

Econ 340

Lecture 16

Currency Manipulation and Currency Wars

News: Nov 4-10

- RCEP nears completion, but India withdraws -- WSJ: [11/4](#) | [Canvas](#) | NYT: [11/4](#) | [Canvas](#) | FT: [11/4](#) | [Canvas](#) | Economist: [11/9](#)
 - RCEP, the Regional Comprehensive Economic Partnership, was to be a 16-country free trade agreement organized by ASEAN, the Association of Southeast Asian Nations, and pushed by China. Its negotiation is nearing completion, but India has now decided not to sign.
 - The 16 countries were to be the 10 nations of ASEAN plus the six with which ASEAN already has FTAs: Australia, China, India, Japan, New Zealand, and South Korea. Negotiations began soon after the Trans-Pacific Partnership began negotiations and have proceeded slowly until now. By including China, which was not in the TPP, RCEP was seen as a counter to the US-centered TPP until Trump pulled out of TPP.
 - At a summit in Bangkok, Thailand, India has now announced that it will not join, fearing a flood of imports from China. But the other 15 countries said they had concluded most negotiations and expect to sign the agreement in early 2020.
- US trade deficit reported -- NYT: [11/5](#) | [Canvas](#) | FT: [11/5](#) | [Canvas](#)
 - FT reports that the US trade deficit for September was the smallest since April, as trade with China shrank due to the trade war.
 - On the other hand, NYT reports that the US trade deficit for the first nine months of 2019 rose by over 5% compared to the same period in 2018.
 - NYT Headline: "Trump Vowed to Shrink the Trade Gap. It Keeps Growing."
- China ends ban on beef and pork from Canada -- WSJ: [11/5](#) | [Canvas](#) | FT: [11/5](#) | [Canvas](#)
 - China had banned these meats from Canada 4 months ago, claiming that export certificates had been falsified. Many believed that the ban was in retaliation for Canada arresting an executive from China's company Huawei, at the request of the US.
 - China's decision comes amid a severe shortage of pork in China, which has been hit by swine fever that has destroyed much of its pork. Increased imports from US, Brazil, and Argentina were not enough to stop the price of pork in China from doubling.
 - China continues to have restrictions on other Canadian exports, including canola seed and soybeans, and it continues to detain two Canadians.

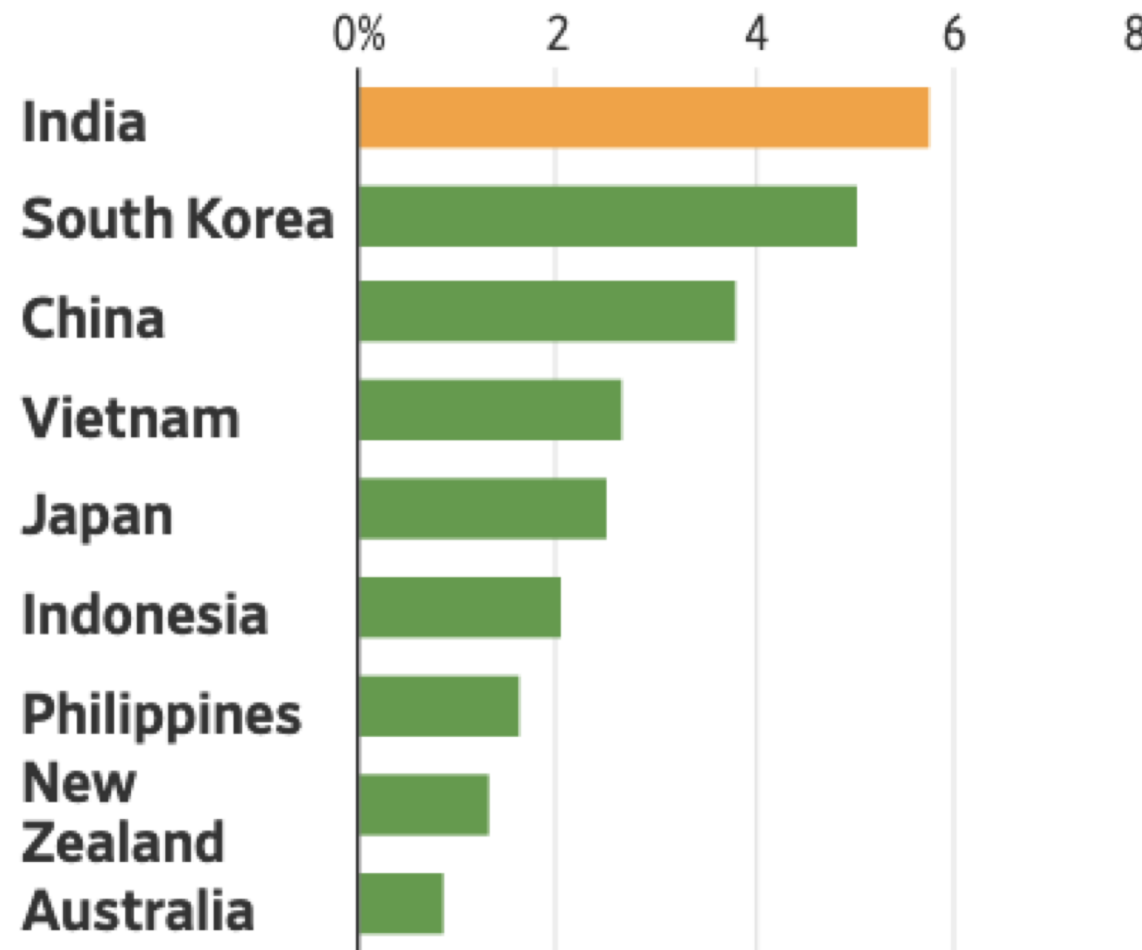
News: Nov 4-10

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India's prime minister Narendra Modi, left, with China's premier Li Keqiang. Screenshot via Getty Images

