Econ 340

Lecture 16
Currency Manipulation and Currency Wars

Outline: Currency Manipulation and Currency Wars

- Currency Manipulation
  - What it is
  - Chinese currency manipulation
  - Other currency manipulation
- Currency Wars
  - History
  - Currency war today?
  - Currency war effects

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Currency Manipulation

- Currency Manipulation
  - Usually defined as intervention intended to reduce the value of a country's own currency
    - In order to make its exports more competitive, and
    - Discourage imports
  - Other countries object to it, because it reduces their exports
  - Congress requires the US Treasury Department to report twice a year on currency manipulation

Currency Manipulation

- Currency Manipulation
  - Many have accused China, especially, of currency manipulation over the years
  - Trump promised, during the campaign, to label China a currency manipulator "on his first day in office." He did not.
  - Had he done so, according to one source, it
    - would have authorized "the US to do nothing except negotiate with Beijing over the renminbi, which it is already doing."

Currency Manipulation

- Currency Manipulation
  - In September 2018, Trump told Reuters: "I think China's manipulating their currency, absolutely. And I think the euro is being manipulated also."
  - In October 2018 and against in May 2019, the fourth and fifth such reports under Trump did <u>not</u> label China a currency manipulator
  - In August 2019, without such a report, the US Treasury <u>did</u> label China a currency manipulator
  - Since 2013, Treasury has issued a report every April/May and October. No second report has appeared yet this year.

Currency Manipulation

- The Trade Facilitation and Trade Enforcement Act of 2015 requires
  - Treasury to report twice a year on foreign exchange rate policies of major US trading partners.
  - Major trading partners are those that conduct at least $55 billion of trade with the US per year
- The Act's Criteria, to be a currency manipulator, a country must have
  - A significant bilateral trade surplus with the US
  - A material currency account surplus (multilateral)
  - Engaged in persistent one-sided intervention in the foreign exchange market

Currency Manipulation

- The Treasury's Criteria: To be labelled a currency manipulator, a country must
  - (As of May 2019, per Treasury Department Report)

1. Run a bilateral trade surplus with the United States exceeding $20 billion over the past 12 months;
2. Run a global current account surplus exceeding 2 percent of the country's GDP over the past 12 months; and
3. Engage repeatedly in net foreign exchange purchases exceeding 2 percent of the country's GDP over the past 12 months.

Currency Manipulation

- Treasury's May 2019 Report:
  - No country met all three criteria
  - Seven countries met criteria #1 and #2:
    - Germany, Ireland, Italy, Japan, Korea*, Malaysia, Singapore, and Vietnam
  - One country, Singapore, met criteria #2 & #3
  - China met only criterion #1, but its bilateral surplus was so large that Treasury kept it on its "monitoring list"

*Korea met only one in May 2019, but had met two in six previous reports, and so was included.

Table 2. Major Foreign Trading Partners Evaluation Criteria

	Bilateral Trade	Current Account
	Goods Surplus with United States (USD Bil., Trailing 4Q) (1)	Balance (% of GDP, Trailing 4Q) (2a)
China	419	0.4
Mexico	82	-1.8
Germany	68	7.4
Japan	68	3.5
Ireland	47	9.2
Vietnam*	40	5.4
Italy	32	2.5
Malaysia	27	2.1
India	21	-2.4
Canada	20	-2.7
Thailand	19	7.0
Switzerland	19	10.2
Korea	18	4.7
France	16	-0.3
Taiwan	16	12.2

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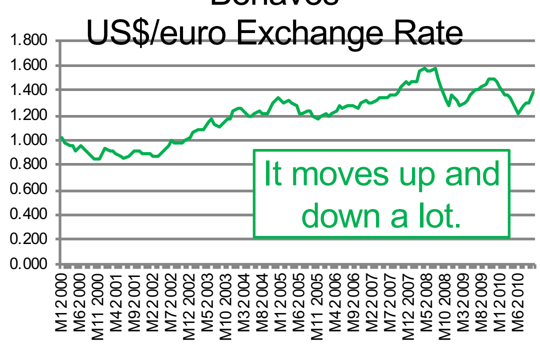
Chinese Currency Manipulation

- Most often accused of currency manipulation is China
- What has been its experience?
- Look at the data on
  - The exchange rate
  - China's reserves
- Recall that: in order to push down your currency, you must
  - Buy foreign currency
  - And thus add to reserves

