

China and the US Trade Deficit: Who Gains from a Rise in the Yuan?

Ian Sheldon

Andersons Professor of International Trade

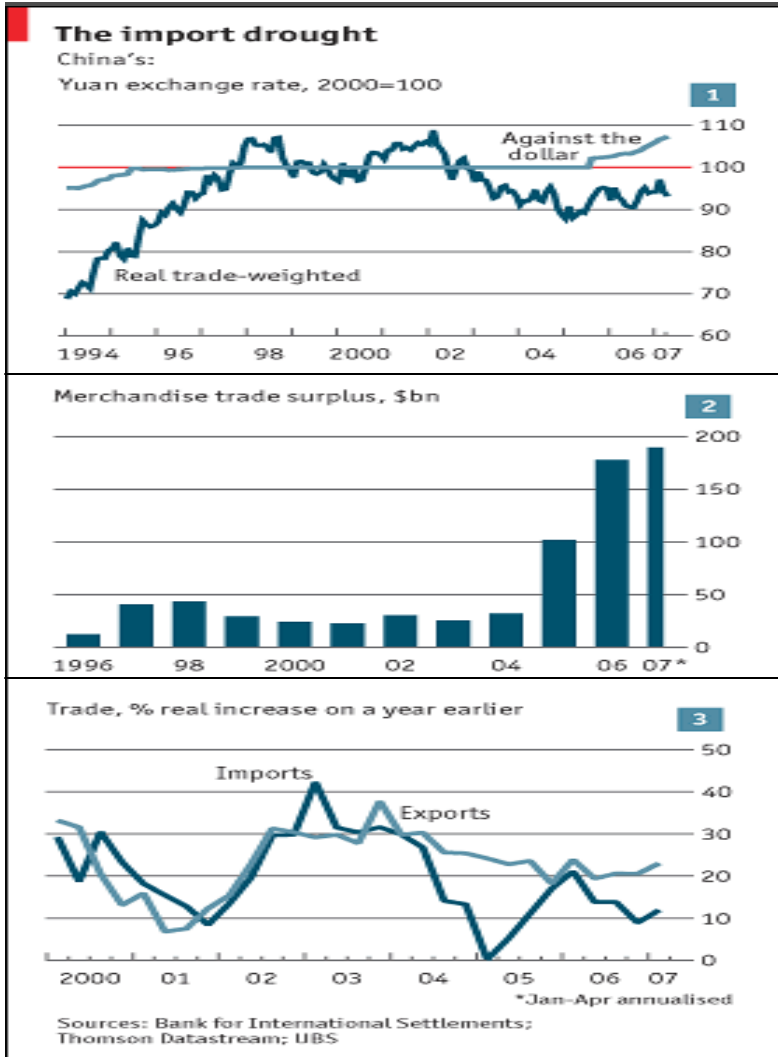
sheldon.1@osu.edu

<http://aede.osu.edu/programs/Anderson/trade/>

***Department of Agricultural, Environmental &
Development Economics***



China's Trade



- ◆ **Growth in merchandise trade surplus**
- ◆ **Rose to \$262 billion in 2007 – 11% of GDP**
- ◆ **Some appreciation of yuan against \$ – 14% since July 2005**

China - US Trade



- ❖ **U.S. bilateral trade deficit with China running at over \$230 billion**
- ❖ **Accounts for almost a third of total US trade deficit**
- ❖ **Members of Congress argue this is due to Chinese “manipulation” of its currency**
- ❖ **Revaluation of yuan will benefit China more than US**

China's Economic Growth



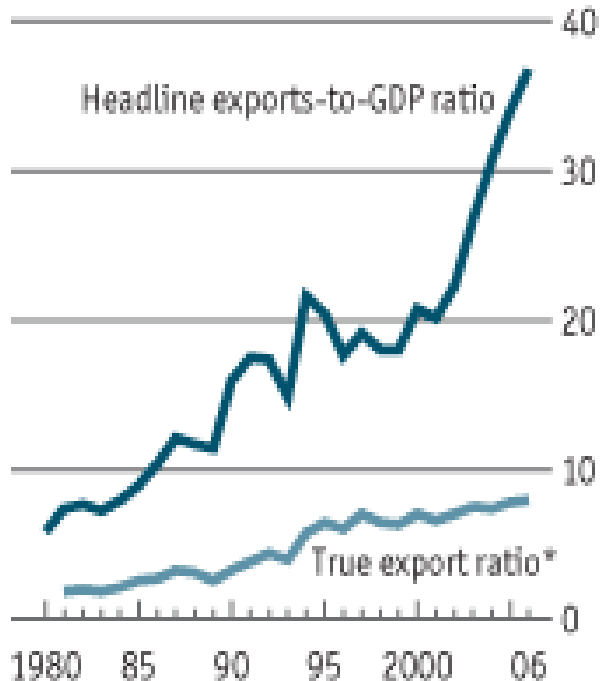
- ◆ **China has grown at 10% a year in real terms since 1978**
- ◆ **Currently world's 4th largest economy, and 3rd largest trader**
- ◆ **Concern among Chinese leadership that growth path is unsustainable**
- ◆ **Outsiders argue it is contributing to global economic imbalances**

