



The China, East Asia, and Global Rebalancing

Menzie D. Chinn

University of Wisconsin, Madison
and NBER

Suomen Pankki/OeNB conference
“European Integration in a
Global Economic Setting –
CESEE, China and Russia”
Vienna, 21-22 Nov 2011



Outline

- China: The end of a model
- Global Imbalances: Past, Present and Prospective
- Rest of East Asia, and China
- The Imperative for Policy Change in China
- The Slowdown in the Advanced Economies



Stein's Law

*If something cannot go on forever,
it will stop.*

- The Chinese development model has proven wildly successful.
- But the current approach has reached the point of diminishing returns in the current global macro environment



China's Development Model

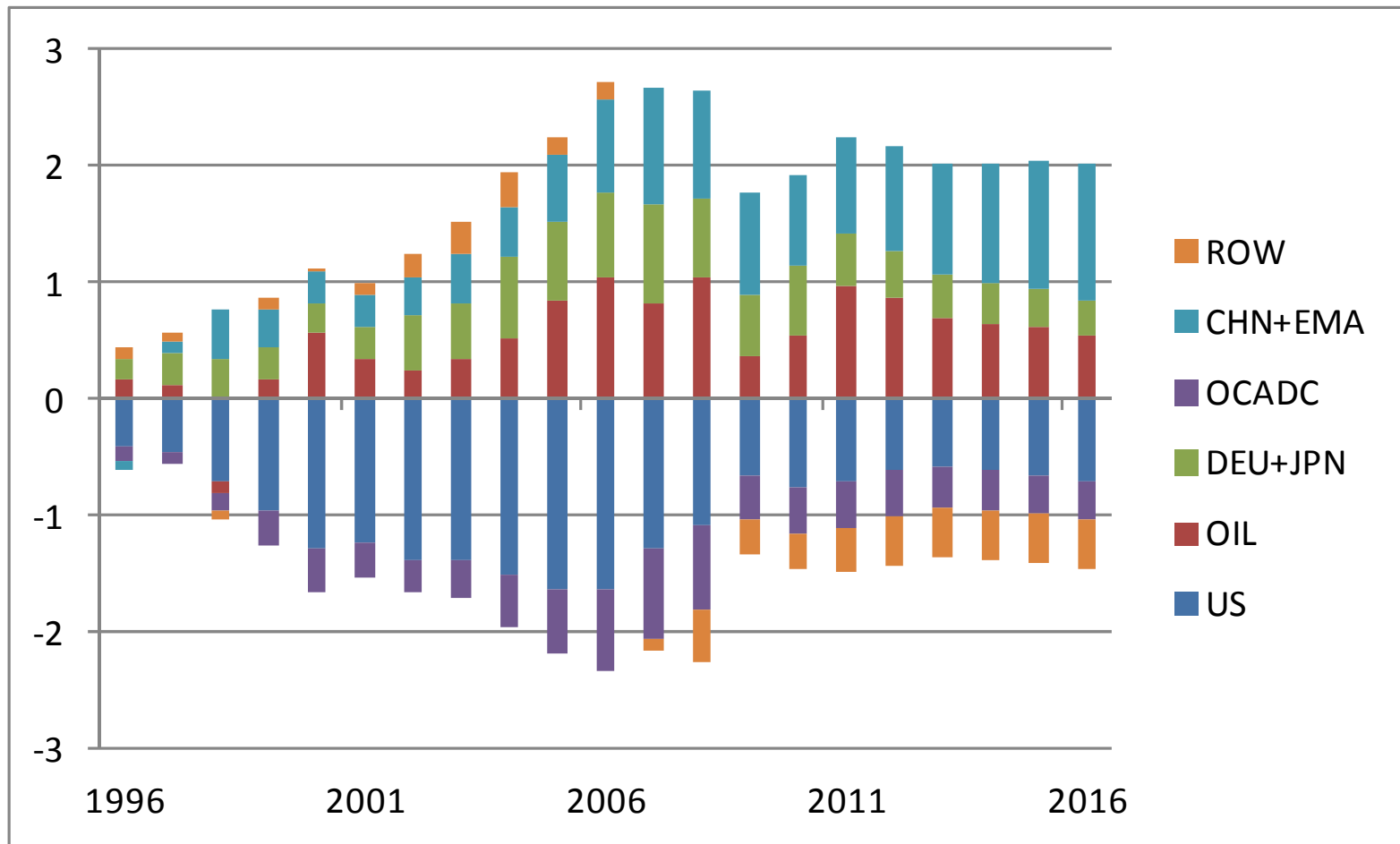
- At times, a weak currency
- An open door to FDI to encourage exports and technology transfer
- Movement of factors of production from low productivity to high productivity sectors
- A repressed financial system to direct capital to the manufacturing and export sectors.



