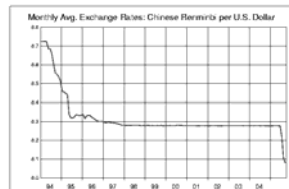


Revaluing the Chinese Yuan

A case study in a government's change in the valuation and management of its increasingly global currency



Revaluing the Chinese Yuan: Case Questions

1. Many Chinese critics had urged China to revalue the yuan by 20% or more. What would the Chinese yuan's value be in U.S. dollars if it had indeed been devalued by 20%?
2. Do you believe the revaluation of the Chinese yuan was politically or economically motivated?
3. If the Chinese yuan were to change by the maximum allowed per day, 0.3% against the U.S. dollar, consistently over a 30 or 60 day period, what extreme values might it reach?
4. Chinese multinationals would now be facing the same exchange rate-related risks borne by U.S., Japanese, and European multinationals. What do you believe would be the impact of this rising risk will be on the strategy and operations of Chinese companies in the near-future?

3-2

Revaluing the Chinese yuan

- They started talking about something that wasn't very useful then started to collect mobile phones and BlackBerrys," said a banker who was briefed later. The Chinese then distributed a four-point statement: Beijing was unlinking the yuan from the U.S. dollar effective immediately.

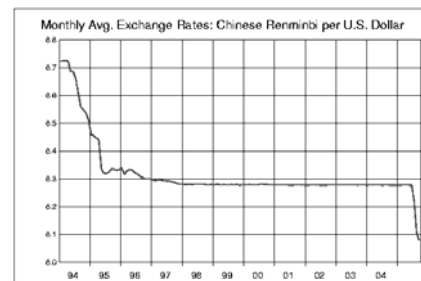
"Behind Yuan Move, Open Debate and Closed Doors,"
The Wall Street Journal, July 25, 2005, pg. A1.

- "This a cautious move," said Zhong Wei, a finance expert at Beijing Normal University. "This is more like a political stance than real currency reform."

"China Ends Fixed-Rate Currency," Peter S. Goodman,
The Washington Post, July 22, 2005, pg. A01

3-3

Revaluing the Chinese yuan



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3-4

Revaluing the Chinese Yuan: Case Questions

1. Many Chinese critics had urged China to revalue the yuan by 20% or more. What would the Chinese yuan's value be in U.S. dollars if it had indeed been devalued by 20%?

- If the yuan had been revalued to Yuan 6.90/\$, it would have constituted an increase in its value by 20% against the U.S. dollar

$$\frac{\text{Yuan } 8.28/\$ - \text{Yuan } 6.90/\$}{\text{Yuan } 6.90/\$} \times 100 = 20.0\%$$

- This is the percentage change calculation of

$$\frac{S_1 - S_2}{S_2} \times 100 = 20.0\%$$

- Which, if using 20% or 0.20, can also be rearranged as

$$S_2 = S_1 \div 1.20$$

5

Revaluing the Chinese Yuan: Case Questions

2. Do you believe the revaluation of the Chinese yuan was politically or economically motivated?

- This is a matter of opinion. The primary pressure on China to revalue the yuan was, however, political in nature.
- China's current account surplus and financial account surplus allows it significant room for currency management. By revaluing the currency, although minor in size initially, it did show the Chinese government's willingness to listen to some of its critics.
- Economics would argue against the revaluation if that was the sole consideration. For Chinese exporters, or multinational enterprises with manufacturing bases in China (cost-bases), a revaluation would increase their direct costs of goods sold which would decrease their gross and operating margins if they were unable to pass the higher costs along into final prices.

3-6

Revaluing the Chinese Yuan: Case Questions

3. If the Chinese yuan were to change by the maximum allowed per day, 0.3% against the U.S. dollar, consistently over a 30 or 60 day period, what extreme values might it reach?

- All the following outcomes follow the calculation as shown here for the 30 day revaluation:

$$\text{Value at end of 30 days} = \frac{\text{Yuan } 8.11/\$}{(1 + 0.003)^{30}} = \text{Yuan } 7.41/\$.$$

- If the yuan were to **revalue** by 0.3% per day for **30 days** against the U.S. dollar, assuming an initial value of Yuan 8.11/\$, its value at the end of 30 days would be Yuan 7.41/\$.
- If the yuan were to **revalue** by 0.3% per day for **60 days** against the U.S. dollar, assuming an initial value of Yuan 8.11/\$, its value at the end of 60 days would be Yuan 6.78/\$.
- If the yuan were to **devalue** by 0.3% per day for **30 days** against the U.S. dollar, assuming an initial value of Yuan 8.11/\$, its value at the end of 30 days would be Yuan 8.87/\$.
- If the yuan were to **devalue** by 0.3% per day for **60 days** against the U.S. dollar, assuming an initial value of Yuan 8.11/\$, its value at the end of 60 days would be Yuan 9.71/\$.

7

Revaluing the Chinese Yuan: Case Questions



4. Chinese multinationals would now be facing the same exchange rate-related risks borne by U.S., Japanese, and European multinationals. What do you believe would be the impact of this rising risk will be on the strategy and operations of Chinese companies in the near-future?

- Chinese multinationals will now increasingly face the multitude of currency risks – transaction exposure, operating exposure, and translation exposure – faced by multinational firms resident in floating currency markets like that of the United States, Japanese yen, and European euro.
- As the following chapters will describe, this rising currency risk will affect every dimension of their sales growth, profitability, and general competitiveness from this point onwards into the future. Life and business was certainly easier under the previous fixed exchange rate regime.

3-8

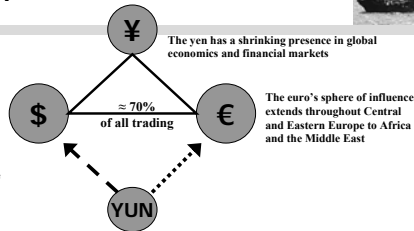
The Future Global Currency Landscape?



Dollar's sphere of influence:

- * North America
- * Central America
- * South America
- * South Asia
- * East Asia/Middle East

Some indications are that the dollar is falling in power and influence globally.



Chinese yuan (YUN) or renminbi (Rmb) continues to grow in influence in parallel with that of the Chinese economy

- July 2005 restructuring of the yuan is its first step towards becoming a stronger and stronger player
- Chinese government will strive to maintain an equal footing/balance against the \$ and the €

3-9