Round and round it goes

America buys Chinese exports, China buys American Treasuries. Can it continue?

At one stage it all seemed to be working, even if it appeared a little surreal. China, a developing country, lent vast amounts of money to wealthy America to feed its spending habit. Americans spent the money on Chinese-made goods, sending the dollars back to China, which lent them to America again. But now many talk of a decoupling of the two economies. Niall Ferguson, a Harvard historian who, only a couple of years ago, popularised the term “Chimerica” for the symbiosis between the two, now says it is a marriage headed for the rocks.

China’s export figures appeared to support the idea that the country depended hugely on overseas markets for its growth, and on America in particular. By 2007 the value of China’s exports amounted to about 36% of its GDP, up from just over 20% in 2001. America was (and remains) second only to the European Union as a customer for Chinese exports, and by far the biggest single country. This year China is on course to regain its position as the biggest supplier of goods to the American market, overtaking Canada. And by September 2008 China had surpassed Japan as the largest holder of US Treasuries (see chart 1), in other words as America’s principal creditor.

But the marriage was not quite as close as the headline figures suggested. China certainly helped its exporters by keeping the value of its currency low, buying dollars that were used to buy US Treasuries. Those Treasury holdings helped keep American interest rates low and American consumers spending. But sustaining such growth in exports was not as vital to China as many assumed. The value-added component of its exports accounted for a much smaller share of its GDP than the gross figure because much of the value of Chinese goods consumed in America was
created elsewhere. The biggest driver of growth in China was investment, and that has become all the more true as China tries to pump up its economy with nearly $600 billion in stimulus spending. So although China’s economy no longer enjoys the double-digit growth rates of a few years ago, it is on course for 8% growth this year and a similar rate next year, says Nicholas Lardy of the Peterson Institute for International Economics in Washington, DC, even as America’s economy is still trying to emerge from recession.

No wonder that China is feeling a little smug. Millions of migrant workers have been laid off from their jobs in the ravaged export industry, but now a rush of Christmas orders is opening up new opportunities. Some factories even complain of labour shortages. In many cities house prices have been rising rapidly (a new bubble, some fear) and consumer spending—though never as strong as the government would like it to be—is holding up well. Students face a tough job market when they graduate, but that is partly because college enrolment has surged in recent years. Official statistics show that urban unemployment has risen only a whisker since the beginning of the year. Chinese job figures can be unreliable, but anecdotal evidence points the same way.

American officials have developed a tendency to put the two economies on a par, but despite all the talk of a G2 (though not by the two governments themselves) they are far from equal. China’s GDP in 2008 was $4.4 trillion, smaller than Japan’s (although next year it could overtake Japan) and less than a third of America’s. Albert Keidel, a former Treasury official, says it makes little sense to equate the economies of China and America. “But in terms of influencing China to think that it is a partner with us and therefore it has certain responsibilities and should listen to what we think is important, that has some salience,” he says.

To help cajole China into joining hands with America, Mr Obama has set up a new annual forum called the Strategic and Economic Dialogue that held its first meeting in Washington, DC, in July. The idea was to bring together leading policymakers from both countries to discuss the entire range of problems confronting them. “The pursuit of power among nations must no longer be seen as a zero-sum game,” the president said as he addressed the gathering.

You lose, we lose

As far as the economy is concerned, China heartily agrees. It may grumble about the dollar’s dominance in the global trading system, but it has no desire to pull the rug from under America’s economy. A run on the dollar would be a blow to China itself, slashing the value of its stash of over $800 billion in US Treasuries. Chinese officials also worry openly about a possible resurgence of inflation in America, which would also drive down the value of the dollar. The American budget deficit spooks China, but appears to make little difference to its willingness to lend. China, says Wu Xiaogu of Renmin University, has been “kidnapped” by America’s currency. China’s purchases of US Treasuries will naturally slow down along with its export growth. But for now the country is still piling them up.

China may dream of a different world in which the yuan ranks alongside the dollar, euro, sterling and yen as a reserve currency. It is beginning to promote use of the yuan instead of the dollar in transactions with some of its trade partners, but it has set no timetable for
making its currency convertible. In September it bought $50 billion in IMF bonds to boost its influence in the institution and strengthen the role of non-dollar currencies (IMF bills are linked to a basket of currencies). But China has not sought to ease the Americans or Europeans out from their dominant roles in the World Bank and the IMF.

When Timothy Geithner, now treasury secretary, said during a Senate confirmation hearing in January that Mr Obama believed China was “manipulating” its currency to gain an unfair trade advantage, the administration was quick to back away from the remark. The yuan’s value has hardly been mentioned in public since. A recent study by the Peterson Institute says that the yuan remains “significantly undervalued”, by 15-25% against a weighted average of the currencies used by China’s trading partners. But American officials know just how prickly China can get when it is accused of mercantilism.

As Americans save more and buy less from China, America’s trade deficit with China—which has been its biggest with any country since 2000—will shrink anyway. But protectionist sentiment in both countries will remain strong. Mr Obama’s decision in September to impose punitive tariffs on imports of Chinese steel pipes and tyres infuriated the Chinese government, although it has so far resisted lashing out (summitry with Mr Obama being too big a party to spoil).

American businessmen, meanwhile, worry no less about protectionism in China. Many saw China’s decision in March to reject a takeover bid by Coca-Cola for a Chinese juice company as a bad omen. As Chinese businesses look around America for bargains, they will get a mixed reception: sellers are eager for China’s cash, but worried about the survival and security of Brand America.