

Guest Column: The Federal Reserve ignores China at Its peril

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A disturbing characteristic of Jerome Powell's Federal Reserve is how U.S.-centric it has become. In following its data-dependent interest rate policy, the Fed makes little reference to world economic developments in general and to those in China in particular. It does so even though those developments could materially affect our economy. This is all the more surprising at a time when China, the world's second-largest economy and, until recently, its main engine of growth, is in deep economic trouble. It is also surprising when that country appears to be on the cusp of deflation and is causing a marked softening in international commodity prices.

A series of egregious economic policy mistakes under President Xi Jinping's watch is at the heart of China's current economic malaise. These mistakes include an over-reliance on a credit-fueled housing market and an export-led economic growth model. They also include an economically disastrous zero-COVID tolerance policy and a heavy-handed clampdown on the all-important tech sector that has undermined investor confidence.

It is also hardly helping matters that China is now paying the economic price for its earlier one-child policy that is now leading to the shrinking of its population. Or its economic relations with the United States have

soured under the Donald Trump and the President Biden administrations. Nor is it helpful that the United States and European companies are seriously trying to reduce their reliance on the Chinese supply chain.

The depth of China's economic troubles is underlined by the difficulties it is experiencing in its housing and export sector. According to Harvard's Kenneth Rogoff study, housing activity accounts for almost 30 percent of the Chinese economy. Meanwhile, the IMF estimates that Chinese exports account for nearly 20 percent of the country's GDP. This implies that at least half the Chinese economy is in deep trouble.

The Bank for International Settlements frequently reminds us that over the last decade, China experienced a housing and credit market bubble that was of a similar size to that which Japan experienced in the run-up to its lost economic decade in the 1990s. Housing prices in relation to income in China's major cities have come to exceed those in London and New York, while credit to the non-financial private sector increased by a staggering 100 percent of GDP. There is now every indication that those bubbles are bursting.

Over the last year, many Chinese property developers, including Evergrande, have defaulted on their loans. Meanwhile, house prices have fallen steadily over the past year, housing starts are in a deep slump, local governments are experiencing financial difficulties due to slumping land sales, and the housing market continues to be characterized by literally many millions of unoccupied dwellings. With China's population declining, it is difficult to see how the country can grow out of its housing and credit market difficulties.

The significant slowing we are now witnessing in the Chinese economy has raised a fundamental question for the Federal Reserve. At a time when the world's second-largest economy is showing every sign that it could soon be exporting meaningful deflationary pressure to the rest of the world economy, might the Fed not be risking monetary policy overkill by hewing to its aggressive interest rate hiking policy?

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