The Chinese Exchange Rate Controversy

A Macroeconomic Perspective

Outline:

- I. The “micro” argument for a trade war
- II. Prima facie counterevidence
- III. Substituting a macroeconomic story
- IV. Does this frame explain imbalances?
- V. Comments and Questions

I. The Microeconomic Story

- The RMB-Dollar XR is “too low”: it has caused a Chinese trade surplus.
- China “pegs” in order to get a trade surplus.
- A 20% RMB appreciation would eliminate the trade imbalance.
- Millions of lost American jobs come home.
- Countervailing tariffs should be imposed.

I. The Microeconomic Story

- The RMB-Dollar XR is “too low”: it has caused a Chinese trade surplus.
- China “pegs” in order to get a trade surplus.
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II. Prima Facie Counterevidence

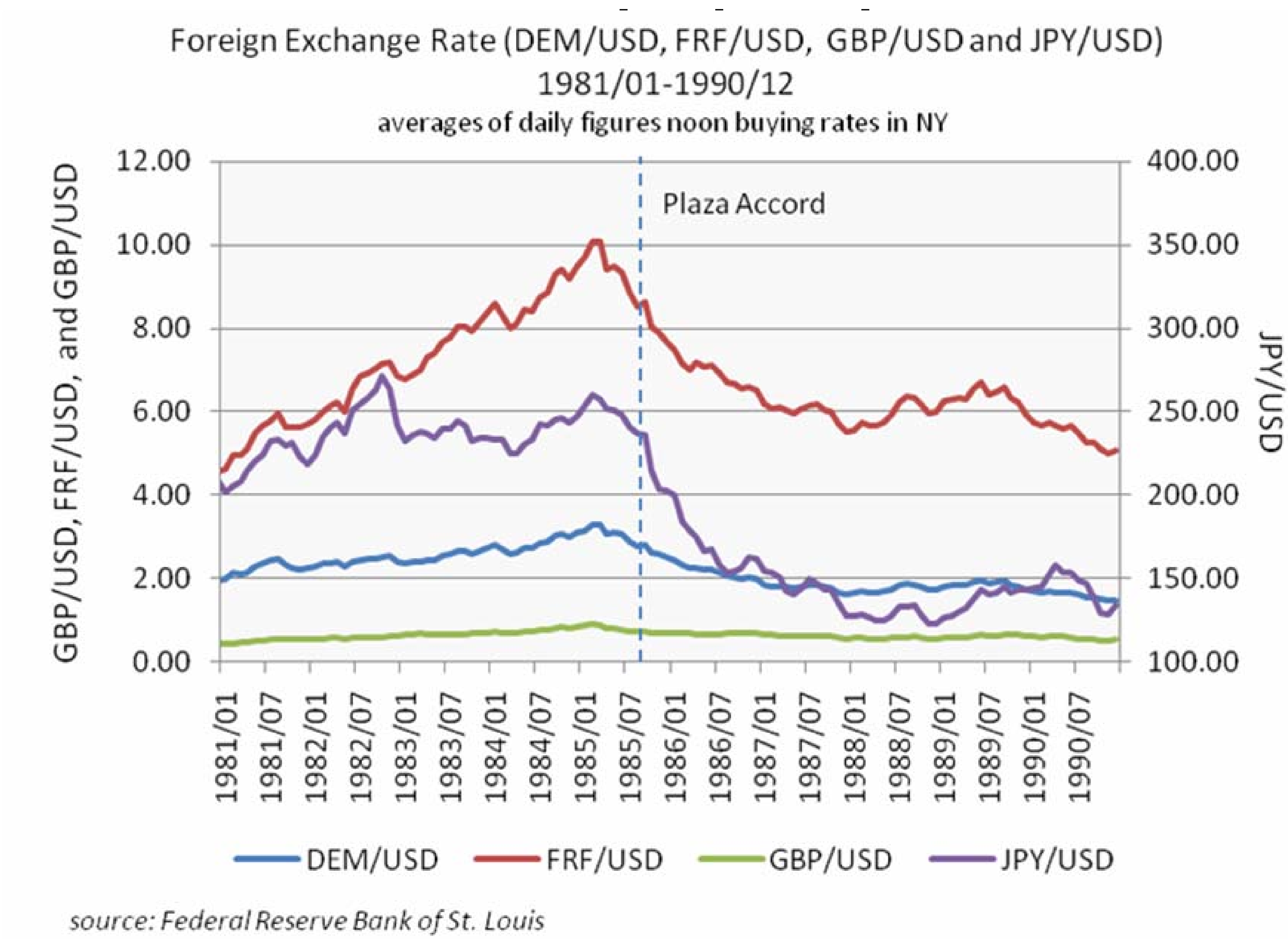
- Plaza Accord (1985-88): US dollar depreciation

- China (2005-2008): Chinese RMB appreciation

Global Imbalances: US and Japan

(3-Year Averages - %GDP)

