Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Jim O'Neill

# A new monetary accord is needed because of China's trade surplus

In keeping with the adage that history never repeats itself but often rhymes, I suspect that we could soon see developments in international macroeconomic policy for which there are clear precedents.

As with the Plaza Accord in 1985, when the United States and four of its major trading partners agreed to coordinate policies to weaken the US dollar, a new agreement to address today's global imbalances has become increasingly necessary.

The reason can be found in China's trade data for August, which shows a whopping 25% year-on-year rise in exports, up from the 23.9% increase recorded in July.

Despite similarly strong import growth (from a smaller base), China has delivered another huge monthly trade surplus, this time totaling $119.1 billion. So much for the idea that globalization has peaked.

Like other major trading powers, China's trade has been dominated by rapid growth in AI-related products.

But many of its other exports have also continued to grow. There has even been a 34.3% year-on-year increase in exports to the US, though this partly reflects the low base from last year's trade war.

And even before that, all the rhetoric and punditry about deglobalization missed what was really going on.

China has been boosting its exports to many other parts of the world, and many of these importers are in turn exporting more to the US. That is why there has been so little change in global trade imbalances.

## China's domestic demand

China's still-weakening domestic demand means that its imports are not growing on the same scale as its exports (in monetary terms).

As a result, its trade and current-account surpluses are rising sharply—quite a feat for a $20 trillion economy. But while many see China's export performance as a sign of its industrial prowess, it should be ringing alarm bells in Beijing.

If Chinese policymakers are happy about the situation, that is only because stronger exports could allow them to hit their annual GDP target.

But they should be careful what they wish for, because such large imbalances cannot be sustained indefinitely.

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The recent figures also pour cold water on the idea that tariffs can influence trade balances.

A country's external trade and current-account balances mirror its capital account, and both are quantitative reflections of the country's balance of savings relative to investment.

If you have a shortage of savings, as the US does, you will need more capital from overseas, and this will show up as a current-account deficit.

But if you have high domestic savings and weakening consumer confidence, as China does, the result will be even stronger exports.

## Economic activity in China is weakening

Moreover, recent monthly data suggest that domestic economic activity in China is weakening—a trend that shows up more clearly in the data on retail sales and second-quarter GDP.

Of course, this weakening owes something to China's soft property market, where policymakers allowed a massive bubble to form before bursting it in 2021.

They arguably deserve some credit for preventing a wholesale financial collapse of the kind we saw in the US in 2008, and in Japan in the late 1980s.

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The upshot, however, is that many previously aspirational Chinese families no longer have as much confidence in the future.

They have lost the optimism that drives social mobility, and this change comes on top of the already high savings rate among rural-born Chinese who cannot count on a strong social safety net.

Meanwhile, China's annualized real (inflation-adjusted) GDP growth rate slowed to 4.3% in the second quarter (down from 5% in January–March).

Unless there is a trend reversal, the government's chances of hitting its 4.5–5% target for 2026 look slim. Unless domestic demand picks up, improving the GDP figure will require even stronger growth in exports.

## A new monetary accord

After accounting for the August trade figures, China's year-to-date cumulative surplus is now around $805 billion, and there is a good chance that it will exceed last year's massive $1.2 trillion surplus (around 6% of GDP).

Such a massive imbalance is in no one's long-term interest, including China's.

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Even countries that have enjoyed the benefits of dramatically increased trade with China—from Germany and Mexico to many others—now find themselves on a one-way street.

As China's exports have grown, their own exports to China have slowed in line with the softening in Chinese domestic demand.

Finally, all of this is happening at a time when the Chinese renminbi appears to be around 20% undervalued (if not more) on a trade-weighted basis.

A stronger currency would make Chinese consumers feel richer, perhaps leading them to spend, and therefore import, more.

And if accompanied by a serious fiscal stimulus, a properly valued renminbi could even put China back on the path toward doubling its GDP per capita by 2035 (from 2020 levels).

As the host of the G20 in 2027, could the United Kingdom help orchestrate a new monetary accord? If so, it will have provided a sorely needed corrective to an increasingly imbalanced global economy.

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