China's Economic Growth

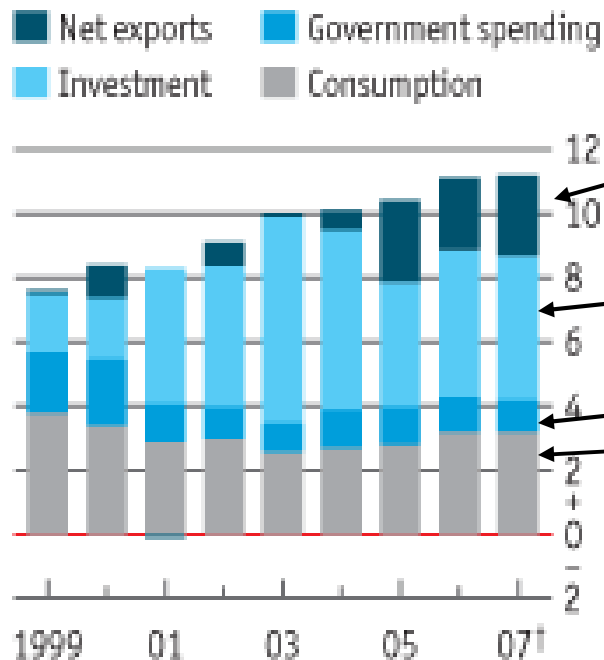


The real export shock

Chinese exports, % of GDP



Breakdown of China's GDP growth
Percentage points



20%

40%

9%

31%

Sources: UBS; Standard Chartered *Value-added share of manufactured exports † Estimate

China's Economic Growth



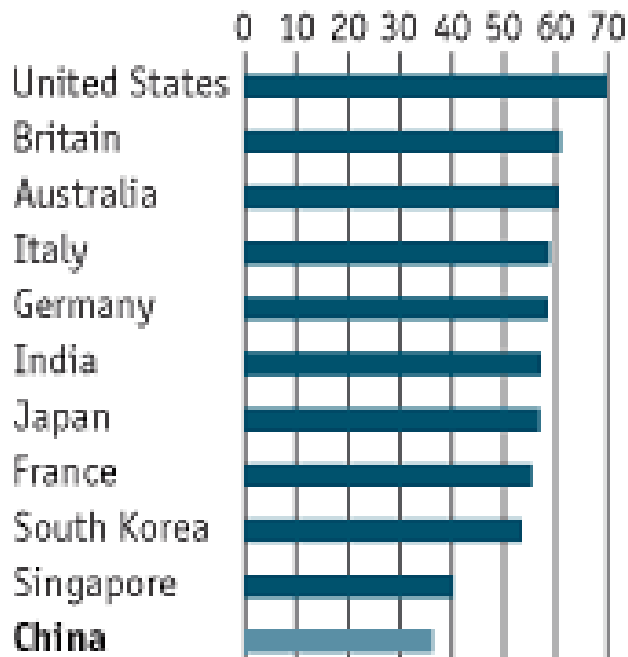
- ◆ **China's growth has largely been driven by investment not exports**
- ◆ **High total savings – 42% of GDP, households (16%), firms (20%), government (6%)**
- ◆ **Chinese consumption very low by international standards**

