CHINA

China Growth Slows to 6.5%; Financial Mandarins Scramble to Soothe Investors

Growth figure is the lowest since first quarter of 2009

Workers checked optical fibers at a factory in China's eastern Jiangsu province on Oct. 17. **PHOTO:** AGENCE FRANCE-PRESSE/GETTY IMAGES

By Lingling Wei

Updated Oct. 19, 2018 2:05 a.m. ET

BEIJING—China's economic expansion slowed to its weakest pace since the financial crisis, as top financial regulators launched an extraordinary coordinated effort to calm jittery investors.

The rate of growth in the third quarter dropped to 6.5%, falling short of market expectations, official statistics released Friday showed. Growth in industrial output and consumption weakened in the quarter, while exports held up despite the country's bruising trade fight with the U.S.

Shortly before the data was released, People's Bank of China Gov. Yi Gang, banking and insurance regulatory chief Guo Shuqing and top securities cop Liu Shiyu all issued statements urging investors to remain calm. Mr. Guo said recent "abnormal fluctuations" in Chinese stock markets don't reflect the country's economic fundamentals and "stable financial system." The Shanghai Composite Index—the worst performer among global benchmarks—has declined 25% so far this year. It fell as much as 1.1% after opening Friday, but rebounded in late morning trading.

Restoring market confidence is proving to be one of the toughest economic challenges for China's leadership. Soon after the financial mandarins' remarks were released, the official Xinhua News Agency published an interview with Vice Premier Liu He, President Xi Jinping's economic captain, in which he said the overall economic situation remained stable. Mr. Liu sought to dispel worries about the impact of the simmering trade conflict with the U.S. on China.

"Frankly, the psychological impact is bigger than the actual impact," he said. "Right now, China and the U.S. are in contact."

Washington and Beijing are preparing for a meeting between President Trump and Mr. Xi at the Group of 20 leaders' meeting in Buenos Aires in late November.

The 6.5% quarterly growth is the lowest since the first quarter of 2009 and is mixed news for Chinese leaders as they brace for a prolonged trade conflict with Washington. While the economy remains on track to meet Beijing's full-year growth target of about 6.5%, the third-quarter performance showed more signs of weakness—a scaleback of industrial production, slowing retail sales, anemic big-ticket investments and rising corporate defaults. That could limit Beijing's room to maneuver when negotiating with the U.S., whose economy is growing robustly.

"China's policy makers are trying to figure out how to react to the U.S.'s trade agenda and are less confident about their standing in the global arena compared with the past cycles," says Bin Shi, a portfolio manager at Acadian Asset Management in Boston.

Third-quarter growth decelerated from 6.8% in the first half of this year. Part of the slowdown is due to Mr. Xi's initiative of the past two years to contain debt and fend off financial risks. That risk-control campaign has curbed borrowing by local governments and businesses alike and caused a sharp falloff in spending on new roads and factories. Even though Beijing started to loosen its tight-fisted control on credit in recent months, easing measures so far have failed to rejuvenate fixed-asset investment, which has been a growth engine for years.

If growth continues to diminish, Chinese officials and government advisers say Beijing is ready to roll out more pro-growth measures, such as releasing more funds for banks to make loans, stepping up government spending on infrastructure and lowering corporate tax rates. However, such steps could further exacerbate the country's debt problems. As it is, soaring corporate and local-government debts are threatening the long-term health of the world's second-largest economy.

"The government is clearly getting concerned about the loss of growth momentum," said Eswar Prasad, a Cornell University economist who consults with Chinese officials. But rising financial risks could constrain China's ability to ease its monetary policy further, Mr. Prasad said. That suggests "fiscal policy ought to play a stronger countercyclical role," he said.

With the palpable slowdown and a pall cast by the trade fight, Chinese consumers have been tightening their purse strings. Retail sales grew 9.3% in the first three quarters of 2018, a sharp drop from 10.4% in the year-earlier period. This year's plunge in China's stock markets, according to economists and analysts, is also taking a toll on consumers. Car sales, for instance, fell for a third straight month in September, putting the country on track for its first yearly decline in passenger-vehicle sales in nearly three decades.

Exports, however, were an unexpected bright spot in the third quarter. Chinese companies' overseas shipments rose an average of 11.7% from a year earlier, a slight improvement from an average of 11.5% monthly growth in the quarter before.

Much of that burst, however, came from manufacturers racing to fill holiday orders and ship out goods before the trade conflict gets worse. That, in effect, is borrowing from future growth.

In Shanghai, Taijing International Freight Co., a shipping firm, has been busy dispatching cargoes of clothes, toys, home appliances and other goods. "Some of them are definitely trying to complete orders earlier than planned," said Pan Haitao, who runs the company.

"The current pace of export expansion is unsustainable," says China economist Larry Hu at Macquarie Capital Ltd., a Sydney-based investment bank. Mr. Hu says export growth will decelerate to between 5% and 10% in the coming months.

The Washington-Beijing trade fight has escalated beyond rhetoric in recent months to imposing tariffs on a wide range of each country's products, with trade penalties now on $250 billion of Chinese goods and $110 billion of U.S. products. Mr. Trump is threatening to raise tariff rates in January to 25% from the current 10% on most of those goods and place tariffs on an additional $257 billion of Chinese products, essentially subjecting all of the U.S.'s Chinese imports to such penalties.

—Chao Deng and Liyan Qi contributed to this article.

Write to Lingling Wei at lingling.wei@wsj.com