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Tables Turn a Bit on Growth as U.S.-China Summit Nears

By BOB DAVIS

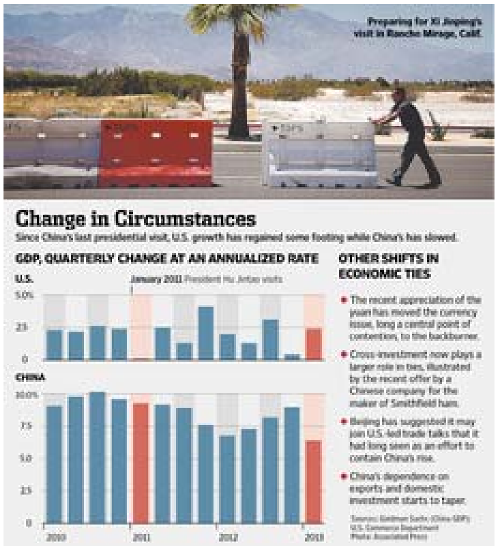
Agence France-Presse/Getty Images

Xi Jinping, left, on a visit to Mexico shakes hands with President Enrique Peña Nieto in the capital Wednesday.

BEIJING—Friday's summit between the leaders of China and the U.S. marks a turning point in economic relations between the world's two largest economies: China growth is slowing sharply after a long boom while the U.S. economy is slowly regaining its vigor after a long slump.

"There has been an air of triumphalism on the part of China in recent meetings of Chinese and U.S. leaders," said Mark Williams, a former British Treasury China hand who is now an analyst for Capital Economics in London. "That has faded as China's recognition of the medium-term challenges it faces has increased."

When a Chinese president last came to the U.S. for a summit— Hu Jintao's visit in January 2011—China's economy was humming: It grew at a 9.3% annual clip in that year's first quarter on the strength of massive stimulus that preserved a rapid growth rate despite the global financial meltdown.



The U.S. economy, by contrast, grew just 0.1% in the first quarter of 2011, while the Federal Reserve was in its second round of bond buying known as quantitative easing, which many developing nations saw as a way to drive down the dollar at their expense.

Now, the tables have turned. The U.S. grew 2.4% in the first quarter this year as the economy has regained its footing. U.S. technological prowess is helping to revive two sectors that seemed down for the count not long ago, manufacturing and energy, as the exploitation of shale gas makes the country a powerful energy supplier.

Meanwhile, China's leaders are still searching for a formula to stimulate innovation in science and industry, and grappling with how to tamp down credit and housing bubbles. According to Goldman Sachs calculations, China's GDP slipped to 6.4% in the first quarter, when measured on an annualized basis—the gauge used by the U.S. and other wealthy nations—making it China's weakest quarter since the financial crisis.

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Mr. Xi is looking for ways to reduce fears of Chinese investment in the U.S. as well as to convince his American host that China is serious about overhauls, say Chinese economists. Mr. Obama wants to encourage Beijing to follow through on years of pledges by Chinese officials that the country will revamp its economy so it relies more on domestic spending than exports and investment, which would provide trade and investment opportunities for U.S. firms.

"We see this [meeting] as an opportunity to get a better understanding of the kind of domestic policies and reforms" that Mr. Xi and other senior Chinese leaders are discussing at home, said a White House official.

"No one can forecast with confidence the future of the Chinese economy," said Harvard economist Lawrence Summers, a former White House economic adviser and Treasury secretary. "In retrospect, U.S. alarmism about Japanese growth peaked at about the same point that the Japanese competitive threat to the American economy peaked."

China's new leaders, who took over the government reins in March, are drawing up plans to steer away from economic dependence on exports and investment in infrastructure and capital-intensive industries, areas that offer much less bang for the yuan than they once did. That planning presents an opportunity for Washington, as Beijing looks for fresh ideas. "This is an opportune time for the U.S. to endorse and support

Reuters
Presidents Barack Obama and Xi Jinping.

China's reform agenda, which is clearly in the long-term interest of both countries," says Cornell University China expert Eswar Prasad. "What China would like to send back home would be images of Xi and Obama rolling up their shirt sleeves and getting down to business as equals."

Others say that the U.S. has little leverage in Beijing, and that an endorsement of its overhauls could backfire if it seems as if President Xi is seen as kowtowing to Americans.

China's previous leaders also talked of changes but did little to turn the rhetoric into reality. Boosting social benefits for migrant workers, for instance, has long been seen as necessary to get them to settle in the cities with their families and open their wallets. But proposals to tap state-owned firms and rich regions for additional cash to pay for the benefits have gone nowhere because of resistance from those benefiting from the status quo.

Moreover, China could settle on strategies that put U.S. companies at a disadvantage, for example by creating government-backed monopolies to reduce excess capacity in the steel, aluminum and other industries rather than by boosting private-sector competition in those areas. "Reforms should be thoughtfully assessed in relation to U.S. interests," said former U.S. Trade Representative Charlene Barshefsky.

What may make Beijing more receptive to U.S. initiatives, some analysts say, is China's search for new foundations for growth.

"China's now having a deep restructuring of its economy," said Chinese Foreign Ministry spokesman Hong Lei. "The purpose is to promote efficient and fast growth of the economy."

Recently, China signaled it might consider joining U.S.-led talks for a free-trade pact known as the Trans-Pacific Partnership, which Beijing officials had previously dismissed as a part of an effort to line up countries against China. Xiao Geng, research director of the Fung Global Institute, a Hong Kong think tank, says that while China's participation remains a longshot, "even talking about joining is progress." That's because it indicates that China is looking to use international agreements as a way to prompt change domestically in the same way that joining the World Trade Organization in 2001 forced China to slash tariffs and open up wide swaths of the Chinese economy to foreign competition.

And as growth in China slows, Chinese companies also have been looking abroad for acquisitions, including a recent bid by Shuanghui International Holdings Ltd. to acquire Smithfield Foods Inc. in the U.S. Mr. Xiao, the Hong Kong economist, said for China to significantly boost its investment in the U.S. it needs to privatize the state-owned firms that make the bulk of the acquisitions. That is because the U.S. and other Western nations suspect state-owned firms make decisions based on Beijing's orders rather than commercial calculations.

David Loevinger, a former U.S. Treasury official responsible for China, said the U.S. can use Beijing's investment drive to argue that China needs to act in a reciprocal manner by opening its market further to would-be U.S. buyers. "US officials will likely contrast the openness of the U.S. to Chinese investment, as evidenced by the recent Smithfield deal, with the inability of foreign companies to buy market leaders in China," said Mr. Loevinger who is now an analyst at investment firm TCW Group Inc.

The yuan is likely to get muted attention at the talks. Since the January 2011 visit of Mr. Hu, the yuan has appreciated 11.9% against the dollar when accounting for inflation, according to Brookings Institution researcher Karim Foda, including a 1.8% increase since the beginning of this year. While China's central bank has intervened to stop the yuan from climbing even further in recent months, tThe appreciation has come at a tough time for China's exporters, giving Mr. Xi a strong argument the U.S. should ease its criticism of China's currency policies.

Further concessions on the yuan around the summit are unlikely. Letting the yuan trade freely now, as the U.S. has long sought, risks further appreciation, which could "do a lot of damage to the Chinese economy," said RBS economist Louis Kuijs, a former World Bank China economist.

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