China’s miraculous growth in exports

- CA Surplus grew rapidly
  - Since 2000, China’s exports grew at phenomenal 25% annually
  - In 2000, China became the largest contributor to the U.S. trade deficit
  - In 2004, China also surpassed Japan in the world’s share of exports
  - In 2005, the U.S. trade deficit with China is $201.5 billion (27% of total), more than double of Japan’s figure ($82.5 billion)
Trade imbalance issue but this time w/ China (Trade balance in $ millions)

Arithmetic of Global Imbalances

National income identity
- Y = “income”
- Y = C + I + G + (X – M)
- Y = C + S + T

If we combine these two ...
- C + I + G + (X – M) = C + S + T
- I = S + (T – G) – (X – M)

S = Private saving = household saving + corporate saving
T – G = Public saving = tax revenue – gov’t spending
– (X – M) = Foreign saving = – Current account
Arithmetic of Global Imbalances

Current account = “Net saving”

- $CA = (X - M) = (S - I) + (T - G)$
  - Private saving
    - = Household saving
    - + Corporate saving
  - Budget balance
    - = Public saving

- $CA = (X - M) = S^A - I$

Saving and Investment for Big 3

[Graphs showing saving and investment trends for Big 3 countries]
"Global Imbalances"

Source: IMF, WEO, Sept. 2005

Current account and capital account

Exports > Imports = trade surplus
≈ current account surplus

Exports < Imports = trade deficit
≈ current account deficit

“Recycled” in US Treasury Bills
China’s Current Account and IR Holding

Japanese Yen and Chinese Yuan against the US Dollar
China is holding the stake

U.S. Treasuries held by Foreign Countries
As of end of August, 2011 in $ Billions
Total held by foreign countries = 4,572.5 billion (appr. 30% of total debt)

- China, Mainland, 1137, 25%
- Japan, 936.6, 20%
- U.K., 397.2, 9%
- East Asia, 441.9, 10%
- Others, 1423.5, 31%
- Oil Exporters, 236.3, 5%

Foreign Holdings of U.S. Long-Term Treasury Debt

- Other (total - upper 15)
- South Korea
- Singapore
- Germany
- Luxembourg
- Switzerland
- Russia
- Taiwan
- Canada
- Hong Kong
- Carib Bkng Chs. 2/
- Brazil
- Oil Exporters 1/
- United Kingdom
- Japan
- China, Mainland
Macroeconomic reasons for foreign reserves accumulation

- Rising unemployment
- Foreign intervention keeps the economy inflated (= expansionary policy)
- Slow progress in streamlining of SOEs
- Possibility of a rise in NPLs
- Precautionary holding of foreign reserves to be prepared for economic uncertainty and instability
  - Possibly, caused by China’s own policy – financial liberalization
  - Possibly, caused by external factors – another round of global crisis

Macroeconomic argument of the CA imbalances: Return of the “Twin Deficit Argument”

U.S. Budget and Current Account Balances (% of GDP)
Macroeconomic argument of the CA imbalances:

The “savings glut” argument

- Those who run CA surpluses are to be blamed!
  - “Asia, esp. China, saves too much!”
  - Underdeveloped and closed financial markets contribute to high saving and low investment opportunities
  - As China keeps running CAS, it increases its IR holding
  - Heaving FOREX intervention => IR accum. more
  - IRs were invested in US gov’t bonds, contributing to lower long-term interest rates
  - Therefore, the Asian savings fed the housing bubble, and helps the U.S. gov’t to continue running budget deficits → Some blame China for the crisis!

Déjà vu of the pre-Plaza accord period (1981 – 1985)

- Japan is the biggest contributor to U.S. CA deficit
- Japan, with manipulative currency policy, keeps its currency undervalued and keeps dumping exports to U.S. markets
- Japan needs to revalue its currency, and
- develop and liberalize its financial markets, so that
- Japan’s excessively high saving rate will go down, and that
- Japan’s enormous current account surplus will be recycled within the country (or the region), not flowing into the U.S.
The savings glut argument is popular in Washington (2000s)

- **China** is the biggest contributor to U.S. CA deficit
- **China**, with manipulative currency policy, keeps its currency undervalued and keeps dumping exports to U.S. markets
- **China** needs to revalue its currency, and
devlop and liberalize its financial markets, so that
- **China’s** excessively high saving rate will go down, and that
- **China’s** enormous current account surplus will be recycled within the country (or the region), not flowing into the U.S.