Weighted mean tariff rate on all products

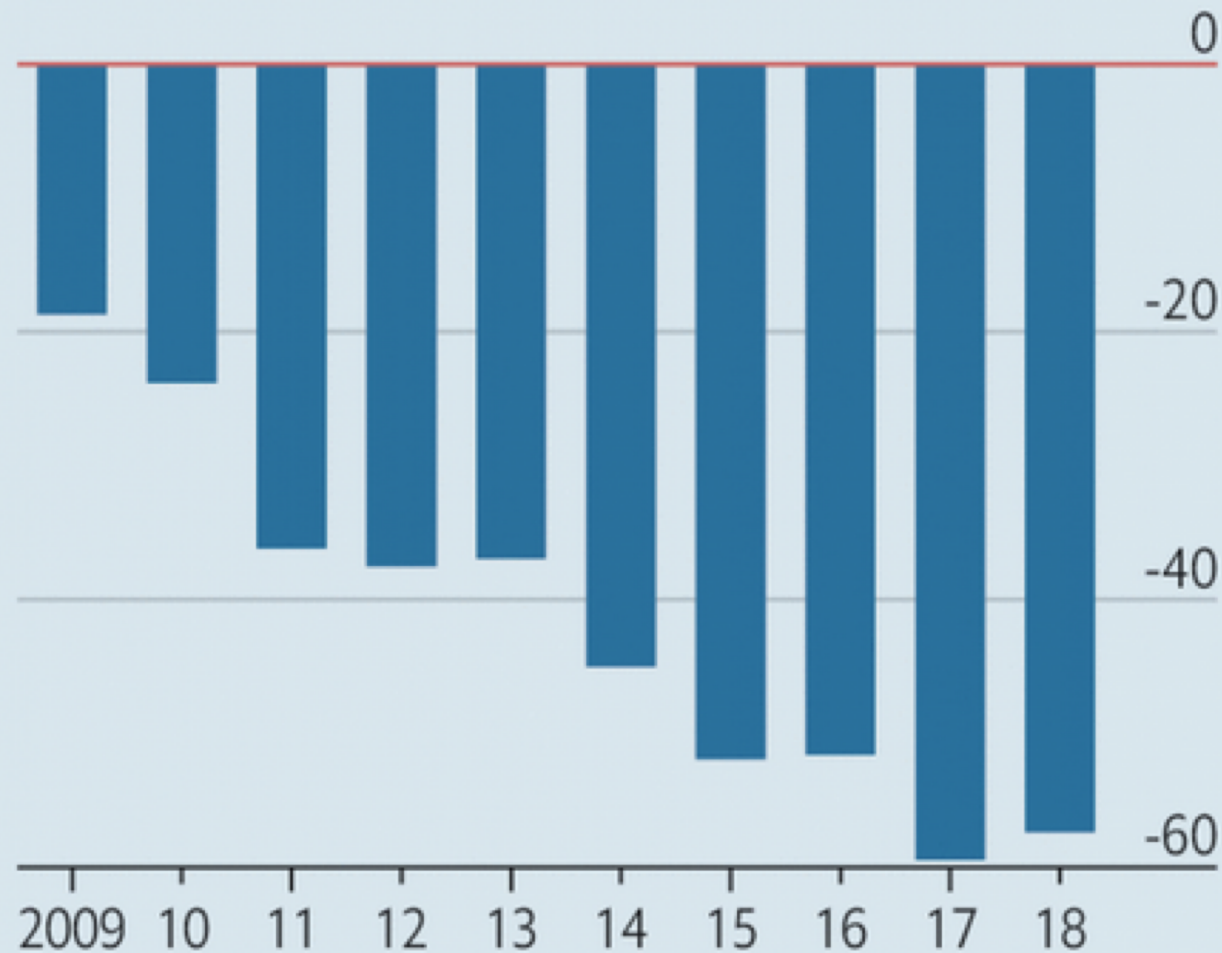


Note: Figures are for 2017

Source: World Bank

The Himalayas are not high enough

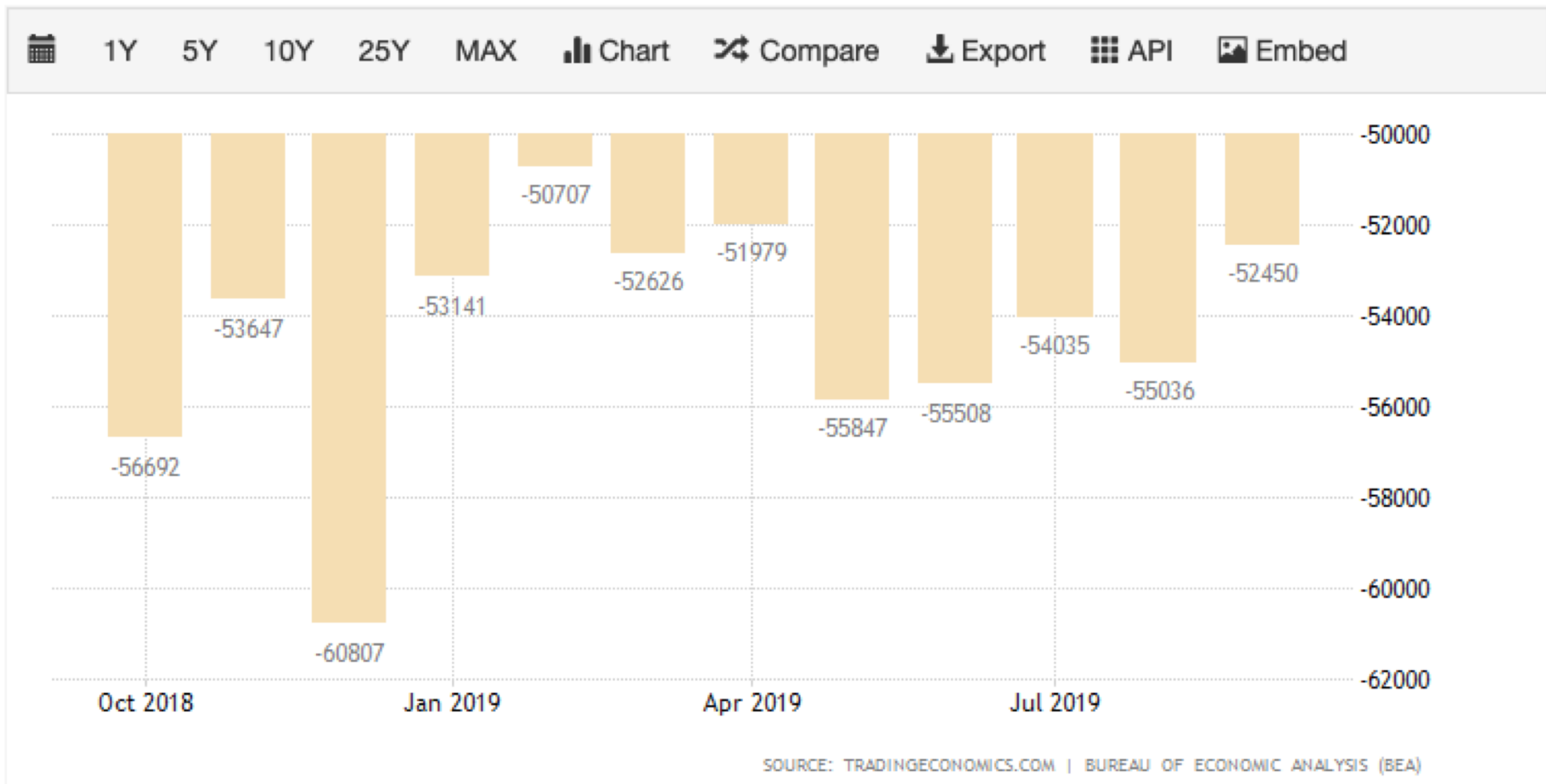
India, trade deficit with China, \$bn



Source: IMF

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China is grappling with massive meat shortages amid a swine flu outbreak Screenshot via Getty Images



Packs of Canadian pork at a supermarket in Beijing in June, just before Canada halted all China-bound meat exports. PHOTO: ANDY WONG/ASSOCIATED PRESS

Value of monthly Canadian meat and edible meat offal exports to China

Canadian dollars, m



© FT

CurWar

(Click on exam for copy of exam, answers, etc. afterwards.)

<u>Midterm No. 1:</u>	Monday, October 21	8:30-9:50 AM	1120 Weill Hall
<u>Midterm No. 2:</u>	Monday, November 18	8:30-9:50 AM	1120 Weill Hall
<u>Final Exam:</u>	Friday, December 13	1:30-3:30 PM	1120 Weill Hall

Office Hours for the Second Midterm Exam

Prof Alan Deardorff

Thursday 11/14, 10-11 AM, 3314 Weill
Friday 11/15, 10-11 AM, 3314 Weill

GSI Huayu Xu

Tuesday 11/12, 9-10 AM, MH 1460
Wednesday 11/13, 10 AM - 12 PM, MLB 2112

GSI Review session:

Friday 11/15, 6-7 PM, Weiser Hall 260

What's Covered on the Second Midterm Exam?

NOTE: You will get two points for correctly recording:

- your name and UMID number, both on the exam booklet and on the scantron sheet so that the computer can read it,
- **AND** your **FORM NUMBER** on the scantron so that the computer can read it.

(In other words, you will lose two points if you don't do all of this.)

The second midterm exam covers all of the material after what was covered on the first midterm exam, through that assigned for Nov 11, Currency Manipulation and Currency Wars. I intend to give roughly equal treatment to each lecture topic, including the outside readings and assigned news items. Thus, the exam covers:

- The assigned portions of Gerber (see syllabus on line),
- All of the online readings assigned from Oct 16 (International Movements of Capital) through Nov 11 (Currency Manipulation), (including any pieces marked as "Other Views" but not those marked as "Optional"),
- You should also be familiar with the **news** that we will have discussed in class, including those items identified on the Assigned News Items Screenshot for weeks: Oct 7 through Nov 10.

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 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

	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

Clicker Question

Which of the following is not required for a country to be named a currency manipulator by the US Treasury Department?

- a) It conducts substantial trade with the US
- b) It has a bilateral trade surplus with the US
- ✓ c) It holds large amounts of US dollar assets
- d) It has a current account surplus
- e) It repeatedly purchases foreign exchange

Clicker Question

Over the last 20 years, how many countries have been named as currency manipulators in the semi-annual Treasury reports?