A New Approach Is *Not* Optional

- Slower growth in the rest-of-world constrains the scope for export-led growth
- Reorientation of demand away from consumption in US adds to this effect
- The export sector cannot absorb labor as rapidly as before (and as needed)
- Declining productivity of capital

Imbalances: Past, Present and Prospective



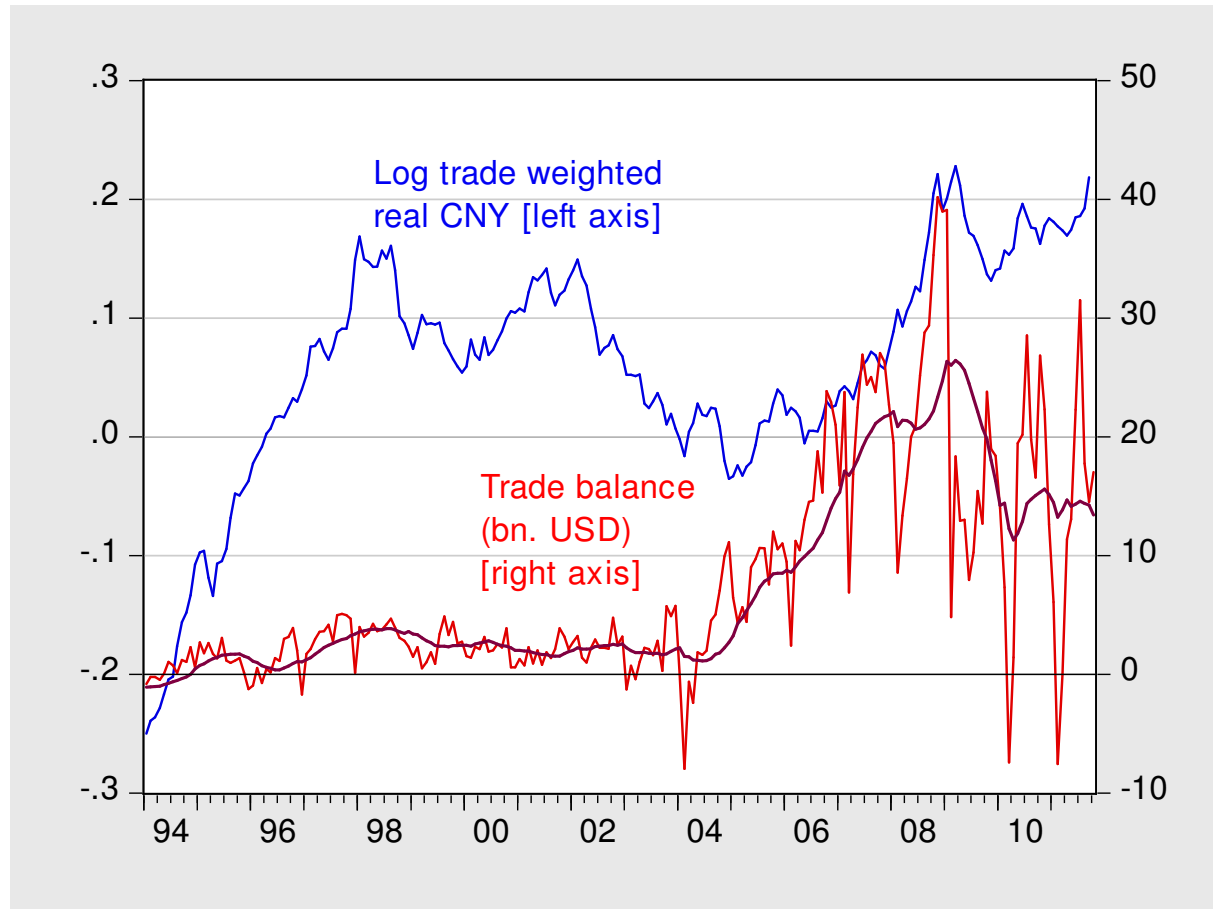
Source: IMF, *WEO*, Sep. 2011



Projections from an Empirical Model (Chinn, Eichengreen, Ito, 2011)

