



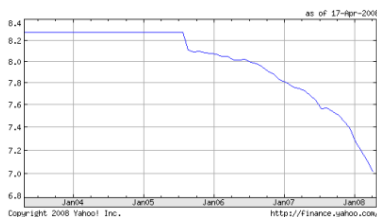
## Getting closer to a revaluation of the Chinese currency?

2009-09-13

Tuesday, July 21st, 2009

After joining the World Trade Organization (WTO), foreign exchange reserves have grown to \$ 2 trillion (2 trillion in European terminology). United States is pushing the Chinese government since 2003 to revalue its currency in order to reduce its trade deficit.

You may not see some American companies welcome this attitude of his government. Some sources estimate that as much as 50% of total imports from this country come U.S. subsidiaries in China.



### Changes in the price of RMB against the USD

Moreover, the impact of a yuan revaluation on U.S. dollar can reduce the purchase of American treasury bonds by the Chinese government resulting in higher cost of interest. Something not very advisable especially at times when the U.S. has injected some 700 billion dollars to save its economy.

The question is: Can China allow a devaluation of American currency?

With the vast reserves that it holds in this currency, China is probably more interested than anyone in the dollar maintaining its status as the reference currency.

On the other side and to the context of generalized crisis in developing countries, China turns its eyes to its domestic market. If, as expected, inflationary pressures begin to loom on the horizon, and given that China also needs to finance internal growth, the fear of importing inflation can give arguments to the Chinese government not to strengthen its currency.

The exchange rate of the yuan vs. the US dollar has remained relatively stable until late 2004. In 2005 it was priced at around 8 yuan per dollar, from that year has been revalued to stand today to 6.86 yuan per dollar.

The two-year economic stimulus plan encryption in 586 billion approved by the Chinese government is in line with the need to maintain growth in the vicinity of 8%.

In the past 30 years, China has staged a success story in fighting poverty through increase in GDP in the first place, improvements in education and increased life expectancy. The average income of a Chinese capita has grown more than 10 times during this period.

However, some shadows threaten these economic plans. Social security covers only 25% of the population that makes families tend to save more to ensure health care.

Environmental degradation, where China has some of the big cities in the top air pollution ranking, is another factor that will require heavy investments in the renewables sector.

The Renewable Energy Plan speaks of installed wind capacity to reach a medium-long term of 1,000 GW (a considerable sum given that the world production today is 120 GW).

The Shanghai World Expo to be held in 2010, is fueled by so-called Shanghai East Sea Bridge Wind Power Plant with a generating capacity of 100 MW.



Will there be decoupling of the Chinese economy of Western countries as some economists predict? 78% of exports to Asia as a whole performs is destined for the U.S., Europe and Japan while interregional trade only accounts for 22%.

If this decoupling does occur, will inevitably be slow but may benefit international growth.

**Ignacio Prieto**

[ignacio.prieto@bwconsultores.com](mailto:ignacio.prieto@bwconsultores.com)