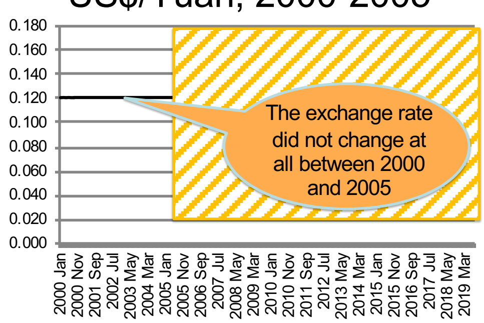
Chinese Currency Manipulation

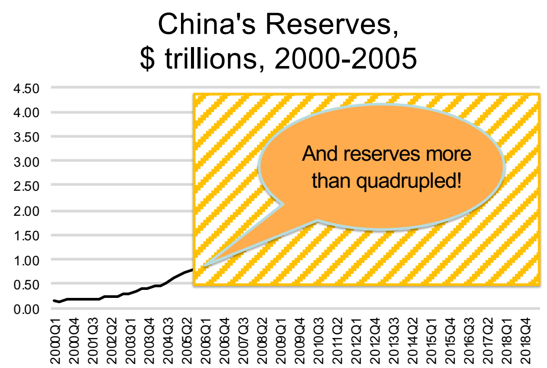
- Note first how a floating exchange rate, without manipulation, performs over time
- Then compare to the Chinese currency, the renminbi (aka, yuan)

How a Floating Exchange Rate Behaves



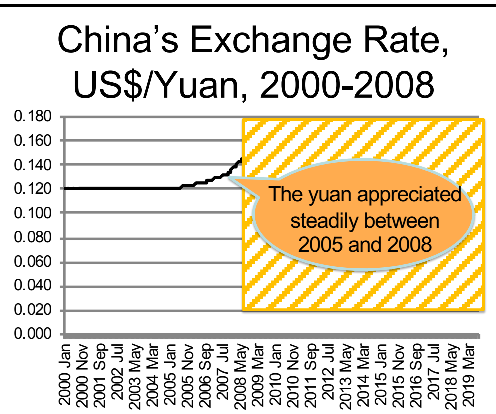
China's Exchange Rate, US$/Yuan, 2000-2005



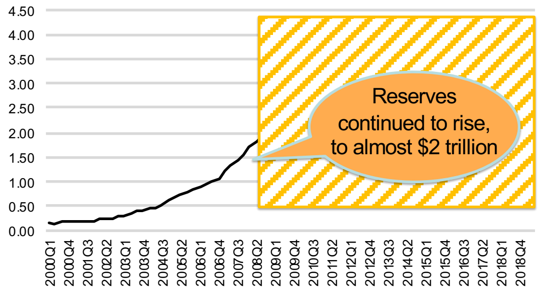


Chinese Currency Manipulation

- During 2000-2005
  - China was intervening keep its rate constant
  - Since it was adding to reserves, it must have been
    - Buying dollars
    - Keeping the yuan below its market clearing value
    - Thus is was manipulating
  - But it did not push the yuan down
  - It was only keeping it from rising



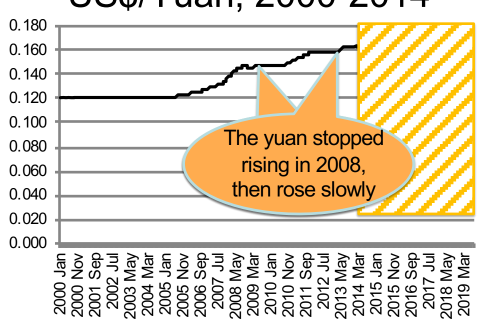
China's Reserves, $ trillions, 2000-2019

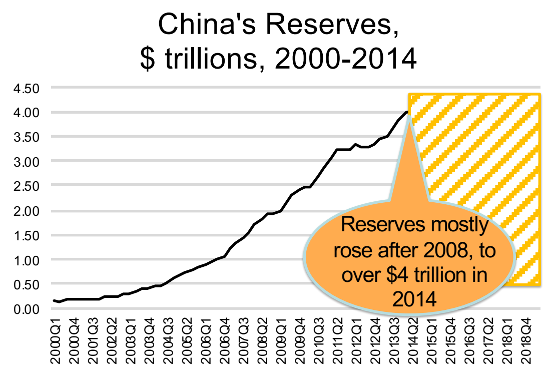


Chinese Currency Manipulation

- During 2005-2008
  - China allowed the yuan to rise
    - In response to pressure from US and others
  - But China's reserves continued to rise, indicating that it was still buying dollars.
  - Was it manipulating?
    - Yes: yuan was below its market value
    - But only to slow its rise

