Mark Sobel: Remarks before Bank of Thailand
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Thank you. It is a great honour to be invited to speak at the Bank of Thailand and to such an illustrious audience.

I’ve been asked to speak about ‘US-China relations and the implications for Asean’. I can certainly offer an American, or better yet, my perspective on this topic. But in some ways, it is presumptuous of me to do so before such a distinguished group, because you know Asean far better than I do. Still, that won’t stop me from trying.

Obviously, the US-China relationship has deteriorated, and on both sides. Perhaps the world is too inclined to lay this deterioration fully at President Trump’s doorstep. I think that would be an exaggerated view. To be sure, his style – including tweets and bellicose rhetoric – is quite different from his predecessors. His focus on bilateralism and bilateral balances, seemingly at the expense of multilateralism, is a major – and in my view, unwelcome – departure for America.

But in other respects, the President’s ascendance to power – even if he did not garner the majority of votes – reflected broader angst and forces in the United States. For better or worse, the forces of populism are gaining ground across the globe. Alas, America is no different. After the crisis, there has been considerable anxiety in many quarters of the economy about real income stagnation, inequality, diminished socioeconomic mobility and financial security – even at a time of very low unemployment.

President Obama as well was concerned about America’s ability to act internationally and meet domestic priorities. He also wanted to pull back America’s global footprint. His Administration was deeply concerned about Chinese statist economic practices.

Americans often blame globalisation for economic woes. In my view, technological change is the true and far greater disrupter.

Notably, when it comes to China, there is a broad consensus across the US political spectrum to adopt a far firmer policy stance. Let me repeat, this view is one of the few that unites Democrats and Republicans. There is a belief that China’s increasing statism, and the scale of subsidies to state owned enterprises, support for technology firms, and industrial policies create an unfair and uneven playing field.

Of course, US concerns are more deep-seated. Twenty years ago, China accounted for roughly 4% of global GDP; now it is well over 15%. China is now the world’s #2 economy, using market exchange rates, and #1 using purchasing power parity – though, as I always say, one can’t buy a Big Mac with a PPP dollar. China used to produce low value-added goods; now is it seen as competes globally with the United States near the technological frontier. America is concerned about China and the South China Sea, etc.
In short, there is now a much more zero-sum American world view, as well as one which sees China as the strategic competitor, perhaps in some quarters conjuring up images of the Soviet Union and the Cold War.

Oh yes. How could I forget? There is a Presidential election next year in the United States. The campaigning has already begun. Do you think US domestic politics may impact what is said and done about the state of US-China relations in the period ahead?

Who am I to speak about China to you? You are China’s neighbours. The East Coast of the United States is 7000 miles away from China, or should I say for you over 11 thousand kilometres? But one thing I’d say based on my years of dealing with Chinese officials is that China, like the United States, is a proud nation. My experience is also that Chinese authorities are pragmatic. Tell them what you want and why, and they will consider the case and see if an accommodation is warranted from their perspective and/or can be found. Further, China acts when it perceives it as in its self-interest to do so. But it will not act if it feels it is being visibly pressured to concede by outside forces, such as tweets, and such action could be perceived as a loss of face. Painting China into a corner will arouse the dragon.

So, what does that mean for Asean? Well, there’s an African proverb: ‘When elephants fight, it is the grass that suffers.’ Certainly, I would never analogue Asean – equal to the world’s seventh largest economy – or Thailand with grass. But were I to do so, I would certainly say the grass is beautiful and lovely. Of course, though, beautiful grass is still grass. In any case, when the world’s two largest economies are at loggerheads, it can’t possibly be good for the rest of the world, let alone Asean, which neighbors China. Let me draw out a few consequences of what I see US-China tension meaning for Asean.

Asean has been a prime beneficiary of the post-WWII order that the United States created and developed. Indeed, my country’s post-WWII support for multilateralism and international organizations such as the United Nations, Nato, the IMF and World Bank helped pave the way for decades of strong global growth and openness. It stood down the Soviet Union. In my four-decade career, I had the great privilege and honor of representing my country’s interests, but always in support of that vision.