	Japanese CA surplus	U.S. CA Deficit
1980-82	- 0 -	- 0 -
1983-85	2.8	-2.8



Foreign Exchange Rate (DEM/USD, FRF/USD, GBP/USD and JPY/USD)
1981/01-1990/12
averages of daily figures noon buying rates in NY
GBP/USD, FRF/USD, and GBP/USD
JPY/USD
Plaza Accord
12.00
10.00
8.00
6.00
4.00
2.00
0.00
400.00
350.00
300.00
250.00
200.00
150.00
100.00
1981/01
1981/07
1982/01
1982/07
1983/01
1983/07
1984/01
1984/07
1985/01
1985/07
1986/01
1986/07
1987/01
1987/07
1988/01
1988/07
1989/01
1989/07
1990/01
1990/07
DEM/USD
FRF/USD
GBP/USD
JPY/USD
source: Federal Reserve Bank of St. Louis

Global Imbalances: US and Japan

(3-Year Averages - %GDP)

	Japanese CA surplus	U.S. CA Deficit
1980-82	- 0 -	- 0 -
1983-85	2.8	-2.8
1986-88	3.5	-3.0

China: 2005-2008 Episode

July 2005: China moves to a managed float. RMB appreciates by 20% to mid-2008, is then pegged

Year	CA (China-US)	CA (China-World)
2004	34.4	68.7
2005	41.2	160.8
2006	53.7	249.9
2007	62.9	371.8
2008	69.7	426.1

III. A Bare-Bones Macroeconomic Story

- Capital also flows between countries

Definitions: CA, KA

- The current account (CA) measures the trade **deficit** (imports>exports) or **surplus** (exports>imports).

- The capital account (KA) measures net capital **inflows** (KA **deficit**) or **outflows** (KA **surplus**).

III. A Bare-Bones Macroeconomic Story

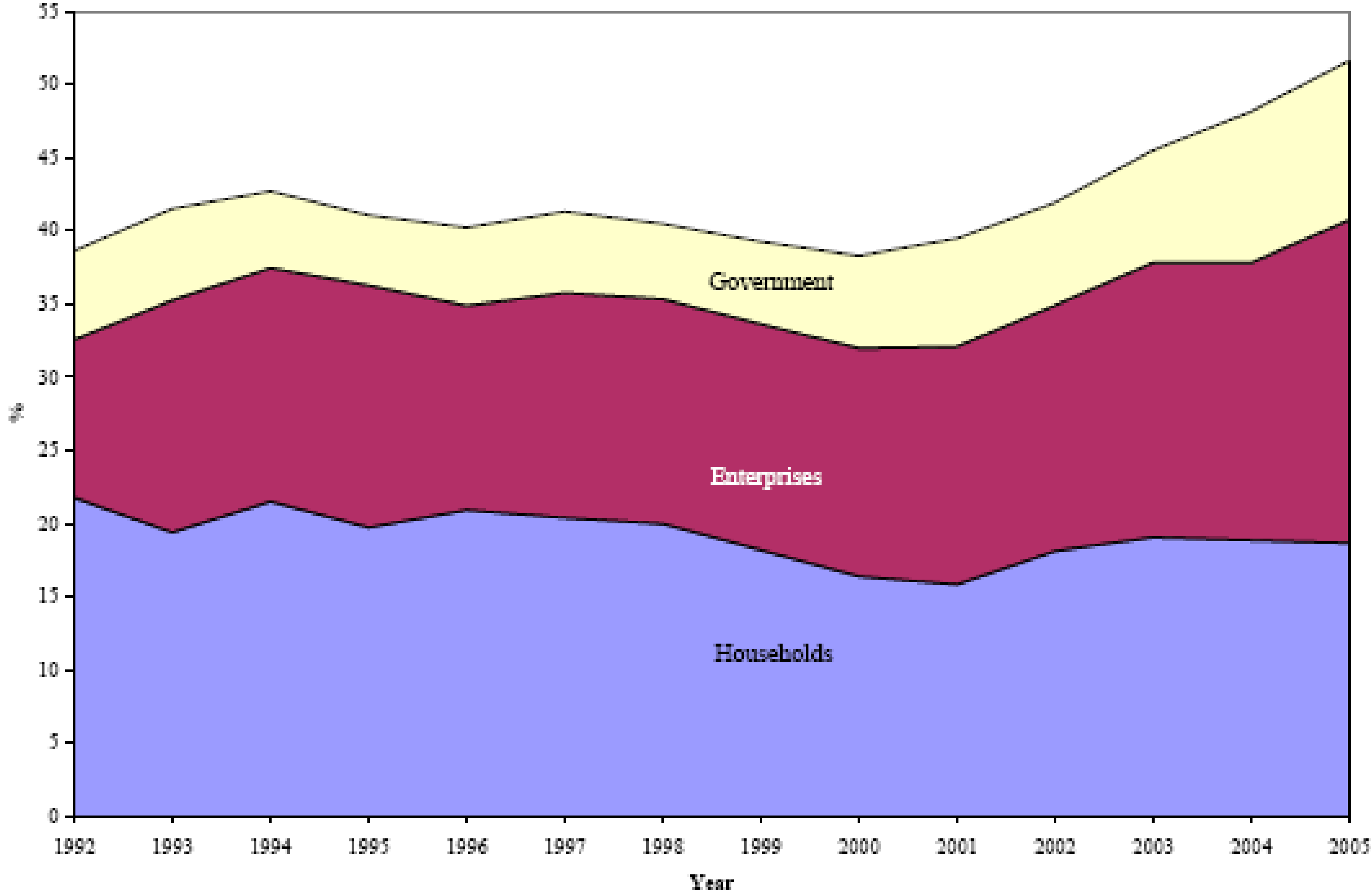
- Capital also flows between countries
- A saving/investment mismatch within one country creates a capital account (KA) surplus or deficit
- An exogenous KA deficit **requires** a CA deficit.
- (They lend us the cash to buy their export surplus.)
- Other important causal factors: changing productivity, fiscal policy, monetary policy.

