The currency war between china and the united states

China Currency

The official currency of the People's Republic of China (PRC) is Renminbi which means " people's currency" in Chinese. The Chinese currency Renminbi is officially abbreviated as CNY by ISO 4217, but the other abbreviation is " RMB" too. In colloquial language, the Chinese currency is also called Kuai and Yuan.

Exchange rate of the American dollar vs. China's Currency (Renminbi)

During the period from 1994 until July 2005, as per the policy on currency, Renminbi was pegged informally against the value of the United States dollar. This policy helped preventing a round of competitive devaluations during the Asian financial crisis of 1998 and got appreciation. But in 2003, this policy was highly criticized by the United States. The value of the Renminbi fell with the fall in the value of the dollar and subsequently mainland Chinese exports became more competitive. With the intention of encouraging imports, decreasing exports, and preserving manufacturing jobs, the United States started putting pressure on the PRC to increase the value of the RMB. Even the G7 and European Union favoured the re-evaluation of the exchange rate.

The PRC government is concerned that the re-evaluation of the RMB would cause mainland Chinese jobs to disappear. And domestic banks would also be exposed to currency risks without any preparation to handle it. It is believed by many economists, only over the long term, fixed exchange rates or floating exchange rates can be stable. Due to one-time change in exchange rates, speculators may take positions in the future on possible exchange rate fluctuations and it may even lead to completely float the currency.

As per the latest claim of the PRC government, the overall balance of payments of mainland China is not out of balance even if it has a large surplus with respect to the United States.

Path of Chinese Yuan against US Dollar in 2010

http://www. rateslist. com/exchange-rates/chinese-yuan. html

US Dollar to Chinese Yuan (/CNYUSD)

http://moneycentral. msn. com/investor/charts/chartdl. aspx

China’s international Currency War:

A “ currency war” is less of an economic condition and more of a political condition. Governments need to frequently step in their currency markets. They can increase the money supply to stimulate trade and reduce unemployment, or decrease the money supply if required to combat inflation. Currencies don’t rise or fall in a vacuum in an interlinked global economy. When China keeps the Yuan low against the U. S. dollar by artificial means, the cost of Chinese goods will be low in the United States, which contributes to a trade imbalance. And this policy puts the United States in a situation to strike back by lowering its currency as well. This race to the bottom does not benefit either party because two countries can have only one exchange rate.

Devaluation of their currencies by many countries at the same time to make their exports more competitive forces other countries to join in to prevent their currencies from rising. Countries often feel that a currency war is a zero-sum game — one wins and the others lose. But the far-flung devaluation of currencies has an annihilating effect on all. Unstable exchange rates discourage foreign investments and slow down the pace of global economic recovery. Currency wars leads to secondary political effects too because two countries fighting over currency are less likely to agree to bilateral trade.

Reasons for China's Currency war against US Dollar:

Both China and the International Monetary Fund are the culprits for the currency war between Yuan and US Dollar. In a broad view, it is also because Europe refused to reform global economic governance and the United States have been politically mismanaged and self-deceptive for the years.

About a decade ago, China accumulated large amounts of foreign reserves by running a trade surplus. And it intervened to buy up the dollars that was generated by the trade surplus. Such intervention would lead to thrust inflation in most countries where the central bank issues local currency in return for dollars. But China did not follow inflationary consequences because its financial system remains tightly ascertained and the investors are given very limited options.

This gave China the ability to accumulate huge foreign-exchange reserves which is approaching close to $3 trillion now. And its export lobby is trying hard to keep the exchange rate roughly as it is relative to the dollar.

The way IMF handled the Asian financial crisis in 1997-1998, it counteracted emerging-market and middle-income countries. The IMF's executive board comprises of lots of West Europeans and they refuse to consolidate their seats and hence emerging markets have no influence in IMF. Because of this, emerging-market countries want to avoid taking financial support from the IMF in the future and follow China's lead. They also want to ensure that they too run current-account surpluses. This can help to prevent their currencies from value appreciation.

The United States is also responsible for this global economic danger because of currency war, for three reasons. First, most of the emerging markets press to appreciate their currencies growing capital inflows. Similar credit risks in Brazil offers yields around 11 per cent and in the US no more than 2-3 per cent.

Second, because of overconsumption, the US has run huge current-account deficits in the last decade which gives the surpluses to emerging markets such as China.

Third, the net capital is flowing from emerging markets to the US. But the gross capital is flowing from emerging market to emerging market through big banks backed by the US states and the European states.

Economic and Business Implication of China's Currency war against US Dollar:

If Yuan gets appreciated, it would cause the PRC government to buy lesser of United States treasury bonds and subsequently bond prices will fall and bond yields will rise. Finally it will hamper improvement in the U. S. economy. On the other hand, the depreciation of the US dollar would lead to pricing of oil which will be stagflation for the American economy. US oil dependant industries may collapse and lead to massive unemployment and other severe economic consequences.

It can be more critical if the PRC relaxes its controls on short-term investment flows without first introducing exchange rate flexibility. It can lead to large speculative flows and threaten economic stability and orderly world trade.

http://www. foreignpolicy. com/articles/2010/10/14

http://www. rateslist. com/exchange-rates/chinese-yuan. html

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http://www. marketoracle. co. uk/Article23382. html