WORLD | ASIA | CHINA

U.S. Seizes on Chinese Economic Vulnerability as Trade Talks Start

Beijing's struggle to maintain economic growth hangs over bid to settle trade battle

Construction workers sit in front of a banner showing the Central Business District in Beijing.
PHOTO: HOW HWEE YOUNG/EPA/SHUTTERSTOCK

By Lingling Wei in Beijing and Bob Davis in Washington
Updated Aug. 23, 2018 2:39 a.m. ET

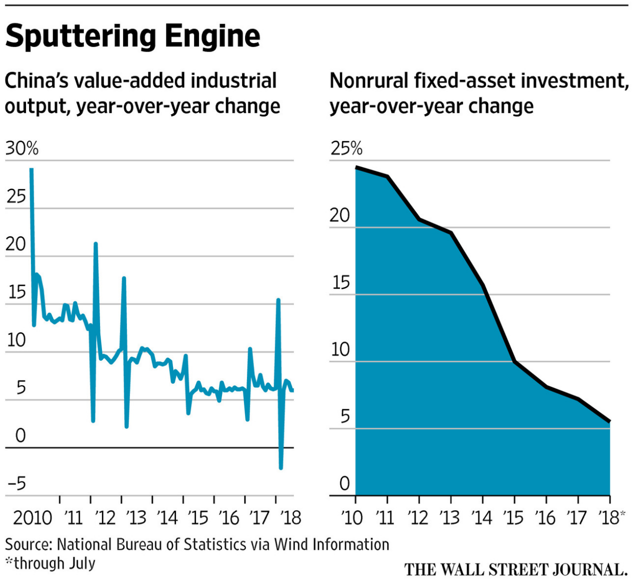
The U.S. and China kicked off two days of talks in Washington aimed at settling an escalating trade battle, with the U.S. claiming the advantage because Beijing is struggling to keep its economic growth from faltering.

Beijing has tried a number of approaches to strengthening its economy in the short term, including relaxing credit controls and encouraging more lending and spending, especially on highways, rail lines and other big-ticket government projects.

But the actions threaten to weaken the economy over the longer term, many economists warn. That is because China's debt load has soared since 2009, when Beijing was fighting a global recession, and the trade fight may prompt Beijing to put off debt restructurings.

The International Monetary Fund said this year that in the 43 cases internationally where credit grew as rapidly as China's over a five-year period, "only five ended without a major slowdown or financial crisis."

Stepped-up government spending, powered by easy financing, exacerbates China's debt woes and crowds out credit available for businesses and consumers, some economists said. “The market is worried about the risk of stagflation,” said Jiang Chao, chief economist at Haitong Securities Co. in Shanghai. Reflecting such concerns, Mr. Jiang said, Chinese stocks, bonds and the yuan have all declined in recent weeks.



The U.S. has focused on China’s weakness in the run-up to the talks that started in Washington on Wednesday. Last week, National Economic Council Director Lawrence Kudlow said Beijing’s economy looked terrible. At the end of July, Reagan-era economist Arthur Laffer, an adviser to President Trump, sent to the White House an economic analysis titled “The Great Fall of China,” which said U.S. tariffs on Beijing were producing “substantial risk of derailing much of the past 50 years of growth in China.”

For some in the administration, including White House trade adviser Peter Navarro and U.S. Trade Representative Robert Lighthizer, the darkening cloud over China’s economy is a reason to delay negotiations until additional U.S. tariffs kick in, U.S. officials said.

On Thursday, the U.S. put tariffs on $16 billion of Chinese goods in addition to the $34 billion in Chinese imports already targeted. By the end of September, the U.S. could add levies on another $200 billion—about half of overall Chinese imports.

So far, Treasury Secretary Steven Mnuchin has Mr. Trump’s blessing to see if a new round of negotiations would pry additional concessions out of the Chinese.

The talks are aimed at finding a way for both sides to tackle the dispute, officials in both nations say, and could lead to more rounds of discussions designed to culminate in planned meetings between Mr. Trump and Chinese President Xi Jinping at November’s multilateral summits, including the Group of 20 and the Asia-Pacific Economic Cooperation forum.

White House press secretary Sarah Sanders said that the talks are continuing. The U.S. is pushing for “free, fair and reciprocal trade.”

Obstacles to progress abound. For starters, the two sides remained at loggerheads over what to discuss at this week’s talks, a person briefed on the matter said.

Chinese officials said they were ready to discuss China’s exchange-rate policy, a U.S. priority. In Beijing on Tuesday, Li Bo, a senior official at China’s central bank, said China won’t devalue the yuan, which is down 10% since April, as a way to hit back at the U.S. on trade. “The yuan’s exchange rate is decided by the market,” he said.

Others tracking the talks said they expected Beijing to promise to buy more U.S. goods—essentially sweetening an earlier offer to boost purchases by $70 billion. Mr. Trump rejected that offer as insufficient and difficult to enforce.

One sign of Beijing’s concern about the impact of a deepening trade conflict: Chinese officials have been quizzing big U.S. technology companies about whether they plan to move their production facilities out of China. Beijing hasn’t offered incentives to stay or threats if they leave, some U.S. executives said.

A U.S. technology executive said his firm’s relocation calculation depends on how long the trade battle continues. If the fight isn’t settled by November—the goal of Beijing and some in the Trump administration—he figures it will last at least another year. Then it would make sense to move factories out of China to service the U.S. market and avoid 25% tariffs, he said.

In the past, Beijing has stepped up infrastructure and property investment to spur growth. But this time, soaring home prices in many areas of the country make the government wary of encouraging more real-estate investment. In fact, Mr. Xi has pledged to continue to rein in housing bubbles.

Beijing’s campaign to slow borrowing is taking a toll on investment and consumption. For the first seven months of this year, official data show, spending on factory machinery and public works cooled to its lowest point in nearly two decades. In July, growth in retail sales fell below market expectations.

That said, Chinese officials are likely to do their best to hit official growth targets, which is an important factor in how they are judged. Beijing has set a growth target of about 6.5% for 2018. Last year, the economy grew 6.9%, though many economists believe official numbers are inflated.

Various levels of government have started to ramp up borrowing to finance more infrastructure projects. Mr. Jiang of Haitong Securities estimates that for the second half of 2018, government-bond sales will average about 700 billion yuan ($102 billion) a month. By comparison, monthly issuance averaged 560 billion yuan last year.

Corrections & Amplifications
Steven Mnuchin is U.S. Treasury Secretary. An earlier version of this article incorrectly had his first name as Stephen. (8/22/18)

Write to Lingling Wei at lingling.wei@wsj.com and Bob Davis at bob.davis@wsj.com

Appeared in the August 23, 2018, print edition as 'U.S. Seizes on China's Woes as Talks Start.'