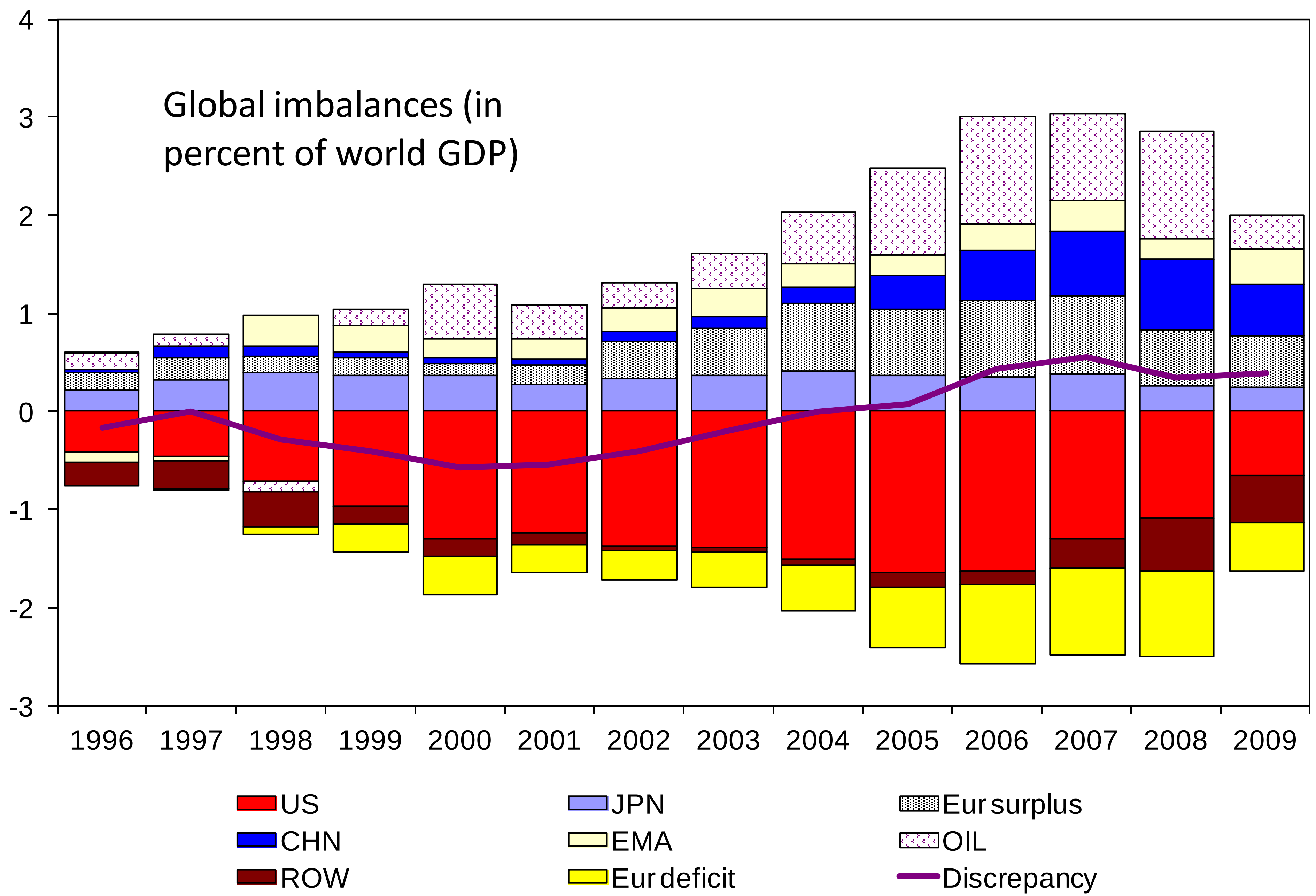
IV. Applying the Macro Frame

- National Saving = $S_{HH} + S_{Bus} + S_{Gov}$
- (S_{Gov} is the fiscal surplus, T-G)
- US: saving $<$ investment; China: $S > I$
- CA imbalances simply reflect these KA imbalances:
- **-** in the U.S., **+** in China

Chinese National Saving

(1992-2005: % of GDP)




Global imbalances (in percent of world GDP)
4
3
2
1
0
-1
-2
-3
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
US
JPN
Eur surplus
CHN
EMA
OIL
ROW
Eur deficit
Discrepancy


Comments, Questions?