The changing value of the currency economics essay

Exchange rates are relatively the most common issue that any government are willing to analyse. Except from factors such as interest rate and the inflation, the exchange rate is the most important economic indicators that are more likely affecting the largest economy in the world (Hill 2006). This report is aim to provide an overview of the international currency wars in between China and the US which recently have been highlighted in the medium. The Republic of China is one of those countries which economically called as an “ emerging economy”. This decade has seen the rise of China economy in international trade, according to the World Trade Organisation; it is currently the third largest trading nation (WTO. org, 2010).

In Section 1, graph figure 1. 1 will be analysing the China Yuan against the US$ for the past 12 months starting from 2010 October. Part 2 of the report will be discussing and evaluating the merits of appreciation and depreciation of the Country`s currency related to its economic and business aspect.

Briefly describe (with a Figure, labelled Figure 1. 1 etc with a title, key and source of the data) the path of the currency against the US$ over the past 12 months

Part 2

Figure 1. 1

(Source: yahoo. com/finance)

Table 1. 1

Percentage change Calculation :

1 US$ to China (Renminbi/Yuan) =

02/11/09 = 6. 82890

02/11/10 = 6. 70090

Source: http://www. oanda. com/currency/historical-rates

Percentage change for the past 12 months is 1. 9% decreases of Renminbi/Yuan to US$. In other words, the US dollar has appreciated over the 12 months from November 2009 to November 2010. The reason behind this change as compared to previous months, when the Renminbi/Yuan has remained almost fixed for more than a year is government intervention policy. In the next part of this report, further research will justified this change.

Explain the key factors that have contributed to the changing value of the currency and comment on the relationship of these factors to exchange rate theories.

In 2009, the China Yuan remained more likely constant by floating averagely around 6. 85Yuan to 1$. This constant fixed float have been caused by inflation furthermore The Chinadaily. com (2009) pointed that the National Bureau Statistic measured the rate of inflation in China in November 2009 and concluded the inflation as the major problem in the economy. On the other hand, FT. com (2009) reported that the inflation rate rose by 20% from 1995 to 1995 and this fixed rate anchor has helped china to gain price level stability which lasted until May 2010.

In mid 2010 June/July the Central Bank of China has announced that the increase of Yuan would led to more flexibility, in the same way from July 2010 the exchange rate of the Yuan drastically slumped as a result of government intervention for example; According to Reuters (2010) china has deliberately devalued its currency thus making them having more emphasize on purchasing power parity and world market competition in terms of exports. This debate has been recently discussed during a G20 meeting in South Korea (Reuters, 2010).

In addition, the US have also planned to buy bonds through quantitative easing, all this part of a planned strategy by the Obama Government who were focused for a weaker dollar for hope of more export in the next five years but with the appreciation of the dollar, there are no hope of more exports in the future. (Reuters. com, 2010). To an extent, the decrease of 1. 9% of the Yuan/Renminbi and the appreciation of the US$ might affect directly FDI and MNE`s, in the contrary a dollar depreciation will serve a longer term interest by generating inflation and lessen the debt of the US.

Discuss the relative merits of currency appreciation/depreciation; including the economic and business implications in the country you are looking at.

The value of a currency can vary with time and affect different factors in an economy, either domestically or internationally. Various factors such as inflation, employment rate, balance of payment and GDP (Hill 2006:?) Changes in exchange rates are described as depreciation and appreciations, for instance if the Yuan changes from 6. 68 Yuan per dollar to 6. 58 Yuan per dollar, it shows depreciation (Krugman 2006).

Depreciation will also serve as long term interest by generating inflation and also help in reducing the national debt (Hill 2006). Furthermore a depreciation of a currency for instance China; can add more value to economic terms of a country for example more future prospect of Foreign Direct Investment (FDI) which other words promotes MNE`s to adjust their organisation on a local based operation. Secondly, the public and private transfer payments, thirdly, the house of property might be cheaper for foreign investors who wish to buy land or real estate investments. In brief, if China does not raise its currency, the imports of the country might increase thus leading more deficits in their national debt which is bad for economic growth. To solve the problem an increase in monetary policy with an increase of money supply.

With the introduction of the Quantitative Easing (QE), the value of the currency depresses to those printing money and forces the value of other currency upfront (Salvatores, 2006). Consequently, the Economist (2010) stated that China`s government in mid-2010`s have been printing more money in order to buy bonds thus it shows that there has been a result of quantitative. Further research was mentioned by Krugman et al (2003) who suggested that an appreciation of a country`s currency makes its goods more expensive for foreigners.

In theory, a rise of China currency would benefits the country as the consumers would have more purchasing power, secondly lower inflation rates. To back up this theory, a report from Reuters (2010) indicate that the Chinese governments are planning to raise their currency exchange rate but this could result to an economic downturn in its microeconomic environment such as unemployment and downturn to small businesses and if it happen to appreciate more in the future, it would eventually have a big impact for the exporters. Furthermore, The New York times (2010) argued that China is manipulating its currency by keeping it artificially under-valued as a mean of increasing its exports and boosting its economic growth (NewYork Times, 2010).

On the other hand, a devaluation of the Yuan would benefit multinational corporations (Hill 2006). Multinational organisations have been outsourcing and relying on China for their product and services, a weaker Yuan would help them be more productive for example the case of Nike, apple and others American Companies which have joint ventures with Chinese company for manufacturing their product at cheap reliable price.(Ref)

Conclusion

The battle of currency wars in between the China and the United States are well discussed into the medium, until recently the appreciation of the dollar to the yuan in Mid- 2010 after more than a year of the exchange rate being relatively fixed. This international currency wars might start to be a common practice used by other countries to take advantage of economic downturns of certain countries weaken by recession or economic growth for example countries such as Greece and Iceland. To sum up, China managed to initiate its floating currency which was based on market demand. This mechanism has productively promoted an economic restructuration and sustainable development on leveraging its macro- economic environment (Nexis. com, 2010).