- ✓ a) 0 Treasury did name China a currency manipulator in August 2019, but that was not in one of those reports.
- b) 1
- c) 2
- d) 3
- e) 4

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Chinese Currency Manipulation

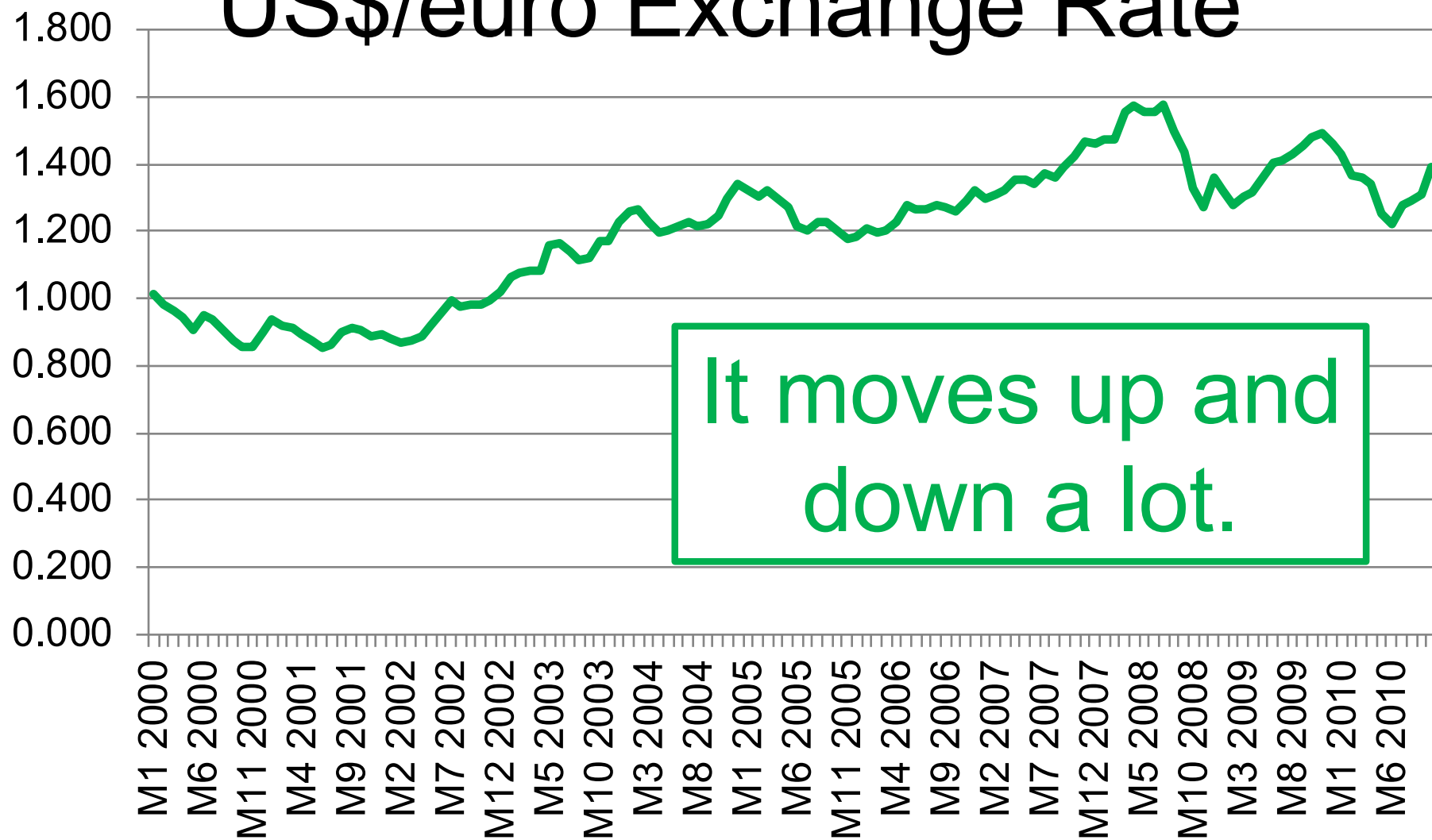
- Most often accused of currency manipulation is China
- What has been its experience?
- Look at the data on
 - The exchange rate
 - China's reserves
- Recall that: in order to push down your currency, you must
 - Buy foreign currency
 - And thus add to reserves