China's Low Consumption

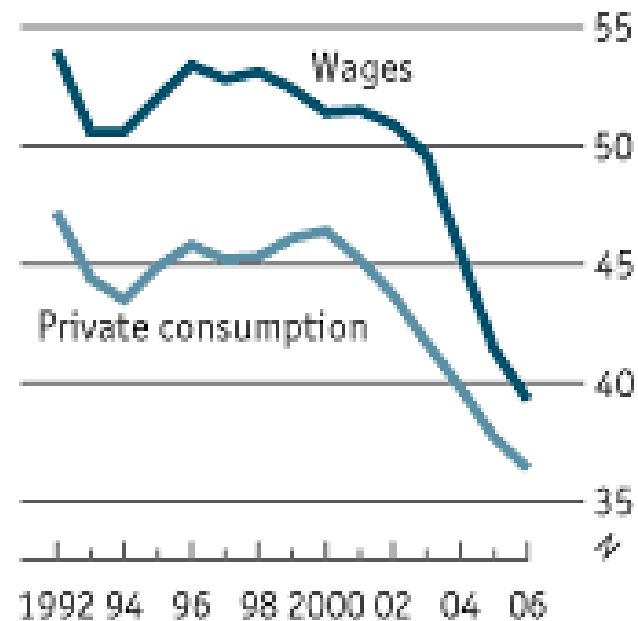


Hey, small spender!

Private consumption as % of GDP
2006



China's private consumption and wages as % of GDP



Sources: CEIC; OECD; World Bank; *The Economist* estimates

Why Rebalance China's Growth?



- ◆ **Low productivity of investment**
- ◆ **Depressed wages**
- ◆ **Rural-urban income inequality**
- ◆ **Regional inequality**
- ◆ **Environmental damage**

How to Rebalance?



- ◆ **Reduce investment**
- ◆ **Fiscal policy to reduce precautionary savings and raise consumption:**
 - **provision of health care, education**
 - **universal pension coverage**
- ◆ **Adopt flexible exchange rate regime**
 - **better able to set interest rates and control inflation**

China's Exchange Rate



- ◆ **Many observers argue yuan is significantly undervalued:**
 - **no improvement in trade balance**
 - **China's foreign exchange reserves continue to grow - \$1.43 trillion**
 - **“sterilizes” inflows by selling low-yielding government bonds/reserve requirements/financial repression**

China's Exchange Rate

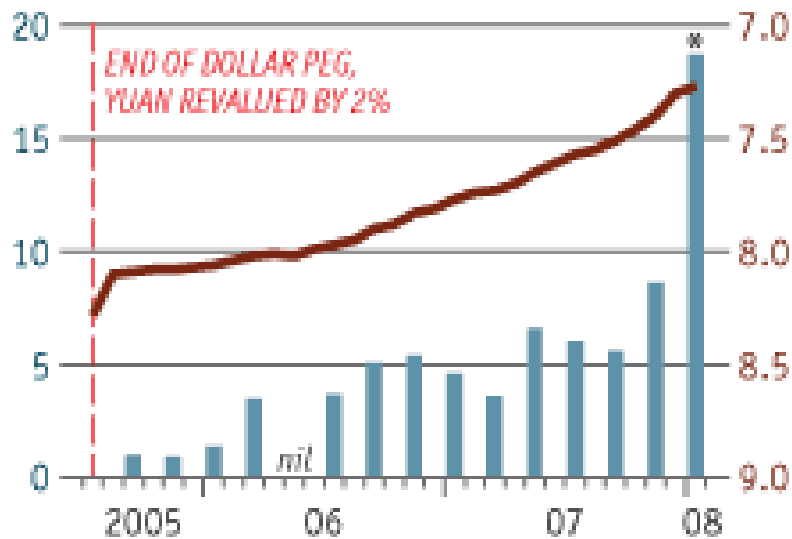


The great crawl of China

The Chinese yuan against the dollar

% rise over two months,
annualised

yuan per \$,
inverted scale



Source: Thomson Datastream *December 1st-January 9th

- ◆ **China allowing faster appreciation – 13% a year**
- ◆ **Increasing inflation – especially imported food/raw materials**
- ◆ **Increasing cost of maintaining yuan due to higher relative yields in China**

US and China's Currency



◇ US Trade Deficit (%)	1985	2004
China	0	24
Japan/Hong Kong		
Korea/Taiwan	52	16

- ◇ China at end of East Asian supply chain**
- ◇ Only 20% of export value captured by China - has trade deficit of \$130 billion with East Asia**
- ◇ 20% appreciation of yuan would reduce US trade deficit by only \$40-55 billion**

China Needs Appreciation



- ◆ **To rebalance growth, has to address external imbalance**
- ◆ **Independent monetary policy**
- ◆ **To get resources out of export sector**
- ◆ **Other Asian currencies will also appreciate – “orderly correction” of US external imbalance**

For Further Information:



- ◇ ***Andersons Policy Bulletin, September 2007, “China and the U.S. Trade Deficit: Why does appreciation of the renminbi matter more for China?”***

Available at:

<http://agecon.ag.ohio-state.edu/programs/Anderson/trade/>