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Currency manipulation

Feb 4th, 2011 by Michael Pettis

Posted in Currency regime, Trade war

On Friday the US Treasury released its presumably semi-annual (it was due last October) report to Congress on currency issues, and in it refrained from calling any of the countries under review "currency manipulators." Today's *People's Daily* had this to say :

> *Major trading partners of the United States, including China, did not manipulate their currencies to gain an unfair advantage in international trade in 2010, according to a report released by the U.S Treasury Department on Friday. "Based on the resumption of exchange rate flexibility last June and the acceleration of the pace of real bilateral appreciation over the past few months," China's behavior did not qualify under the official definition of manipulation, the Treasury said in its long-delayed semiannual report to the Congress on International Economic and Exchange Rate Policies.*
>
> *With respect to exchange rate policies, ten economies were reviewed in this report, accounting for nearly three-fourths of U. S. trade. Many of the economies have fully flexible exchange rates. A few have more tightly managed exchanges rates, with varying degrees of management. "No major trading partners of the United States" met the standards identified by the Congress as currency manipulator, concluded the report.*

Perhaps not surprisingly the *Bloomberg* version of the story was a little more nuanced:

> *The U.S. declined to brand China a currency manipulator while saying its No. 2 trading partner has made "insufficient" progress on allowing the yuan to rise. China should follow through on President Hu Jintao's commitments to allow more exchange-rate flexibility and boost domestic demand, the Treasury Department said in a report to Congress yesterday on foreign-exchange markets.*
>
> *The yuan "remains substantially undervalued," according to the report, which was originally due in October and says no major trading partner meets the legal standard of improperly manipulating its currency. "It is in China's interest to allow the nominal exchange rate to appreciate more rapidly."*
>
> *The Obama administration and U.S. lawmakers say China's currency policy gives the nation's exporters an unfair competitive advantage. U.S. concerns have grown as China's rising economic power put the economic relationship off balance. China had a $252 billion trade surplus with the U.S. in the first 11 months of 2010, according to Commerce Department data. "The Treasury will continue to closely monitor" the pace of appreciation, the department said in a statement.*

I know a lot of people in the US and around the world — including some in the Treasury Department itself — were very unhappy (although not surprised) by the report's failure formally to name China a currency manipulator, even while insisting that the RMB is kept artificially low and that this is hurting US manufacturers. It seems hard to see how you can believe one thing without believing the other.

So should Secretary Geithner have called China a currency manipulator? I am ambivalent. It is pretty clear to me that domestic policies within China are at the source of the huge imbalance between production and consumption.

High savings rates rarely have to do with culture or personal preferences, as is widely assumed, and a lot to do with policies that affect the balance between production and consumption. After all a nation's savings is simply its total production minus its total consumption, and to the extent that there are explicit policies aimed at constraining consumption and boosting production, they inevitably affect the savings rate. These policies also inevitably force a rising trade surplus onto the rest of the world.

The RMB has appreciated a scant 3.7% in the past two years. I know many people are arguing that Chinese CPI inflation of 5% should be considered as part of the RMB's real appreciation, but as I argued in my newsletter last week, that would only be true if Chinese inflation affected all input prices equally. If the price of inputs in the tradable good sector rose by less (and most inflation has been in food prices), it is not at all clear that there has been real appreciation anywhere near the CPI inflation numbers.

On that topic I had an interesting email conversation with one of my favorite China analysts, Mark Williams of London-based Capital Economics, who pointed out the following:

> *This talk of real exchange rate appreciation does seems to have become a big talking point recently and is being repeated by people that should know better. One way to cut through confusion about what is the appropriate price measure is to look at export prices. The US produces a quality-adjusted measure of the unit price of goods shipped from China. According to the latest figures (December), China's export prices were up 0.8% y/y in dollar terms. In other words, once currency appreciation is factored in, factory gate export prices in renminbi continue to fall.*

So clearly there is a problem with relative prices and just as clearly it is not being resolved. This suggests that the world may be justified in being angry with China's currency policies. But against that I would make two points.

First, we are in the final period before the change of leadership in 2012. It is widely understood that during a presidential election year in the US we come close to policy paralysis, with no important initiatives. It is less widely understood that in China, similarly, at least one or two years before the succession very little gets done. I think it is unlikely that we will get major moves on the currency, or on anything else for that matter. Once the new leadership is in place they will have to decide on the timing and extent of the adjustment, and I think everyone understands that it is going to be a difficult process. The current leadership won't do it.

Second, I worry that we are focusing too much on the currency while ignoring all the other variables that cause the domestic imbalances in China. If China is forced into a major revaluation, this may simply result in a worsening of the other domestic variables.

It's not just the currency

To explain why, let me turn to an article published in the *New York Times* two weeks ago by Harvard Law professor Mark Wu, about the revaluation of the renminbi. Probably because it was the eve of President Hu's visit to the US it got a certain amount of comment. Although I think I am in broad sympathy with his sentiments, I have to say nonetheless that he repeated two very common fallacies that have been repeated so many times and in so many different places that I think they should be (again) addressed and explained.

In his article Wu said that many American believe a stronger renminbi would create jobs in the US. But, he argues, these claims "are more wishful thinking than actual truths." He goes on:

> *Consider the first idea, that a strengthened Chinese currency would increase the growth rate of American exports to China. From 2005 to 2008, the renminbi appreciated nearly 20 percent against the dollar. Yet, American exports to China over those three years grew at a slightly slower pace than in the previous three-year period when the renminbi did not appreciate at all (71 percent versus 89 percent).*
>
> *This is because many of America's top exports to China are for capital-intensive goods like aerospace and power-generation equipment. Price is but one of several factors for these purchases, along with technology, quality and service. In addition, American companies in those industries are usually competing against European and Japanese firms rather than Chinese manufacturers.*
>
> *…Second, I recently did an analysis of the top American exports to our 20 leading foreign markets, and found little evidence that an undervalued Chinese currency hurts American exports to third countries. This is mostly*

> *because there is little head-to-head competition between America and China. …By and large, we are going after entirely different product markets.*
>
> *…Finally, it is unlikely that a stronger renminbi would bring many jobs back home. Instead, companies would most likely shift labor-intensive production to Vietnam, Indonesia and other low-wage countries.*

His first argument, that if the currency mattered to the trade balance, a rising RMB after 2005 should have caused an increase in the growth rate of US exports to China, is broadly correct only if the wage-productivity growth differential, real interest rates, and credit growth were constant. But they weren't. This is the problem with looking at individual factors within an economy without an overall model that shows the relationship between different factors.

