China Slowdown: Little Headwind for Texas

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The much-heralded slowdown of growth in China presents a limited challenge to Texas' growth because of the state's relatively small direct trade exposure.

However, deceleration in China that morphs into a broader global drag and spills over to Texas' main trading partners—namely, Mexico and Canada—would pose a more significant risk.

Texas has been the top U.S. exporting state since 2002. Overseas sales of petroleum products, manufactured goods and agricultural commodities exceeded $287 billion in 2014. Since 1998, the dollar value of Texas exports has risen at an average annual rate of more than 8.5 percent, or about 3 percentage points faster than the U.S. rate, making exports an important contributor to the state's growth over the past two decades.

The upside of this global orientation is that when the global economy is doing well, Texas benefits. The downside, however, is that when global growth is weak or faltering, Texas growth suffers.

The big story in the international arena over the past quarter century has been the emergence of globalization—the increased economic integration of the various nations of the world—which has taken the form of greater cross-border flows of capital, labor and goods.

To many people, globalization is shorthand for one thing: the extraordinary expansion of the Chinese economy. By opening to international trade and liberalizing markets, living standards in China have gone from 2.5 percent of U.S. levels in 1980 to 25 percent of U.S. levels today, according to recent International Monetary Fund (IMF) estimates.

China is already the world's largest economy, at least when measured on a purchasing power parity basis, which attempts to correct for differences in price levels between rich and poor countries. And by virtue of its size and rapid increase in recent years, about one-third of global gross domestic product growth in recent years can be attributed to China.

At a very basic level, Texas export growth is driven by two factors: the state's exports' global competitiveness and how rapidly growth is occurring in world markets, including the Texas market itself. With regard to China's impact, we must also consider that country's share of Texas exports.

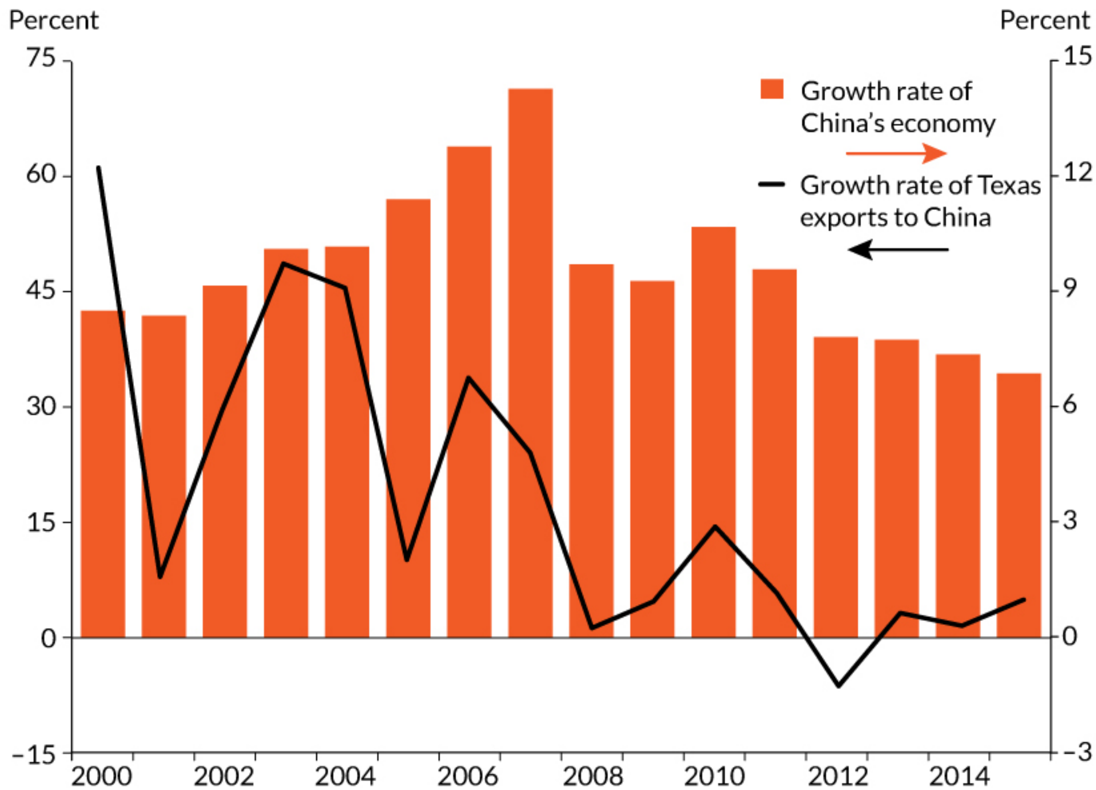
Texas export competitiveness is determined by the dollar price of its goods and services and also the exchange rate between the dollar and the currencies of the nations to whom it exports. As of 2014, Texas exported to 166 countries, almost all with currencies whose value fluctuates against the dollar.

The other key determinant of Texas export growth prospects is the rise in demand in target markets.

Two key developments in China during 2015 gave rise to concerns that Texas exports to that country may be somewhat weaker going forward. First, there is the widely noted slowing of China's growth rate. For several decades, China's economy climbed at unsustainable rates as it caught up with the rest of the world.

In November 2015, the Chinese government leadership suggested a growth target for 2016–20 of 6.5 percent, well below the double-digit rates in the years prior to the 2007–09 global financial crisis (*Chart 1*).

Chart 1: Texas Exports to China Decline as Nation's Growth Slows



SOURCES: International Monetary Fund; Census Bureau.

The second key development was the loosening of the link between the Chinese renminbi and the dollar. Historically, the People's Bank of China (PBoC) has tried to manage the exchange value of the renminbi to limit fluctuations against the dollar. For many years, this led to accusations of currency manipulation to obtain an unfair competitive advantage in international markets.

Measured in real terms against all of its trading partners, which is what ultimately matters for international trade, the renminbi appreciated by about 26.4 percent between 2005 and 2015.[1] The IMF, at the conclusion of its Article IV consultation mission to China in 2015, noted that the real effective appreciation of the renminbi over the preceding year had brought it to a level that is no longer undervalued.[2]

But what matters for Texas' trade prospects with China is the bilateral exchange rate between the dollar and the renminbi. From July 2014, when the dollar began its recent upward trend, through the end of 2015, the renminbi depreciated only 3 percent against the dollar. By contrast, the Mexican peso, the Canadian dollar, the euro and the yen depreciated by more than 20 percent.

While the value of Texas' exports to China has increased at an average annual rate exceeding 15 percent over the past two decades, the rate of expansion has slowed markedly in recent years. Exports to China increased just 5.7 percent in 2015, and, despite earlier rapid growth rates, accounted for only 4.6 percent of total Texas exports. This small trade exposure to China will limit the impact of a slowdown there on Texas' expansion.

On the other hand, recent policy developments in China will make trade with that country more sensitive to exchange rate movements. In December, the PBoC launched a new trade-weighted index for the renminbi that tracks its value against 13 currencies, including the dollar. There are growing expectations that the PBoC will seek to manage the value of the renminbi against this new basket rather than against the dollar, which will potentially mean greater future volatility in the dollar-renminbi exchange rate.

NOTES

1. As measured by the JPMorgan Chase & Co. broad real trade-weighted index deflated by the producer price index.
2. See "IMF Staff Completes the 2015 Article IV Consultation Mission to China," International Monetary Fund press release, May 26, 2015.