

Us-china external imbalances essay samples

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China-US External Imbalances

Current economic surplus of China was in the focus of attention of economic policy discussion as well as academic studies on external imbalances for over a decade. The core of this discussion is the relationships between the growing trade and the country radical exchange rate regime. Modern economic environment in China is often blamed for taking jobs away and slowing down economic growth in its major partner, the United States. The statistics presented in the Appendix 1 reflect the relationships between the level of the U. S. BoP and global economic crises over the past 2 decades. The reality of the U. S. and China relationships is determined by overconsumption in the United States and overproduction in China. This situation has double effect: financial element of the relationships and trade. First of all, on the financial side, China has reached critical level of the United States debt, overcoming even Japan on this economic indicator. In combination with loose monetary and fiscal policies of the U. S. this relationships created great level of uncertainty about the value of the U. S. external debt (IMF, 2012).

Until recently the picture was quite clear, China was using its large reserve capital mainly in US dollars to control exchange rate, which allowed the country to purchase the U. S. debt. This gave financial liquidity to the U. S. to fund its budget deficit and maintain reasonably low level of interest rates. In 2012, however, Total China deficit for the capital and financial account has reached negative figures, which means that monetary instruments and liquidity of capital situation are endangered. The reality is that China sells out its reserve assets to be able to keep yuan from appreciating (Appendix

1). Low exchange rate for Chinese currency allows growing trade with the U. S. With the current negative BoP, China will lose its flexibility in terms of liquidity condition and monetary instruments, which creates adverse reaction on international market.

The effect of the China-U. S. economic relationships on the economies as well as on global financial market are complex. It is not a secret that undervalued Chinese currency is a sort of financial substitute that keeps China exports to the U. S. extremely cheap. This, undoubtedly creates favorable environment for domestic market in the U. S. that benefits from cheap Chinese products. On the other hand, this situation completely undermines competitiveness of local business. Additional adverse effect is based on the financial impact under the floating exchange rate, whereas undervalued yuan can damage overall export potential of the United States. Overall external imbalances of these countries put a lot of pressure on the international economic environment. Based on the IMF report for first quarter 2013, The speed of yuan appreciation is extremely slow, preventing global economic recovery. The effect of undervalued yuan on China economy is significant as it boost the costs of export and creates even further gap in the country trade balance. Current monetary policy reflects Chinese approach to global economy recovery expressed through growing imports and historical downfall of export levels (Appendix 2).

The U. S.-China external imbalance and China currency policy created concerns on international arena for almost a decade. Even though Chinese currency appreciated against the dollar over the last year, this level is not enough to generate economic recovery. Recent evolution in IMF evaluation

of the state of the Chinese currency shifting from significantly undervalued in 2011 to moderately undervalued in 2013 is a big, but not sufficient step on international scene. There is a clear need for comprehensive economic reforms in Chinese monetary policy to be able to maintain strong commercial relations between the countries and leverage the risk of economic crisis. Should China allow floating exchange rate, it is likely that its level would be considered adequate determined by general market condition. The reality shows, however, this currency policy is a dream of international economic community not considered by China itself.

References

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- Appendix – Balance of Payment (BoP) 1990-2015
- Source: FRED. Retrieved from: <http://research.stlouisfed.org/fred2/graph/?id=BOPGSTB#>
- Appendix 2 – Change in China trade Flow (%)