Remember that an undervalued currency creates upward pressure on the trade surplus because it reduces the real value of household income while subsidizing production in the tradable goods sector. This causes production to grow faster than consumption (which is normally constrained by the level of household income), forcing the balance to be exported.

But the wage/productivity growth differential and very low interest rates do the same thing. By constraining the growth of real household income and subsidizing production, they too increase the gap between what is produced and what is consumed.

So raising the value of the currency would only have resulted in a positive impact on trade rebalancing – by reversing the flow of wealth from households to producers of tradable goods – if real interest rates and credit growth had stayed constant and workers wages had kept pace with productivity growth. In fact they moved in the wrong direction after 2005 – making Chinese products more, not less, competitive. As with Japan after the Plaza Accord, policies aimed at unwinding the employment effect of currency appreciation more than compensated for the appreciation.

In other words, the exchange rate appreciation after 2005 may very well have caused a relative improvement in the trade balance between the two countries, but the widening differential between wages and productivity and, more importantly, the reduction in real interest rates and the forced expansion of credit would have had the opposite effect.

So while it is true that China's trade surplus increased after the RMB started revaluing in 2005, that doesn't mean the currency appreciation had no impact. There is a big difference between saying that the RMB exchange rate is not the only thing that matters to the US trade account and saying that the RMB exchange rate doesn't matter at all. The former statement is almost certainly true, while the latter statement violates common sense and nearly all historic precedent.

The rest of Wu's arguments are implicitly based on the second fallacy, that international trade can only settle on a bilateral basis. He says that because there is little overlap between what China produces and exports and what the US produces and exports (a claim about which I have already expressed my skepticism), changes in China's balance of trade will have no effect on the US balance of trade. It can only matter if when China sells one fewer widget to the US or Mexico, American widget makers immediately take up the slack.

This is only partly true. In fact trade almost never settles bilaterally. It settles multilaterally. It doesn't matter whether or not China and the US produce the same thing for currency appreciation to have an affect on the two countries' trade balances.

So even if Wu is right in saying that a revaluation of the renminbi would directly reduce Chinese exports to the US without directly stimulating production in the US, so what? If Americans weren't producing what China used to sell, that just means that the US purchased those products from another country, let's say Mexico.

But aside form the fact that this is not such a terrible outcome for Mexico, it will still affect US production. After all if Mexico suddenly increases its exports to the US by a very large amount, wouldn't that cause Mexican wages, interest rates and the peso to rise. And wouldn't Mexicans begin to import more, from the US for example?

Remember that Mexico's current account (which is mostly the trade account) is exactly equal to the excess of domestic savings over domestic investment. It is hard to imagine that a massive surge in Mexican exports would be perfectly matched, dollar for dollar, by a surge in Mexican savings, and no increase in Mexican investment. Wouldn't Mexican workers consume at least part of their higher income? Wouldn't Mexican exporters increase capacity at least a little? Both of these would cause imports to rise.

How to make Chinese capital goods more competitive

As I have written in the past, in fact Mexico's trade surplus wouldn't change much, and it certainly wouldn't change by the full value of the increase in exports. This means that Mexican imports would rise, perhaps by the same amount as Mexican exports. Those imports have to come from somewhere, and if they didn't come at least in part from the US, the other country that saw its exports to Mexico increase would undergo the same process as Mexico, and its imports in turn would rise, mutatis mutandi, until someone somewhere purchased something from the US.

I would argue that in fact there is a very different reason why the US should not push China so hard on revaluing the currency, and this reason in implicit in my response to Wu's *New York Times* article. What would happen if the US were indeed able to force China to raise the value of its currency faster than China could tolerate?

The good news for China is that raising the RMB shifts income from the tradable goods sector to households, and so lowers the trade surplus. The bad news is that if this happens too quickly, and results in an increase in domestic unemployment, as export companies experience financial distress or move abroad, gross household income might actually decline. The rebalancing would still take place, but it would take place very painfully.

So how would China respond? Almost certainly by stepping up investment and lowering real rates. This effectively shifts wealth from households to borrowers, and allows the capital-intensive sector to take up the slack created by the contracting tradable goods sector (and of course there is a lot of overlap between the two).

So would the world be better off? No, China would be worse off because not only has there been no meaningful rebalancing, but of China's two vulnerabilities, it has exchanged some reliance on the lesser of the two evils (export growth) for greater reliance on the greater of the two (overinvestment).

The US also would be worse off. Not only will there have been no Chinese trade rebalancing, but there would have been a shift in the composition of Chinese trade that would more directly harm the US.

This is because all Chinese exporters would suffer, but at the same time all Chinese capital-intensive industries would benefit. The net result would be a shift in Chinese exports away from labor-intensive exports (shoes, lighters, toys, etc.) and towards capital-intensive exports (steel, ships, chemicals, cars, etc). In other words Chinese exports will become more directly competitive with US-produced goods.

So of course the level of the RMB matters, and of course the US is right to be very impatient with the glacial pace of China's rebalancing attempts, but by focusing only on the currency the US may actually make things worse for both countries.

Back to trade tension

On a related topic Monday's *People's Daily* has this article:

> *China has no need to revalue the yuan for trade reasons, as export growth will slow to a 10 percent this year and its surplus is set to contract by 2015, its trade chief said. Imports from the world's second largest economy will probably grow faster than exports this year, Commerce Minister Chen Deming said at the Davos forum.*
>
> *Chen dismissed calls for China to strengthen the yuan to tackle the trade surplus, and called instead on countries with reserve currencies – a reference to the United States – to prevent their currencies from weakening. "It is not a sound argument to ask China to appreciate the yuan for trade reasons," Chen told Reuters on Friday in an interview during the World Economic Forum in Davos.*

Chen Deming, as Minister of Commerce, has always opposed RMB revaluation, so there is no need to read too much into these statements. But if Chinese imports do rise faster than exports, it doesn't follow that the RMB is not undervalued and that the world is correctly rebalancing.

It may have far more to do with very anemic demand growth in the rich countries. According to the article Minister Chen also said that he "saw little prospect of a currency or trade war, but it was necessary to remain alert over exchange rate tensions."

I am not sure I agree with the first part of his statement. Monday's *Financial Times* had two very interesting, related articles about just that topic. In the first one, it says:

> *Trade tensions between Brazil and China are expected to increase after the Asian country emerged last year as*

the biggest foreign direct investor in Latin America's largest economy. Analysis of data from Brazil's central bank shows that [China](#) accounted for about $17bn of Brazil's total FDI inflows in 2010 of $48.46bn, up from less than $300m in 2009, according to Sobeet, a Brazilian think-tank on transnational companies.

