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World Should Act to Push Up Yuan

CAPITAL ACCOUNT

By Greg Ip

In 1985, the world's leading economic powers met at New York's Plaza Hotel to deal with a currency so out of whack it was putting the global economy at risk.

The world today needs another Plaza Accord, this one not to bring down an overvalued dollar but to push up China's undervalued yuan.

China's growing trade surplus threatens to hollow out its trading partners' industrial bases. For years, the rest of the world has pleaded with China to change its economic model to rely more on domestic demand, and less on exports, to no avail.

A currency accord, enforced with tariffs, might be the only way to get China to act. The time may be ripe. Frustration with China is boiling over, especially in Europe. "This Chinese surge now threatens…the very core of Europe's productive system," a French government report said in February. In June, German Chancellor Friedrich Merz called for a new Plaza Accord aimed at China.

A meeting by central bank governors and finance ministers from top economies this weekend in Asheville, N.C., would be a good place to start the conversation.

Two facts aren't in dispute. First, China has a monstrous and growing trade surplus. Goldman Sachs projects it will hit $1.2 trillion this year. It estimates ~~that~~ its surplus on the "current account"—a measure encompassing goods, services and investment income— is headed to 1% of global GDP, a share no country has achieved in postwar history.

Second, its currency is deeply undervalued relative to where fundamentals such as trade balance and purchasing power say it should trade: by 19%, according to Goldman, and by 35%, according to Brad Setser, a scholar at the Council on Foreign Relations.

The disagreement is over the link: Did the second cause the first?

In the view of the International Monetary Fund and most orthodox economists, the undervalued yuan isn't the cause of China's current- account surplus but a symptom of inadequate domestic demand.

The current account reflects the difference between how much a nation saves and invests. In the orthodox view, this is rooted in economies' underlying structure. The U.S. runs a current-account deficit because it saves too little. China runs a current-account surplus because it saves too much.

The IMF attributes China's excess saving to structural factors such as an inadequate safety net and a fiscal system that taxes households too heavily and thus depresses consumption. More recently, a collapsed property bubble has shriveled investment and further widened the current-account surplus.

The alternate view is that China fixes its currency with the explicit aim of boosting exports and suppressing imports. A cheap yuan lowers Chinese prices abroad and raises foreign prices in China, boosting the surplus. It also shifts "income between consumers of tradable goods and producers of tradable goods," writes Michael Pettis, a China expert affiliated with the Carnegie Endowment for International Peace. This depresses consumption and expands the current-account surplus.

China's currency has traded in a relatively stable range against the dollar for a decade. But as Goldman economists Kamakshya Trivedi and Hui Shan show, goods prices have fallen in China since the pandemic, a result of lockdowns and the property bust, while rising in developed markets because of stimulus and supply-chain disruptions. This means the inflation-adjusted yuan exchange rate has plummeted.

This has increased China's competitiveness. Goldman compared costs experienced by manufacturers in China, such as New Balance and **Tesla,** with their costs elsewhere, and prices of Chinese companies, such as Haier, to foreign peers such as **Siemens** . China's price discount is 32% in electric vehicles, 38% in refrigerators and 53% in shoes. In theory, such gaps shouldn't persist if the yuan is fairly valued.

Chinese officials pay only lip service to boosting consumption. Xi Jin--ping believes boosting exports while restricting imports makes the world more dependent on China and China less dependent on the world.

Goldman economists argue that currency revaluation would complement domestic reforms by sustaining growth as the trade surplus shrinks. Yet the undervalued yuan takes the pressure off China to reform because it sustains exports while the rest of the economy is moribund, Setser says.

In the Plaza Accord, the U.S. and allies combined joint intervention to push the dollar down against the West German and Japanese currencies with domestic reforms, such as a narrower U.S. budget deficit. It worked.

West Germany and Japan, though, were close American allies. "China will not accept using exchange rates as a pretext for oppression, nor will it return to the old era of great powers coordinating the fate of a few countries," the Global Times, a mouthpiece for the Chinese Communist Party, said in June.

Nor can China's trading partners simply buy up yuan to force it higher, since China tightly controls access to its currency. Instead, they could impose tariffs, with a promise to dial them back if China revalues.

President Trump, of course, likes tariffs and might not be willing to trade them for currency appreciation. Nor has he shown much interest in deficit reduction. Other countries are reluctant to antagonize China and aren't disposed to cooperate with Trump.

Yet if they can get past the politics, the U.S. and its allies would recognize a common problem, and that a currency accord could be the cleanest, least distorting and most effective solution.

