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China's Currency Move Not Enough To Impact Mexico Trade

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MEXICO CITY -- China's long-awaited announcement it would revalue the yuan provoked little optimism about Mexico's trade competitiveness, with experts viewing the move as too small to make a dent in the Asian giant's cost advantage in supplying the lucrative U.S. market.

The 2% appreciation of the Chinese currency and switch to a tightly managed float against a basket of currencies is a far cry from the 15% revaluation that many economists view as necessary to correct the trade advantage that an undervalued yuan can provide. Thus, the move isn't likely to improve Mexico's status with its northern neighbor and biggest trade partner, having been overtaken by China as the No. 2 exporter to the U.S. in 2003.

"I don't think a 2% increase in the Chinese yuan will affect trade relations between the U.S. and Mexico," said Usha Haley, a professor of international business at the University of New Haven and an expert on Asia-Pacific business.

While a 7% to 10% appreciation "would tip the cost factor in favor of Mexico in some industries," she said a cheap currency is only one of many factors that come into play in deciding whether to move operations to China.

"It's not just the currency, it's also the fact that China is a very efficient place to do certain kinds of manufacturing," added Haley, noting cheap labor costs and government subsidies for land and utilities.

Still, for industries operating in Mexico, especially foreign-owned "maquiladora" assembly-for-export factories that primarily export to the U.S., any adjustment in the competitive landscape helps.

Doug Donahue, a principal at San Antonio, Texas-based Estrada Group, has been watching currency developments in China closely. His company offers a wide array of services to maquiladoras in Mexico, from providing the labor and the plant to managing the import and export process.

He said labor costs for maquiladoras are already pretty competitive with those in China, and that any appreciation of the yuan could help tip the balance. He estimates that hourly wages, including benefits, range between $1.25 and $1.35 in north-central Mexico, versus about 95 cents to $1 in Shanghai.

"When comparing Mexico to China, 2% or 3% isn't going to make a big difference," said Donahue. "But the psychological part of that - seeing that now the Chinese currency can revaluate - will go into people's cost models as they are making decisions" about which country offers a more attractive manufacturing base.

But while Mexico has the advantage of sharing a border with the U.S, it still needs to develop its market for making the intermediate products being shipped to the border assembly plants in order to further eliminate China's competitive edge, he added.

Moreover, economists at Deutsche Ixe don't believe Mexico can improve its competitiveness over the long term without structural reforms to boost productivity.

They also discounted the impact of China's announcement, saying in a report that a 2% adjustment means the Chinese currency will remain "basically stable" and is unlikely to appreciate much in the near term.

"We believe that the adopted measures will have little significant effect on the financial markets, competitiveness and trade of our country," the economists said.

Merrill Lynch analysts gave more weight to China's currency regime change, writing in a note that "whether deemed insufficient or not, final or not, the Chinese move will reverberate over the rest of the (foreign exchange) markets and beyond."

They expect the peso to appreciate as much as the yuan against the dollar, amid hopes of a more favorable trade environment for Mexico.

Still, Merrill Lynch views any peso move as temporary, dismissing the view of Mexico as "the archetypal case study of China's unrelenting damage through third party competition to traditional exporters to the U.S."

Indeed, after a knee-jerk surge to a two-year high around MXN10.5850 to the dollar in early trade, the peso gave back most of its gains. It ended at MXN10.6175, modestly stronger than Wednesday's close of MXN10.63.

A local trader said he expects the peso to be able to strengthen to around MXN10.50 over the medium term on the back of a stronger yuan.

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