Similarities b/w Japan during the early 1980s and China now

Japan in the early 1980s
- CA Surplus grew rapidly 0% in 1981 to 4% in 1985
  - US CA deficit → 0% in 1981 to 3% in 1985
  - J contributed 45% of US trade deficit in 1985

U.S. in the early 1980s
- The White House was hesitant to intervene
  - “strong dollar, strong America”
  - Yen-dollar committee
- Congress became protectionist
  - Gephardt resolution – 20% tariff on Japanese imports unless it corrects its “unfair trade practices”
Plaza Accord in September 1985

- G5 agreed to jointly intervene the FOREX market to guide yen and DM to appreciate
- By 1989, Yen appreciated by 50%
- In 1987, J’s CAS started declining
- Although it did not lead to complete reversal of U.S.-J. trade imbalances, it left a significant impact on international finance in the Asian region in the following years
  - Creation of the bubble economy
  - High yen trend continued till 1995
  - Japan’s FDI increased considerably in the Asian region

U.S. pressures China in a similar way to what it did to Japan

- Some Congress members are protectionist
  - Schumer-Graham bill – 27.5% tariff on Chinese imports unless it corrects its “manipulative currency policy”
  - Grassley-Baucus bill – require Treasury to work w/ IMF to fix the Yuan value
- Presidential candidates try to sound “tough” against China
Second Plaza Agreement?

Fred Bergsten, president of IIE

- “The second Bush administration should take a page from the second Reagan administration and do a midcourse correction”
- China needs to revalue Yuan by 10%
- G7 and IMF should joint the U.S. efforts and achieve China’s alteration of currency policy and coordinated appreciation of other Asian currencies
- If China does not cooperate, there should be sanctions

Possible Impacts of Yuan Appreciation

Benefits

Costs
This is what China wants to say to the rest of the world

- “Don’t blame the bartender for your own alcoholism”
- America needs to change its addiction to consumption!
- The current form of international monetary system is too much reliant on the U.S. dollar
- The Bretton Woods system (1944 – 1972)
- “Triffin’s Dilemma” and creation of SDR
- Claim by Japan and West Germany in the 1960s

A new international monetary system?

- China: The world needs a new international monetary system that is not too reliant on the dollar
- China: The dollar based system yields negative or minimal rates of return!
- China: We should use SDR more, but SDR needs to include Yuan
- ROW: Well, before that, China should liberalize the financial markets!
A new international monetary system?

<table>
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<tr>
<th>Country</th>
<th>Quota millions of SDRs</th>
<th>Quota % of the total</th>
<th>% of votes</th>
<th>% out of total votes</th>
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</table>

China – Slowing down?

- Economic indicators showing signs of slowdown
- The biggest concern is the “shadow banking system”
  - “Financial repression” – interest rates kept artificially low
  - “Wealth management products”
  - Financial liberalization – more fierce competition and thinner profit margins
  - Rise in Non-Performing Loans (=5 trillion?)
Is China’s miraculous growth sustainable?

**Political concerns**
- Another swing of the pendulum?, i.e., another Tian’anmen Sq.?
- Socialist market mechanism??, i.e., can a politically socialist nation have a capitalist economic system?
- Rise in nationalism
- Social unrest related to property rights vs. Gov’t industrial policy
- Corruption

**Economic concerns**
- Income disparity across regions
- Inflation in the real asset sector, i.e., bubble economy?
- Rise in labor cost (among tech.-skilled workers)
- industrial transformation and education policy

**International concerns**
- Rivalry w/ Japan
- Natural resources policy (esp. oil) and other environmental concerns
- Trade war(?) w/ the U.S., EU, Japan, and Korea
- Increase in China's presence in IR