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Higher prices ahead for sneakers, toys imported from China

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WASHINGTON — Attention Kmart and Wal-Mart shoppers: The prices you pay for sneakers, sweat shirts, toys and thousands of other items made in China are likely to be rising soon.

That's thanks to China's announcement yesterday that it is revaluing its currency. More uncertain is whether the small revaluation will make a noticeable dent in America's huge trade deficit with China.

In its announcement, China said it will now take 8.11 yuan to purchase one dollar instead of the 8.277 yuan it has taken over the past decade. That had the immediate effect of revaluing the yuan by 2.1 percent.

"This 2 percent increase in the cost of currency will mean nothing," said Usha Haley, an international business professor at the University of New Haven in West Haven, Conn. "That is why (China) did it. They do not want to revalue the yuan significantly. ... I do not think anything under 10 percent will cause an effect."

China also said it would switch from linking the yuan to the dollar and instead link it to a market-basket of unspecified currencies. Beginning today, the yuan will be allowed to change in value within a 0.3 percent band each day.

An undervalued yuan has made Chinese products cheaper in U.S. markets and American products more expensive in China. American companies contend the yuan is undervalued by as much as 40 percent against the dollar.

Pleasantville-based Reader's Digest Association Inc., which sells products in more than 60 countries including China, will not see a major change concerning its financial outlook because of China's currency increase, said William Adler, vice president of global communications.

The basics

Beijing's surprise: China announces it will stop pegging its currency, the yuan, to the dollar, succumbing to pressure from the U.S. and other trading partners. Instead, it will peg it to a basket of as-of-yet unnamed currencies.

How it works: At the end of each day, China will announce an official price for the yuan which will be set as the midpoint for a 0.3 percent band in which the yuan will be allowed to trade the following day.

The impact: The stronger yuan could make exports from China more expensive for U.S. and European countries. But it also could make imports into China cheaper, "From a financial standpoint, the scale is small," Adler said. "The currency moves announced (Thursday) will not have much or any impact on us."

boosting the market for U.S. and European goods.

The Bush administration, facing political pressure because of a record $162 billion deficit with China, hailed the announcement as a victory. Officials from President Bush on down have pressed China to stop linking the value of the yuan at a fixed rate to the U.S. dollar.

"This is a very positive development. It clearly puts China on the right path," said Treasury Secretary John Snow.

But some economists worry that China may have unleashed economic forces that will eventually worsen inflation in the United States by making imports not just from China but all of Asia more expensive for Americans.

"Christmas is going to cost a lot more this year," said John Malott, former U.S. ambassador to Malaysia and current managing director of Manatt Jones Global Strategies, an international business consulting firm, in Washington, D.C. "It makes all the Chinese imports more expensive because we will have to spend more money to buy them."

The biggest initial impact on consumers may come in toy prices, since about 75 percent of toys sold in the United States come from China.

The effect on U.S. financial markets was immediate: The dollar fell against other major currencies and yields on U.S. Treasury securities rose. If that rise in interest rates is sustained, it could make it more expensive for U.S. consumers to finance purchases of new cars, homes and other big-ticket items.

"It's a dumb move," said Dr. John Rutledge, a former economic adviser to President Reagan and frequent guest on Fox News and CNBC's "Squawk Box." "We pushed (China) out of the business to buy U.S. Treasury bills. When treasury bills lower, interest rates go up ... mortgage rates go up. It puts an end to the housing-market boom."

Still, most analysts argued that the overall impact on the U.S. and world economies will be extremely positive by trimming America's huge deficits, which pose a threat to global financial stability.

A stronger yuan could encourage domestic spending, making China's economic growth less dependent on exports, said Frank Gong, managing director of JPMorgan Chase & Co. in Hong Kong.

"The winner in all of this will be American businesses and ultimately U.S. workers," said Mark Zandi, chief economist at Economy.com, a forecasting firm.

Administration officials say that as American products become cheaper in China, U.S. exports will rise and rising prices for Chinese goods will cause Americans to eventually curb their own purchases. Another significant boost will come when other Asian countries such as Japan, South Korea, Taiwan and Malaysia allow their currencies to rise against the dollar, no longer fearful of losing competitive ground to China.

The dollar's value, which has fallen by about 17 percent against major currencies — mostly in

Europe — over the past three years, will probably decline by an additional 15 percent over the next three years with the biggest declines being against Asian currencies, analysts predicted.

Some forecasters predicted that China will only allow its currency to rise in value by about 5 percent this year and another 5 percent in 2006, fearing that anything more dramatic would undercut Chinese exports too much.

"We are playing with fire," Rutledge said. "(China's) economy is going to slow. You cannot diddle with a currency without affecting interest rates in both places, economic growth, prices and wages. What this change is going to do is raise interest rates, lower U.S. growth, lower China growth and lower China's prices and wages."