As I’ve said, the cause of multilateralism is not now doing well in the United States. I think the abandonment of TPP by the President was a horrible strategic and tactical blunder. If one wished to rally America’s allies in Asia and present a united front for encouraging greater liberalisation and reform in China, abandoning TPP – let alone attacking Europe, Canada, and Mexico – is akin to shooting oneself in one’s own foot. It must have left you in the audience scratching your heads and wondering where this left you between the two elephants.

And it’s not just TPP. The President has shown fundamental disregard for the WTO, for example, blocking judicial appointments to the WTO’s Appellate Body. On the IMF, the Administration will not support a quota increase, even though the Fund may need more quota resources over the medium to long term and not raising quotas means China will remain woefully underweight and have reason to drift further from multilateralism.

The world has changed. The United States is no longer as dominant as before. China is much larger. China in some ways can be seen as building its order – that is perhaps one perspective on
the Belt and Road Initiative and the Asian Infrastructure and Investment Bank. Dealing with China is far more difficult than dealing with our traditional and far more like-minded allies in Europe. Even if in a post-Trump world there will be some mean reversion from bilateralism back toward multilateralism, the order is changing, recent years and some realignment appears inevitable.

That leaves Asean members caught in a fluid state, figuring out how to avoid getting stomped on by the elephants.

There will also be other more concrete ramifications for Asean economies.

Rising tariffs, trade tensions and the uncertainties they generate for investment and overall economic activity could be quite large. The IMF’s recent G20 surveillance note argues that the cumulative impact of announced US-China tariffs, including financial market and confidence effects, could shave 0.5% off of global growth next year. Of course, that figure does not include the impact of what might or might not transpire with Mexico, or Europe down the road.

Earlier this year, analysts on the whole predicted a decently growing US economy, slowing toward potential, but exceeding it in 2019. Perhaps analyst mood swings can be abrupt. But now, several analysts, given the recent tumble in US rates, the inversion of the yield curve, stock market declines and some weak data, suggest that the downside risks to the US economy are now more pronounced and that US recession probabilities – still less than half – are on the rise. They also point to downbeat nowcasts. Such analysts now expect two or even three Fed rate cuts this year.

I’d be remiss, though, if I didn’t mention that other prominent economists think the pace of US economic activity remains firm with continued low unemployment, that the current pullback in the latest quarterly data was expected, and that the market is getting ahead of itself in its predictions of rate cuts from a data-dependent Fed.

Of course, the outlook for Europe isn’t great. European growth is modest in any case. But on top of US-China trade questions, uncertainties associated with Brexit, Italy’s fiscal picture and German and French politics further cloud the picture.

Lower global growth clearly will not help the Asean economies. And even beyond the shorter run, medium- and longer-term potential growth in the advanced economies will be far lower going forward than in past decades.

On top of the modest outlook and trade tensions, there is also the question of China and its growth model. As many challenges as we have in the United States, such as our inability to run responsible fiscal policies, putting the debt/GDP ratio on a gradual slowing path and dealing with our entitlement and social problems, I think the challenges facing China are far greater.

China’s rapid growth of the past decades has relied on a state-driven investment intensive manufacturing surge, funded by state owned commercial bank lending to state owned enterprises at highly favourable terms. But with increasingly inefficient use of investment, as seen in a rising ICOR, and huge savings often returning little to investors, China faces financial stability challenges.
The financial system is rickety, filled with NPLs – not reflected in the official data. Investors want a return on their money, and the reach for yield is reflected in the growth of ‘shadow banking’ and huge leverage, which the regulators have sought to stamp out. Of course, deleveraging means lower growth, which runs afoul of China’s unsustainable 6%+ growth targets.

Recent years have also been associated with China’s current account surplus heading toward balance, and ever tougher capital controls trying to bottle up capital in China lest the currency fall and a massive outflow be triggered.

China needs to move to a new growth model. It needs to cultivate consumer and services led growth. It needs to allow banks to lend to the private sector on market terms, rather than directing resources to SOEs. It needs to clean up its financial system. And it needs to do all of this while facing a huge demographic kink in the next decade.

It means accepting a much lower sustainable rate of growth, some even saying 4% plus or minus. And the longer reforms are delayed, the lower the sustainable long-term rate of growth will be. These are not challenges for the faint-hearted. Chinese officials know this, but the path ahead will be extraordinarily difficult. How China deals with its debt, external sector, and demographic challenges will clearly impact Asean.

