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Signs that the trade war will hamper China's deleveraging are appearing

YOKO HAGIWARA
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

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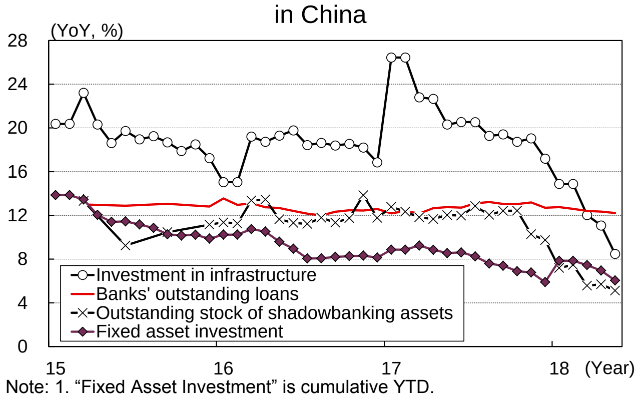
It has long been said that deleveraging (trimming excess debt) in China is an important issue for maintaining economic stability. Since the National Congress of the Communist Party of China last year, the government has been serious about curbing debt. Strict shadow banking regulations were published in November last year (implemented in April this year), and the growth of shadow banking loans, which had been in double figures, slowed by 5.1% YoY in May (Chart 1). Alongside this, the cumulative total of fixed asset investment from January to May also decelerated to 6.1% YoY. In particular, growth of investment in infrastructure, which was around 20% YoY annualised over the past five years, slowed considerably to 8.5% YoY. This reflects the position taken by the central government, who is concerned about the rise in local government debt.

Such measures to control debt are reasonable and in line with requests made by financial institutions, predominantly the IMF. As a result, a slowdown in investment is within the realm of expectations. On the other hand, the escalation from tension over trade between China and the US closer to that of a "trade war" was not foreseen and it is hampering China's deleveraging policies. On 15th June, the US published an official list of USD50 billions' worth of Chinese products which will be subject to a 25% tariff. From this list, the tariff is scheduled to come into effect for USD34 billions' worth of items from 6th July. On the following day (16th), China also announced a list of items also totalling USD34 billion against which it will impose retaliatory tariffs from 6th July. On 18th, President Trump suggested that the US would draw up another list of goods worth USD200 billion (and impose a 10% tariff) and that if China announced that it was retaliating with their own measures again, the US would apply tariffs to a further USD200 billions' worth of Chinese products. However, on 19th June, the Chinese government said that it would oppose the US' tariffs with comprehensive measures that combine quantity and quality. The scale of tariffs announced by both the US and China up until now roughly covers the value of bilateral trade between the two countries.

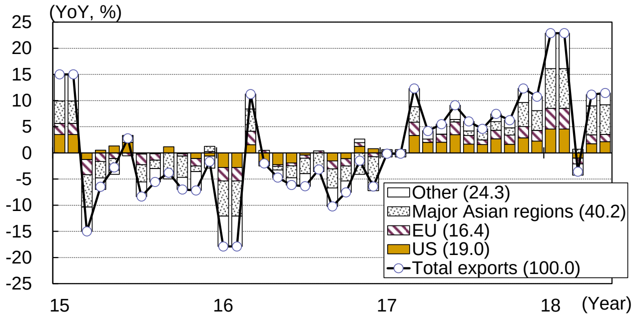
Chinese exports showed strong, double-figure growth in May (most recent data, Chart 2), but warnings that growth of exports will slow in the future is forcing Chinese authorities to halt their tightening monetary policy and deleveraging. The People's Bank of China (central bank) decided not to raise the interest rate for open markets operations following a rate hike by the US in June. It boosted financing in the market and cut the reserve requirement ratio. As well as the rising trade friction with the US having an adverse effect on trade, it is possible that solving the domestic issue of excessive debt will also slow growth indirectly. With this in mind, it is important to keep an eye on future developments.

Chart 1: Fixed Asset Investment and Outstanding Debt in China



Note: 1. "Fixed Asset Investment" is cumulative YTD.
2. "Outstanding stock of shadow banking assets" is a total of "entrusted loans", "trust loans", "bankers' acceptances" and "corporate bonds".
Source: National Bureau of Statistics of China,
MUFG Bank Economic Research Office

Chart 2: Value of Chinese Exports by Destination



Note: 1. Brackets next to the country/region denote the share of total exports (as of 2017) on a preliminary basis.
2. "Major Asian regions" consists of Japan, Hong Kong, Taiwan, Korea, ASEAN and India.
3. To even out the fluctuation caused by the Lunar New Year, a total of Jan and Feb is used for both months.
Source: General Administration of Customs,
MUFG Bank Economic Research Office

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Yasuhiro Ishimaru Tel: +81-(0)3-3240-3204

Written by Yoko Hagiwara <youko_hagiwara@mufg.jp>