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

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

FACT OF THE WEEK

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RMB PEG FUELS CHINA TRADE SURPLUSES, UNDERCUTS U.S. RECOVERY

MEDIA INQUIRIES: Lloyd Wood
(202) 452-0866 or press@faircurrency.org

The laws of monetary physics hold that when country A runs a current account surplus with country B, country A's currency should rise in value compared to the currency of country B. Trade figures released by the U.S. and Chinese governments earlier this month show that China's RMB peg still is defying this law.

For the twelve-month period from Q3 2008 through Q2 2009, the United States ran a \$294 billion current account deficit with China according to the U.S. Bureau of Economic Analysis (BEA). Instead of rising in value, however, the RMB has remained firmly pegged at 6.8 to the dollar since July 2008 due to persistent, massive intervention by the Chinese government. Factoring in inflation, the pegged RMB actually is declining in value against the U.S. dollar despite China's massive current account surpluses. This peg constitutes an illegal subsidy that gives all Chinese goods an unfair price advantage over their competition. In turn, China's subsidy-induced price advantage fuels that country's trade surpluses and undercuts America's economic recovery.

Year-end 2009 trade figures for goods tell the same story. In 2009, the United States ran a \$226.8 billion trade deficit with China for All Merchandise, including a \$240.1 billion deficit for All Manufactured Goods, according to U.S. government figures.¹

The 2009 deficits are part of a bigger trend. From 2002 to 2009, the United States ran a cumulative trade deficit of nearly \$5.4 trillion for All Merchandise, including almost a \$1.6 trillion deficit with China. China's share of the U.S. trade

¹ U.S. trade deficit data collected from the U.S. Department of Commerce TradeStats Express website for the NAICS All Merchandise and All Manufactured Goods categories.

deficit for All Merchandise has grown annually, rising from 22 percent in 2002 to 45.3 percent in 2009.

For All Manufactured Goods, the deficit figures are even more troubling. From 2002 to 2009, the United States ran nearly a \$3.7 trillion trade deficit for All Manufactured Goods, including a deficit of more than \$1.6 trillion with China. China's share of the U.S. trade deficit in All Manufactured Goods rose continually from 28.5 percent in 2002 to a staggering 75.2 percent in 2009!

These trade deficits, caused in significant part by China's policy of currency undervaluation, represent a U.S. production shortfall that undercuts the U.S. economic recovery. The cumulative production shortfall is a key reason why U.S. manufacturing output was down 2 percent in 2009 when compared to 2002 according to the U.S. Federal Reserve. It is also a key reason why the U.S. employment in the non-farm (-1.064 million jobs), private (-2.159 million jobs), and manufacturing (-4.058 million jobs) sectors was lower in January 2010 than January 2002 according to the U.S. Bureau of Labor Statistics.

Even China's customs data shows that trade with the United States accounted for 72.3 percent of China's trade surplus in All Commodities. It also accounted for 40.2 percent of China's trade surplus for HS Chapters 28-99 (generally all manufactured goods, with some exceptions).

Clearly, the data above paint a compelling picture as to why the United States should take action against China's illegally undervalued currency. If this is not done, it is difficult to see how the U.S. economy can recover. A good first step would be for Congress to pass the Currency Reform for Fair Trade Act, H.R. 2378 and S. 1027, the only WTO-consistent legislation that addresses the subsidy effects of currency undervaluation.

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