- Saving glut variables (financial development, openness, and institutional development) matter, but have done so persistently
- Imbalances will resume and persist with current policies in place
- Ignorance reigns (large, unexplained country-specific component)
- Deleveraging might result in faster CA reversion than we predict

Impact of Currency Appreciation



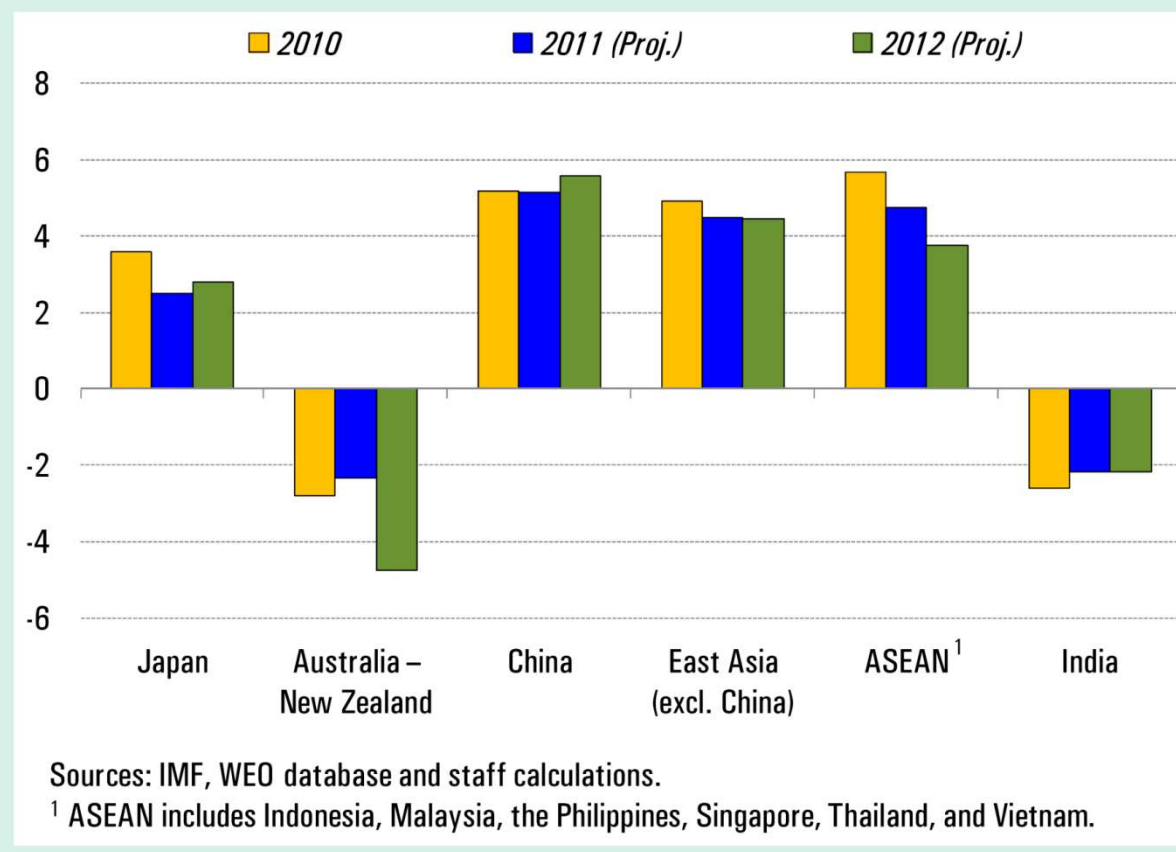
Estimated
Price elast of
Exports =
0.75

Implies 10%
appreciation
leads to \$70
bn
reduction
exports

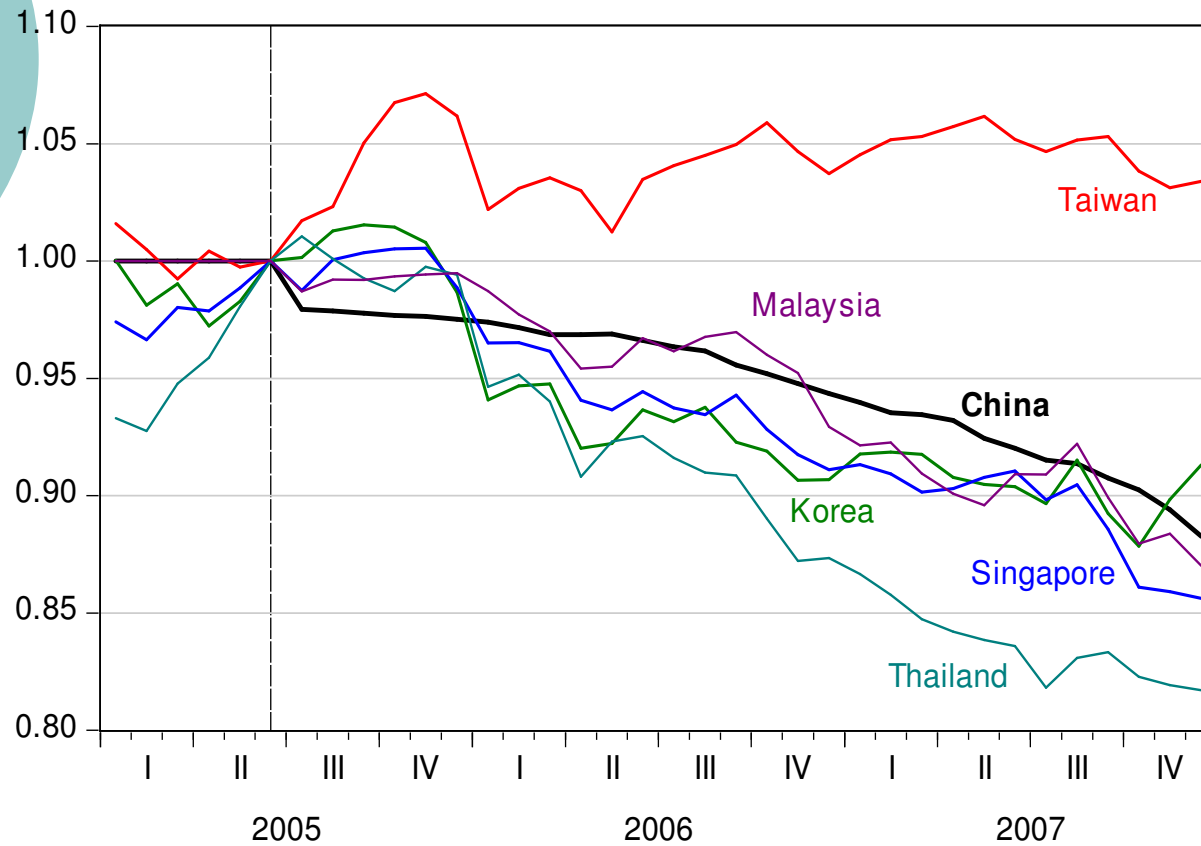
Trade weighted real CNY: Up is appreciation

What about the Rest-of-Asia?

Figure 1.11. Selected Asia: Current Account Balances
(In percent of GDP)



