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Economic Snapshots

A weekly presentation of downloadable charts and short analyses designed to graphically illustrate important economic issues. *Updated every Wednesday.*

Snapshot for October 30, 2003 (special edition)

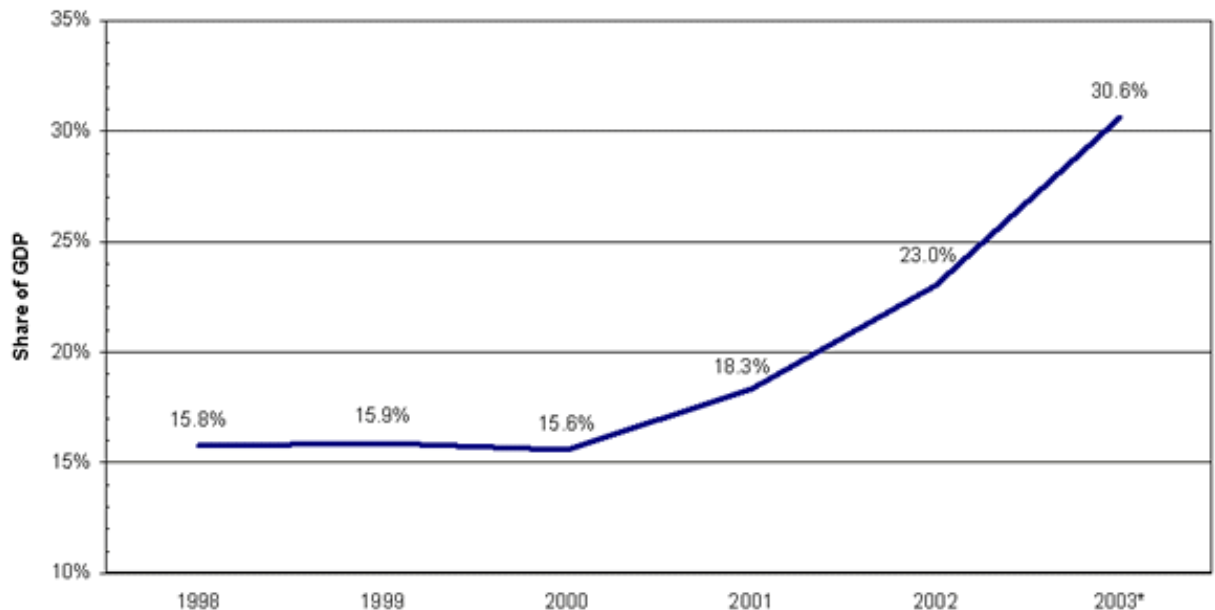
China's currency manipulation and U.S. trade

In recent years China's booming economy, fueled by large inflows of foreign direct investment (FDI) and rapid export growth, has emerged as a significant force in the global economy. This year, China surpassed the United States as the world's largest recipient of FDI, and its bilateral trade surplus with the United States reached \$117 billion in the 12 months up through August 2003.

Both inward investment and export growth create strong demand for China's currency, the yuan. All things being equal, such demand pressures should cause the yuan to appreciate relative to the U.S. dollar and cause China's external position to return to balance.

But all things are not equal: China pegs the yuan to the dollar at a fixed rate and strictly regulates imports and the allocation of foreign exchange. In order to maintain the yuan's fixed value, China must create a residual supply of yuan to counter growing demand for its currency; China achieves this by buying dollars in foreign exchange markets. Between December 2000 and July 2003, China more than doubled its foreign reserve holdings from \$168 billion (16% of its GDP) to \$361 billion (31% of its GDP).

China's foreign reserve holdings



* estimate

Source: International Monetary Fund and Economic Policy Institute analysis.

How should the United States respond? On nine occasions between 1988 and 1992, the U.S. Treasury found that similar external surpluses accompanied by much smaller accumulation of foreign reserves constituted evidence that countries—including China—were manipulating their currency's value for competitive trade advantage. When such a finding is made, U.S. law requires the Treasury Secretary to undertake negotiations to end such manipulation. Current evidence indicates that China is engaged in just such a manipulation of the yuan for competitive gain.

This Snapshot was written by EPI senior research assistant [Adam S. Hersh](#).

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