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CHINA-U.S. TENSIONS

IMF WARNS OF THREAT TO WORLD ECONOMY

Creation of blocs based on geopolitics has been detrimental to global trade and mostly harms low-income countries, top agency official says

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A top official with the International Monetary Fund (IMF) has lamented the economic fallout from years of strained relations between China and the West, and warned the situation for the world economy would only grow more dire if the acrimony continues unabated.

With the world now divided among three broad blocs of countries – China-leaning, US-leaning, and nonaligned – both a "significant reversal of the gains from economic integration" and "a broad retreat from global rules of engagement" were on the horizon, said Gita Gopinath, the first deputy managing director of the financial agency.

Gopinath, who has often led annual audits of China's financial system, made the remarks in a speech at Stanford University on Tuesday.

Her remarks come at a time of increased geopolitical uncertainty over a number of challenges, most notably an escalating rivalry between the US and China and the war in Ukraine.

Although economic fragmentation was not yet as severe as it was during the Cold War, Gopinath said, it carried a much greater potential cost thanks to higher global reliance on trade.

China's share of US imports fell by 8 percentage points between 2017 and 2023 as trade and overall relations between the two countries fragmented, while the US' share of China's exports fell by about 4 percentage points during the same period.

Trade between blocs of countries aligned with either China or the US was also negatively affected, Gopinath said.

Between the middle of 2022 and 2023, the average weighted quarter-on-quarter trade growth between US-leaning countries and China-leaning countries fell by nearly five percentage points compared with the five-year period between 2017 and early 2022.

Similar patterns could also be observed following Russia's invasion of Ukraine, with trade and investment between blocs falling more than trade within blocs.

Meanwhile, the currency composition of trade finance had also changed more for China-leaning countries than US-leaning ones, according to Gopinath. The proportion of US dollar-denominated trade finance payments among China-leaning countries fell since early 2022, while the yuan-denominated share doubled from around 4 to 8 per cent. US-leaning countries experienced little change.

Gopinath's speech coincided with President Xi Jinping's first diplomatic visit to Europe in five years – with stops scheduled in France, Serbia and Hungary – to mitigate alarm over China's economic ambitions and its close ties to Russia.

Foreign direct investment into China has suffered, with flows over January to March this year totalling only 301 billion yuan (HK$326 billion) – a 26 per cent year-on-year drop, according to official data released last month.

Despite Beijing's attempts to woo back foreign investors, many international companies remain wary, citing China's economic slowdown and ongoing geopolitical tussles.

A survey from the American Chamber of Commerce in China released in February found that nearly half of the respondents did not plan to expand investment in China.

A separate survey from the European Chamber of Commerce in China in June found that 11 per cent of respondents had already shifted investments out of China, with a further 8 per cent moving investments planned for China to other destinations.

So far, the erosion of direct US-China economic ties had been allayed through third-party "connector countries" like Mexico and Vietnam, which had become conduits for redirecting trade, Gopinath said.

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GITA GOPINATH, IMF

But the cost of worsening divisions could vary greatly, she added, with losses ranging from as little as 0.2 per cent of world gross domestic product in a mild scenario to 7 per cent in an extreme one.

The consequences of such a downturn would not be suffered uniformly, with the IMF predicting low-income countries would be hit harder by trade fragmentation due to a greater reliance on agricultural imports and investment from more developed countries.

Going forward, "pragmatic steps" would need to be taken to rebuild trust, Gopinath said, starting with countries keeping open lines of communication.

"Dialogue between the US and China – which we are now seeing – can help prevent the worst outcomes from occurring. Non-aligned countries can also play a bigger role, using their economic and diplomatic heft to keep the world integrated," she said.