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.

• A 20% RMB appreciation would eliminate the trade imbalance.
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)

<table>
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<tr>
<th>Year</th>
<th>Japanese CA surplus</th>
<th>U.S. CA Deficit</th>
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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

source: Federal Reserve Bank of St. Louis
Global Imbalances: US and Japan
(3-Year Averages - %GDP)

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<td>1986-88</td>
<td>3.5</td>
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China: 2005-2008 Episode

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

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<th>Year</th>
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<tr>
<td>2004</td>
<td>34.4</td>
<td>68.7</td>
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<td>2005</td>
<td>41.2</td>
<td>160.8</td>
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<tr>
<td>2006</td>
<td>53.7</td>
<td>249.9</td>
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<td>2007</td>
<td>62.9</td>
<td>371.8</td>
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<td>2008</td>
<td>69.7</td>
<td>426.1</td>
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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)