# Demanding a higher Yuan is an attempt by developed countries (G-8) to destroy China's growth model

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For someone whose business is exporting made-in-China plush toys to the United States and Europe, Xu Xujin isn't as worried as you might think about the yuan's sudden rise in value against the U.S. dollar.

Competition could be about to get tougher, the foreign sales manager for Xianju Yidu toy manufacturing company knows. The rising currency eliminates some of the cost advantages Chinese exporters like his have enjoyed for the past two years while their country's currency was unofficially pegged to the dollar.

But more interesting to Mr. Xu was that the yuan-denominated savings he'd accumulated through 10 years in the toy business were now worth slightly more – in terms of what they could buy outside China – than they were a day before.

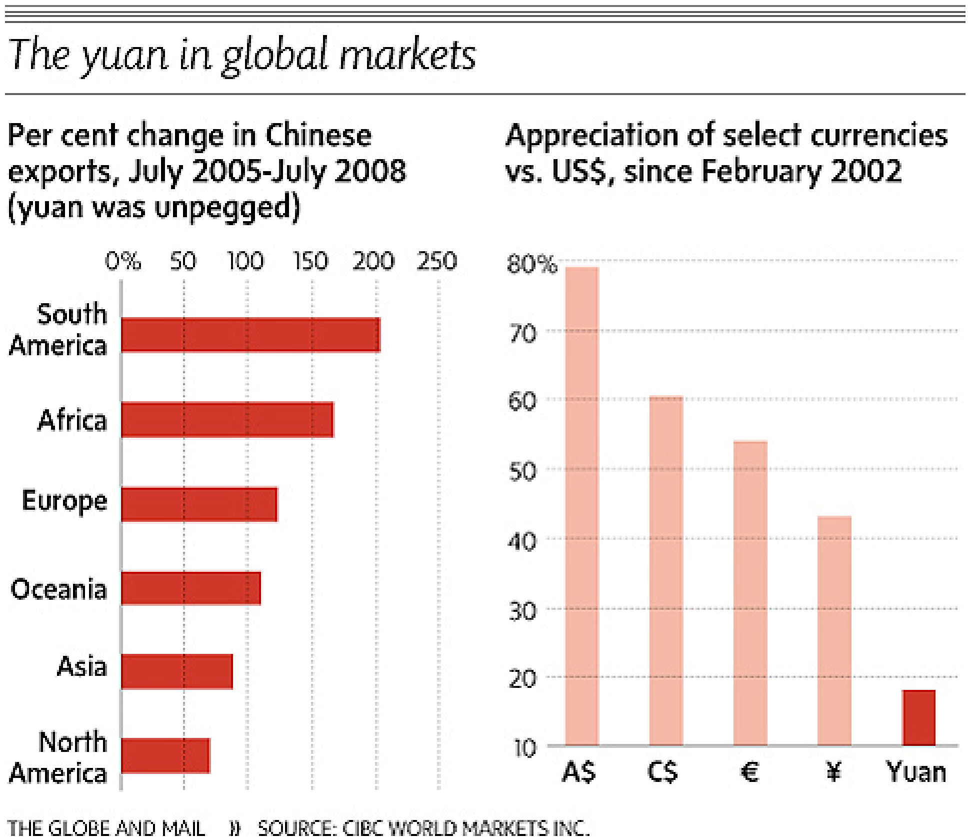
It's exactly the kind of logic that many inside and outside China are hoping will help spur consumption in the world's largest, and perhaps thriftiest, country. There is little else that could do more to rebalance the world's out-of-whack economy than a sudden surge in spending by China's 1.3 billion citizens.

The old model – which sees low-wage Chinese workers with high personal savings rates producing goods for debt-ridden consumers in the United States – no longer works. Nor does a system where China, a country where hundreds of millions still live in poverty, essentially funds the excesses by buying up U.S. dollars and Treasury notes while keeping its own currency artificially low.

