CHINA TAKES THE BULL BY THE HORNS

Last week's shock announcement by the **P**eople's **B**ank of **C**hina (**PBC**) (), the Central Bank of the **P**eople's **R**epublic of **C**hina (PRC), to devalue the renminbi by 1.90 percent, rattled investors, round the world.

After the shockwaves had subsided, it appears that many people failed to appreciate the rationale behind the PBC's determination.

The Government of the PRC did not make an official announcement as to the reasoning behind PBC's decision, but anybody with an ounce of sense should have been able to fathom it out.

Among other things, in brief, by devaluing the renminbi, the PBC wants to achieve, initially, the following:

1. Improve export earnings for the country; and,

2. Encourage more consumer spending on domestically produced goods.

For the past year or so, the relatively strong renminbi has caused the economy of the PRC to suffer as the US dollar continued to strengthen, vis-à-vis most '*hard*' currencies: Currencies that are unlikely to depreciate suddenly or whose values are unlikely to fluctuate, greatly, in the short term.

As the US dollar went from one plateau of strength to another, the currencies of many countries with which the US trades tended, de facto, to weaken against the mighty greenback.

In countries, whose economies were having serious problems, of one kind or another, their currencies slid back, some very materially, causing their goods and services to become cheaper in terms of the US dollar.

The PBC has been maintaining the exchange rate of the renminbi to the US dollar for a number of years and, as a direct result of this policy, the effect of the strong US dollar has come to mean that goods, produced in the PRC for export, have become more and more expensive, compared with the currencies of quite a number of other countries.

As the US dollar made more and more gains against various hard currencies, the PRC found itself in a predicament from which there appeared to be no immediate solution.

The renminbi, up to the middle of the week, ended August 7, 2015, was relatively too expensive when standing alongside the euro and the British pound.

Thus, PRC manufacturers lost out as US dollar-denominated orders for goods and services increased in regions of the world, such as the **E**uropean **U**nion (**EU**), those orders, being fulfilled by countries whose manufacturing and/or operating costs were relatively lower than those of the PRC.

The EU and Great Britain are very important trading partners of the PRC, with the EU, being the second-largest customer of PRC-manufactured goods.

In terms of the exchange rate of the euro vis-à-vis the US dollar, it has shed about 18 percent in the past year or so … and continues to lose ground as the US dollar makes further gains.

But, with the renminbi, standing, as it had up until the first week of August, at a fixed rate to the US dollar, the PRC found itself unable to compete, to be trite, on a level playing field with its major trading partners, as well as with many of its competitors in Europe.

This had, absolutely, nothing to do with PBC, trying to start a currency war, as had been suggested, or of the PRC Government, trying to manipulate its currency to the benefit of the economy of the country and, by so doing, harming the economies of its trading partners.

Far from it: The PRC Government is desirous of improving its economy and recapturing lost markets for its goods and services, and, by so doing, bringing its economic growth rate back to at least 7.50 percent per annum or higher.

With the PRC, today, being an ever-expanding economy with some pundits, suggesting that, within the next decade or so, the economy of the country could well overtake that of The United States of America, that which transpires in the second-largest economy of the world is watched very closely.

When the PRC was buying raw materials from Australia, the Australian economy was on a roll.

The Australian economy took a decided hit when the PRC made material reductions in its purchases of many raw materials from this antipodean country, especially coal.

From the point of view of the PBC, it made excellent sense to devalue its currency in order to regain lost export revenue, among other things.

At the same time, however, the renminbi's devaluation will have the tendency to make foreign imports relatively more expensive for PRC's consumers.

This, without question, will be a definite plus for the economy, as far as the PBC is concerned.

Ergo: Encourage PRC consumers to purchase domestically produced goods rather than the more expensive, foreign imports.

One may expect the PRC Government to promote its population to be patriotic and to purchase, locally produced goods, forsaking the more-expensive, imported goods for the time being.

On the flip side of the coin, from the point of view of foreign investors, those, having invested material sums of money in the PRC's industrial sector, they cannot be very happy with their lot, today, seeing the very rapid devaluation of the renminbi.

Factories, producing goods, those PRC factories, having been funded by foreign investors, will have to pay more for their raw materials, most of which will have to be imported.

But in order to keep the wheels of industry turning, these foreign investors shall have to bite the proverbial bullet.

The goods that are produced in such factories, however, will be sold at relatively lower prices due to the devaluation of the renminbi vis-à-vis the currencies of countries to which the goods are to be exported.

Profit margins will, inevitably, be cut, no doubt.

It can only be surmised, of course, but it appears that a number of foreign investors, having spent very material sums of money in establishing manufacturing bases in the PRC in order to produce goods for export to their home countries, must be smarting at the thought that net profit margins are about to the cut, deeply.

This is quite likely to have a long-term effect on the PRC's economy because investors with deep pockets, also, have very long memories.

Aside from the foreign-exchange risk in trying to produce goods in the PRC, existing foreign investors, as well as prospective foreign investors, those who have been sitting on the fence, considering moving part of their manufacturing bases to the PRC, will, now, have to weigh up the PRC policy risk, too.

The policy risk will, now, unlike days of yore, always be an unknown factor in any and all contrived formulae in trying to make a determination with regard to investing in the PRC.

In the past, such considerations as a policy risk were almost non-existent.

Foreign investors' confidence in the PRC may well have been shaken to its core by the recent, unpredictable and seemingly aggressive actions of the PBC.

It could be held that the PBC had been more than a little too aggressive in its determination to devalue the renminbi at the stroke of a pen, so to speak, but what has been done cannot be undone.

In the long term, things are quite likely to be pan out to the benefit, not only to the economy of the PRC, but also to quite a number of economies, throughout the world.

-- E N D --