The Yuan and Other Currencies

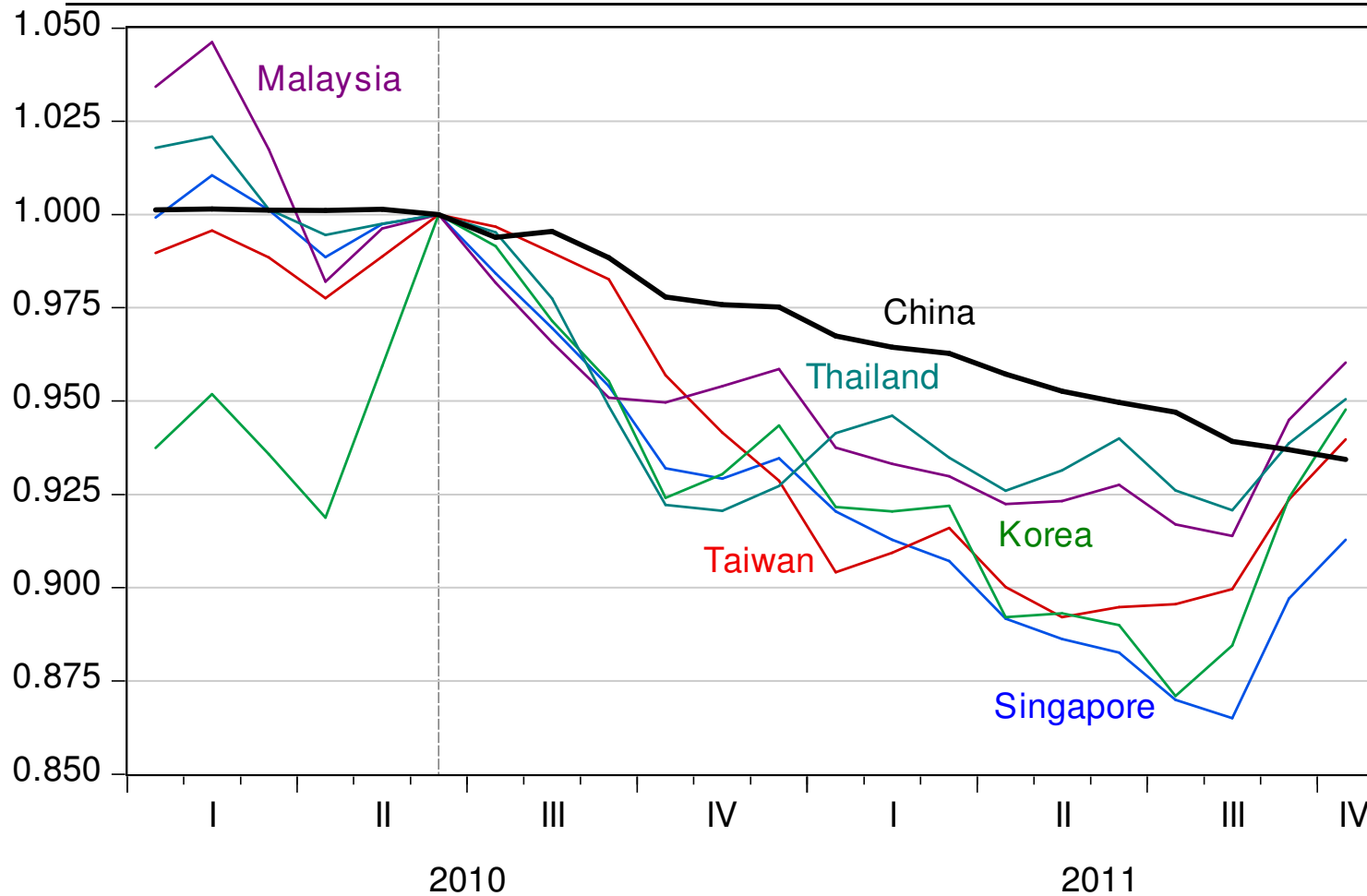


Thorbecke & Smith (2010): 10% regional appreciation induces 10% export reduction

Notes: Down is appreciation; all rescaled to 2005M06=1

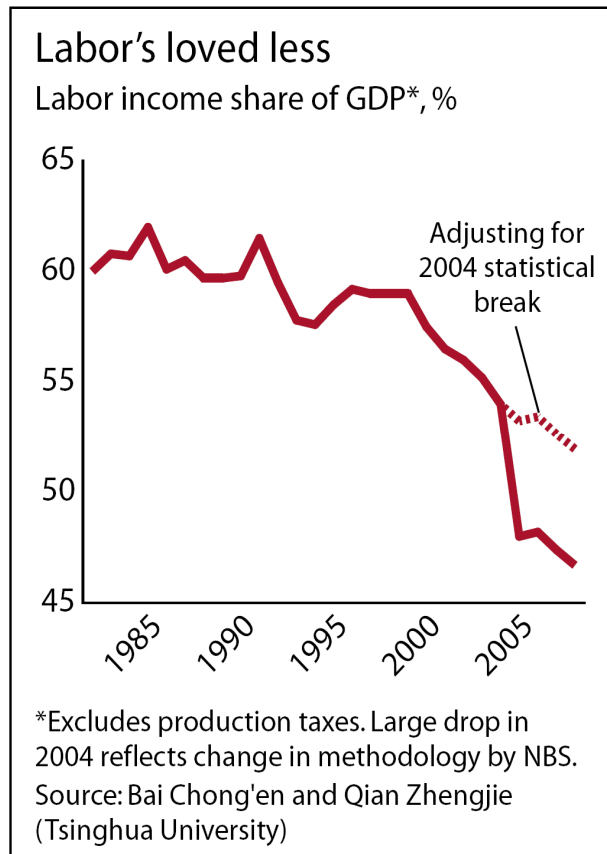
Yuan weakly exogenous for most currency pairs over this sample

