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THE RENMINBI v. U.S. DOLLAR:
THIS IS WHERE ONE GOES FOR HONEY ?

It is more than likely that the renminbi will appreciate between 20 percent and 30 percent against the US dollar in the coming few years.

That is provided, as some Wall Street gurus attest, that the recession in the US will come to an end in the first half of 2010 or sooner.

(**TARGET** [] does not, necessarily, concur with this prognostication, however. Nevertheless, the translation value of the renminbi vis-à-vis the US dollar is quite likely to rise, markedly, in the next 2 years, in any event, but the amount of the gain will depend on the global economic situation.)

That the renminbi, today, is undervalued, vis-à-vis the US dollar, is almost unquestionable, but the government of the most-populous country of the world seems intent on keeping its currency undervalued as long as is possible.

It would appear to **TARGET** that this policy could return to bite the leaders of the PRC on their proverbial arses, in due course.

The Government of the PRC increased **V**alue **A**dded **T**ax (**VAT**) rebates in order to mitigate the downturn in the country's exports.

This started in November of 2008 and the raison d'être for this move was, inter alia, to promote exports and to counter slowing external demand for goods, produced in the country.

Screams of unfair trade practices were heard from the US and from Europe, with pressure, being brought to bear on Beijing to reform its policy in respect of its foreign-exchange regime.

Nevertheless, the Government of the PRC continues to raise VAT rebates, paid to its manufacturing entities which are exporting goods, made in the country.

The Government of the US continues to pressure Beijing to revalue the renminbi vis-à-vis the US dollar.

But to no avail.

The PRC, as with most other economies of the world, is suffering due to global financial crises as its economic growth levels dwindle.

The annual economic growth rate of the PRC has fallen from about 14 percent in the second quarter of 2007 to about 6.10 percent in the first quarter of 2009.

That is a drop of about 56.43 percentile points in a period of just 9 months.

In the quarter, ended June 30, 2009, the annualised economic growth rate of the PRC was about 7.90 percent.

The Past: Goodbye The Peg

It was in July 2005 that the PRC Government determined to abolish the renminbi-US dollar peg, opting instead to pegging the renminbi with a basket of currencies.

This was not a new idea since, more than 30 years ago, such a concept was known in Europe as *'the snake'*.

The abandonment of the US-dollar peg did little for the translation value of the renminbi whose appreciation was minimal for the next few years.

Then, in 2007, starting from November, the translation value of the renminbi increased substantially against the US dollar.

What the PRC Government did, by careful design, in order to bring about the appreciation in the translation value of the renminbi was:

1. To reduce VAT rebates on a large number of exports; and,

2. To impose restrictions on the export processing regime.

As at June 30, 2009, the PRC's foreign exchange reserves hit about $US2.10 trillion.

Should the PRC permit only a small currency appreciation, during the latter part of this Fiscal Year, and, at the same time, continue to raise VAT rebates, the country is threatened with the Current Account Surplus risk, expanding much too quickly, once again, as was the case in the 2005-2007 Fiscal Years.

The PRC, today, is enjoying an external imbalance that is much greater than it was, say, in 2005.

In 2008, the Current Account Surplus was about $US426 billion.

That compared with its Current Account Surplus of about $US68.70 billion in 2004.

Beijing, today, faces several economic challenges which appear, on the face of it, to be ignored by many people who maintain that the global recession is a thing of the past.

(**TARGET**, definitely, does not subscribe to this suggestion.)

These economic challenges include, inter alia:

- Trying to maintain currency reforms while, at the same time, attempting to use monetary reform as an instrument of macroeconomic management;
- Trying to reduce reliance on investments and external demand in order to sustain economic growth while, simultaneously, increasing demand on services and domestic demand as a viable alternative to reliance of export earnings;
- Trying to defend the present currency regime from thwarting the efforts to strengthen and transform PRC banks into truly commercial corporate entities instead of the present situation whereby Beijing is sworn to prop up the country's banks when needs be such; and,
- Trying to contain protectionism abroad as the buildup of the PRC's Current Account Surplus continues apace.

Beijing cannot afford to be apathetic in view of the challenges that it faces, today, because, by so doing, it will, eventually, distort determinations in respect of investments, domestically.

If Beijing is earnest in trying to promote a more consumer-driven economy, it cannot afford to close its eyes to the distorted situation that exists in the country, today, with regard to the undervalued renminbi vis-à-vis the US dollar/the euro.

If Beijing is determined to maintain an undervalued renminbi, it will come to mean that it will, constructively, (and, perhaps, unknowingly) be offering preferential treatment to some of the most, labour-intensive industries of the country at the expense of expanding services and the industries in the country that Beijing seeks to develop: Beijing sees its future, embracing, inter alia, **I**nformation **T**echnology (**IT**), biology, aerospace, new energy sources, and the technology required to discover new materials.

It seems clear that VAT rebates on exports must be curtailed, if not completely abolished.

If this is not done, then, it will undermine domestic investment since investors would prefer to put their money into manufacturing rather than in the services sector of the economy.

The services sector of the economy has one of the highest potentials for job creation in the future.

Look at the situation in India and The Philippines where tens of thousands of people are gainfully employed in the services sector in centres, established by US and European multinationals.

One of the many drawbacks for Beijing is that an undervalued renminbi permits manufacturers to tend to rely on this situation in order to prop up, artificially, profitability.

It is only too apparent that PRC Government, sooner rather than later, will be forced to encourage and embrace a revaluation of the renminbi against the currencies of its biggest trading partners, the currency of the United States of America, being at the forefront.

By so doing, inter alia, it will endear the Middle Kingdom to its trading partners. No doubt.

It is easier to catch bees with honey than with vinegar: No bees, no honey; no work, no money.

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