The Daily Dish

China and the Economic Outlook

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Yesterday *The Wall Street Journal* reported that "Banks in China cut benchmark interest rates on loans to households and businesses, a small attempt to help revive growth in an economy struggling with a property bust and Beijing's zero-tolerance to Covid-19." This marks the second central bank to move rates south this past week, but the situation seems very different than Turkey's. China has a growth problem but, unlike Turkey, does not have a pressing inflation problem.

China is probably in or near a recession, which is one of the reasons global oil prices are $30 below their peak. If China is able to relax its draconian quarantines and provide monetary stimulus, there is a good chance growth will pick up. This is clearly in the interest of President Xi Jinping ahead of the Communist Party Congress, where he expects to be re-elected. It is less of a blessing for the U.S. economic outlook.

The good news is that a better-performing Chinese economy means fewer supply chain problems and less inflation pressure on that front. The bad news is that China's return to global oil demand means a U-turn on the lower crude prices that underlay the recent decline in gasoline and other energy prices. It also means stronger global growth. This will spill over to the U.S. economy and force the Fed to counter demand even more strongly.

The rate cut in China is one more data point that the Fed will feed into its deliberations at its next meeting on September 20 and 21. Another data point will be this Friday's release of the PCE price index for July. Recall that the June index showed an acceleration in inflation; another acceleration in core PCE inflation would further add to the arguments for a continued strong increase in the federal funds rate.

China's rate cut highlights the recession risks around the globe. But its most likely impact will be to strengthen the case for the Fed to push back strongly on inflation and err on the side of a larger rate increase.