“China-US Trade: Is It All ‘Yuan’-Way?”

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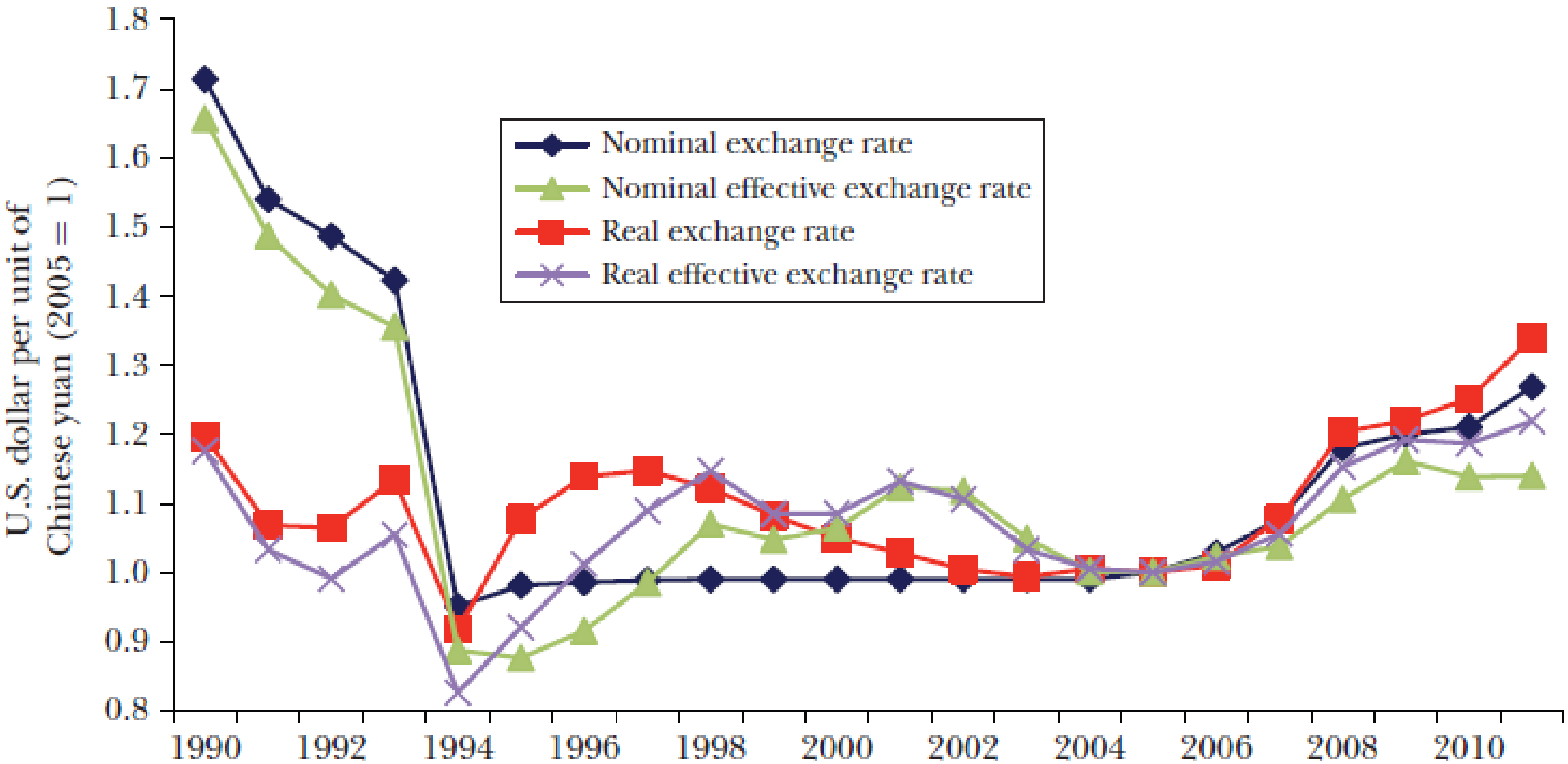
- **China recently became world's largest trading economy, trade being significant factor in its economic growth**
- **1991-2007: US imports from China increased by 1,156% compared to US exports to China which increased by 456%**
- **During 2000s, China's current-account surplus averaged 5% of GDP – similar to share of US trade deficit in GDP**
- **High rate of US unemployment has intensified concerns over perceived impact of China's exchange rate on US economy**

- **Historically, US imports from low-wage countries have been small, but this changed in 2000s**
- **Between 2000 and 2007, share of US imports from low-income countries rose from 15 to 28%, China accounting for 89% of growth**
- **Recent research suggests significant impact on US unemployment and wages in local labor markets with import-competing sectors (Autor et al., 2013)**
- **What has been role of China's exchange rate?**

- **<u>Pre-1994</u>: China maintained dual exchange rate - an official rate (5.77 RMB/$), and rate set in "swap market" (8.7 RMB/$)**
- **<u>1994</u>: two rates unified at 8.7 RMB/$, allowed to rise to 8.28 RMB/$ and pegged – essentially convertible on current account basis**
- **<u>July 2005</u>: a "managed float", whereby peg was relaxed, RMB appreciating 20.8% by July 2008**
- **<u>July 2008-June 2010</u>: exchange rate kept relatively constant at 6.83 RMB/$**
- **<u>June 2010</u>: RMB/$ appreciation resumed, value increasing 10.7% by July 2013**

