, 0.9% and -0.6% in 2008 to -2.8%, -4.2% and -6.2% in 2009. As for the major emerging markets, particularly China, India, Brazil and Russia, their growth rates are projected to 6.5%, 4.5%, 1.3% and -6% in 2009, down from 9%, 7.3%, 5.1% and 5.6%.

The global economy is now at a crossroads with dim prospects for quick recovery. Forecasts by the IMF, the World Bank and the OECD predicted that the global economy would gradually recover only in 2010. I agree and expect that the recovery will appear like the “NIKE” logo rather than a “U” or “L” shaped trajectory, based on some positive and negative factors.

The positive factors include:

(1) Fiscal stimulus (2.5-3% of GDP in emerging economies and less in developed economies)

(2) Lower interest rates, especially G7 central banks which have set interest rates close to zero

(3) Bank recapitalization, guarantees and restructuring in the U.S. and Euro area

(4) Falling oil prices

(5) Some encouraging results from the G20 Summit in London, in particular,
support to the economically vulnerable countries by increasing IMF resources

In addition, there are tentative indications recently that the freefall in activity may be slowing. Global stock market rallied in recent month. Consumer sentiment and the IMS index in the United States were up in April to the highest level since the collapse of Lehman Brothers last September.

However, significant downside risks remain:

1. The world economy may stagnate once the recession bottoms out
2. Stabilization and stimulus measures may fail to break the vicious feedback loop between the financial crisis and economic recession
3. Central and Eastern European financial systems could worsen dramatically with spillovers into Western Europe, further destabilizing the global banking system
4. Sub-prime credit sectors are expected to face increasing defaults during the recession
5. Pension and other institutional investors’ balance sheets have been significantly hurt by the financial crisis and falling share prices
6. The global economic downturn and increasing job losses may cause the re-emergence of protectionism

Therefore, even though the crisis is near bottom, recovery will not be easy. Mr. Lawrence Summers, senior economic adviser to U.S. President Barack Obama recently remained cautious about the outlook, saying: “It's going to be a very long road. There are going to be steps forward and there are also going to be steps backwards.”

II. China’s Challenges and Policies

China, as a developing country relying heavily on foreign trade, is experiencing hard times in terms of economic growth. It is clear that China has faced some challenges.

1. The economy decelerated substantially. GDP growth was down from 13% in the fourth quarter (Q4) of 2007 to 6.8% in Q4 of 2008 and 6.1% in Q1 of 2009, while industrial production, production of electricity, PMI, auto sales, and residential home sales also declined.
(2) Imports and exports fell sharply. Since November 2008, China’s imports and exports have seen negative growth for 4 consecutive months, with -17.9%, -21.2%, -42.9% and -23.8% in imports and -2.2%, -2.8%, -17.5% and -25.7% in exports.

(3) Weaker labor demand created labor market pressure. Rural migrant workers were hit hardest. According to a survey conducted by the Ministry of Agriculture, before the Chinese New Year festival 20 million migrant workers had lost their jobs.

To tackle the crisis and these challenges, the Chinese government responded rapidly by decisively adopting a proactive fiscal policy, easing monetary policy, and launching a bundle of timely, targeted and temporary policies and measures.

First, ten measures were launched to stimulate domestic demand and promote stable and relatively rapid economic growth. The central government planned to invest an extra 4 trillion RMB over two years, which would mainly go to the agricultural sector, welfare and affordable housing, transportation infrastructure, and energy conservation and emission reduction. Second, ten measures to revitalize the industrial sectors were initiated, aiming to strengthen policy support for enterprises. At present, the revitalization plans cover ten industries including light industry, automobiles, steel, textile, equipment manufacturing, shipping, petrochemicals, non-ferrous metals, IT and logistics, with the aim to curb and reverse the trend of declining growth in these industries. Third, the government has bolstered financial support for economic developments. Since September 2008, People’s Bank of China has lowered the benchmark interest rates five times and reduced the reserve requirement ratios on four occasions, for the purpose of maintaining adequate liquidity for the banking sector and promoting stable growth of monetary and credit supply. In addition, nine measures to strengthen financial support for economic growth were launched. Fourth, earnest efforts have been made to promote employment, improve people’s livelihood, improve support and benefits for farmers, and stimulate household consumption demand. Fifth, policy measures were adopted to advance the reform of important areas including VAT tax transformation, reform of taxes and fees imposed on oil products, and medical and healthcare system reforms. Having taken the above-mentioned measures, China expects to maintain stable
economic growth by boosting domestic demand and reducing dependence on external
demand, thus serving as a stabilizing force in the global economy.

China’s economy showed signs of better-than-expected positive changes in the
first quarter as a result of the economic stimulus package adopted by China. First,
domestic demand rose on a sustainable basis. Simultaneously, investment in fixed
assets increased rapidly and consumer demand grew steadily and relatively rapidly.
Second, industries above the designated size registered month-on-month growth, with
a year-on-year increase of 3.8% in both January and February, and a year-on-year
increase of 8.3% in March. Third, the PMI and the entrepreneur confidence index of
the manufacturing industry both rose in April, indicating that the Chinese economy
has begun to stabilize and recover in some fields. Fourth, market confidence went up
and the economy became more active over the first three months, with increases in
both the stock market and housing market transaction volumes.

