Chinese exporters struggle with rise in yuan's value
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For policy makers in Beijing, increasing the yuan's value at a faster pace is looking like a clever way to tackle both surging inflation and the intractable Chinese trade surplus.

But for Xu Jianchang, general manager of a garment exporter in eastern China with nearly 4,000 workers, the change threatens to cut annual net profit by more than half. "Each percentage point rise in the yuan means a half percentage point loss in our foreign exchange earnings," Xu said by telephone from Ningbo, where his company, Ningbo Seduno Group, is based.

Two and a half years after China revalued its currency and freed it from a peg to the dollar, the yuan's appreciation - accelerated by Beijing's decision to use currency policy to fight inflation - is starting to bite deeply into profits at many small and midsize businesses with low margins.

The yuan has appreciated 4.5 percent against the dollar since late October, for a annual rate of 15 percent.

Foreign exchange dealers expect the full-year pace of appreciation to be 8.5 percent to 10 percent, compared with 6.9 percent in 2007 and 3.4 percent in 2006.
The central bank, and many analysts, argue that this faster appreciation will do little serious harm to China's economy as businesses cut costs, move to higher value-added products and focus on booming domestic demand.

But for smaller export-oriented businesses, which have already been hurt by an end to tax rebates and other policy changes, the pain is real. In Wenzhou, a center for private-sector start-ups in Zhejiang Province, the higher rate of the yuan's rise late last year forced about half the new companies that opened in 2007 to suspend operations before the end of the year, said Zhou Dewen, who heads the Wenzhou Small and Medium-Size Enterprise Development Promotion Association.

In 2006, fewer than 20 percent of Wenzhou's new businesses failed to survive until the end of the year. "The average profitability of Wenzhou enterprises stands at only 3 to 5 percent of assets," Zhou said by telephone. "A 3 percent yuan rise will wipe out profits in many firms here, in particular textile and shoe companies with low profitability."

Wenzhou is home to more than 300,000 small enterprises, which focus on labor-intensive, low value-added products like textiles, shoes, lighters, eyeglasses and electronics. About a half of them produce for export, Zhou said.

When the yuan was rising against the dollar in 2006 and 2007, many exporters cushioned the impact by shifting exports to Europe from the United States.

During the past four months, however, the yuan's rise has also exceeded the dollar's depreciation on global markets, with the result that it has also strengthened against a basket of currencies including the euro, hurting exports to the European Union.

Many smaller exporters were already reeling after China removed or reduced tax rebates on nearly 3,000 exported products last July, as part of its efforts to ease its huge trade surplus, which rose 48 percent last year to $262.2 billion.

Tax rebates for garments were cut to 11 percent and for shoes to 9 percent, both from 13 percent. This reduction helped slow growth in the volume of China's knitted textile exports to 5.4 percent in 2007 from 12.2 percent in 2006 and 15.1 percent in 2005, according to data from the Ministry of Commerce. Shoe export growth slowed to 6.8 percent in 2007 from 10.7 percent in 2006 and 17.5 percent in 2005.

Moreover, an amended labor law, which took effect at the start of this year and requires labor contracts and pension payments for all staff, including migrant workers, will add 10 percent to 15 percent to costs for small and some medium-sized exporters in the next several years, analysts said.

These burdens come on top of China's monetary tightening, which was adopted in November to curb inflation and which has made it very difficult for smaller businesses to obtain new financing. Industrial officials and analysts, though, say they believe that the impact on major Chinese companies, as well as the stock market, will be limited, with no stock market meltdown similar to what happened Japan in the 1990s, when the steep appreciation of the yen was partly to blame.

"Domestic consumption remains the major portion of sales by major Chinese companies, which can also shift most costs to downstream industries," said Xu Dongsheng, vice president of the Home Appliances Association.

Wang Xinjiu, spokesman for China International Marine Containers (Group), the world's largest shipping container maker, which earns over 80 percent of its revenue in dollars, said it transferred most of its foreign exchange-related costs. "Yuan appreciation against the dollar is largely reflected in our pricing overseas," Wang said. "Of course, we are also seeking other ways to reduce currency risks, including more settlements in euros, adjusting durations in our loans and rationalizing the timing of raw materials purchases."

Economists say that they expect slower export growth this year, at perhaps less than 20 percent, compared with 26 percent to 28 percent from 2005 to 2007, but at that this will be mainly due to a U.S. economic slowdown rather than yuan appreciation.

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