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Yuan vs. Bay Area: Some analysts expect real estate market, low-end retail to suffer from revaluation

By George Avalos

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China's decision to revalue its currency caused interest rates to jump Thursday and cast a shadow over a super-heated housing market that has been bolstered by relatively affordable loans.

Since 1996, China has kept its currency fixed to the value of the dollar. But Thursday, China announced it would let the yuan float within a narrow range tied to a basket of currencies from China's primary trading partners, which would include the dollar, the yen, the euro and others. The United States and Europe have complained that China's undervalued currency has given that country an unfair trade advantage by making its products artificially cheap.

Talk of currency fluctuations and the value of the dollar vs. the yuan might cause a person's eyes to glaze over. Yet the move by the emerging Asian economic power, a response to pressure from the White House and Congress, could have a significant impact on personal pocketbooks and property portfolios.

Why? To keep the yuan's exchange rate against the dollar fixed, China has had to scoop up huge amounts of dollars. And China has invested much of that money in U.S. treasury bonds. That, in turn, has helped keep U.S. interest rates quite low.

The market's reaction to Thursday's decision was immediate. The yield on the 10-year Treasury note, a benchmark for mortgages, jumped from 4.16 percent to 4.28 percent. That's the highest interest rate for that note since early May.

"This is another nail in the coffin of the housing bubble," said Christopher Thornberg, an economist with the UCLA Anderson Forecast. "Inflated prices are the biggest factor in the housing market. But this is going to hit mortgage rates, which are also a factor."

The outlook for the housing market -- a major engine for the Bay Area economy and especially important in the fast-growing East Bay and Solano County -- is ominous, according to John Rutledge, chairman of Rutledge Capital, a Connecticut-based investment firm. Recent buyers could be especially vulnerable, he warned.

"Because China has been forced to revalue, that has shut off the U.S. housing boom," Rutledge said. "I would not want to be the last person to buy a house when this happens. This is very bad for the U.S. housing market."

The currency maneuvers have imperiled markets besides housing. China had artificially fixed the value if its yuan in part to keep its exports relatively cheap. American business and political leaders had lambasted this decade-old policy in recent years, claiming manufacturers and exporters in this country were being harmed. They pointed out that this country's trade deficit with China had widened to a chasm.

Now, a lot of products imported from China could become more expensive. And that again would hit consumers in the wallet.

"There will be fewer trips to Wal-Mart and the auto dealer," Rutledge said.

Rutledge believes the possible benefits for American manufacturers and exporters will be offset by the harm to home buyers and shoppers.

One East Bay retailer, Pleasanton-based Ross Stores Inc., is not sure how it will be affected by the potential increase in import prices.

"It's premature to make a judgment about that," said Katie Loughnot, a vice president with Ross. The retailer derives about 10 percent of its revenue from sales of items it has imported. Loughnot did not immediately provide a breakdown of the countries from which it receives imports.

Some East Bay real estate agents remained hopeful that the housing market can avoid a collapse even if interest rates rise for whatever reason.

"I just can't imagine the market crashing or prices dropping drastically," said Nancy Erfan, a Keller Williams Realty agent who is active in the Tri-Valley and Castro Valley. "I'm not seeing a slowdown. When I have clients who are buyers, they seem to regret it if they don't act quickly. People will probably not hold off on a purchase just because they think prices will go down later."

Yet while residential brokers believe the real estate market can sail ahead despite the head winds from China and interest rates, some concede that the housing bubble has to pop, or at least deflate.

"At some point it has to cool off," said Teresa McKinney, an agent with Intero Real Estate Services in Danville. "I don't think it will get cold, or will crash, but there will be a slowdown. It's been such an intense seller's market that the pendulum has to swing back to a buyer's market."

Yet American consumers could be bolstered in other ways -- including with lower gasoline prices -- because of the yuan revalue. If China's exports slow, that country's economy, which has sizzled the last few years, could turn more sluggish.

"China's appetite for energy might decrease," said Scott Anderson, an economist with San Francisco-based Wells Fargo Bank. "There could be a decline in oil prices, steel prices, prices for timber and lumber."

Rutledge, though, worries that the overall impact on Americans could be negative.

"For every one person or manufacturer who wins, maybe 99 people in America are going to lose," Rutledge said.

Here are some answers to basic questions about the Chinese currency revaluation and what it means for average Americans:

Question: What did the Chinese do?

Answer: The Chinese allowed their currency, the yuan, to rise in value against the dollar by 2.1 percent, with the possibility of further increases in the future. Since 1994, the yuan's value had been fixed at 8.28 yuan to the U.S. dollar. On Thursday, the Chinese changed the peg to 8.11, and also allowed the yuan to fluctuate somewhat in value against a group of foreign currencies.

Q: Why did the Chinese keep this peg for so long?

A: Among other things, the Chinese maintained that their financial system was too fragile and underdeveloped to handle the demands of a free-floating currency like more advanced economies such as the United States, Japan and European Union.

Q: Then why did the Chinese finally revalue the currency?

A: The Chinese were under international pressure from numerous countries, including the United States. These countries argued that the dollar peg kept the yuan artificially cheap, because the dollar also has been weak in recent years. That gave the Chinese an unfair trade advantage, because an artificially low yuan makes Chinese goods less expensive in the United States and other foreign markets.

Q: But what's in it for the Chinese?

A: Having a more flexible currency will enhance the Chinese government's ability to regulate their economy's growth, which is in danger of overheating.

The Chinese also are said to want to become a full-fledged member of the global financial community by the 2008 Beijing Summer Olympics, which they view as their coming out party to the world. A flexible currency is seen as a prerequisite for being part of the global financial system.

Q: How will the move affect American consumers?

A: A stronger Chinese currency could eventually hit American consumers with higher costs for everything from toys to mortgage loans to fruit juice, illustrating the U.S. economy's dependence on cheap Chinese-made goods and China's influence on interest rates. By some estimates, about 14 percent of U.S. imports are from China. Many American companies manufacture goods in China for shipment to the United States.

However, to try to keep prices down, these American companies might shift some production of goods to other countries where labor and other costs are low.

Q: How could the move result in higher mortgage rates?

A: Mortgage rates are largely determined by yields on 10-year U.S. Treasury notes. The Chinese have been huge buyers of those notes, pushing down their yields. If the yuan strengthens and the dollar weakens, that might prompt the Chinese to reduce their buying of U.S. securities.

Q: How could the revaluation help create jobs?

A: Because a lower dollar and stronger yuan will make American products cheaper in China, thus encouraging the Chinese to buy more of everything from U.S. cotton to copper to soybeans. That could create jobs at companies exporting those products to China.

Q: Will the revaluation help to reduce the American trade deficit with China?

A: The U.S. trade deficit may not fall all that much, some economists say, because other low-cost countries would simply replace any sales lost by China.

The impact:

HOUSING: The decision could slow the housing market because it will likely increase interest rates.

RETAIL: Prices for goods imported from China will probably rise.

ENERGY: Thursday's decision may slow China's economy and its thirst for oil. If that happens, gas prices may fall.

MANUFACTURING: American factories could become more competitive because China's exports would become more expensive.