China rejects US demands for currency float

Nick Beams
21 October 2003

China's President Hu Jintao has ruled out floating his country's currency, the yuan, or any immediate revaluation. In a meeting with US President Bush on the eve of the Asia Pacific Economic Co-operation (APEC) meeting in Bangkok, Hu insisted that any rapid deregulation of the yuan, also known as the renminbi, would destabilise both China and the international economy.

China has come under intense pressure in recent weeks from the Bush administration, which has claimed that an undervalued yuan is contributing to the US balance of trade deficit and the loss of jobs in American-based factories. This pressure was intensified at the recent meeting of the Group of Seven finance ministers which called for currency values to be determined by "market forces"—a veiled criticism of the actions of both the Chinese and Japanese central banks, which have intervened heavily in currency markets to prevent their currencies rising against the US dollar.

But Hu did not leave Bush officials entirely empty-handed, agreeing to the setting up of an experts' group to examine how quickly China could move toward the establishment of a floating currency.

Earlier he told a meeting of international business executives that "keeping the exchange rate of the renminbi stable serves China's economic performance and conforms to the requirements of the economic development of the Asia-Pacific region and the whole world".

The governor of the People's Bank of China also rebuffed calls for a revaluation and rejected claims that China was responsible for the US trade deficit and the loss of jobs.

"The US trade deficit," he told the official Xinhua news agency, "may be attributable to structural imbalances and fiscal deficits in the United States rather than the renminbi exchange rate. Some people even relate the loss of jobs in some developed countries to the renminbi exchange rate [but] in our view, each country has to face the issue of employment in its presidential election, and what we need to do is to identify first domestic causes for the job losses."

The US calls for a yuan revaluation have come under fire from numbers of international economists who point out that US job losses are not caused by an undervalued Chinese currency and warn that such a move could have major consequences for the international financial system. One of the biggest fears is that a float would set off a series of collapses in the highly indebted Chinese banking system. Furthermore, it is estimated that not even a 30 percent revaluation of the yuan would assist US manufacturers, while adversely affecting US firms with large investments in China.

According to the vice-chairman of Goldman Sachs Asia, Kenneth Courtis: "The idea of China revaluing its currency as a panacea to US trade problems is about as loony as the tariffs on steel last year."

Courtis pointed out that some 60 percent of China's exports are generated by joint-venture companies, many of them involving US corporations.

Morgan Stanley chief economist Stephen Roach has insisted that China is being made the scapegoat for problems which have their source in the US economy and the policies of the Bush administration, in particular the growth in the US budget deficit resulting from tax cuts.

The increasing protectionist calls emanating from US politicians—both Republican and Democrat—cite figures which show that China accounts for the largest portion of the US trade deficit, some $103 billion in 2002 and probably more than $120 billion in 2003.

But further calculations presented by Roach show that this increase in exports is the result of the inflows of foreign direct investment over the past decade and the outsourcing of manufacturing operations by major corporations, many of them based in the US. "[T]he Chinese factory sector," he noted, "has become a critical ingredient in the global supply chain. Fully 65 percent of the tripling of Chinese exports over the past decade—from $121 billion in 1994 to $365 billion in mid-2003—is traceable to the outsourcing dynamic of Chinese subsidiaries of multinational corporations and joint ventures."

The Chicago-based international economic analyst David Hale has repeated a warning made by others that US-China economic relations are being tied into the US political cycle. He told Asian officials and businessmen in Bangkok that "the situation in the US is extremely dangerous" with congressional Democrats and Republicans attacking China.

He said Bush was under pressure because of the "jobless recovery" under conditions where support for free trade within the Republican Party had collapsed. "Much will depend on what happens to US employment over the coming months. If we keep losing jobs, my great fear is that early next year, Karl Rove, the president's political strategist, will say, 'Mr President, it's time for you to join the China bashers'."

Hale warned that if that happened it could trigger a financial crisis as Asian funds, which have been financing the US balance of payments deficits and keeping interest rates low, were withdrawn. This would lead to a rise in interest rates, undermining US consumer spending and the housing market.

Hale's remarks point to the fact that the international financial system is increasingly coming to resemble a house of cards. With slow or non-existent growth in Europe and Japan, the world economy as a whole has become ever more dependent on the US economy—it accounted for some 96 percent of the cumulative increase in world gross domestic product in the period 1995 to 2002. However, this growth has been financed by increasing debt, much of it financed by capital inflows from the rest of the world.

During the investment bubble-boom of the late 1990s, much of this investment was attracted by the greater profit opportunities and capital gains available in the US. But with the collapse of the bubble much of the capital inflow is now emanating from Asian central banks—China and Japan in particular—which are purchasing dollar assets in order to keep down the value of their currencies and maintain export levels.

This mechanism is inherently unstable—the world economy cannot be sustained indefinitely by US growth financed by increasing debt. Consequently, a sudden turn in the situation, resulting from either economic or political factors, such as "China bashing" in the US 2004 election campaign, could rapidly result in international financial turbulence leading to a recession in the global economy.