China Offers to Help Europe

Nicholas R. Lardy says the Beijing leadership is waging a brilliant strategy of promising to help Europe with its debt crisis but offering no specific commitments.

Steve Weisman: There have been headlines about China's new charm offensive in Europe—and reports of China helping to stabilize the euro. Nicholas Lardy, senior fellow at the Peterson Institute for International Economics, is here to clarify what's going on. This is Steve Weisman—thanks again, Nick, for coming back so soon.

Nicholas Lardy: Thank you, Steve.

Steve Weisman: What's going on?

Nicholas Lardy: I think it's brilliant Chinese diplomacy. They're making vague promises about helping the euro stabilize, but they haven't made any specific commitments to buy euro-denominated debt. Premier Wen [Jiabao], when he was in Greece in the late fall, did make a commitment for Chinese investment in Greek shipping and port development and so forth. That had a specific number attached to it. But the more recent general assurance that they're going to buy euro-denominated debt issued by some of the European peripheral countries has not had any numbers attached to it. So they're getting great press.

Steve Weisman: Why do they want great press in Europe?

Nicholas Lardy: It's part of their new global role. They're certainly a rising economic power over the last decade and now we see them trying to—shall we say—collect, if that's not too crude a word, on the political side, playing a major role in the refurbished global of the G-20, which is the big steering group for the global economy, and improving their bilateral relations with Europe.

Steve Weisman: How important is Europe's economic stability for China?

Nicholas Lardy: If you take the euro area as a whole, they buy more from China than the United States does. But the United States is still far and away the biggest single-country destination for China's exports. So obviously Europe is quite important for the Chinese. The lucky thing for the Chinese, of course, is that their banks have very, very little exposure to euro-denominated debt, and the foreign exchange reserves are still predominantly—in the Chinese case—in dollars. So they don't have a massive amount of exposure to Europe—certainly the banks have very little—the central bank and the government itself somewhat more.

Steve Weisman: What about the sickest parts of Europe—Spain, Portugal, Greece, Ireland? Is there anything that China can do to help the so-called peripheral countries?

Nicholas Lardy: I think at the margin, they can make a small contribution by buying a small amount of Spanish or Portuguese debt that's euro denominated. I would be very surprised if it amounts to very much. And one of course has to put it in the context of China's foreign exchange reserves. At the end of September [they] stood at 2.6 trillion US dollars; far, far, far and away the largest pile of foreign exchange reserves anywhere in the world.

Steve Weisman: What portion of that is dollars?

Nicholas Lardy: The global dollar share is roughly 70 percent. China is certainly the biggest holder of foreign exchange reserves, but I don't know what it represents as a percentage of a total. But the point is by taking a very small share of their reserves, they could put them in euro-denominated debt issued by the Portuguese or Spanish or Greek governments [and] play, at least at the margin, a somewhat helpful role. I think politically, their contribution is probably going to be somewhat greater. They're making very, very positive statements in support of the euro and the euro area as a whole, and I think they will get some credit for that eventually—standing with Europe in its moment of need.

Steve Weisman: What about the possibility of buying some of these new eurobonds that are being discussed that would be swapped for some of the sovereign debt of these countries?

Nicholas Lardy: They certainly could, but I don't believe the Chinese have yet hinted or said that they would be buying some of the new euro-denominated debt, which is going to be issued by the European Central Bank, some of which ultimately is going to be used to buy some of the bonds from financial institutions elsewhere in Europe. So that remains to be seen. I think that would be seen as a higher risk venture, but the Chinese might tiptoe into that as well.

Steve Weisman: What does it mean for the United States? There's always concern: Will the Chinese get cold feet about US debt?

Nicholas Lardy: Some people have characterized this as the beginning of China's real diversification out of dollar-denominated debt. I think that's very unlikely to be the case. At least 70 percent of China's massive foreign exchange reserves are held in dollar form, and I don't think that can really change significantly because the US bond market—particularly the government bond market—is the only one that's big enough to accommodate the massive size of China's reserves. So I think they're in what I called before the dollar trap. They're going to have a major position in dollar-denominated assets for the foreseeable future. Maybe at the margin they can diversify a little bit, but the euro share is not going to grow steadily and surpass the dollar-denominated share of their reserves anytime in the foreseeable future.

Steve Weisman: Is this charm offensive in Europe by China going to make it harder for the United States to enlist European support in pressuring China to allow its currency to appreciate?

Nicholas Lardy: The issues are indirectly linked. The Europeans in general—with a couple of exceptions of a few brief periods—have not spoken out so strongly on the Chinese currency issue. We're seeing Brazil now making a major statement about the RMB [renminbi] undervaluation; other countries have from time to time. But the Europeans in general haven't pushed on that issue. I think quite frankly, as in some other cases, the Europeans are willing to let the Americans do the heavy lifting. If the Americans are successful in getting the Chinese to appreciate a little bit more rapidly, the Europeans will benefit. And to the extent to which that's a cause of friction in the bilateral relationship between China and the United States, the Europeans avoid that cost.

Steve Weisman: You and I are speaking in the first week of January and President Hu is visiting later in the month; let's return to that subject the next time we talk.

Nicholas Lardy: Good.

Steve Weisman: Thank you.

Nicholas Lardy: Thank you, Steve.