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PACIFIC BUSINESS NEWS

LATEST NEWS
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China stops tying its money to dollar

Howard Dicus

In a move that could affect business decisions all over the world, China has finally begun to take steps to raise the official value of its currency closer to what economists say is its actual value.

"The move is aimed at easing trade imbalances, boosting domestic demand and increasing Chinese companies' competitiveness," said the Peoples Bank of China, the Chinese central bank.

It will increase the cost of having goods made in China, possibly affecting consumer prices in the United States.

"China's decision may raise the cost of the mega-retailers such as Wal-Marts that purchase inexpensive clothing from China," noted Johnson Choi, executive director of the Hong Kong-China-Hawaii Chamber of Commerce.

For a decade China's currency -- officially called the renminbi but better known as the yuan -- has been officially worth about 8.28 yuan to the U.S. dollar. But as China's economy soared and America's didn't, this made the yuan artificially undervalued. It meant U.S. companies could cut costs and boost profits by laying off American workers and moving manufacturing to China, where they could pay Chinese workers high wages (in yuan) at very low cost (in dollars.) It was a similar story around the world. Hundreds of thousands of jobs disappeared in the Japan, Korea and Europe as companies moved manufacturing to China.

China found itself under increasing pressure to let the yuan float. But the gap between its official and its actual value grew so big that a free-floating yuan would shake up the world economy. China used the specter of that to resist change, not without some support from Western economists. Even Federal Reserve Chairman Alan Greenspan agreed that small steps would be advised. After election year pressure from U.S. Treasury Secretary John Snow, Chinese officials pledged to do something about it but set no timetable.

The action announced Thursday, Hawaii time, was the first public sign that Beijing really intends to act.

What China did neatly solves the problem of how to move in small steps. It still ties the yuan to other money, but instead of the dollar it will be a market basket of currencies, which can be adjusted from time to time to make incremental changes in the yuan's value. This first move effectively resets the exchange rate at about 8.11 to the dollar, roughly a 2 percent revaluation. Malaysia, which has benefited from a similar system of tying local currency to the dollar, announced a parallel move.

(The dollar fell from 112 1/2 yen to a little over 110 yen on the news, increasing buying power for Japanese visitors to Hawaii.)

Chen Zingdong, an economist with BNP Paribas, owner of the parent company of First Hawaiian Bank, called the move "minimal." Korea, Japan and other nations issued statements suggesting they, too, thought the step was kind of small. But not everyone wanted bigger action.

"It's the type of step that you would want to take when you've had a decade-long fixed structure, and so I think they've been cautious, and I think admirably so," Greenspan said Thursday.

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