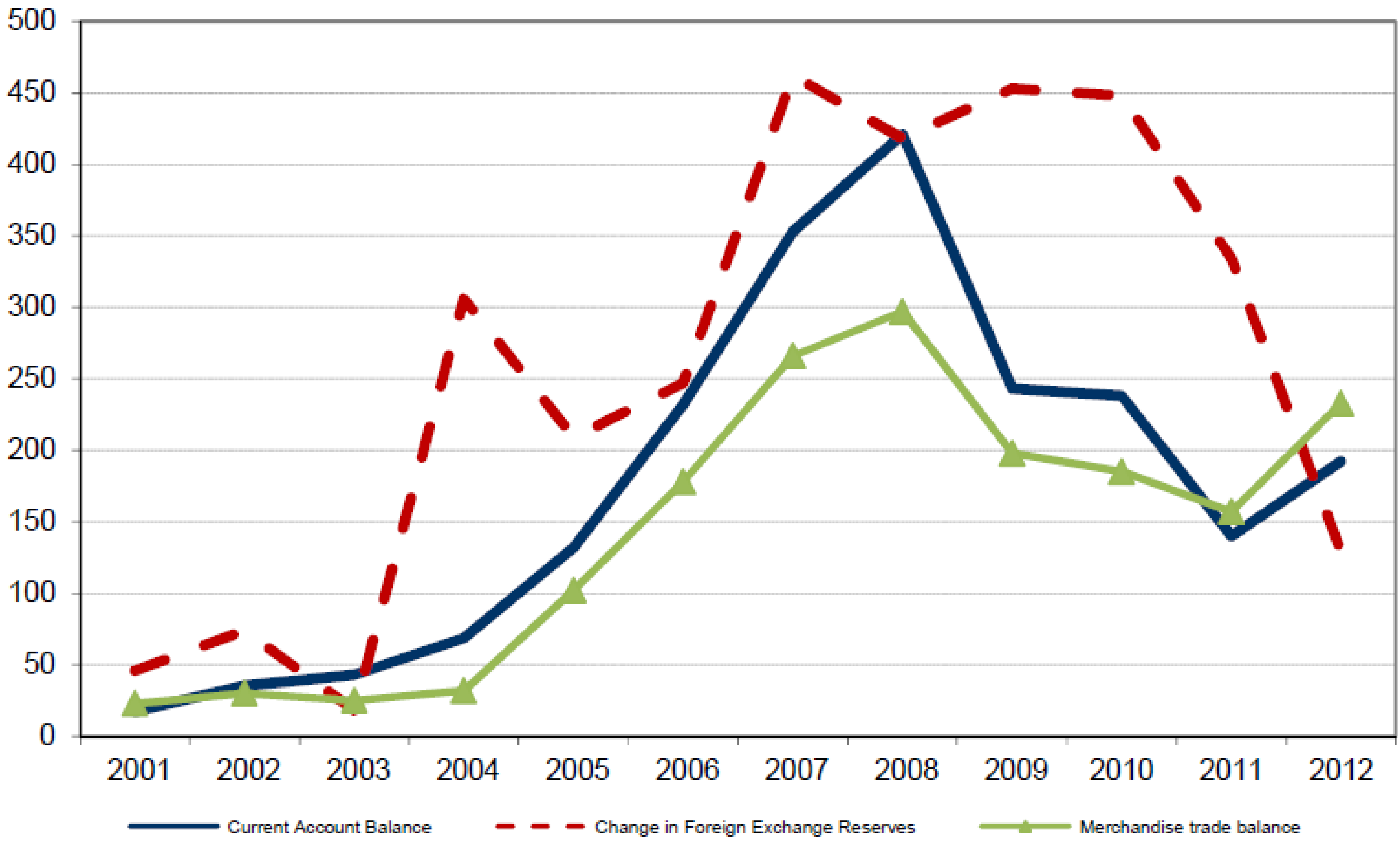
Figure 1: RMB Exchange Rate Against US$, 1990-2011



Source: IMF (2012)

- **Argued China deliberately manipulates currency, resulting in growth of US bilateral trade deficit with China - $325 billion in 2013**
- **Increases in foreign exchange reserves seen as evidence of Chinese manipulation of RMB**
- **Decline in China's trade surplus linked to RMB appreciation, but more likely due to falling global demand and foreign direct investment in China**
- **Nevertheless, some analysts claim US trade deficit and US job losses are correlated – hence, RMB appreciation will boost US jobs**