"This is the first time we have had so much investment from China," Luis Afonso Lima, president of Sobeet, told the Financial Times. Exports of commodities, such as iron ore and the "soya complex" of beans, oil and meal, to China helped to keep Brazil's economy afloat during the financial crisis. However, tensions have surfaced after China last year also emerged as one of the biggest sources of cheap imports into Brazil, helped by a surge in the value of the real, which is undermining the competitiveness of domestic industry.

My friends in Brazil tell me that the anger arises from the perception that with all the difficulty Brazil has had in preventing its currency from revaluing excessively, the surge in Chinese investment has made the process all the more difficult. More Chinese investment requires more central bank intervention, and so more monetary expansion.

This hurts partly because of inflationary pressure and partly because a rising real reduces the value to Brazil of its commodity exports and makes it more difficult for Brazilian manufacturers to survive. And that difficulty is the topic of the second *Financial Times* article:

Brazil's new government has warned [of] a looming "trade war" between Latin America's biggest economy and its main trading partners, including China. Brazil has until recently viewed China as a crucial market for its exports and a close ally in the "Brics" club of fast-growing, large developing countries, which also includes India and Russia. But a growing flood of cheap Chinese manufactured goods into Brazil is testing the relationship.

"The relationship with China is important but, from an industrial perspective, it is extremely negative," said a statement from the São Paulo Industrial Federation, known as Fiesp. While Brazil reported a trade surplus with China of $5.2bn last year, this was due to commodity exports, Fiesp said. On the industrial front, imports of manufactured goods from China rose a "devastating" 60 per cent last year. The deficit in manufactured goods was a record $23.5bn, up from only $600m seven years ago.

I am often asked about the shifting balance of global power relations, away from the traditional West and towards the BRICs. I am skeptical. BRICs are a great marketing concept with which to sell emerging market paper, but the idea that they have the same global interests requires that you squint ferociously when you look at them. Four countries with more diverse and even opposed global interests, economic as well as political and geopolitical, it would be hard to find than Brazil, Russia, India and China.

This is an abbreviated version of the newsletter that went out Monday. Academics, journalists, and government and NGO officials who want to subscribe to the newsletter should write to me at chinfinpettis@yahoo.com, stating your affiliation, please. Investors who are clients of Shenyin Wanguo Securities will already receive the newsletter. Investors who are not clients but who want to buy a subscription should write to me at that address.

« How big is Chinese GDP?
Chinese stock markets and European politics »

49 Responses to "Currency manipulation"

1. *on 04 Feb 2011 at 10:37 pm*1*Tweets that mention Buy Online Viagra, Cialis, Levitra » New Levitra -- Topsy.com*

   

   [...] This post was mentioned on Twitter by David Taff and Conduit Journal, MyOddField FX. MyOddField FX said: [mpettis] New Levitra: On Friday the US Treasury released its presumably semi-annual (it was due last October) r… http://bit.ly/fcGsVb [...]

2. *on 05 Feb 2011 at 1:56 am*2*Links 2/5/11 « naked capitalism*

[...] Currency manipulation Michael Pettis [...]

3. *on 05 Feb 2011 at 7:58 am*3*Bob_in_MA*

Michael,

In your outlook, you always assume that the manner and timing of China's adjustment is in the hands of policy makers. But if they don't make the move, don't they at some point have the decision made for them? At some point, don't they hit a brick wall?

Is it just that you see that point still so far off in the future as not to be relevant, or do you see it as avoidable at any point in time with one more pull of a policy lever?

With the recent GDP/investment figures, I believe investment must now north of 60% of GDP (Chanos claims 70%.) Given that no country has ever been in that position before, it seems likely that at some point there will be consequences that none of us now foresee.

4. *on 05 Feb 2011 at 11:46 am*4*RN*

Astonishing.

How is it that China doing whatever it takes in open market purchases to manipulate the value of its currency doesn't count as "currency manipulation"?

Why do we all lie to ourselves like this?

This hypocrisy is truly disgusting.

5. *on 05 Feb 2011 at 11:46 am*5*RN*

(sorry for the double post – looked like the first one didn't take)

6. *on 05 Feb 2011 at 3:23 pm*6*Dennis*

Hi Michael,

Great post as usual I had a quick question. You write "US we come close to policy paralysis, with no important initiatives. It is less widely understood that in China, similarly, at least one or two years before the succession very little gets done," which seems to be pretty logical. However, Victory Shih writes in his book Factions and Finance in China that unlike American elections where after the election there is a clear break between policy making cliques in China it takes several years for the new generation to dislodge the old guard from places of influence and actually carry out new policies — in fact if I remember correctly he suggests that it isnt until the last year or two that the new generation of leadership [or rather its dominant clique] is able to pursue its own policies.
I guess I was wondering whether you explicitly are disagreeing with him?

7. *on 05 Feb 2011 at 4:18 pm*7*Bob_in_MA*

   Michael,

   I came across this Brooking' piece today: "China's Population Destiny: The Looming Crisis"
   http://www.brookings.edu/articles/2010/09_china_population_wang.aspx

   Apparently, it's even worse than previously thought (or, at least what I understood.) Best bit:

   "For Chinese aged 20 to 24, that decline will come sooner and will be more drastic: Over the next decade, their number will be reduced by nearly 50 percent, to 68 million from 125 million."

   Just thought I'd bring it to your attention in case you missed it….

8. *on 05 Feb 2011 at 9:07 pm*8*daniel*

   Just totally awesome post, as usual. I have a couple oddball questions.

   First, so much of what you write seems very common-sensical. But Paul Krugman disagrees. Repeatedly he has castigated China both for not lifting its currency and for taking measures to tighten monetary policy. Is there really such a wide gulf between your views or am I misreading?

   Second, like most economists, your prescriptions seem intended to get the world economy on a steady growth track. But reading this piece I started wondering: with respect to energy usage, food supply and environmental concerns, would a successful "rebalancing" of the world economy to get it back on a steady growth track in terms of average household demand be a good thing or a bad thing? I sort of wonder if economists are so focused on growth that they are missing the bigger picture question of how we can all manage to share this planet without drilling it dry. I suppose economists ignore this larger question because the answer is so unclear.

9. *on 06 Feb 2011 at 12:25 am*9*Michael A. Robson*

   "the idea that they have the same global interests" ultimately they have different resources (wow, Russia? oil and not much else), but we almost look to them as 4 totally different (disparate) avenues for capital growth

   The only overlap I see are Btw Brazil and China. In that sense they compete for resources.

10. *on 06 Feb 2011 at 12:33 am*10*Michael A. Robson*

    "Astonishing.How is it that China doing whatever it takes in open market purchases to manipulate the value of its currency doesn't count as "currency manipulation"?
    Why do we all lie to ourselves like this?This hypocrisy is truly disgusting."