However, China's economy is still facing very serious hardships, which can be
attributed to the shrinkage of external demand and a relatively sharp fall in exports.
This has negatively impacted export enterprises, export-oriented industries and
export-oriented zones, and has resulted in decreases in business profit-making,
declines in financial revenues and heavier pressure on employment. As the
international financial crisis is deepening and spreading, we should remain vigilant.
China's power generation fell in April, indicating an economic recovery is still some
way off. Some analysts argue that the figures could be volatile and the economy has
to deal with the structural problem of overcapacity. "It's still too early to say the
economy is experiencing a real recovery," said Zhu Baoliang, a State Information
Center, (SIC) economist. As the crisis has not touched its bottom, we can hardly say
that the Chinese economy alone has gotten out of the crisis. China cannot save the
world, nor can it survive without the world.

III. Challenges and Opportunities for Sino-U.S. Economic Ties

The economic ties between China and the U.S. are affected by the international
financial crisis.
Trade and investment slowed down and even contracted. China’s statistics show bilateral trade dropped 6%, and U.S. investment in China slumped 19.4%, on a year-on-year basis in the fourth quarter of last year and the first quarter of this year.

Trade measures by the U.S. against China are on the rise. Recently, American industries have petitioned the U.S. government for antidumping investigations, and for investigations under the WTO’s “special safeguard provision,” which could restrict imports of Chinese products.

There is friction in many other fields where the U.S. puts great pressure on China, for example, the issues of the trade imbalance, financial sector liberalization and currency reform, intellectual property rights, food and product safety, and so on.

China’s government is deeply concerned about its holding of U.S. dollar-denominated assets. The Obama administration’s massive bailout plan, with an even higher budget deficit, is likely to further weaken the dollar, which would hurt the Chinese Central Bank’s balance sheet.

The crisis also challenges the modes of economic growth on both sides, i.e. the heavy U.S. dependence on consumption and China’s heavy dependence on exports for growth. In the short run, this is bad news for China, whose growth fell as a result of the collapse in U.S. spending. In the long run, this collapse will help reduce economic imbalances between the two sides.

The crisis also provides opportunities for closer cooperation between China and the U.S.

We have strengthened high level dialogues. The meeting between Chinese President Hu Jintao and U.S. President Barack Obama in London marked a positive beginning to the effort to enhance bilateral cooperation. After talks, the two sides decided to establish the "U.S.-China Strategic and Economic Dialogue." The creation of the new dialogue, along with the existing Joint Commission on Commerce and Trade, would substantially bolster cooperation between the two nations on key issues.

We have cooperated in confronting the international financial crisis. As the U.S. administration increased government debt to finance its economic stimulus, to fund its soaring budget deficit and bail out its banks, China’s government bought
around one quarter of the net increase in T-bonds over the past two years. China is America’s largest creditor. According to The Economist magazine, China has about $1.5 trillion invested in dollar assets, of which about half are in T-bonds. At the same time, the U.S. government promises to bail out “Fannie Mae” and “Freddie Mac,” whose $400 billion in bonds are owned by the Chinese government.

(3) We have coordinated and cooperated in bilateral and multilateral macroeconomic and financial policies.

The challenges and opportunities facing both countries have never been greater. A broadening and deepening cooperation between China and the U.S. will not only help to overcome short term difficulties, but surely will also bring new and longer-term prosperity and development to both economies. To that end, I would like to put forward five proposals:

First, continue to tackle the financial crisis. At present, China’s strategic investment choice to keep holding and properly purchasing U.S. assets for foreign reserve is in China’s interest. But the U.S. should take responsible measures to guarantee the security of China’s investment.

Second, improve bilateral dialogue mechanisms. We need to use the U.S.-China Strategic and Economic Dialogue and other institutions such as JCCT and JEC to boost strategic mutual trust, resolve differences, and expand dialogue and cooperation.

Third, resist protectionism and mutually open markets to expand trade and investment. The Chinese government does not pursue a trade surplus with the U.S. We will continue to encourage Chinese companies to import more from the U.S. U.S. economic problems must be addressed at home and the U.S. must not hold China accountable for this painful adjustment. The blame game is completely counter-productive in a world faced with crisis and recession.

Fourth, look for new opportunities for cooperation. We need to explore ways to expand bilateral cooperation in areas such as climate change, energy and environment and technology. In addition, we should also seize the opportunity for cooperation from both governments’ massive economic stimulus packages, which in turn are expected
to become new growth areas for our trade and investment cooperation. For example, China’s demand for infrastructure, machinery and equipment, and environmental protection is huge.

Finally, intensify dialogue and communication in multilateral and regional trade and economic affairs. We should work together to advance the Doha Round, enhance financial regulation and reform the international monetary system. Zhou Xiaochuan, China’s Central Bank governor, wrote in an article that it was necessary to create a “super-sovereign reserve currency” to overhaul the existing international monetary system of using the currency of one nation as the global reserve currency. The existing system is out-of-date. It does not reflect the profound changes in the world economy and is no longer workable. The essence of Zhou’s article was to find appropriate mechanisms to ensure that the U.S. takes into account the global effect of its monetary policy in the short term and help move toward a new global monetary system conducive to long-term sustainability.