



2015.8.24

## The Devaluation of the Chinese Yuan – From a Purchasing Power Point of View

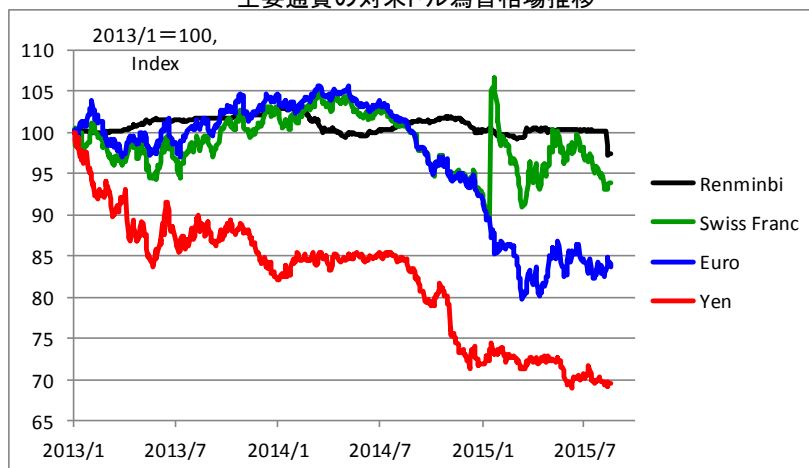
Koji Sakuma, Chief Economist  
Institute for International Monetary Affairs

### Devaluation of the Chinese Yuan

On August 11<sup>th</sup> the People's Bank of China ("PBOC") devaluated the median rate of the U.S. Dollar / Chinese Yuan rate by 1.9% and on the following 12<sup>th</sup> and 13<sup>th</sup>, by 1.6% and 1.1%. As a result the Chinese Yuan rate against the U.S. Dollar dropped from 6.1162 on the 10<sup>th</sup>, to 6.4010 on the 13<sup>th</sup>, a total devaluation of 4.5%.

Since 2013 autumn when the FRB announced the end of the monetary easing policy, in the foreign exchange market the U.S. Dollar became the sole strong currency. The Chinese Yuan being concerned about the stability of the exchange rate against the U.S. Dollar, as the U.S. Dollar became strong against other currencies the Chinese Yuan got stronger as well. Compared to the drop of other currencies against the U.S. Dollar, since 2013, the Chinese Yuan, and even after recent devaluations, is still considered being high. If the PBOC thinks that devaluation will bring about a positive effect such as a recovery in exports, this is probably not the last. This time's devaluation could be a chance where in the market sentiments for a lower Chinese Yuan may rise and gradual market-driven adjustments may begin. Or, these kinds of sentiments may not soon arise in the market and the PBOC will devalue several times until they do.

Exchange rates of major currencies against US dollars  
主要通貨の対米ドル為替相場推移



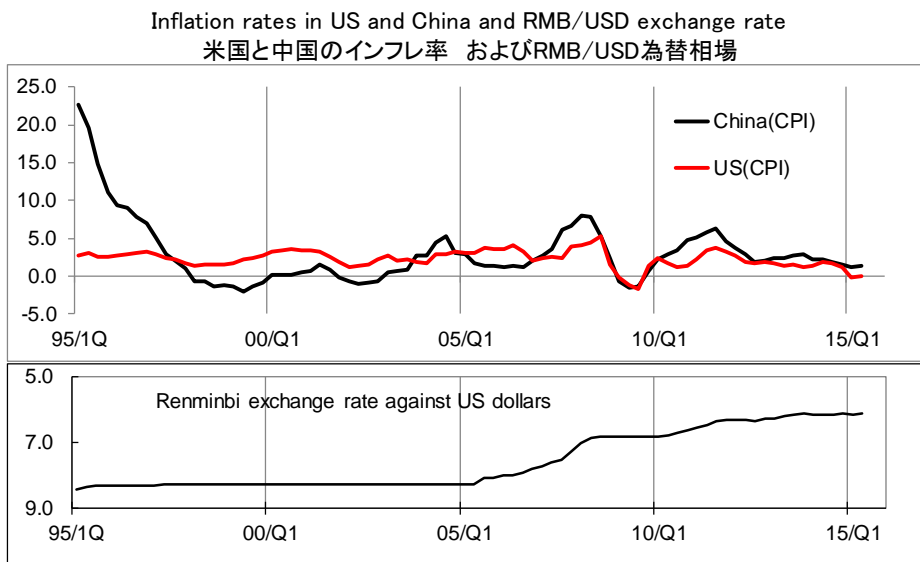
(Source) Datastream

Of course the PBOC is afraid of a rapid decline of their currency. It may bring about capital flight and a rise in inflation pressures. The situation will continue in which the PBOC, while watching carefully matters, will fearfully take their next step. Central bank's actions like this are the same even in Japan. A certain amount of depreciation may feel right but too much may be fearful. The worries of the keeper of the value of one's own currency are common throughout the world.

**From a purchasing power point of view**

From a purchasing power point of view or looking at the inflation rate difference between China and the U.S., since 2007 China's has been higher. A direction of the Chinese Yuan dropping since then would not have been unusual. But, in the first place, the Chinese Yuan rate was considerably low and the concern then was how to adjust this lowness, therefore the trend of a high Chinese Yuan continued. While not giving in to pressures from outside, China might have had the thought of doing something about their trade surplus with the U.S. Also, amid the high growth driven by, increase in exports due to low production cost and real estate construction boom since 2008, the high Chinese Yuan rate, had been acting as a brake in the too vigorous economy.

But unnoticeably the fundamentals of China had changed. Wages and prices rose accordingly and China had begun to lose its advantage as a production center. As income standards begin to rise naturally the growth rate begins to fall. Plus there is the issue of taking care of the huge excess fiscal spending since 2008. This naturally affects China's foreign exchange policies. In this sense, the Chinese authorities are one of the market participants who need to analyze the real economy thoroughly and try to find the proper exchange rate. The government and the central bank cannot continue with something against market principle in this globalize economy. They probably are aware of this and therefore the target for this time's devaluation is trying to return to an amicable and proper standard.



(Source) Datastream, IMF

Copyright 2015 Institute for International Monetary Affairs  
 All rights reserved. Except for brief quotations embodied in articles and reviews, no part of this publication may be reproduced in any form or by any means, including photocopy, without permission from the Institute for International Monetary Affairs.