FAIR CURRENCY COALITION

Media Inquiries: Lloyd Wood•202.452.0866•press@faircurrency.org

Other Inquiries: Charles Blum•202.904.2475•execdir@faircurrency.org

faircurrency.org

FACT OF THE WEEK
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How China's currency defies the laws of monetary physics

One immutable law of "monetary physics" is that when a country runs current account surpluses, the value of its currency must appreciate. Current account surpluses accumulate as foreign exchange reserves, and only a currency correction can prevent destabilizing imbalances in the monetary system. Thus, the only plausible explanation of the failure of China's RMB to obey this law is that the Chinese government has been massively intervening in a sustained manner to prevent the RMB's increase in value relative to other currencies.

China announced that it would allow its currency to begin appreciating against the U.S. dollar in 2005. In that year, China ran a $161 billion current account surplus, a figure larger than the $150 billion surplus of the three previous years combined. According to the laws of monetary physics, China's current account balance should decrease in the years following 2005 if its currency was allowed to trade freely. Instead, China's cumulative current account balance 2006-08 exploded to $1.05 trillion! Even with a collapse in global trade due to the recent financial crisis, China is on pace to run a current account surplus of $268 billion in 2009.

These surpluses prove that the value of China's RMB still is far below where it would be if it were allowed to be traded freely. This unfair subsidy is one of the key reasons why the United States has lost more than 5.5 million manufacturing jobs in the last decade.

The only way to combat the job-destroying unfair trade practice of currency manipulation to change U.S. law to make such activity actionable under U.S. anti-dumping and countervailing duty (CVD) law. That's what H.R. 2378 and S. 1027, the Currency Reform for Fair Trade Act would do and is why the U.S. Congress must pass the legislation without delay.

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