    Why? It is currency manipulation and everyone knows it. The Yuan has never been a freely floating exchange rate, nor has China claimed it to be such. How is this hypocritical? The Chinese Govt (effectively run by economists) has been very smart on this. They're a poor country promoting Chinese exports.

11. *on 06 Feb 2011 at 12:37 am*11*Michael A. Robson*

    "This hurts partly because of inflationary pressure and partly because a rising real reduces the value to Brazil of its commodity exports and makes it more difficult for Brazilian manufacturers to survive"

    Of course they're angry. Competing against China in manufacturing is like competing against Microsoft in OS's. They're competitors, they're bound to be upset.

12. *on 06 Feb 2011 at 4:21 am*12*Sunday links: the technical process Abnormal Returns*

    […] Michael Pettis, "BRICs are a great marketing concept with which to sell emerging market paper, but the idea that they have the same global interests requires that you squint ferociously when you look at them." (china financial markets) […]

13. *on 06 Feb 2011 at 4:37 am*13*RS*

    PROF PETTIS,

    (There was an example of a Canadian-US consortium who were bidding on a GE contract to make wind turbines but instead GE went with a Chinese company even though the prices were the same.)

    In theory the example of the Mexico-US trade model should be right if more things are made in Mexico they should be able to buy more from the United States. However, jobs even with the weaker US dollar are still leaving the US. Even when costs are leveled between the two countries there are environmental and labor laws that make the US unattractive. It would take new trade laws to protect the US worker that simply don't exist or a significant weakening of the US dollar which would raise raw material costs for manufacturers. Is this not right?

14. *on 06 Feb 2011 at 4:45 am*14*RS*

    Please, one more thing, due to NAFTA an increasing number of cars are being built in Mexico for US consumption. If Mexico can build US spec cars is there any other manufacturing jobs that cannot be outsourced to Mexico? Also could not Mexico peg their currency to the US dollar?

15. *on 06 Feb 2011 at 10:15 am*15*RN*

    "Astonishing.How is it that China doing whatever it takes in open market purchases to manipulate the value of its currency doesn't count as "currency manipulation"?
    Why do we all lie to ourselves like this?This hypocrisy is truly disgusting."

    Michael Robson said: "Why? It is currency manipulation and everyone knows it. The Yuan has never been a freely floating exchange rate, nor has China claimed it to be such. How is this hypocritical? The Chinese Govt (effectively run by economists) has been very smart on this. They're a poor country promoting Chinese exports."

    You misunderstood my comment. I probably didn't express it well.

I agree with you. It is as clear a case of currency manipulation as you could possibly imagine. Their stated goal is to keep the currency where they want it.

The hypocrisy is that we don't call it that and do something about it. And by "we", I don't mean you and me, I mean Geithner, Goolsby, Obama, and all the others who could actually DO something about it.

But we DON'T do anything about it. We just let China get away with destroying the US economy job by job. And while China is aggressively subsidizing businesses like clean energy, we the American people, in our infinite wisdom, elect a bunch of brainless ideologues who – far from actually investing any anything useful, like China is doing – just want to cut anything and everything and send all the money to the superwealthy via unending tax cuts.

One could hardly write a story of greater stupidity.

16. *on 06 Feb 2011 at 6:54 pm*16*Judy Yeo*

Prof Pettis

Happy CNY! Nice to see you back in action so early in the new year. Read the same article on the NYT, in fact, believe I posted a link in my comment on an earlier post? Agree with most of your analysis, just one tiny part:

Pettis:Those imports have to come from somewhere, and if they didn't come at least in part from the US, the other country that saw its exports to Mexico increase would undergo the same process as Mexico, and its imports in turn would rise, mutatis mutandi, until someone somewhere purchased something from the US.

From a single party/ country's perspective, yes, it's multilateral. However, when we talk about trade tensions, more often than not we focus on bilateral aspects, figures included. From that perspective, Mark Wu is correct in asserting that a revaluation of the renminbi would directly reduce Chinese exports to the US without directly stimulating production in the US. Your response reminds me of the butterfly effect, interesting but can we honestly attribute the final effect to the innocuous flapping of the wings of a butterfly? Causation and effect are rather tricky things at times like these.

As for BRIC, agree with the "convenient" labelling part. Honestly, when growth partners turn into competition, elbows tend to fly and won't be too surprised when people start getting elbowed in the face.

17. *on 06 Feb 2011 at 7:55 pm*17*Judy Yeo*

Had a quick read over at Yves Smith's site and found this interesting post (http://www.nakedcapitalism.com/2011/02/guest-post-leverage-inequality-and-crises.html) , most intriguing was the conclusion:

'This line of research could be extended to an open economy setting. An increase in lending by high income households would then extend not just to domestic poor and middle income households, but also to foreign households. The counterpart of this capital-account surplus in the foreign country would of course be a current-account deficit. In other words, this approach provides a potential mechanism to explain global current-account imbalances triggered by increasing income inequality in surplus countries.'

Doesn't take a genius to connect the dots. Perhaps the Chinese government would find it more politically and socially acceptable to tackle this aspect of matters when the new guard takes over?

18. *on 06 Feb 2011 at 10:59 pm*18*Rien Huizer*

Michael,

You are probably right. Currency hawks tend to ignore the effect that exporters try to maintain their USD export prices, despite RMB increases and until many more have gone out of business, that may dominate FX effects. Also, the shift towards more advanced production technologies, optimal scale and much greater domestic supply of parts etc, will continue to keep China extremely competitive (with not necessarily the same firms competing in the same industries) and a favorite place for sourcing manufacturing. And the more links in the supply chain are in China, the harder it becomes to compete from abroad and the more pricing power gets ultimately developed. And at that point the exchange rate does not matter too much either, except for domestic monetary policy. For example, we will soon reach the point that carmakers like Volkswagen make more than half their output in China. Just imagine the scale effects available to parts makers. It is not only Chinese firms that fight these trade wars. Incidentally, Brazil should simply scrutinize FDI like Australia does and a pply a national interest test. So part of their trouble is of their own making.

19. *on 07 Feb 2011 at 4:41 am*19*Bomlat*

If the consumption is so low,then how the investment go up significantly?
I mean,if the consumption is high,then it is easy to increase the investment- how now the chinses sconsumption is low,so if the intrest rate suprassion will transfer more savings to the investment sector then the consumption have to decrease by double digit percentage.

I mean,to get a visible bang (10% investment growth) the consumption have to go down by more than 20%.

I don’t think that it will be acceptable.

Actualy,I think that the current inflation is the result of the still-invesmtent friendly politics.
They try to increase the consumption , but without touching the ownership/income distribution problem,and due to that percentage vise nothing change,at least not to the right direction….