Chinese Currency Manipulation

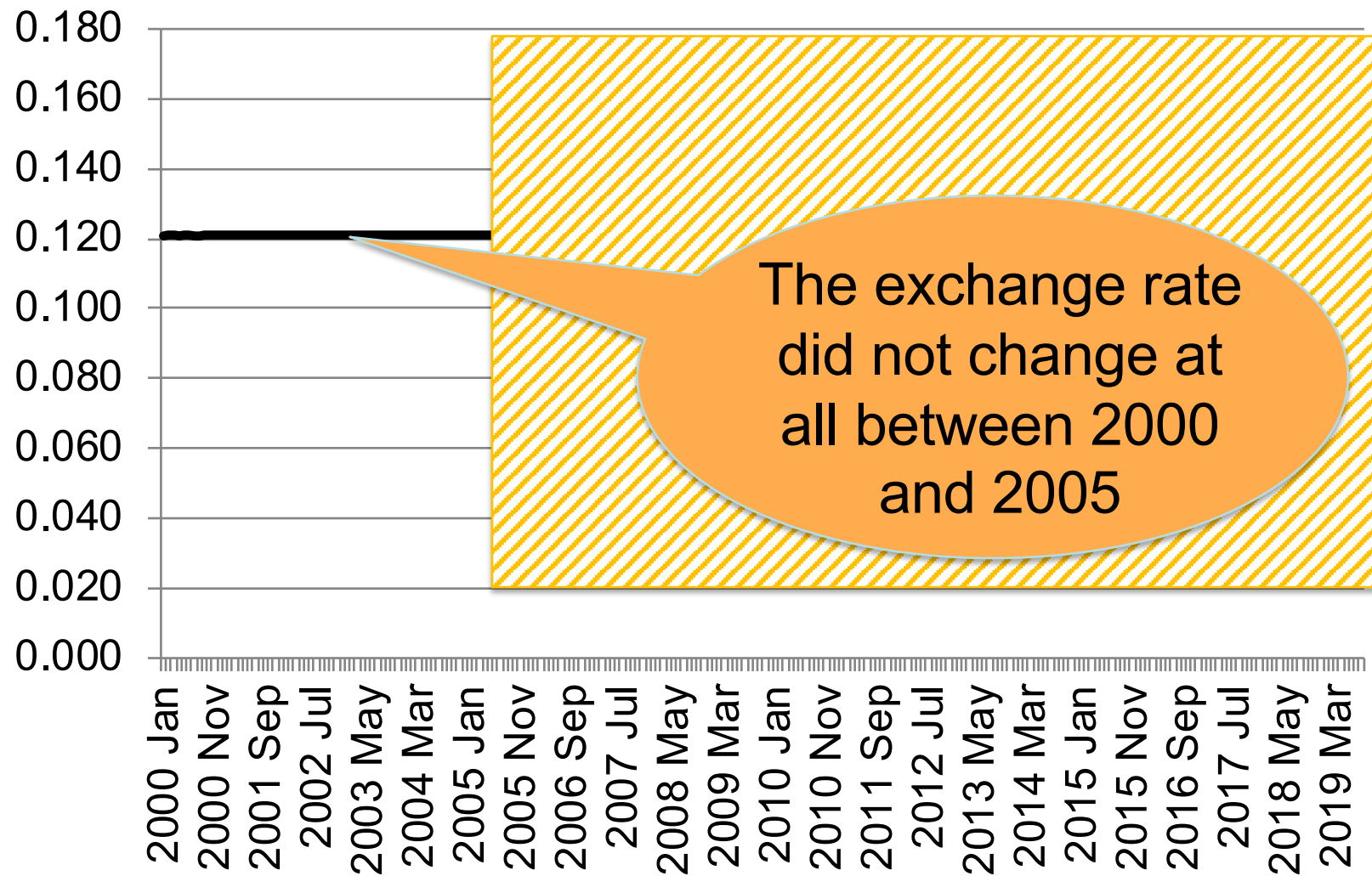
- Note first how a floating exchange rate, without manipulation, performs over time
- Then compare to the Chinese currency, the renminbi (aka, yuan)