The Yuan and Other Currencies (II)



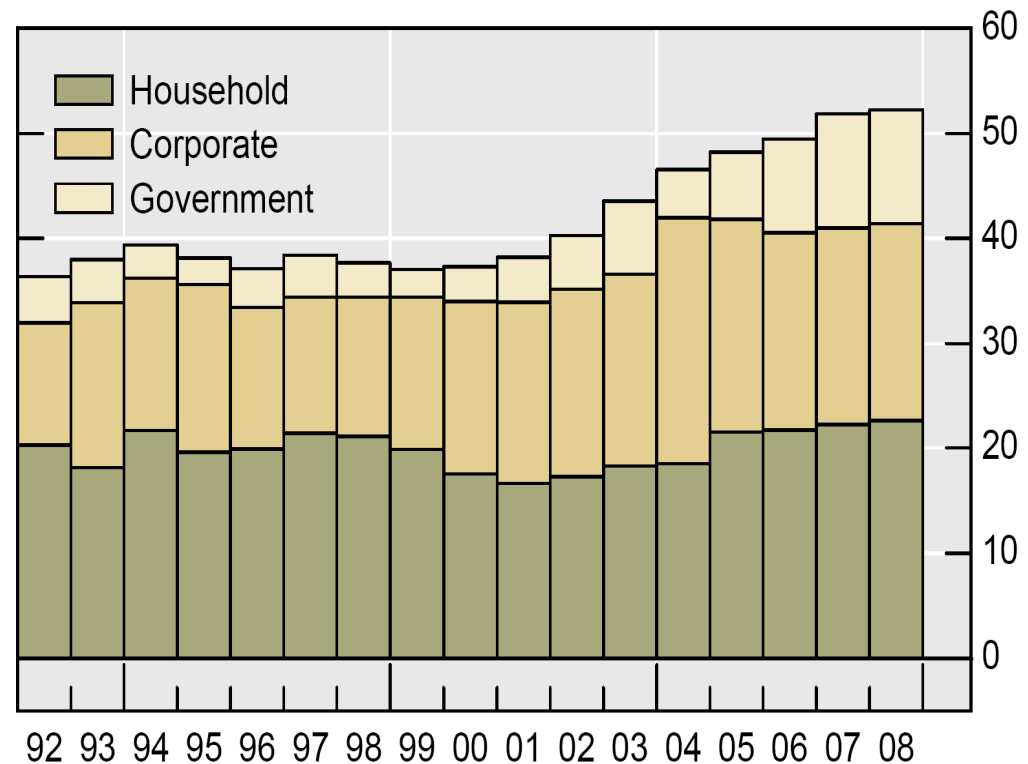
Notes: Down is appreciation; all rescaled to 2010M06=1

The Imperative for Policy Change



Source: Kroeber, *CEQ*, Mar '10

China's gross national saving



Source: Ma & Yi, BIS WP 312 (Jun '10)



The Need for Change Is Understood

It is clear that China should have brought to an end to the endless piling up of foreign exchange reserves long time ago. ... China is faced with a stark choice between bearing increasingly large capital losses in its foreign exchange reserves and tolerating immediate losses in terms of significant drop in current account surplus and large revaluation losses. Certainly, neither choice is pleasant. However, this is the bitter fruit of China's past hesitating and dithering and it has to swallow now.

-- YU Yongding (Oct. 2011)



Goals versus Timing

- Despite high-visibility debates over the policy direction, there is substantial agreement
- The conflict is over extent and *timing*.
- Policymakers tend to err on the side of caution, with slow and calibrated moves.
- In the current environment, to be cautious is to be incautious



