China US Dialogue

Dear China,

Thank you for being a good partner over the last decade. You have been a great help in helping to keep inflation low by being a low cost producer. We have been happy to export our productive capacity to you. We have been happy to buy your exports. While this has created a large trade deficit for us against you, we have been very happy with getting more stuff in return for giving you more dollars.

Thank you for providing us the capital to continue to be your trading partner. As a provider of vendor finance, few have your capacity and favorable terms. You make GE Capital look small time. Your purchase of our government debt has been helpful in keeping our long term interest rates down and allowing us to expand the level of debt in our economy.

Thank you for your interest in investing in our country. We do have a patchy track record of cooperation in this area. Feel free to continue to invest in our country, particularly in our debt markets, particularly the public sector debt. We thank you. There are, however, some strategic industries where we would prefer to remain self sufficient. Throughout your own history you have sought to be self sufficient as well and I am sure you understand our position. We can’t sell you our resource assets, or our strategic assets, or our politically sensitive assets. Trophy assets are fine, and for that we have a special discount. We offered the same to the Japanese some twenty years ago.

There are, however, a number of issues we need to discuss. The global economy has gone to pieces, growth is weak, trade is weak, credit has fallen off a cliff, and so have our stock markets and bond markets. As valued partners in global growth we feel that a frank discussion towards cooperation to stabilize and rebuild the world economy is in order.

While we have been happy to buy your cheap exports, the trade balance and current account have now become quite imbalanced. Part of this has probably been because the terms of trade have been distorted by your keeping your currency undervalued against the dollar. A market level of exchange rates would serve you and us and the rest of the world far better and would probably help to unwind some of these imbalances.

We need your help.

Our corporates are not investing but are retrenching. They are reducing inventory, capacity, headcount, debt and they are hoarding cash. Our banking system is under great stress. Our banks are acutely undercapitalized, they are holding toxic assets that nobody seems to know how to value, there is a slow creeping return to the mutual mistrust between banks in the wholesale funding market. Our central bank and treasury have plans to address both the capital adequacy of the banks as well as their problem assets. This will take time and money but we will not allow our banks to fail.

Our people are now in saving mode. With unemployment and falling wages combined with high debt service obligations, they are in fact in forced saving mode. They cannot afford to consume. We need you and your people to step in where our people are now absent. We could use some demand for our exports. We can offer capital goods and industrial supplies. We can offer technology and high value added services. We need your people to start saving less and consuming more, whether it is domestically or on imports.

A perverse situation has now arisen where even if our people could afford to consume, they would not. Collectively, it is rational to increase consumption whereas individually, it is rational to save. This is one of the arguments for Keynesian policies and believe me when I say that we would love to step in and spend and invest on behalf of the private sector. Unfortunately, we ourselves, the government, are also broke. Fiscal reflationary policies would involve accumulating even more debt. We have little choice but to go down this route in any case but we hope that as we do, you will be a continued customer of our debt issuance. The United States is good for its obligations in USD, rest assured. If your appetite for risk is somewhat higher, and we recognize how astute the Chinese are as investors, there is also our private sector corporate debt and asset backed securities which are very attractive.

We hope we can engage each other in a constructive dialogue on these matters. As the two mutually largest trading partners, it makes sense that we look after one another’s interests.

Yours truly, Uncle Sam

Dear USA,

Thank you for your kind words. We consider you a good customer for our exports. Please continue to buy our products. We are happy to continue to run a large trade surplus. We will consider providing you further vendor financing, although the terms may have to reflect new economic realities.

We are not interested in trophy assets. As a country, there are many other things we lack and we are happy to buy those. We can discuss what those things are in the fullness of time.

To your point about the banking system, ours is still functioning well. We have instructed our banks to lend. They will do so. We notice that there has been some reluctance to borrow. Do you see the same thing at your end?

Our people are also saving. If you think you have problems with unemployment, you should see ours. Thanks to your consumers retrenching, we have millions unemployed. Our people have grown up with a culture of fiscal rectitude. Rising unemployment will only make them save more. We are doing what we can to make up for the fall in consumer spending. An infrastructure expansion plan is underway. We will not only encourage the private sector to employ and spend and invest, we will be employing directly ourselves. Since the 1980s we have been privatizing large portions of our economy. We will be temporarily reversing this campaign. We will resume again when things stabilize. Until we can stabilize unemployment, do not expect our people to be spending. Our own expenditure will be to invest in infrastructure and improving the potential of the economy in the long run.

Thank you for your offer of your public debt securities. We have plenty of that. We will be purchasing at a more measured rate from now. Note that a strong Renminbi is equivalent to a debt default by your government with a recovery rate equal to 1 minus the depreciation of your currency relative to ours. We have already sustained losses in our local currency terms. This is very much interrelated to our discussion on exchange rates. We are not intervening significantly in the currency markets, and when we are, it is not always one sided. There are periods of natural strength in the USD. You have frequently encouraged us to operate under capital account convertibility. Be careful what you wish for. We are happy to support the USD as the de facto reserve currency of the world. We are equally happy to consider the CNY in the same competing role.

Yours truly, Regular Zhou