Perhaps because I spent my career at the US Treasury, for many years with responsibilities for currency policy, I should be a ruthless truth teller and speak a bit about foreign exchange issues and Asean. There has long been much focus in the United States on harmful currency practices abroad. Now, there is a penchant in my country to blame the foreigners, especially at this time of anxiety over globalisation and given the state of political discourse in our country, rather than acknowledge quite a few of our sins that impact foreign exchange markets. Symptomatic of this, you may have recently seen that the Commerce Department proposed treating currency ‘undervaluation’ as a countervailable subsidy, a proposal I oppose and believe is unworkable.

But let’s be honest – some countries have tended to rely on export led growth models, often depending on US and/or global demand, and they intervened heavily with the effect of holding down their currencies, further boosting competitiveness. China’s surplus is disappearing. Even if some individual Asean country surpluses are not large in nominal terms, Asean’s as a whole remains considerable, especially if one excludes Indonesia. It reminds me of an alleged saying by a famous US Senator about our budget – ‘a billion here, a billion there, and pretty soon you’re talking real money’. As you know, the Treasury modified its criteria in the last Foreign Exchange Report to pick up more trading partners for analysis, including many in Asean. I believe Asean has to expect continued attention on this front, especially Thailand.

I’d be remiss if I didn’t mention that there might be some unintended benefits from the US-China trade tensions for Asean. In particular, the tensions may contribute to some dismantlement of China’s role in the global value chain, and foreign producers may increasingly look elsewhere, including Asean – and Vietnam in particular – to relocate production. I surely don’t think this benefit will offset the broader costs I’ve enumerated.

So, to sum up where I stand – the cause of multilateralism may be waning; future potential growth around the world will slow; many in the United States face angst about their futures and
in part blame globalisation; China faces heroic challenges and must move to a more sustainable growth model, which will be associated with much slower growth; US-China relations will remain fraught and free trade questioned in the United States, even after President Trump departs from the scene.

What should Asean do?

If some Asean countries in the past have relied on export-driven growth in the context of a multilateral and open global system, they should probably reflect on the wisdom of continuing to depend on this growth model. They should sustain prudent macroeconomic policies, strengthen financial systems, and allow for greater flexibility in their currencies. But they should also look for ways to boost domestic demand, including through the use of fiscal policy where fiscal space exists, building up infrastructure and other structural reforms. Of course, you already know this and you know far better than I do how to reorient your economies toward domestic demand.

There is much to do at the regional level as well. You know Asean and its activities far better than I do. But there can be ‘wins’ on the trade and monetary fronts. On the trade front, despite the Trump Administration’s extraordinarily unwise abandonment of TPP, many Asean members went forward with the Comprehensive and Progressive Trans-Pacific Partnership, keeping TPP provisions largely intact, including many state-of-the-art chapters originally negotiated with the United States. Perhaps one day, my country will find the wisdom to join.

There are now discussions about the Regional Comprehensive Economic Partnership, which could bring in China. I hope that the negotiations on RCEP will simply import the high-quality standards of the CPTPP and thus meaningfully broaden free trade throughout Asia, and thus hold China to a much higher bar.

On the monetary front, as part of the global financial safety net and continued adherence to the IMF’s central role in the international monetary system, Asean members can make efforts to strengthen the Chiang Mai Initiative Multilateralisation and the Asean+3 Multilateral Research Office.

Finally, I urge Asean countries to stand up and be a voice for multilateralism and openness. Collectively, Asean voices can be potent. Please remind the United States how much America benefits from the multilateral system, to say nothing of yourselves. While at this moment, it may seem that doing so will be like banging your heads against the wall, there is no downside and the upside could be positive. Your Singaporean friends are masters in this regard. Of course, as neighbours of China, you know it better than us Americans. You should use your knowledge of your neighbourhood to help improve American understanding.

Governor Veerathai, I thank you for this opportunity to speak to you and your colleagues today. I hope whether you agree with my observations or not, I’ve said something sufficiently provocative to catalyse a good discussion.

Mark Sobel is US Chairman of OMFIF.