China's Exchange Rate, US$/Yuan, 2000-2014



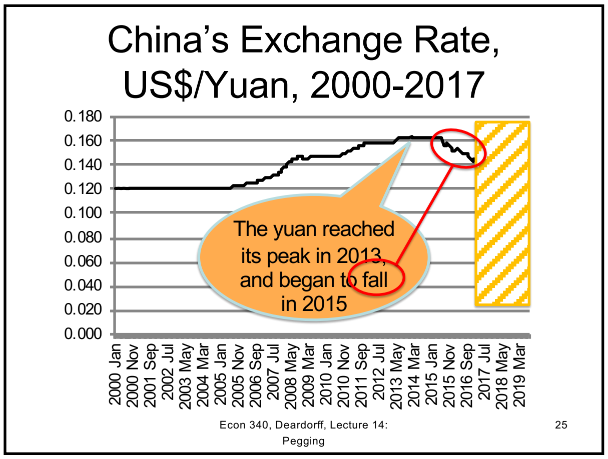


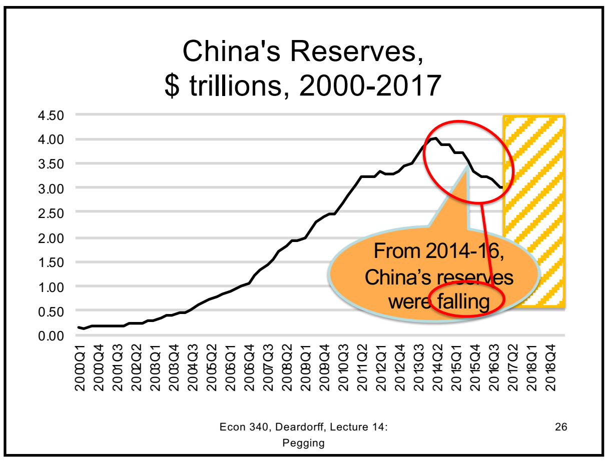
Chinese Currency Manipulation

- During 2008-2014
  - The financial crisis of 2008 slowed down both
    - The appreciation of the renminbi, and
    - The growth of reserves
    - But both continued after a pause
  - Why did the appreciation pause?
    - “Flight to safety” led US $ to appreciate
    - China let ¥ rise with $, but not faster
  - Was it manipulating?
    - Yes, to keep it from rising faster than $

Chinese Currency Manipulation

- Then all changed in 2014





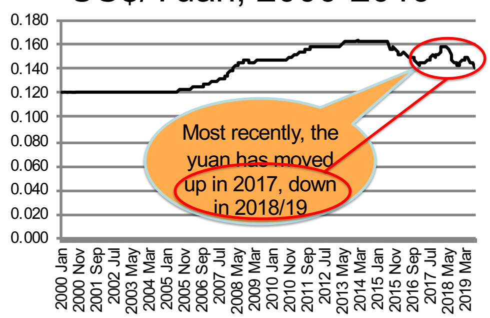
Chinese Currency Manipulation

- Conclusion:
  - China did intervene extensively 2000-2014,
    - Sometimes to keep the yuan from moving,
    - Other times to slow its rise
  - But since 2014, until 2017,
    - Although the yuan was falling in value until 2017,
    - This was in spite of Chinese intervention, not because of it
    - They sold close to $1 trillion of reserves, slowing its fall (over $1 trillion as of March 2017)

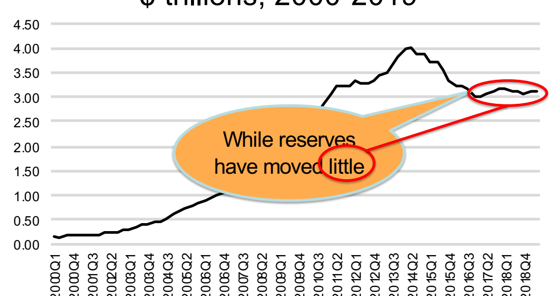
Chinese Currency Manipulation

- During 2014-2017
  - China's currency fell by about 12%
  - But so did China's reserves, by $1 trillion
- Was China intervening? Yes!
- But was it manipulating? No!
  - It was intervening to slow the fall, not cause it.

China's Exchange Rate, US$/Yuan, 2000-2019



China's Reserves, $ trillions, 2000-2019



Chinese Currency Manipulation

- Since 2017
  - China's currency has moved up and down, much more like a normal floating exchange rate
  - Its reserves have changed little
  - Is China manipulating? No

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Other Currency Manipulation

- The *Economist* in March 2017 devised a measure of currency manipulation based on
  - Current account balances
  - Foreign asset purchases relative to GDP

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Other Currency Manipulation

- They found that
  - China's manipulation score was
    - High in 2007
    - Declining since
    - Negative since 2014
  - Score was positive for Germany, South Korea, and Taiwan
  - Highest for Switzerland
    - But based on prices, the Swiss franc was the most over-valued, not under-valued.
    - That's why the Swiss were intervening.