20. *on 07 Feb 2011 at 12:14 pm*20*Glen*

1.) Michael, if that was the short post, I would have loved to see the long one.

2.) Did the Treasury Report make any mention that China’s S.A.F.E. is setting itself up to become the all time record holder losses realized? If China is not manipulating its currency, then what the hell is SAFE up to?

21. *on 07 Feb 2011 at 5:12 pm*21*August*

You forget who is really the biggest currency manipulator. It’s not china. China is just following by pegging the yuan to that major manipulated curreny.

22. *on 08 Feb 2011 at 12:07 am*22*Michael Pettis*

Bob, I would argue that as long as there is debt capacity the timing is definitely in the hands of policymakers. You can always borrow and invest to create growth in the short term, which is exactly what is happening. The limit to these things is always debt capacity. Once businessmen or government officials believe that debt levels are too high to be sustained or increased, then they behave in ways that cause growth to collapse. I have no idea however when that limit to debt capacity will be reached. In systems that lack transparency, credibility can be very brittle. In other words it lasts longer than it otherwise might, but when it breaks it breaks very quickly. I am afraid that by the time we start seriously worrying about debt levels in China it might be too late to do much about it, which is why Beijing should begin adjusting sooner rather than later.

23. *on 08 Feb 2011 at 12:07 am*[23](#)[*Michael Pettis*](#)

    Dennis, yes unfortunately Victor is probably right. The beginning of a new administration can be quite difficult as the various factions work to consolidate power, and this can take years, as it seem to have done during the trnaition from Jiang Zhemin to Hu Jintao. The problem with factional systems, as opposed to organized parties, is that they tend to be personalist, and so it is very difficult for leaders to "retire" and for power to be transferred. The US faced this problem in its own early history, when factional disputes quickly became bitter disputes among factional leaders with no chance to opt out and little chance to compromise. As an aside, I just finished Ron Chernow's magisterial biography of Washington, which completely changed my views of (and respect for) George Washington. For anyone interested in US history, in revolutionary transitions, or in political and Great Power history, this is one of the best books of many years.

24. *on 08 Feb 2011 at 12:07 am*[24](#)[*Michael Pettis*](#)

    RN, I am not sure it is any more hypocritical than other policies by Beijing and other governments. The problem is that a system that introduces unsustainable distortions but which worked very well at first becomes increasingly difficult to change, and policymakers in Beijing, like elsewhere, face the same set of difficult short-term versus long-term trade-offs. Like policymakers elsewhere, they usually postpone the difficult decisions until they no longer can.

    Bob, thanks for the link. I read the piece. I would have liked some more hard data, but yes, Feng Wang makes some very worrisome claims, although these are not totally new.

25. *on 08 Feb 2011 at 12:07 am*[25](#)[*Michael Pettis*](#)

    Daniel, I agree with most of what Krugman says. We both agree that raising the RMB is a good thing for China and the world. I am sure he would also nonetheless agree with my warning that the level of the RMB is not the only thing that affects the trade balance, even if it is one of the few things that the US can affect. My only serious disagreement with him is that he assumes that raising interest rates in China will slow demand growth and so is bad for rebalancing, whereas I assume that it will shift demand from investment to consumption, and so is good for rebalancing. It might be arrogance on my part, but I suspect that I could convince him in fifteen minutes. My suspicion is that he has not seriously considered the impact of severe financial repression on the imbalances.

26. *on 08 Feb 2011 at 12:08 am*[26](#)[*Michael Pettis*](#)

    Michael, I don't think China and Brazil compete for resources in any meaningful way. China is a huge importer, and Brazil a huge exporter, of food and non-food commodities. And I don't think Brazil is angry just because they are competitors in manufacturing. They are angry because Chinese intervention in the RMB and in the Brazilian real is artificially forcing up the cost of Brazilian manufacturing products and forcing down the cost of Chinese manufacturers.

    RS, yes, generally in an open economy policies that alter the balance between consumption and production affect employment and the trade balance. Environmental and labor laws are part of that process. Yes, Mexico could peg their currency to the dollar, and they have in the past. But simply undervaluing a currency to get jobs is not a panacea. It distorts the economy and angers trading partners. China does it, but I am not sure Mexico feels they can do it.

27. *on 08 Feb 2011 at 12:08 am*27*Michael Pettis*

 Judy, yes, people tend to focus on bilateral numbers because they are more politically effective, but that can also lead to misleading conclusions, as we see in the Wu article.

 Rien, I think in the second part of your comment you are restating one of the insights in Alexander Hamilton's Report on the Manufactures. As for your comment on Brazil, I am more sympathetic to the Brazilian argument. They could restrict capital imports on the grounds of national interest, but their experiences in the past with controls make them worried about the distortion impact on capital allocation. Rather than blame Brazil for not changing their approach towards something they think sub-optimal, it might be more appropriate to blame countries whose own distortions force Brazil into changing. By the way, if they do start forbidding Chinese investment, I suspect the response in Beijing won't be that Brazil is finally doing the smart thing.

28. *on 08 Feb 2011 at 12:08 am*28*Michael Pettis*

 Bomlat, since consumption and investment are the two sources of demand (domestic private, government, and foreign) if consumption is too low then almost by definition investment is high under conditions of rapid growth.

 Glen, I don't thing whether the Treasury lists a country as a currency manipulator is a function of their true belief. It is really a political decision.

 August, I am not sure if you get your information from hyperventilating commenters on other blogs, but the idea that the US dollar is the most "manipulated" currency is pretty silly. All currencies are to some extent manipulated, but the US dollar is among the least. Even if you include just the existence of domestic monetary policy as evidence of manipulation (which I suspect you are doing without understanding what that means), it is still less manipulated than most other currencies.

29. *on 08 Feb 2011 at 7:09 am*29*Anon*

 I read that China is increasing the minimum wage by some 22% this year. I suppose this will surely add to the prices of exported products of China and reduce further the trade surplus with the US.

30. *on 08 Feb 2011 at 7:11 am*30*Anon*

 Hello Michael, Is US incessant printing of US dollars(QEs) a form of currency manupulation?

31. *on 08 Feb 2011 at 2:05 pm*31*John Erroll*

 Michael, whenever the possible damages to the U.S economy are being recounted by the advocates for labeling China a currency manipulator, they seem to ignore one of the long standing benefits to US from this imbalance. Thanks to this currency imbalance, the US has been able to import deflation for years thus increasing the purchasing power of household incomes in ways that benefit the poor and middle class the most. Upward currency revaluations will effect their purchasing power. There are already projections that higher prices in clothing and other goods are on their way. Higher Chinese inflation levels may well add to the pricing pressures. A couple of years from now we will be looking back wistfully at "those good old days."