But the bad news for those hoping a rising yuan might be a cure-all for China's economy, and perhaps the world's, is that Mr. Xu wasn't about to head out and buy something flashy and foreign with his now slightly-more-valuable savings. "I'll probably just save more or invest a little extra in the business," he said in a telephone interview from District One of the sprawling "International Trade City," an 18,000-stall mega-mall in the eastern Chinese city of Yiwu that is the world's largest market for wholesale goods.

China's currency moved upward in Monday trading, albeit a tiny 0.4 per cent, closing at approximately 6.80 to the U.S. dollar. Nonetheless, that represented a historic shift after the yuan (also known as the renminbi) spent 23 months pegged at 6.83 to the dollar. "It's still a managed float. If it moved in the wrong direction, or moved too rapidly, [the People's Bank of China] would step in," said Ben Simpfendorfer, a Hong Kong-based economist for Royal Bank of Scotland. He forecast a gradual increase of about 2 per cent in the yuan's value over the rest of the year, but no major spikes.

Some exporters are more worried than Mr. Xu, and none are sure that a rising yuan would help them by spurring domestic consumption to compensate for any losses on the export market. Mr. Simpfendorfer and others predicted that some small-scale Chinese manufacturers with low profit margins could be forced out of business as the yuan rises, though medium-sized and larger businesses should be able to withstand the blow.




The yuan in global markets

Low-cost Chinese manufacturers already face rising labour costs as a series of strikes have spread across the country, prompting more than 20 provinces and cities to raise minimum wages.

“Personally, I am very worried about changes to the value of the renminbi, because it is very important to the shoe industry which, as you know, is very reliant on export markets,” said We Yafei, a representative of China’s footwear manufacturers. “To export is easier than selling domestically, because there is so much work and financing required to develop the [domestic] market rather than simply getting the orders out to good partners abroad. During the world economic crisis, some factories turned to the domestic market but when the international business came back they quickly turned back to [foreign] markets.”

While the People’s Bank of China has made it clear that it will allow only a gradual rise in the value of the yuan, the upward move is welcomed by China’s competitors and trading partners, who have long complained that the yuan gave Chinese exporters an unfair advantage, fostering global trade imbalances.

However, China’s state-controlled media emphasized that the central bank decision was based on domestic concerns, not foreign pressure. “Chinese policy makers have sent a clear signal that the country cannot wait any longer to shift away from its heavy dependence on exports for growth,” read an editorial distributed yesterday on the Xinhua newswire, which regularly carries government policy statements.

“It will definitely not be easy for Chinese exporters hit by the double whammy of weak global demand and rising domestic labour costs to adapt to a stronger Chinese currency. Yet, the country’s need to pursue consumer-led growth has made it more compelling for its currency to strengthen, which can increase the buying power of its consumers and help curb inflation by reducing the cost of imported goods,” the Xinhua editorial read.

Convincing more of its 1.3 billion citizens to spend so that domestic demand can replace the country’s reliance on exports has been a long-time goal of the Communist Party leadership. While the country maintained a surprisingly strong pace of growth through the global economic crisis, it has done so largely thanks to a massive injection of public money, which has created concerns about price bubbles in some sectors.

General inflation, especially in the price of some foods, has also recently emerged as a concern. Consumer prices rose 3.1 per cent in May, compared to the same month in 2009, exceeding the government’s target of 3.0 per cent.

Some Chinese analysts were skeptical of the supposed advantages a stronger yuan would bring. Alex Lin, the chief executive officer of ChinaValue.net, a business news website, said most Chinese importers wouldn’t feel any gain from an increase in the yuan’s value since a large portion of what China imports are high-technology parts, which are then assembled in China into finished products for re-export.

Mr. Lin also said he would be surprised to see a sudden rise in consumer spending as a stronger yuan only benefited the minority of Chinese who buy imported goods and travel abroad. For China’s hundreds of millions of rural poor and migrant workers, the high savings rate is a reaction to the country’s weak social safety net – specifically a lack of affordable health care or any kind of pension plan in many parts of the country. Neither problem can be fixed on the money markets.