How a Floating Exchange Rate Behaves

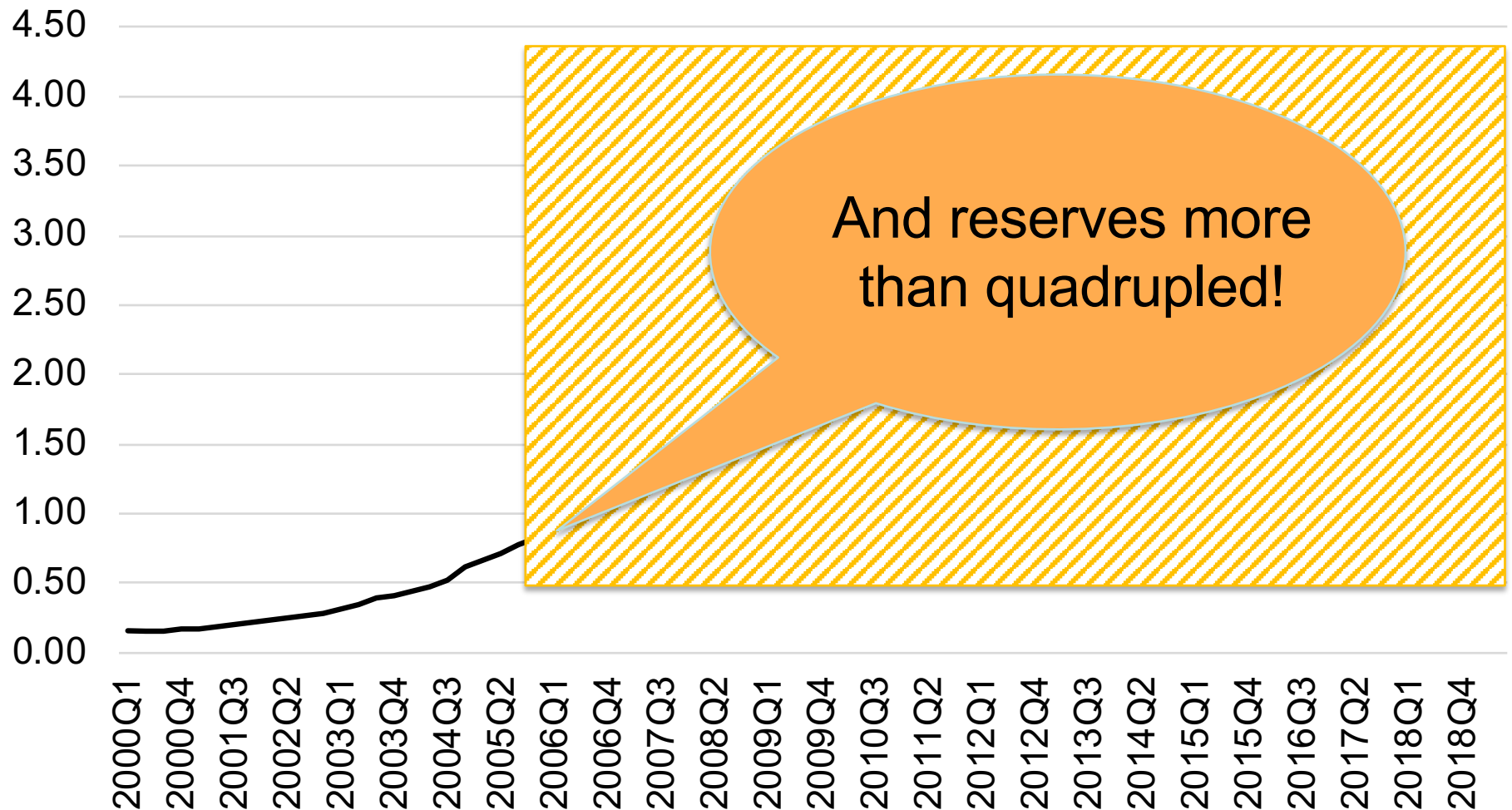
US\$/euro Exchange Rate



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



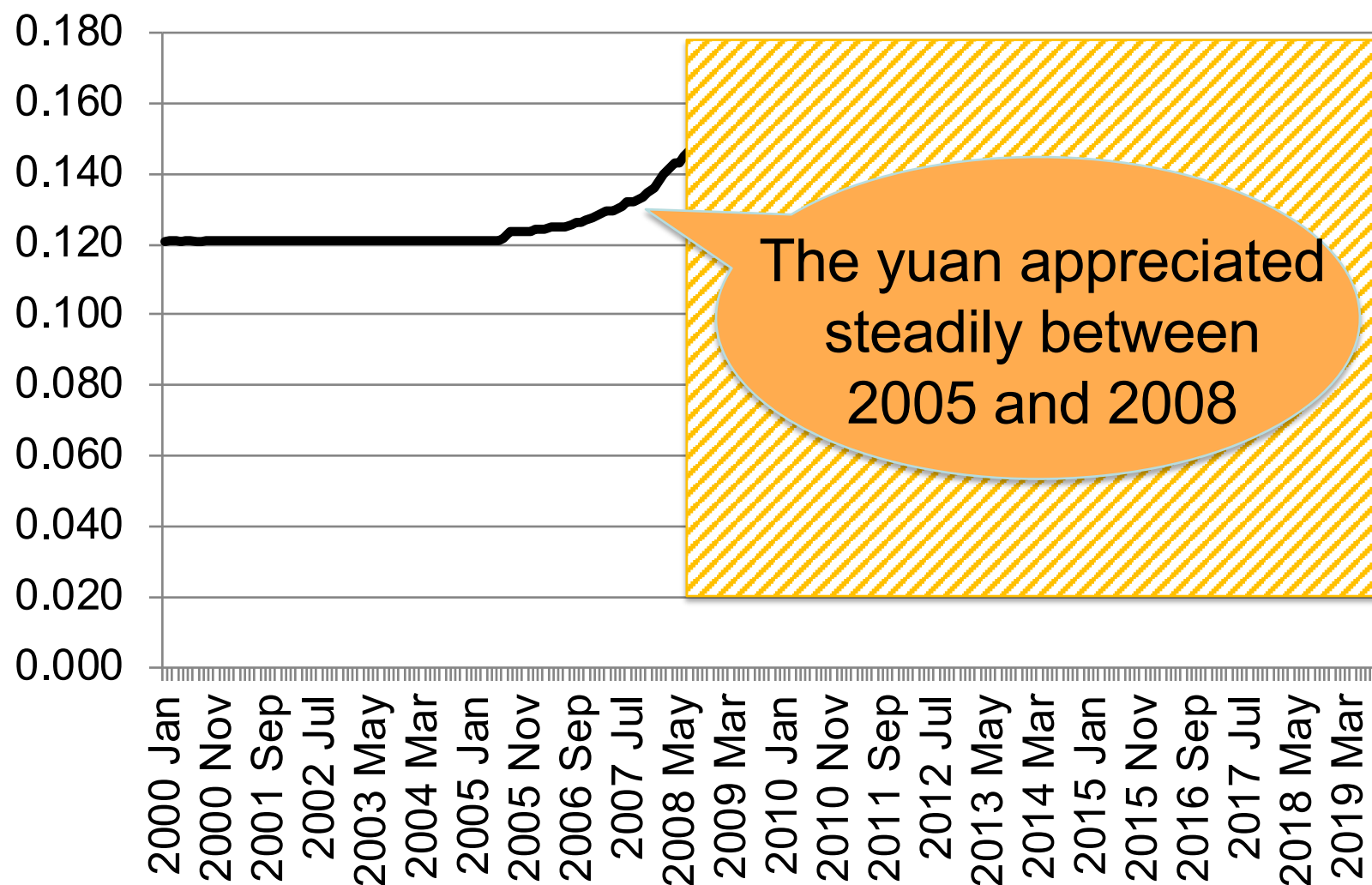
China's Reserves, \$ trillions, 2000-2005



