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China's debt a factor in the trade arguments

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For a short time on Friday, 20 July, Chinese economic debate experienced a rare moment of public dissension. Financial News, a State media organ, ran a story asserting that China's monetary policy management was inadequate to the task of managing the risks of economic slowdown.

The thrust of the argument will be familiar: the central bank (which is largely confined to monetary policy levers) wants wider reflation of the economy through fiscal measures. The Ministry of Finance, which has some options, makes the point that other agencies (such as those regulating state enterprises) have influence that the People's Bank may not account for.

The newspaper article was taken down fairly quickly, but its finger-pointing character underlined the possible severity of tensions in China's economic management that emerged a week earlier in a testy public exchange between the head of the central bank research department and a proxy for the Ministry of Finance.

Shortly after, it became apparent that the trade war threat had tipped China's State Council over, with the 23 July announcement of a liquidity boost that appears designed solely to lift pressure on some of the more troubling components of its unsettled financial system. At best, China's focus on financial discipline has been suspended. The fact that the liquidity policy change came with a $US200billion boost to local government for "infrastructure" is itself astonishing, given the role local government has had in building debt risk.

At the heart of the Chinese sensitivities is the uncertain effects of "deleveraging". For some time, China's leadership has built pressures to rein in runaway lending practices (notably in the non-bank and state enterprise sectors). In recent months, the effects had become more obvious – in the number of bond defaults and in a tightening of credit.

Across the Pacific, a different risk is in the frame. A variety of authorities – inclusive of the IMF and Goldman Sachs – are alarmed that the US has allowed the economy to boil over.

In short: China's debate is about increasing stimulus, while the US is being urged to cut back on deficits. It is unlikely that a trade war will assist either side of those debates. More likely, an aggressive trade battle might be the fuse that brings on that which everyone has sought to avoid since capital markets fell over in 2008: the problem of excessive debt.

As time goes on, the stakes should become more apparent. China has already given some ground to banks on a tightening of solvency requirements. The core problem is characterised as soft lending disciplines, notably in the priming of local government agendas. The US, on the other hand, has boosted a rising economy with tax cuts that put its fiscal deficits on track for levels not seen since World War Two.

So the IMF thinks global growth is peaking and will come off when the priming of the US economy wears off. Or, it suggests, growth might take a hit if the trade war gets really serious.

The debt issues in this case is indicative of another, bigger problem. The problem is acceleration; a raising of stakes in what has been recently a fractious period of resentful domestic affairs across most of the OECD.

If US debt is not managed well, it would seem inevitable that its future governments will withdraw social programs and widen the gaps in a society already exhibiting serious social tension. Such is the fuel of isolationism and aggressive parochialism. Similarly, China's leadership gives every impression of holding one certain default position: maintain economic stability at all times.

For 25 years or more, we have become used to the notion of economics and markets as an abstract discipline. A benevolent "invisible hand". Even in the wake of the 2008 debacle, citizens turned to Bernanke and Draghi and Stevens – technocrats – for trusted management. Not now.

Today's economic outlook is intensely political. Popular concerns and national identities are raging in some ways against powerful forces of globalising effect that will neither go away nor prevent the harsh intrusion of popular reaction. Up to now, the expression of these concerns has been channelled in the Brexit vote, the election of President Trump and some other prominent cases of political revolt. But if the next stage evokes a Chinese response, we may prepare for something quite different.

Unlike the US and its OECD compatriots, China's centralised leadership and social influences are both comprehensive and singular. That is, they move on an issue with focus and massive capacity. Especially when that issue concerns domestic stability.

As we watch events, it is not so much the rhetoric of trade wars that one should fear. The real danger is threatened when China's leadership senses a loss of its grip on the sensitive process of shifting from its all-out pump-priming to a stable landing. Because that is when it is most at risk of mobilising against a foreign enemy. This much is certain: when it comes to rousing popular anger, President Trump would not get even an apprenticeship in China.

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