32. *on 08 Feb 2011 at 9:21 pm*32*RS*

John Erroll

That is precisely what needs to happen. Savings rates in those populations in the US need to move higher and those people need to move out of the service sector and into manufacturing sector. More jobs (lower incomes?) more even distribution or wealth is what will ideally happen.

33. *on 08 Feb 2011 at 10:46 pm*33*T c*

@John
President Hu put the savings to American people at 600 b over the past decade in his statements during his visit to US in Jan 2011.

34. *on 09 Feb 2011 at 12:06 am*34*Michael Pettis*

Anon1, yes, all other things remaining constant (which they won't) higher wages should feed into export prices, but remember that China is very capital intensive, not labor intensive, so this won't occur to the same extent that it might in other very poor countries. If wages rise while real interest rates decline, as they are both doing now, the main effect will be a shift from more labor-intensive exports to more capital-intensive exports.

Anon2, no, QE2 is simply domestic monetary policy management, and while it may increase high-powered money it seems to be having little impact on overall monetary conditions thanks to lower lending levels at the banks. Certainly there is as of yet no evidence that it is causing dollar inflation. Inflation in the US is much lower than in China. At any rate it is hard to complain that the Fed is creating money without complaining even more that other countries, including China, are creating money at a far more rapid pace. Remember that in order to keep the RMB low the PBoC is constantly creating money and CB bills. This is a criticism that is never seriously made by monetary economists.

35. *on 09 Feb 2011 at 12:09 am*35*Michael Pettis*

John, I disagree that "whenever the possible damages to the U.S economy are being recounted by the advocates for labeling China a currency manipulator, they seem to ignore one of the long standing benefits to US from this imbalance." On the contrary, this is brought up all the time even though it doesn't make much sense. Everyone agrees that the US consumes too much and of course it is equally clear that US unemployment is too high. In that case it is hard to see why a policy by a foreign entity that lowers even further the cost of consumption while raising domestic unemployment is of much benefit to the US. By definition raising the US savings rate must entail increasing production and reducing consumption (at least reducing it relative to the change in consumption).

RS, exactly right. We cannot both raise US savings and lower US consumption costs unless there is a tremendous surge in external demand for US goods.

Tc, it is very generous of him, but when the US proposes instead to reverse the generosity and save money for Chinese consumers, whose income is a fraction of that of the US, Beijing gets angry. It is strange to call it much of a gift when neither the giver nor the receiver wants anything to do with it. By the way the Brazilians, the Japanese, the Koreans and nearly everyone else react with fury when they are forced into receiving that same gift.

36. *on 09 Feb 2011 at 7:25 am*36*anon*

"Certainly there is as of yet no evidence that it is causing dollar inflation. Inflation in the US is much lower than in China"

It is observed that prices of most commodities surged when newly released economic data and majority of economists opinions indicated high likelyhood of QEs (forboth QE1,2) and also US dollars lost substantial values against most other major currencies. Also, many emerging market economy central banks reported significant inflow of hot money soon after each QEs, particularly QE2, and the hot money caused booms in property and stock markets in most of these economies. I think it is very hard to say that the US QEs does not cause inflation. When QEs happen, US dollars being world's reserved currency, it flows and impacts the whole world. The Renmibi at least is control and within the border of China and does not have the same impacts as the excessive US dollar liquidity around the world due to QEs.

37. *on 09 Feb 2011 at 8:26 am*37*Tc*

"Tc, it is very generous of him, but when the US proposes instead to reverse the generosity and save money for Chinese consumers, whose income is a fraction of that of the US, Beijing gets angry"

If one thinks about the impacts of revaluing Renminbi by some 40-50% on the millions of Chinese workers's jobs and lives, it should not be hard to understand why Chinese leaders should be angry at being asked to take action that harm its workers just so to help American workers(which is not at all clear Renminbi revaluation helps in a meaningful ways to create jobs in US). No political leaders (if they were to want to stay in power) would acquiese to the such demand of polical leaders from another country. As I have noted China has not refused to adjust the Renminbi but it has repeatedly agree to continue to reform mechanism to determine value of Renminbi based on economic development in China(just like any country would make decisions based on conditions in that home country first). Surely the market place has seen the appreciation of Renmibi in last 6 months by some 3-4% (and it should be noted that the Renminbi revaluation and other trade surplus reduction and life improving actions like significant raising of wages, general social benefits to the populace, substantial building up of cheap housing, thus freeing more money from savings, all have contributed and continued to contribute to the progressive reductions of its trade surplus. The US is not without blame for the trade deficits it suffers with China because it bans an awful lot of high tech exports to China(which might be US's right but its contribution to trade deficits with China on the part of US should not be dismissed). It should also be noted that China has little trade imbalance with ROW other than with US. On the other hand, US has trade defiits with more than a hundred countries, including China….this is a clear indication to me that US consumes too much …annually 700-800 b in military budgets and wars, excessive social benefits for Americans which US economy could not afford and …who is to blame for all these American troubles?).

Another thing that is puzzling to me is that the western economists keep saying that Renminbi is undervalued by as much as 40-50% but none could show their calculations,be it back of the envelope type or approximation, the excuse being it is too complicated to calculate how much a currency is undervalued but the economists insists it is 40-50%? and China is expected to just accept and agree to revalue 40-50%?

Chinese wages is close to 10 times cheaper than in US and its consumption share of GDP in 2010 is about 36%(compared with US which is close to 70% of GDP) which the Chinese government is aware is too low for both the wage and consumtion and is taking a lot actions in its 12th 5 year plan (already started this year) to rebalance the situations. China's 2010 GDP is closed to 6 thrillion US. If China could increase its consumption share of GDP by some 10%more(translates into about 600 billions dollars in additional annual consumption) over the current 5 year plan, then its trade surplus should disappear. Signs are it is disappearing as the current trends continue.

38. *on 09 Feb 2011 at 8:45 am*38*anon*

@Michael
" Everyone agrees that the US consumes too much.."

As far as I know, if it is certain that US over consumes, then it follows that the overcomption on the part of US forces trade surplus on other countries. In such a situation, the solution is clearly for the US not to over consume. Asking other countries to raise their currency so that their trade surpluses with US would disappear seems not a good solution to me …what if US continues to over consume even more after currency revaluation by trade partners? Signs are US is habitually over consuming.

39. *on 09 Feb 2011 at 10:00 am*39*Glen*

Michael, did you catch Barry Eichengreen's story about the possibility of China to experience the type of upheaval that Tunisia and Egypt are having?