Implications

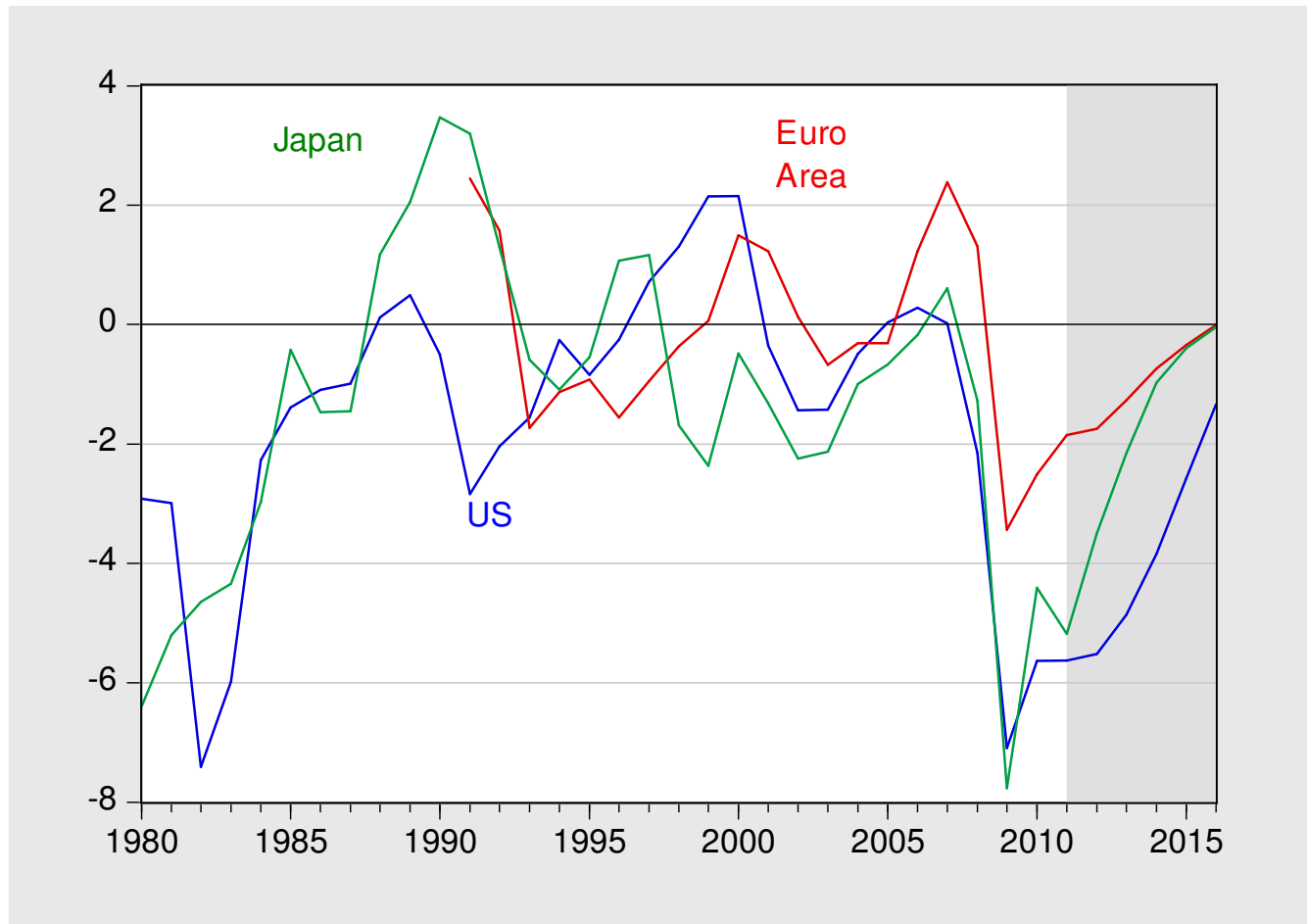
- A new development strategy will be years in the making
 - Solidifying social safety net
 - Integrating domestic labor markets
 - Developing secondary securities markets
- But some measures can be implemented fairly rapidly
 - Currency appreciation
 - Liberalizing services sector



Why Would a Cooperative Outcome Be More Likely Now?

- The declining marginal benefits of export oriented growth
- The high costs of large forex reserves
- The increasing likelihood of slowdown or recession in the advanced economies
- These must be weighed against strength of interest groups

Economic Activity in Advanced Economies



Source: IMF, *WEO*, Sep. 2011



Summing Up

- Despite recent shrinkage in the Chinese current account surplus, it's not clear this is a new trend
- Chinese revaluation would not alone eliminate the imbalances, but would facilitate East Asian adjustment.
- Adjustment is even more needed if Europe (and the US?) slows down drastically.