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## **Renminbi needs to appreciate 25% in the coming two years to avoid world economic strains**



making business sense

The dollar purchases, domestic Chinese fiscal stimuli, and credit expansion risk an asset price bubble in China that will lead to inflation that kills off their economic expansion unless the renminbi is revalued by around 25 per cent over the coming two years.

Envious at their economic success, it is difficult for Western eyes not to realise that Chinese economic policy stands on a knife edge. Too much growth will lead to inflation and risks a boom and bust cycle. Too little growth and there will not be enough jobs for those migrating from the rural areas.

About five years ago, I visited China for the first time. I travelled from the Western border with Tibet through the countryside and then through the rapidly growing coastal cities, including Shanghai and Beijing, mainly by train: I went on to the easternmost "village" on the mainline railway in Inner Mongolia: this pulsating "village" had a population of over 2 million.

In the first few days of the journey I looked out of the train window and saw the picturesque landscape with agricultural workers and their buffaloes: I was surprised to see how every square metre of land available was cultivated. It then dawned on me that, having travelled for several days, I had not seen a tractor.

The lack of tractors was not a failure of the economic might of China, but must have been premeditated: it was a way of abating the inevitable flow of individuals from the agricultural land in China into the cities. A migration which is predicted to exceed 400 million people - the world's largest ever migration of people and more than the population of the US. A role of the Chinese state is to ensure that when individuals migrate to the cities there are jobs for them, so that riots or social upheavals do not ensue. To create these jobs China's GDP has continued to grow at circa 8% per annum: latterly assisted by a significant government stimulus.

The Chinese resent being lectured by the West about optimal economic policy. But as they consolidate their leading position in the world's economy their actions will have an increasingly great impact on the rest of the world. They should not be surprised that this leads to comment - in fact they ought to revel in the fact that this reflects their rising significance.

A revaluation of the renminbi will both help stabilise Chinese policy, by reducing the risk of boom and bust, and stabilise the relationship between the Chinese economy and the rest of the world by reducing the excessive Chinese trade surplus and the excessive overseas purchases of assets that this leads to. **cebr** calculations suggest that a 25% revaluation over two years would bring down the current account surplus to 1-2% of GDP, about right for a country with China's current economic dynamism.

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