BERKELEY – A strictly economic interpretation of events in Tunisia and Egypt would be too simplistic – however tempting such an exercise is for an economist. That said, there is no question that the upheavals in both countries – and elsewhere in the Arab world – largely reflect their governments' failure to share the wealth……..It may stretch credulity to think that a high-growth economy like China might soon be facing similar problems. But the warning signs are there. Given the lack of political freedoms, the Chinese government's legitimacy rests on its ability to deliver improved living standards and increased economic opportunity to the masses. So far those masses have little to complain about. But that could change, and suddenly.

snip

http://www.project-syndicate.org/commentary/eichengreen27/English

40. *on 10 Feb 2011 at 5:45 pm*40*michael gordon*

Michael:

As usual, a remarkably illuminating post— the best I've read on the huge imbalanced Chinese-American trade-relationship, including the domestic influences (political and economic) that hinder a quick shift away from its reliance on low domestic consumption and on export-led growth to higher household consumption and lower savings rates as components of Chinese GDP.

One query remains though.

In your post, you note rightly that Chines exports are labor-intensive. In your reply, though — no. 34 comment above — you mention in passing that China's manufacturing production is capital-intensive. Do you mean by the latter that mfg. output for domestic use is capital-intensive — say, steel and concrete and oil refining (but surely not agriculture and food-distribution) —but otherwise the labor-intensive manufacturing firms are mainly oriented toward exports?

I'd be grateful for your reply here.

Otherwise, your lucid, to-the-point comments about the need to consider not just relative price changes in the growing Chinese trade surplus with the US — that is to say, the 20%-plus rise in the Yuan/$US after June 2005 and July 2008 (and a slight rise since then) —but also the impact of the gap in real wage/productivity rates of growth, real interest rates, and credit availability for household consumption, are the most convincing explanation I've encountered.

…

Then, too, your brief explanation of what Chinese policymakers would likely do if compelled to revalue the Yuan significantly to the point that its multilateral trade surplus would fall dramatically —- not least, presumably, in its bilateral trade with the USA — is particularly thought-provoking: they'd likely reduce real interest rates and increase domestic investment (however inefficient for overall development much of that increased investment might be, say in real estate), rather than increase real wages and provide more credit for domestic consumption.

Even so, another query prompts itself here. Specifically, if the inflation rate is as high as most Chinese and foreign economists believe it is in China — about double the official rate of around 5.0% now — would a noticeable rise in the Yuan (Rmb) in currency markets be enough to offset the stimulus to faster inflation that a lower interest rate would entail?

..

Thank you again for these terrific posts. Though I'm a retired political science prof (UC Santa Barbara), I find you economic posts full of knowledgeable and thoroughly illuminating light on the developmental path of the Chinese economy and its political causes . . . not to forget the likely fall-out on the overall US-Chinese global relationship, political, power-wise, and diplomatic.

Michael Gordon, AKA the buggy professor (web site)

41. *on 10 Feb 2011 at 9:36 pm*41*Michael Pettis*

Tc, it seems strange to argue that the only two options China face is no revaluation or an immediate 40-50% revaluation. First of all, I am not sure why you think most people are calling for a 40-50% reval of the RMB. In fact it seems to me that most people I know are in the 15-30% range, and I would suggest that many of them have done precisely what you claim no one is doing – showing how they get to those numbers. I would suggest that you read work prepared by economists directly rather than check the summaries in local newspapers. Secondly the revaluation should have been occurring over several years, probably beginning in 2005. Had that happened the employment effect would have been minimal because there would have been time to shift demand from foreigners to domestic households. It doesn't make sense to argue that because Beijing has avoided adjusting for so long, we can no longer ask it to adjust because that would be too painful. For nearly a decade analysts have been arguing that China need tor raise the value of the RMB at least as rapidly as the productivity growth differential, but it refused to do so.

Finally I agree that many in China believe they shouldn't adjust the RMB because it would cause employment problems in China. But the argument form foreigners is that by not adjusting, China is causing employment problems abroad, so your argument that Beijing should do what is in its best interests and ignore the problems it causes abroad is also an argument that the rest of the world should do the same. That could mean imposing trade sanctions on China. I agree that the US is also to blame for its own imbalances, but not because of its refusal to sell high tech products to China. This is an argument that Beijing has been making for a long time for purely political reasons, but the numbers are too small to matter. I would argue that the problem in the US was the way it funded the unpopular war in Iraq, which worsened the domestic consumption imbalance.

42. *on 10 Feb 2011 at 9:36 pm*42*Michael Pettis*

Anon1, the surge in commodity prices started long before QE2 and most people would argue that the biggest factor has been Chinese investment, which is itself linked to domestic monetary and credit policy, as I have argued many times. In that case you might as well argue that excessively rapid Chinese monetary expansion is more to blame for high commodity prices than excessively rapid US monetary expansion. And against which currency has the dollar lost value? I think most people believe that the dollar is on average overvalued because of Asian currency intervention.

Anon2, if I read you right you are actually suggesting, without realizing it, that the US should impose tariffs on China. This would be one way to reduce its domestic overconsumption, just as an undervalued exchange rate is one way for China to create excessively low consumption and high savings. By the way the statement that " it follows that the overconsumption on the part of US forces trade surplus on other countries" is not true. Overconsumption in one country must be accompanied by under-consumption in another. There is no obvious direction of causality. It can flow in either or both directions. What is more, it is always strange to me when people argue that because the US over-consumes, it has no right to intervene in trade. Over-consumption and over-savings are both consequences of intervention. To criticize the US for over-consuming and then to criticize it for taking steps to reduce over-consumption suggests to me that people simply do not understand the process at all.

43. *on 10 Feb 2011 at 9:37 pm*43*Michael Pettis*

Michael, thanks for your kind comments. Actually I didn’t mean to suggest that Chinese exports are labor intensive. SMEs tend to be relatively labor intensive because the cost of capital is high, whereas SOEs and large companies tend to be capital intensive because the cost of capital is extremely low. On average China is very capital intensive. My concern here is how the change in relative inputs will also decide the capital-intensivity of outputs. It is hard to make the calculations very precisely because so many factors affect the outcome, but in the past I would argue that the reduction in real interest rates and the expansion in credit that accompanies the revaluation (both for Japan after 1958 and China after 2005) seemed in retrospect to be far more than would have been required simply to compensate for the revaluation. This just suggests the perhaps-obvious point that policymakers are more likely to over-react in favor of more employment rather than less.

44. *on 11 Feb 2011 at 2:34 am*44*Lin*

Prof Pettis
(Judy, yes, people tend to focus on bilateral numbers because they are more politically effective, but that can also lead to misleading conclusions, as we see in the Wu article.)

