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Finally, some news that is worthy of comment. With the recent replay, and re-replay of the Greek debt crisis in the news so much, I was beginning to think that we would have to wait until this upcoming corporate earnings season to get something noteworthy.

Over the weekend, China announced that it will allow the value of their currency, the Yuan, to appreciate versus the US Dollar. While many news outlets are reporting this news, they are focusing on the implied "vote of confidence in the global economy." While I agree that the move does underpin the confidence in the global economy, there is more to this move than meets the eye.

A couple of weeks ago, China announced that they would expand the use of their own currency to conduct large institutional transactions, to encompass the vast majority of the country. The displaced currency, as you may guess, is the US Dollar. Previously, China had announced that it was "testing" the use of its own currency as a reserve currency by only opening it up to trade in 5 of the Chinese provinces. Trade between China and Hong Kong has been moving towards the Yuan since June 2009 and continues to expand with the amount of transactions more than doubling to over 7.2 billion Yuan in May, up from 3 billion yuan in March & April. Further, China has been signing trade pacts with many foreign governments over the past year, not only in the Asian region, but also in Latin America. Each of these decisions weaken the demand for the US Dollar.

The lynchpin of resistance to using the Yuan as a reserve currency has been the "pegged" nature of the Yuan to the US Dollar, which has been seen as arbitrary and opaque. Trading partners want a currency that has liquidity and is easily exchanged with their local currency. China's move this weekend is another step in the right direction and will start to lessen resistance for use of the Yuan by the international community.

It is no secret that China's government wants to see the removal of the US dollar as the default reserve currency. Since the financial crisis of 2008, China has been consistent in its backing for the creation of an international currency standard that is not solely reliant on the US Dollar. To further this goal, the People's Bank of China (their Federal Reserve Bank) is beginning to offer Yuan denominated bonds to international banks for resale to other governments and large corporations. This will provide an alternative to the much-used US Treasury bond.

I have to note that in the last two months reported, China has been a heavier buyer of US Treasuries than they have been in the past year, boosting China's holdings to back above \$900 Billion. While this short-term action goes against the trend, it can be better interpreted in light of China's history and culture of making slow and measured changes. The long-term trend of China ridding itself of US Dollar dependence remains intact and I would be very surprised to see China reversing its departure from the US Dollar. If I am China, I don't want to reveal all the cards in my hand at the same time.

Overall, the move to allow the Yuan to float is part of a bigger picture that will transition international currency power away from the US and towards China. This will bring US consumers higher prices for imported goods and make US exports more attractive overseas.

Best Regards,

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