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Yuan Vs. Dollar: The Game Goes On

By Sarwar A. Kashmeri

For the Valley News

The Chinese government's \$243.5 billion investment in United States Treasury bills will be worth at least \$5 billion less tomorrow than it was last Friday when the Chinese currency, the yuan (also called the renminbi) was devalued by 2.1 percent.

The yuan had been pegged to the dollar for more than a decade. The stability this peg brought to the Chinese markets opened up a torrent of inward investment from United States companies into China -- more than \$350 billion cumulatively to date -- which, together with its low labor costs, has transformed China into an ever-growing manufacturing powerhouse.

Low cost consumer products from China have kept American inflation in check, and the prodigious purchases of low-interest American Treasury securities by the Chinese has continued to underwrite the ballooning American deficit, kept interest rates low, and the American economic recovery on track.

But outsourcing and the flood of Chinese goods into the United States, coupled with the strength of the Chinese economy, has led many experts to point out that the fixed yuan-dollar exchange rate no longer represented reality, and the fixed exchange rate came under increasingly fierce pressure, a lot of it from members of the National Association of Manufacturers.

Currency policy and politics intersected last week, with the announcement by the Chinese that the days of a fixed yuan-dollar exchange rate were over.

The yuan will not be allowed to float freely, however. To maintain currency stability it will only be allowed to move within a 0.3 percent band against the dollar. The closing price of the yuan against the dollar each day will become the mid-point of the band the next day, so theoretically, the yuan could continue to depreciate a percent every 10 days seeking market equilibrium.

John Engler, president of the National Association of Manufacturers, described the Chinese currency change as "a creeping peg" at a news conference at NAM headquarters in Washington on Thursday. "It is highly significant, but not adequate, but it does put us on a path to seeing significant results by October," he said.

October 2005 is when the U.S. Treasury Department will issue its next report on currencies, and absent a minimum 10 percent depreciation of the yuan by then, Congress seems poised to take retaliatory action against Chinese imports into this country.

Around 75 percent of Vermont's exports, and 80 percent of New Hampshire's exports are manufactured goods. So, what are the implications for Upper Valley companies of the new Chinese currency regime?

Hypertherm Inc., the Hanover-based manufacturer of laser and plasma torches for cutting steel, looks to China for double digit growth. "The continued health of the Chinese economy is very important to our company," said Evan Smith, Hypertherm's vice president and general manager. He supports the gradual approach the Chinese have taken to removing the fixed exchange rate.

Officials at Newport-based Latva Machine Inc., say the company has lost more than a million dollars of business to Chinese firms in the last five years. "I have seen bids from Chinese companies come in at 50 cents on the dollar," said Mitch Latva, the company's president. "China has few if any environmental regulations, there is forced labor, no employee health benefits, and an artificially low exchange rate. That is unfair competition. I'd like to hold their feet to the fire until we have a level playing field."

On the other hand, Warren Garfield, plant superintendent at Lovejoy Machine Inc. in Springfield, Vt., said he has watched as many of his American customers have "moved their entire plants to China because manufacturing costs are so much lower there." So it is not Chinese currency competition that he fears as much as a diminishing customer base.

Garfield said he is optimistic that the flight of small- and medium-size American companies to China will be short-lived. "American shipping ports are now clogged," he said. "Deliveries from China that used to take four to six weeks can now take four to six months, which significantly increases the cost of doing business."

Garfield said Lovejoy is fighting low-cost Chinese competition with "lean manufacturing techniques, which let us make a lot more product for a lot less cost." The company can already manufacture a number of products at prices that are equal to or lower than the Chinese, he said.

Peter J. Gundermann, president of Luminiscent Systems Inc., the manufacturer of aerospace lighting systems, agrees that the United States was right to put pressure on the Chinese because "fixed exchange rates distort their economy, which puts pressure on other economies around the world, and those distortions create artificial winners and losers." The new currency regime does not mean much for LSI because the aerospace industry prices and settles its products in dollars. "Germans buying a French airplane would have to deal in dollars," he said.

Mao Zedong, the late Chinese premier, was once asked by a reporter about the impact on civilization of the 200-year-old French Revolution. The sage thought for a moment and replied that it was too early to tell. The Chinese announcement is only three days old, so it is certainly too early to tell what its impact will be.

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marketing strategy and is a fellow of the Foreign Policy Association. He also writes a twice-monthly column for the Valley News exploring the issues and conditions affecting the region's economic health. Kashmeri can be reached at skashmeri@aol.com.

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