This paper presents a discussion on inflation

This paper presents a discussion on inflation in China and its currency policy. It is imperative first to define the technical term, inflation, and then proceed to analyze various dynamics of inflation in China. The sphere of inflation in China relates to the consumer price index which has recorded a rising orientation in the near past. Economic expansion extending from Australia to South Korea has adversely affected trade and development in China. This factor will be analyzed in-depth.

Furthermore, money supply, M2, plays a significant role in perpetuating higher inflation. Incorporated in the discussion is the price inflation of producers which recorded an upward trend at the beginning of the year. To reduce the adverse effects of inflation, the essay samples out the currency policy as instituted by the Chinese government. Both fiscal and monetary policy instruments are available to be used by government in eliminating inflationary effects.

Inflation in China

A continuous increase in price of common goods including industrial products and raw materials is termed as inflation. The price index of consumers with domestic GDP deflator shows inflation.

Inflation can either result from cost-push inflation or wage pull inflation. For a business experiencing rising cost of production, it has to increase their prices if profits are to be realized (McConnell, 300). Among the reasons why the costs rises is the costly price of imported raw materials. These high costs of raw materials results from inflation in countries that depends on exports of the expensive commodities. A wage price spiral is another element causing inflation in a country. If people are expecting the prices to rise in the future, they will decline fewer wage because they are aiming to protect their real purchasing power. At the beginning of March this year, Inflation in China recorded a level of 2.

4 % (Miller, 23). This was a lower intensity of inflation as compared to 2. 7 % inflation rate in January. An investigation into the consumer price index reveals a rise to 2.

2 % during the first part of the month. Measurement done by the national bureau of statistics details increased price of the producers by 6. 4 % which is likely to cause inflation.

Economies of South Korea to Australia

Rapidly developing economic activities beginning South Korea to Australia is a disincentive to trade in China.

Subsequently economic activity tightens. Countries in the world especially the sub-Saharan countries, are resorting to trade with these developed economies having favorable terms of trade.

Money supply, M2

A measure of supply of money rose by approximately 25 %. The increase was from a new disbursement program of $ 103 billion liquidity resulting from a stimulus package of $ 585 billion (McEachern, 19). Although the stimulus package was aimed at jumpstarting the economy, their side effect is a decline in values of real estate and equity (Krugman 84). Money in circulation has eroded access to businesses and consumers capital. The increase in money supply is not good for the stability of a nation since it creates demand.

High demand for goods and services generate deficits and a subsequent price change. This leads to inflation.

Industrialization and fast growing pace of development

The present trend of industrialization and a fast pace of economic development has pulled many people from their rural place to the urban centers where production of goods and services for exports is taking place (McConnell, 229). The movement into the city center with an aim of assuming city life created middle class (social class) which can access higher wages while consuming in relation to their earnings. This observation has the effect of driving upward the prices of consumer goods and energy due to higher demand. In the same note, its competitive strategy of taking advantage of cheap and readily available labor to manufacture and export more than US and Germany has lead to higher prices of raw materials. If the cost of raw materials expands then the cost of output will be magnified.

The earlier mentioned cost push inflation is likely to creep into the economy. Investment idea in China where steel has a growing demand reduces exports and ultimately increase price in the international market. The expectation here is that local steel manufactures will increase their prices as international price level expands.

Measures to deal with inflation in China

Policy makers in China have increased the requirements for reserve bank to about 15%. This increase reduces the amount of money available for lending by financial institution. It is also in the policy that Renminbi (RMB) will be allowed to appreciate at a higher rate. If the interest rate is increased by the central bank, few people will obtain loans consequently reducing demand in a fast growing economy (Fireside, 30).

A recent observation was a weakening USD whilst the Chinese currency also weakened against the Euro which forced Europe to exert pressure on Yuan to appreciate. A Price control measure is also used by the Chinese government to control increase in prices.

Chinese currency policy

In the year 1949, the communist issued Renminbi with an aim of curbing hyperinflation. A study by McEachern (31) reveals that " The convertibility of renminbi is based only on the current account while it is not convertible on the capital account". It has been the goal of Chinese government to make the currency fully convertible but in view of handling cross border movement of hot money, full convertibility remains a mirage (McConnell, 301). The Chinese currency policy emphasizes on pegging the value of RMB against the USD.

This policy was highly regarded during the financial crisis in Asia since it avoided devaluation competitively. However, the policy was criticized in 2003 when the exports reduced due to a fall in USD. Although the Chinese government was under pressure from US to increase the value of its currency, fear was on exposing local commercial bank to currency crisis. The consequences of revaluating Renminbi are complex in nature. If Yuan appreciates, few treasury bonds from US will be bought consequently raising its price. This will lead to a reduction in US economic development. The subsequent weakening of dollar can have the effect of highly priced oil causing stagnation of the economy. The risk of undervaluing the Renminbi is inflation.

Further damage results from stimulus package in form of more money supply pumped into the economy. It is essential to note that the rate at which Chinese buys is a determining factor in a commodity market. The nature of the Chinese currency makes it the origin of probable world inflation and this has a direct effect on the US economy despite an attempt to regulate prices by the use of Federal Reserve Bank. A study conducted by McEachern (34) in China shows that ‘‘ relationship between Balance of Payment, inflation and the value of currency is strong’’. A body given the authority to regulate value of Chinese currency in relation with other foreign currency notwithstanding its ‘ float’ nature is The People’s Bank of China.

In the year 2007, there was inflation resulting from rising prices of fuel and meat. The response was to allow the value of Yuan to rise.

Conclusion

This essay presented a clear illustration of inflation in the republic of China. First, it recognizes that China was classified among the fast growing economies in the world with the industrial sector taking the lead. Although the nation records a rising GDP, there are inflation factors which are caused by industrialization and the fast pace of growth. To realign this statement, the essay stated vividly the role played by human migration in putting pressure on prices of consumer goods.

Higher wages earned by city dwellers increases their purchasing power consequently creating demand. On the same note, industrialization leads to higher cost of raw materials. The increase in money supply in the economy by 25 % has cumulatively contributed to inflation in China. While the stimulus package was intended to jumpstart the economy, their side effect is a decline in values of real estate and equity.

More money in circulation eroded access to businesses and consumer’s capital. The paper equally addressed policy issues to deal with inflation. On a final note, Chinese currency policy was tackled expeditiously with reference to its nature in the ‘ float’ system.

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