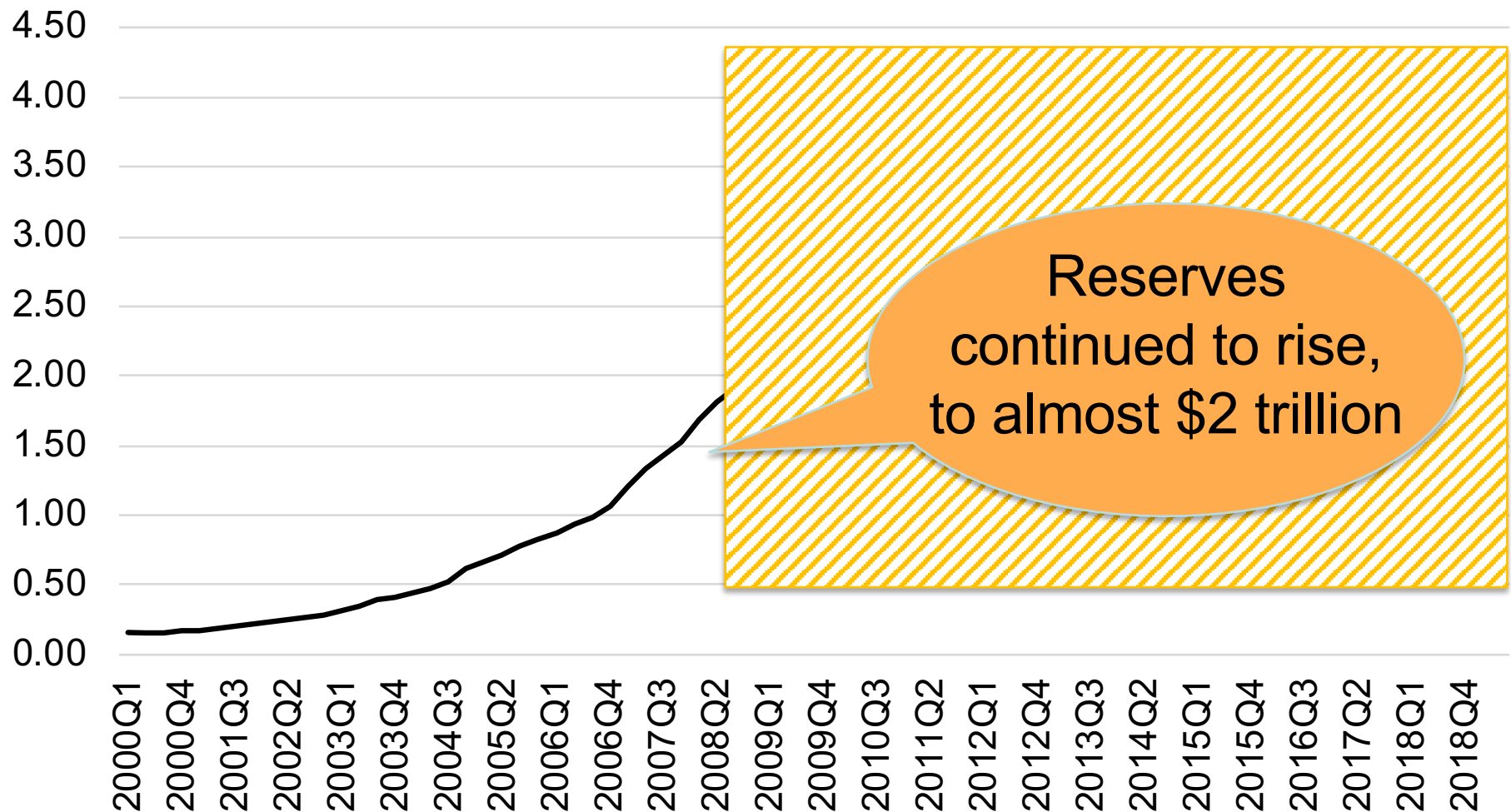
Chinese Currency Manipulation

- During 2000-2005
 - China intervened 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 China 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



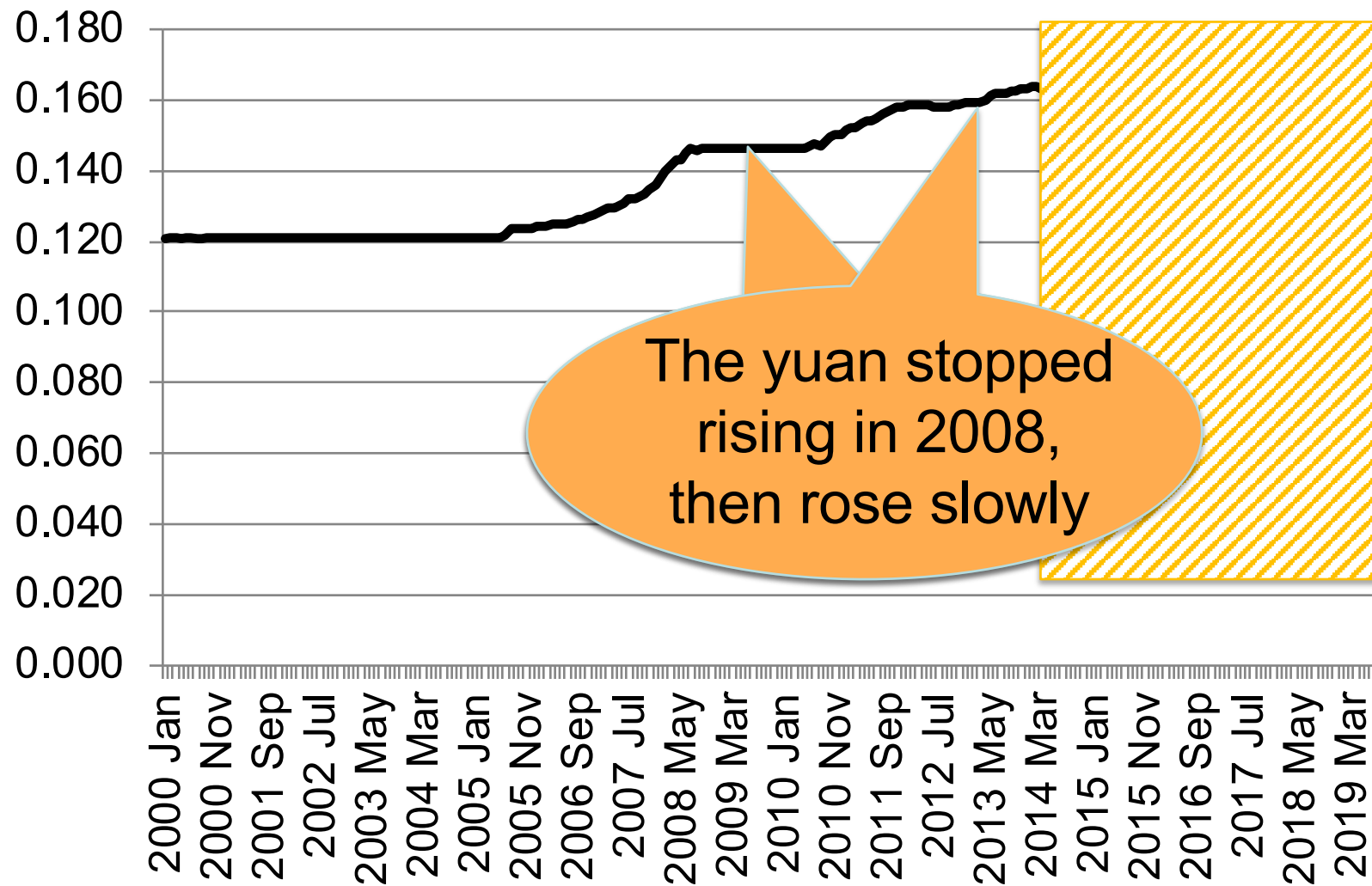
China's Reserves, \$ trillions, 2000-2019



