

The Politics of the Yuan



Jamie Archer-Perkins

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 it is having on trade imbalances and the health of the global economy as a whole. On September 29th 2010, 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) confirms 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 an import tariff of 10% were added on top of that, an estimated 947,000 jobs would be lost in the USA.

Then there is the "Walmart effect" – cheap imports from China actually help the US consumer's pocketbook, increase companies' profitability, therefore encourage 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 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) A number of other countries are arguably "manipulating" their currency. For example, Japan recently completed its first unilateral yen intervention in six years. We can only hope that the West (and the US in particular) learnt its lesson from the Smoot-Hawley import tariffs of the 1930s 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 which were held in mid-October.

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 Jiabao 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 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.

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, labor 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.

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 (which Foxconn has recently done). 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. ■

Jamie Archer-Perkins is a Board member of ET2C International (www.et2c.com), a sourcing company focused on providing clients with transparency of supply chain and maximising the benefits of sourcing from China and Vietnam. Contact him at Jamieap@et2cint.com