Opinion

Undervalued yuan? Not any more

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Daniel Griswold, Financial Post · Thursday, Jan. 20, 2011

Chinese President Hu Jintau's Washington visit turns the spotlight once again on U.S.-China trade and China's allegedly undervalued currency, the yuan. Not one to let such an opportunity go to waste, U.S. Senator Charles Schumer is introducing legislation that would threaten to impose duties on imports from China if the yuan does not appreciate quickly.

Count me skeptical that a more expensive yuan relative to the U.S. dollar would make much of a dent in our bilateral trade deficit with China, or that it would have any positive effect on U.S. economic growth and employment. But even if those assumptions were true, the big story is how much the yuan has already appreciated against the U.S. dollar.

It has been a mantra of Mr. Schumer and other critics of U.S.-China trade that the yuan is undervalued by 15% to 40%. They were saying that before the 2005 appreciation and they're saying that now, as though nothing has changed.

Yet a lot has changed. In nominal terms, the yuan appreciated by more than 20% between 2005 and 2008. That's when China relaxed its hard peg with the dollar and allowed its currency to gradually appreciate. After holding the peg steady again during the recent financial turmoil, China has again allowed it to rise another 3% since last June.

The nominal rate is just part of the story, however. Price levels in the United States and China determine the real exchange rate -- the actual amount of goods that can be bought with each currency. A big story in China recently is its rising inflation rate, which makes Chinese goods relatively more expensive at any given exchange rate. In this way, a relatively higher inflation rate in China compared with the United States acts in the same way as a nominal increase in the exchange rate of the yuan.

When you combine the effect of rising prices in China with the higher nominal value of the yuan, you get a double boost to the real exchange rate. The real value of the yuan has appreciated by 50% since the beginning of 2005. In early 2005, 100 Chinese yuan could be exchanged for about US$12; today it can be exchanged for US$18 (in real, inflation-adjusted dollars).

Rather than complain, Mr. Schumer and his allies should congratulate themselves on achieving their goal of a much stronger yuan and a much weaker dollar, even if we are still waiting for the tonic effect they predicted it would have on jobs and growth.

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