A simple question re bilateral numbers etc, your counter point to Mr. Hu is that US may indeed still profit from some other trading partners importing more from US and hence improve the trade imbalance. Wouldn’t the same hold true for China as well, that China by producing & exporting less in some products may in the end also benefit itself with some of its trading partners’ increased buying power due exactly to the same reason you quote ? I mean Mexico can import more things from US, it can also do so from China.

With this mind, are we actually saying that there is no direct relationship between reducing China’s export to US and the improvement of the trade balance between the two ?

45. *on 13 Feb 2011 at 1:49 am*45*T c*

@Michael
“Tc, it seems strange to argue that the only two options China face is no revaluation or an immediate 40-50% revaluation”

[I am not suggesting such. As a matter of fact, China has repeated indicated that China would continue to improve Renminbi rate determination mechanism and adjust Renminbi based on China's economic situation. In the last six months of 2010, the Renminbi appreciated 3.7% against US dollar and it further accelerates appreciating in Jan 2011 to 6.58-59, some 0.6%. Further, the min wage in China is this year raised between 15-20%. Considering China's higher CPI of some 3% over the US, all these would add up to at least 5%rise in Chinese export prices. This trend of course is continuing.]

‘ I would suggest that you read work prepared by economists directly rather than check the summaries in local newspapers’
[i would appreciate a link or 2 where I could see those calculation.

In my opinion, if US seriously wants to pursue the case of Renminbi valuation, then it should officially specify how much undervalued Renminbi is and show calculation to back up the claim. It has been years now with regards to Renminbi value, there is no reason why US authorities could not furnish such details which I think are necessary so that the problem could be specifically pinned point, discussed and addressed, rather than just a vague "the Renminbi is undervalued" and no matter what China does is not enough. What I mean is there is a need to fix the goal posts rather than dealing with shifting ones]

“Finally I agree that many in China believe they shouldn’t adjust the RMB because it would cause employment problems in China. But the argument form foreigners is that by not adjusting, China is causing employment problems abroad, so your argument that Beijing should do what is in its best interests and ignore the problems it causes abroad is also an argument that the rest of the world should do the same”

[I think the US needs to analyse the trade data between China and US and break down the data into products and services which contribute to most of the trade surplus/deficit beween US and China. Some investment banks reports indicated that some 60% of China manufactured products in China were attributed to US MNC factories or OEM in China and exported to US markets. These US MNC products have generally 2-5% margin for the factories in China while the retail prices for those products are few times the import price for the MNC. The pertinent question to ask is "Is 2-5% margin unfairly high..should China revalue such that the busness become untenable and factories closed and job lost?" The benefits to China is jobs and low margin profits while the beneifts to US is cheap consumer prices and huge profits for the MNC at the expense of US jobs. There needs to be a detail study whether the appreciation of Renminbi in reality helps create more jobs in US. I think it is a political call for US leaders whether to forgo huge MNC profits and cheap consumption for American people in order to create more jobs(supposedly)]

“. But the argument form foreigners is that by not adjusting, China is causing employment problems abroad, so your argument that Beijing should do what is in its best interests and ignore the problems it causes abroad is also an argument that the rest of the world should do the same”

[China does not cause employment abroad and in US. Before the sub prime recession, nobody complained about unemployment. You seem to suggest surplus countries take jobs from deficits countries and by corollary, all countries should have balanced trades. I am afraid this is ideal and not practical to acheieve. China however has indicated that it could accept the US proposal of capping trade surplus at under 4% of GDP which unfortunatedly most other G20 countries objected. Please remember there are great many other surplus countires such as Japan, Germany, India, Malaysia, Indonesia, Korea, Thailand, Singapore.....]

46. *on 13 Feb 2011 at 9:44 am*46*anon*

“Anon1, the surge in commodity prices started long before QE2 and most people would argue that the biggest factor has been Chinese investment, which is itself linked to domestic monetary and credit policy, as I have argued many times. ”

[If you watched the market actions over expectation and announcemnts for QE1 and QE2, you would get the answer. You could could ask economists and traders in IBs for confirmation.]

47. *on 13 Feb 2011 at 10:08 am*47*anon*

“Anon1, the surge in commodity prices started long before QE2 and most people would argue that the biggest factor has been Chinese investment, which is itself linked to domestic monetary and credit policy, as I have argued many times. ”

[If you watched the market actions over expectation and announcemnts for QE1 and QE2, you would get the answer. You could could ask economists and traders in IBs for confirmation.]

“In that case you might as well argue that excessively rapid Chinese monetary expansion is more to blame for high commodity prices than excessively rapid US monetary expansion. ”

[If you checked the PBoC annoucements you should note that PBoC has taken actions to limit to gerat extent both M1 and M2 growth. Commodities prices jumped becaused QE's debased US currency and commodities which are traded in US dollars need to go up in prices to make up for the dollar debasement. This actions were reflected in the markets]

“Anon2, if I read you right you are actually suggesting, without realizing it, that the US should impose tariffs on China”

[No, I am not suggesting that. US has annual military budgets of 700-800B. The wars in Iraq and Afghan todate cost more than a thrillion already, plus few hundred thousand lives. I thought it is a no brainer to stop wars in Iraq and Afghan and also to cut military budgets to reduce some US debts and improve traded balance(a Pentagon official testified in Congress last year that some 70% of war budget went to foreign contractors)]

” By the way the statement that “ it follows that the overconsumption on the part of US forces trade surplus on other countries” is not true. Overconsumption in one country must be accompanied by under-consumption in another. There is no obvious direction of causality."

[If US invades 10 countries now and incurs 10 thrillions dollar war expenditures resulting in say 7 thrillion trade deficits for US and same amount o trade surplus on ROW. You are saying this form of overconsumption is not to blame on US?

48. *on 16 Feb 2011 at 5:34 am*[48](#)*Rien Huizer*

    Tc,

    Good comments, but to the wrong audience. You hit the nail on the head here: (hypothetical) US insistence on CNY appreciation (which is not really the official line as you know, do not confuse politicians without responsibility and grandstanding with US policy) would lack foundation. As you knowe official US sources always stop short of hard statements in this respect.

    However, it is a great issue for use by politicians domestically. So do like the PRC gvt does, hear it and pay no attention because it will be inconsequential. It may be in the interest of China, the Us or maybe the world, but there are so many good things, why make an issue obsolete that can be so useful diplomatically, and do so without any political reward..?

49. *on 17 Feb 2011 at 9:32 am*[49](#)*T c*

    Thank you Huizer!

    My concern is that the Renminbi issue plus many more China related issues would make people of US and China very unfriendly to each other and making the world more treacherous in the future.

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- ## Michael Pettis' book