Figure 2: China's Trade Balance and Foreign Exchange Reserves

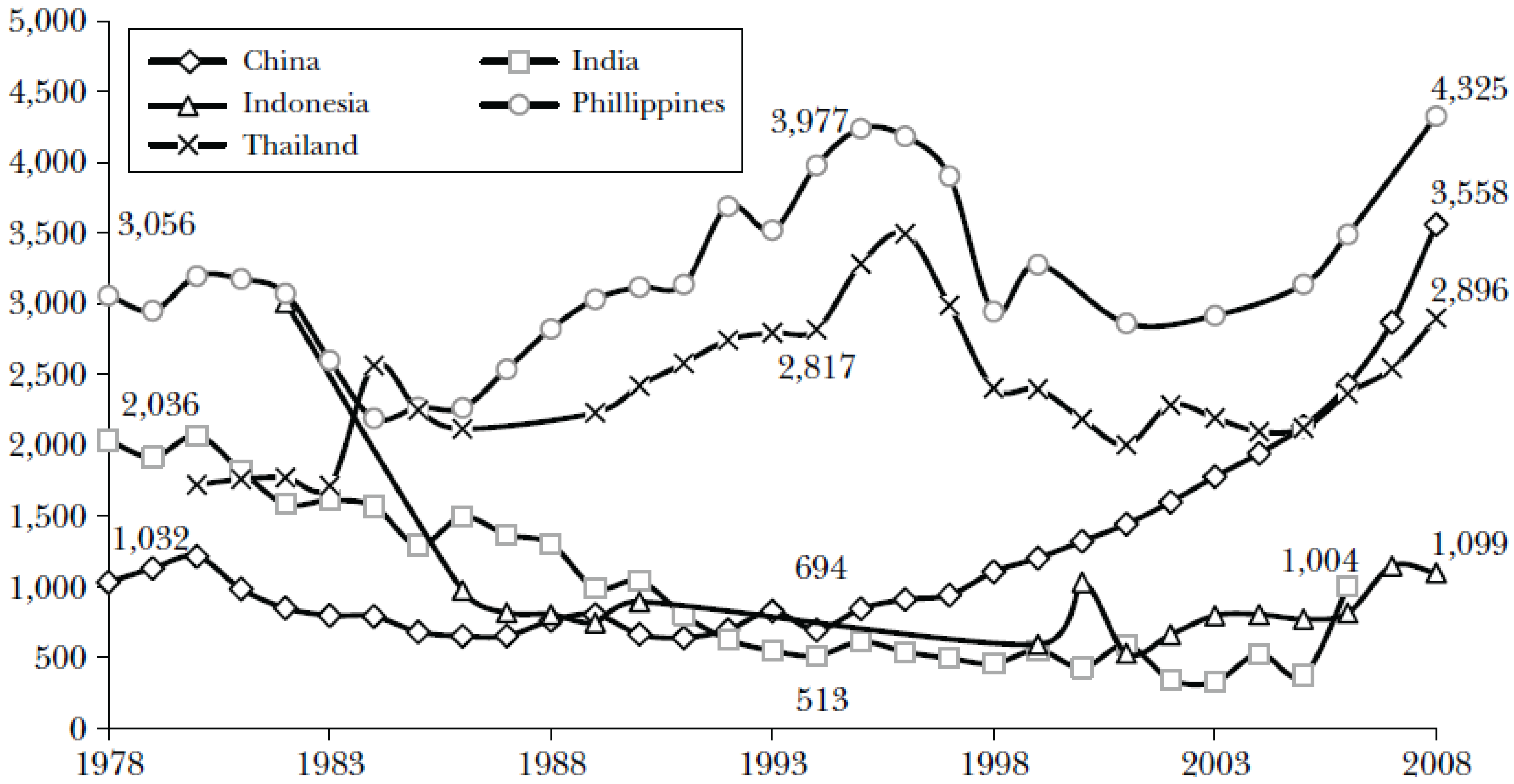


Source: EIU, IMF and CSAFE (2012)

- **Some argue China has managed exchange rate to provide an anchor for its inflation rate**
- **But if RMB is undervalued, common claim it is equivalent to an export subsidy-cum-import tariff**
- **Nominal depreciation only leads to temporary real depreciation - increase in import prices eventually feeds back into higher wages and domestic prices**
- **Hard to detect impact of RMB change on US-China trade: despite appreciation of RMB between 2005-08, US trade deficit with China grew by 30%**
- **So what has driven Chinese exports?**

- **China has competitive edge in labor-intensive industries – shifting over past decade from footwear and toys to electronics**
- **Due to availability of cheap labor, multinational firms have outsourced assembly to China**
- **Foreign-invested firms account for over half of China's trade flows, importing intermediate goods used to assemble final goods for export**
- **Appreciation of RMB in combination with rising Chinese wages may result in outsourcing elsewhere in emerging Asia – but US trade deficit unlikely to decline**

Figure 3: Manufacturing Wages in Emerging Asia (2010 dollars)



Source: Li et al., 2012

- **Overall trade balance a function of difference between domestic savings and investment**
- **Disparity between US and Chinese savings rates means US is a net debtor (trade deficit) and China a net creditor (trade surplus)**
- **US and Chinese contribution to global imbalances unlikely to change with appreciation of RMB**
- **As China's capital account becomes more porous, its ability to manage its exchange rate and target inflation will simply become unsustainable**