Other Currency Manipulation

- In June 2019, Trump accused the European Central Bank of acting to deliberately weaken the euro
- His basis: ECB President Draghi's statement that "additional stimulus would be required."
- Does that make sense?
  - Yes: Reducing interest rates tends to weaken the currency
  - The ECB's interest rate was already below zero

Other Currency Manipulation

- Is monetary policy currency manipulation?
  – Not by normal definitions
- Most would say that countries with weak economies
  – Are right to lower interest rates,
  – Even though that will depreciate their currencies

Other Currency Manipulation

- In 2010, Brazil's finance minister complained that
  – The US and others were using monetary expansion (due to the recession)
    - This was causing the dollar and other currencies to fall
    - Hurting Brazil and other emerging economies
  – He didn't call it "currency manipulation" but he did complain of a "currency war," a term that he coined.

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Currency Wars

- Currency war defined:
  - Competitive currency depreciations
    - Multiple countries engaging in currency manipulation
    - Competitive devaluations of pegged exchange rates

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Currency War History

- 1930s (See Mihm reading)
  - Competitive devaluations accompanied the higher tariffs of the trade war
  - One after another countries left the gold standard and let their currencies depreciate
  - Unlike tariffs, which may be targeted at individual countries, currencies affect all other countries
  - Thus a currency war can't be confined to a pair of countries

Currency War History

- 1934 US Silver Purchase Act*
  - Roosevelt administration bought large amounts of silver
  - At the time, China was on a silver standard (defining their currency in terms of silver)
  - By buying silver, the US pushed up its price, and thus the value of China's currency

*Source: Hanke, Steve, "U.S. Currency Wars With China—Past And Present," *Forbes*, August 6, 2019.

Currency War History

- 1971 Nixon Shock*
  - President Nixon suddenly ended dollar convertibility to gold, his purpose being to
    - Stop countries pegging to the dollar and
    - Let the dollar depreciate

*Source: Wolf, Martin, "Currencies clash in new age of beggar-my-neighbour," *Financial Times*, September 28, 2010.

Currency War History

- 1985 Plaza Accord*
  - After the US dollar had appreciated some 50% during 1980-85, governments (France, West Germany, Japan, US, UK) met at Plaza Hotel in NYC
  - Agreed to push for dollar depreciation

*Source: Wolf, Martin, "Currencies clash in new age of beggar-my-neighbour," *Financial Times*, September 28, 2010.

Currency War History

- 2010 Response to Great Recession*
  - Guido Mantega, finance minister of Brazil:
    - "We're in the midst of an international currency war, a general weakening of currency. This threatens us because it takes away our competitiveness."
  - He was responding to
    - Monetary expansion by US and others
    - Currency intervention by others

*Source: Wolf, Martin, "Currencies clash in new age of beggar-my-neighbour," *Financial Times*, September 28, 2010.

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Currency War Today?

- 2019 News headlines with "currency war"
  - None before June 22
  - June 22, *Economist*: "Low interest rates and sluggish growth may lead to currency wars"
  - Since June 22, many:
    - 6/27, 7/1, 7/15, 8/5, 8/6, 8/7, 8/8, 8/9 (3),8/10, 9/3,

Currency War Today?

- 2019 Current signs of looming currency war (See Prasad)
  - Some countries have cut interest rates to weaken their currencies (India, New Zealand, Thailand)
  - Trump has threatened to devalue the dollar (not clear how)
  - News of possible currency war proliferates as
    - US labels China a currency manipulator
    - China (lets its?) currency depreciate past 7 ¥/$
    - Trump calls on Fed to lower interest rates

Currency War Today?

Donald J. Trump
@realDonaldTrump

China and Europe playing big currency manipulation game and pumping money into their system in order to compete with USA. We should MATCH, or continue being the dummies who sit back and politely watch as other countries continue to play their games - as they have for many years!

67.2K 9:21 AM - Jul 3, 2019

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Currency War Effects

- Prasad argues that currency war would actually cause dollar to rise, due to uncertainty and "flight to safety"
- Note too that while people speak of a "US-China currency war," neither country can depreciate only with respect to the other.
  - Their depreciations will hurt others, who will likely respond in kind.

Currency War Effects

- If all countries participate, each depreciating by the same percentage, then
  - Exchange rates do not change
  - Only effect is the movement of assets into central bank reserves
- If only some countries participate (or participants depreciate by different amounts) then
  - Those who depreciate most get increased exports
    - Stimulating their economies to higher incomes and/or prices
  - Those who depreciate least get reduced exports
    - Weakening incomes and prices there
  - Ideally, countries may use different macro policies to handle these effects

Currency War Effects

- Currency War versus Trade War
  - The tariffs of a trade war distort choices, cause inefficiencies, and reduce welfare
  - The currency depreciations of a currency war need not distort anything, especially if macro policies adjust for any differences
- Thus, if given a choice, I'd prefer a currency war

Next Time

- The Euro
  - What is it?
  - History of European monetary integration
  - Pros and cons of currency unification
  - Effects on US
  - What happened?