China’s Economy Is Slowing Just as Trump Readies a Trade Beating
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By Bloomberg News

(Bloomberg) -- China’s economy fell short of expectations and its central bank chose not to follow the Federal Reserve in raising borrowing costs, adding fresh caution on the outlook for global growth as trade tensions with the U.S. escalate.

With President Donald Trump renewing threats to impose tariffs on the world’s second-largest economy, May data for industrial output, retail sales and investment all came in beneath economist forecasts on Thursday. The People’s Bank of China kept the cost of reverse-repurchase agreements steady, defying predictions it would track the Fed’s hike of Wednesday.

Investors now face greater uncertainty over what had been the strongest global upswing since 2011. That doubt is set to fester after Trump said on Wednesday that he’ll confront China "very strongly" over commerce in coming weeks. His administration is scheduled to announce a new list of duties on Friday.

"A slowing China will add to the challenges for the global economy," said Louis Kuijs, chief Asia economist at Oxford Economics in Hong Kong and a former International Monetary Fund researcher. "Until recently, the resilience of growth in China was an important buffer for the global economy in the face of headwinds from trade friction, slower growth in Europe, higher oil prices and issues in various emerging markets."

Both industrial output and retail sales rose less than expected in May compared to a year ago. Fixed-asset investment growth in the first five months was the slowest since the data began in 1999, as was the investment in the services sector. The decade-long decline in investment has intensified this year, as policy-makers act to reduce leverage at state-owned companies and local governments. While that’s a deliberate policy, officials risk a worse-than-desired deceleration in growth.

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China’s weaker performance comes amid a slew of mixed signals for the global economy. While the IMF sees robust global expansion of 3.9 percent this year and next, Managing Director Christine Lagarde last week warned that clouds on the horizon are getting darker by the day. Topping the worry list are ongoing fears of protracted trade disputes between the U.S. and China, the European Union, Canada and Mexico.

China has promised to retaliate if the U.S. pushes ahead with plans to levy tariffs on $50 billion in imports, threatening an escalating, tit-for-tat trade war. At the same time, rising interest rates have jolted emerging markets, while fears of an Italian debt crisis have returned, along with worries over higher oil prices. A gauge of world trade devised by Oxford Economics Ltd. fell in May to its lowest level since early 2017.

China, which is the world’s second-largest economy, is already slowing after a stronger-than expected start to 2018, even before any new U.S. tariffs on its exports.

Economists surveyed by Bloomberg see a 6.5 percent expansion this year after 6.9 percent in 2017, in line with the government’s own target. A gauge of early indicators developed by Bloomberg Economics in May showed some sectors of the economy slowing while others, buoyed by global trade, held up.

While economists are interpreting the lack of an increase in the 7-day reverse repurchase rate on Thursday as a signal of easing policy, the central bank can react at any time to the Fed’s decision, particularly if downward pressure on the yuan materializes.

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“It’s possible that the PBOC will follow in due course,” writes Tom Orlik, Chief Economist at Bloomberg Economics. “The decision not to do so today looks like an indication that the PBOC is more focused on supporting growth and alleviating financial stress as markets fear an increase in corporate defaults.”
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The central bank is trying to walk a fine line in its efforts to cut debt without tightening too much and strangling lending and growth.

Its campaign to curb debt at state firms and local governments, plus efforts to shrink the shadow-banking sector, are adding to a cyclical moderation in the pace of growth. That campaign led to a sharp deceleration in credit growth, and the central bank has tried to support growth by increasing liquidity.

China has been trying to ensure liquidity supply to cushion any economic slowdown and help lenders meet repayment obligations. It boosted injections via the Medium-term Lending Facility last week to the most in more than a year to support smaller firms, while in April it cut the RRR by 1 percentage point, citing a similar goal.

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"The liquidity strains are already having an impact on the economy," said Nathan Chow, senior economist at DBS Bank Hong Kong Ltd. "To stabilize growth, the PBOC will show greater policy flexibility."

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