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ET2C International Inc

CARGO

COMPANY NEWS

"Sourcing Update – Current Economic Landscape"

The Politics of the Yuan

Against the backdrop of a stuttering global economy and stubborn unemployment rates, there has recently been a lot of posturing and rhetoric about the valuation of the Chinese Yuan (RMB) and the impact that this is having on trade imbalances and the health of the global economy as a whole. On the 29th September 2010 and probably as a result of election-year politics over the unemployment rate, the United States' Congress even passed a bill aimed at imposing tariffs on imports from countries whose currency is deemed to be undervalued (which itself is likely to be in contravention of the WTO).

The problem is that the existing political dialogue is plagued with arguments that are simply not true. Contrary to the emotive rhetoric, a rapid appreciation of the RMB is more likely to actually hurt consumers in Europe and the US and is unlikely to lead to an increase in manufacturing jobs in the West.

The Centre for Economic Policy Research (CEPR) has confirmed this. Many US exporters buy parts and components from China and any revaluation would raise their costs and impact the gross profit margins. In terms of trying to quantify the impact of any appreciation, the CEPR believes that if the RMB were to appreciate 10%, there would be a loss of 424,000 jobs in the US. If one were to add an import tariff of 10% on top of that and China were to respond with similar imports into China, an estimated 947,000 jobs would be lost in the USA.

Then there is the "Wal-mart effect" – cheap imports from China actually help the US consumer's pocketbook, increase companies' profitability, therefore encouraging more hiring and jobs. An increase in the RMB is likely to increase the cost of products for the consumer on the high street or at the mall (Walmart alone currently imports 70% of its goods from China).

There are a number of other factors that could also be considered in greater detail: (1) any revaluation of the RMB is more likely to lead to an increase in production in other Low Cost Countries (such as Vietnam) before the USA. (2) Western economies have evolved into economies that are more service and high-tech orientated for more than 10 years and any revaluation will not reverse this. (3) Although it might reduce any trade deficit with China, it is likely to increase the deficit with other Low Cost Countries. (4) In addition, a number of other countries are arguably "manipulating" their currency. For example, Japan recently completed its first unilateral yen intervention in six years.

It is certainly not in the West's interest to become embroiled in the "international currency war" that Brazil's finance minister used to describe the existing trade environment. We can only hope that the West (and the US in particular) learnt its lesson from the Smoot-Hawley import tariffs of the 1930's that are recognized as significant contributory factors to the Great Depression. The signs are promising - fears of a global currency and trade wars have jumped to the top of the agenda at IMF and World Bank meetings to be held mid-October.

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All of the above said, the RMB is undervalued and will appreciate at a pace that will allow China (and the global economy) to gradually rebalance. Chinese Premier Wen Jiabo has confirmed that China was indeed planning to proceed with reforms aimed at "increasing flexibility" in the exchange rate, but has also suggested that it would not be rushed. It is not in anyone's interest for there to be a rapid appreciation. Currently the 1 year futures (Non-Deliverable Forwards) suggest that the RMB will be closer to 6.5 RMB to the $ one year from now. Notably, the head of Morgan Stanley Asia recently commented that the fact that the Chinese have pegged their currency to the US Dollar was providing some stability to what is a fragile global financial system at this time.

When looking at China's overall economic development, we see the RMB as a red-herring. There are more pressing issues that need to be addressed on a structural level (such as a State health-care system) to allow the economy to continue to develop and grow. The politicization of the RMB's undervaluation against the Greenback has brought it to the forefront of recent meetings of world leaders (UN General Assembly and now at the IMF talks with the World Bank) and expect to hear more about it in the lead up to the mid-term elections in the US.

What impact will any RMB appreciation have on supply chains throughout the West?

First of all, there is certainly no need to panic. As a country, we believe that China's expertise, labour force, infrastructure and productivity will continue to be factors that will enable China to offer competitive pricing and absorb the appreciation of the RMB to some extent (as set out in our last newsletter which is available at www.et2c.com/resources).

China has spent the past 40 years developing an infrastructure and logistics capability that will allow the manufacturing base to migrate further inland to leverage off lower cost bases (such as foxconn have recently done). We are currently working to develop more relationships with inland factories and are well positioned to do so from Shanghai. It is also important to look at China in comparison with other countries and not to lose sight of the fact that China is also not the only Low Cost Country to suffer inflationary pressures.

In relation to ET2C's clients specifically, we still see opportunities on a daily basis to reduce the cost of goods across the board. ET2C's negotiating strength, ability to identify and remove hidden agency commissions, and our developing relationships with factories further inland as the infrastructure continues to improve are just a few of the important aspects enabling our clients to remain highly competitive in today's macroeconomic climate. ET2C's expertise on the ground in China operates as an additional mitigating factor to any currency appreciation in addition to managing the risk of buying from China.

Furthermore, ET2C's business in Vietnam continues to develop as the factories are starting to become more sophisticated and more competitive. Our clients benefit from our presence in Vietnam and our capability to cross-quote from both countries to ensure that you are receiving the most competitive quote.

Miscellaneous

There has been a considerable amount of raw material inflation over the past 6 months as global demand has begun to pick up again, or at least pick up from the low's of the global downturn. Notably, in September, Cotton exceeded $1 for the first time since 1995 on supply concern as the global crops have had a bad year. For garments and textiles, expect to see price increases coming into the Global supply chain as a result, if they have not already.

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Finally, we are proud that the continued efforts by ET2C on behalf of our clients in both Vietnam and China have been recognized. Please refer to our website (www.et2c.com/resources) to read the article.