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
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 again in May 2019, the fourth and fifth such reports under Trump did not label China a currency manipulator
  - In August 2019, without such a report, the US Treasury did 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

<table>
<thead>
<tr>
<th>Country</th>
<th>Goods Surplus with United States (US$ Bill., trailing 4Q) (1)</th>
<th>Current Account Balance (% of GDP, trailing 4Q) (2a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>419</td>
<td>0.4</td>
</tr>
<tr>
<td>Mexico</td>
<td>82</td>
<td>-1.8</td>
</tr>
<tr>
<td>Germany</td>
<td>68</td>
<td>7.4</td>
</tr>
<tr>
<td>Japan</td>
<td>68</td>
<td>3.5</td>
</tr>
<tr>
<td>Ireland</td>
<td>47</td>
<td>9.3</td>
</tr>
<tr>
<td>Vietnam*</td>
<td>40</td>
<td>5.4</td>
</tr>
<tr>
<td>Italy</td>
<td>32</td>
<td>2.5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>27</td>
<td>2.1</td>
</tr>
<tr>
<td>India</td>
<td>21</td>
<td>-2.4</td>
</tr>
<tr>
<td>Canada</td>
<td>20</td>
<td>-2.7</td>
</tr>
<tr>
<td>Thailand</td>
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<td>Switzerland</td>
<td>19</td>
<td>10.2</td>
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<tr>
<td>Korea</td>
<td>18</td>
<td>4.7</td>
</tr>
<tr>
<td>France</td>
<td>16</td>
<td>-0.3</td>
</tr>
<tr>
<td>Taiwan</td>
<td>16</td>
<td>12.2</td>
</tr>
</tbody>
</table>

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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

US$/euro Exchange Rate

It moves up and down a lot.

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

The exchange rate did not change at all between 2000 and 2005
Chinese Currency Manipulation

- During 2000-2005
  - China was intervening to 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 it was manipulating
  - But it did not push the yuan down
  - It was only keeping it from rising

China’s Exchange Rate, US$/Yuan, 2000-2008

The yuan appreciated steadily between 2005 and 2008
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

- The yuan stopped rising in 2008, then rose slowly
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 $
China's Exchange Rate, US$/Yuan, 2000-2017

- The yuan reached its peak in 2013, and began to fall in 2015.

China's Reserves, $ trillions, 2000-2017

- From 2014-16, China's reserves were falling.

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

Most recently, the yuan has moved up in 2017, down in 2018/19

China’s Reserves, $ trillions, 2000-2019

While reserves have moved little
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
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 overvalued, not undervalued.
    • 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


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


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

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


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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, 7/16, 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

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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?