Managing china’s float

Economics, Macroeconomics

Managing China’s Float Why do you think the Chinese government originally pegged the value of the Yuan against the U. S. dollar? What were the benefits of doing this for China? What were the costs? Over the last decade, many foreign firms have invested in China and used their Chinese factories to produce goods for export. If the Yuan is allowed to float freely against the U. S. dollar on the foreign exchange markets and appreciates in value, how might this affect the fortunes of those enterprises?

By some estimates, the decline of the dollar undervalued the Yuan by as much as 40%. That has allowed China to dramatically increase its exports, but at the same time Chinese import restrictions and other trade mechanisms made it more difficult for foreign exporters to sell their products to China. But a stronger Yuan with, and increased purchasing power, may result in an increase in Chinese firms' investment and expansion abroad. How might a decision to let the Yuan float freely affect future foreign direct investment flows into China?

If China were to abandon its peg, that could result in a slowdown in its exports. That kind of sudden shift in policy could make foreign direct investment less likely to take place in China. Currently, China is an attractive investment destination, but a stronger, and a less stable Yuan could change that. Under what circumstances might a decision to let the Yuan freely destabilize the Chinese economy? What might be the global implications of this be? Do you think the U. S. government should push the Chinese to let the Yuan float freely?

Why? At this point, the Chinese have gobbled up so much of the dollar that they control the largest part of the dollar's reserves. It is foregone that the Yuan will be the reserve currency of this century, so why not let the currency float freely and allow market forces to dictate its value? That way exports from China can be realized at a fairer value and investment can be more fairly distributed to among countries that have equally cheap labor to China and competing resources for FDI. What do you think the Chinese government should do?

Let the Yuan float, maintain the peg, or change the peg in some way? I would think that the Chinese would want to stabilize the Yuan before removing the peg. Their inflation levels have been above 5% over the past two years and given the large supply ofmoneyalready on hand in their financial system, they could see a dramatic devaluation. With the lessons learned from the Asian financial crises of the mid-1990s and the current U. S. bubble that recently burst, the Chinese would be wise to allow the, markets to absorb some of their dollar reserves as a means to stabilize the value of the dollar.