Slowdown in China’s manufacturing growth sets tone for New Year

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Last year opened to claims that the world economy had entered a period of “synchronised” global growth, after experiencing its best year since the 2008 financial crisis. There was also talk of a “melt up” in US stock markets on the back of major corporate tax cuts at the end of 2017.

It is a very different picture at the start of 2019. Wall Street and global markets have just experienced their worst year in a decade amid growing signs that the world economy has begun a significant slowdown.

The New Year began with the news that a key manufacturing index in China had recorded its worst reading in 19 months—another sign that the Chinese economy is starting to slow. There are fears that it will be further adversely impacted if no trade agreement is reached with the US by the deadline of March 1 and Washington proceeds with its threat to lift tariffs on $200 billion worth of Chinese goods from 10 percent to 25 percent.

The worsening outlook for the Chinese economy was highlighted by the Caixin purchasing managers index (PMI), mainly tracking privately-owned factories, which fell to 49.7 in December from 50.2 in November. It was the first time since May 2017 that the index fell below 50, which marks the line between expansion and contraction.

The data on the private sector were published two days after China’s official PMI, which mainly tracks state-owned corporations, came in at 49.4, the first time it has fallen below 50 since July 2016.

It was significant that in both indexes new orders fell from expansion to contraction between November and December. PMIs in the China-dependent economies of Taiwan, Malaysia and the Philippines have also recorded declines for the month of December.

Other Chinese data point in the same direction. In November profits of industrial companies fell for the first time in three years and the growth in retail sales was at its lowest level in 15 years, with the auto industry particularly hard hit. According to the global consulting firm PwC, as a result of large foreign investment by major car producers, including Ford, Peugeot, Hyundai and Volkswagen, China has the capacity to produce 43 million vehicles but will build fewer than 29 million.

Reporting on the latest news of the manufacturing downturn, the *Wall Street Journal* commented that it was a “sign that nine months of monetary easing by the central bank has failed to boost lending in the real economy, though it has succeeded in pushing government-bond prices into bubbly territory. This kink in China’s monetary-policy machinery bodes ill for 2019, and makes predictions that growth could bottom out in the first quarter look optimistic.”

The banks were continuing to lend, but to other financial institutions and not to “the cash-starved companies that really drive growth.”

Besides the slowdown in manufacturing, the whole economy is being threatened by an escalation of tariffs.

Seeking to provide a boost to the battered US stock market, Trump issued a tweet last weekend that he had talked with Chinese President Xi Jinping and “big progress” had been made in trade discussion. A deal, if made, he tweeted, would be “very comprehensive, covering all subjects, areas and points.”

However, the key issue remains how far China will agree to US demands that it cease alleged theft of intellectual property rights and wind back, if not entirely eliminate, subsidies to state industries which the US claims are “market distorting.” These issues will be at the centre of talks between leading trade representatives of both countries on January 7.

China has already agreed to boost its imports of US products in order to address the trade imbalance between the two countries. But this is regarded as insufficient by the anti-China hawks within the Trump administration who see its industrial development, especially in high-tech areas, as a threat to the global economic and military dominance of the US.

Trump attempted to provide a further boost to the markets in a tweet yesterday. He said that the US stock market had suffered a "little glitch" in December and would recover once he had negotiated trade deals with China and other countries. The market appeared to respond, adopting a wait-and-see approach when trading began for the New Year, with the Dow recovering to finish marginally up after falling by almost 400 points at the opening.

Trump's description of the stock market turmoil recalled the comments of President Clinton when he remarked that the Asia financial crisis of 1997–98 was just a "glitch" on the road to globalisation. Clinton was confronted with a major fallout from the Asian turmoil when the US firm Long Term Capital Management had to be bailed out in 1998 in order to prevent a meltdown of US financial markets.

The trade conflict with China and its worsening growth prospects are not the only factors impacting on the world economy. The latest indications are that growth in both Germany and France is slowing. There is continuing uncertainty over the terms of British withdrawal from the European Union amid warnings that a "no deal" Brexit will have major economic and financial consequences.

Trade is also a point of conflict between the US and the EU. Under a deal struck between Trump and European Commission President Jean-Claude Juncker in July, the US agreed to put threatened auto tariffs of 25 percent on hold in return for negotiations on tariff reductions and other trade constrictions.

However, there has been little progress in the discussions, with a leading EU trade representative accusing the US of undermining the July agreement.

Writing in the *Financial Times* on December 18, Bernd Lange, the chairman of the International Trade Committee of the European Parliament and the standing rapporteur for EU-US trade relations, said that with "tariff threats, intimidations and divisive rhetoric," Trump's negotiating tactics were as "clumsy as they are alienating."

Noting that he was "highly sceptical" that the US would deliver on the temporary truce, Lange said American envoys were now questioning the terms of the July 25 statement and were displaying "utter disregard for standard EU procedures in preparing for formal trade negotiations."

"Finally, having brought the EU, China and others to the negotiating table with tariff threats, the US now regularly turns to blackmail," he wrote, adding that he remained "unconvinced" that the EU should enter into formal discussions under such "troubling conditions."

Any transatlantic partnership had to be based on "mutual respect," Lange stated, warning that "as it stands, the current US rhetoric and disregard for our values and red lines have the potential to poison transatlantic relations for years to come."

The year 2018 was marked by slowing growing global growth, increased financial turbulence, trade war and tariff measures. The New Year has opened with clear indications that all these conditions are set to intensify.