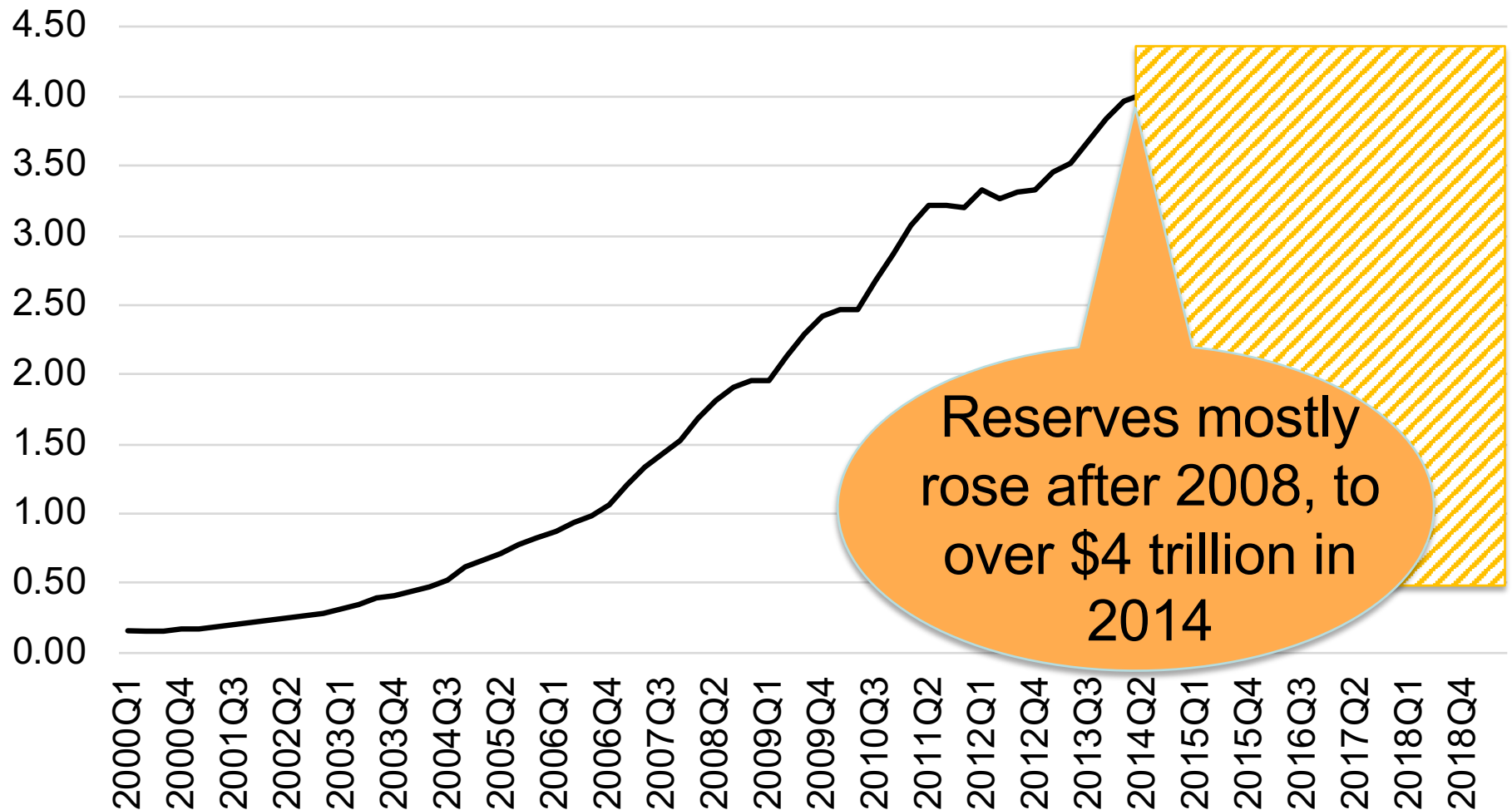
Chinese Currency Manipulation

- 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



China's Reserves, \$ trillions, 2000-2014



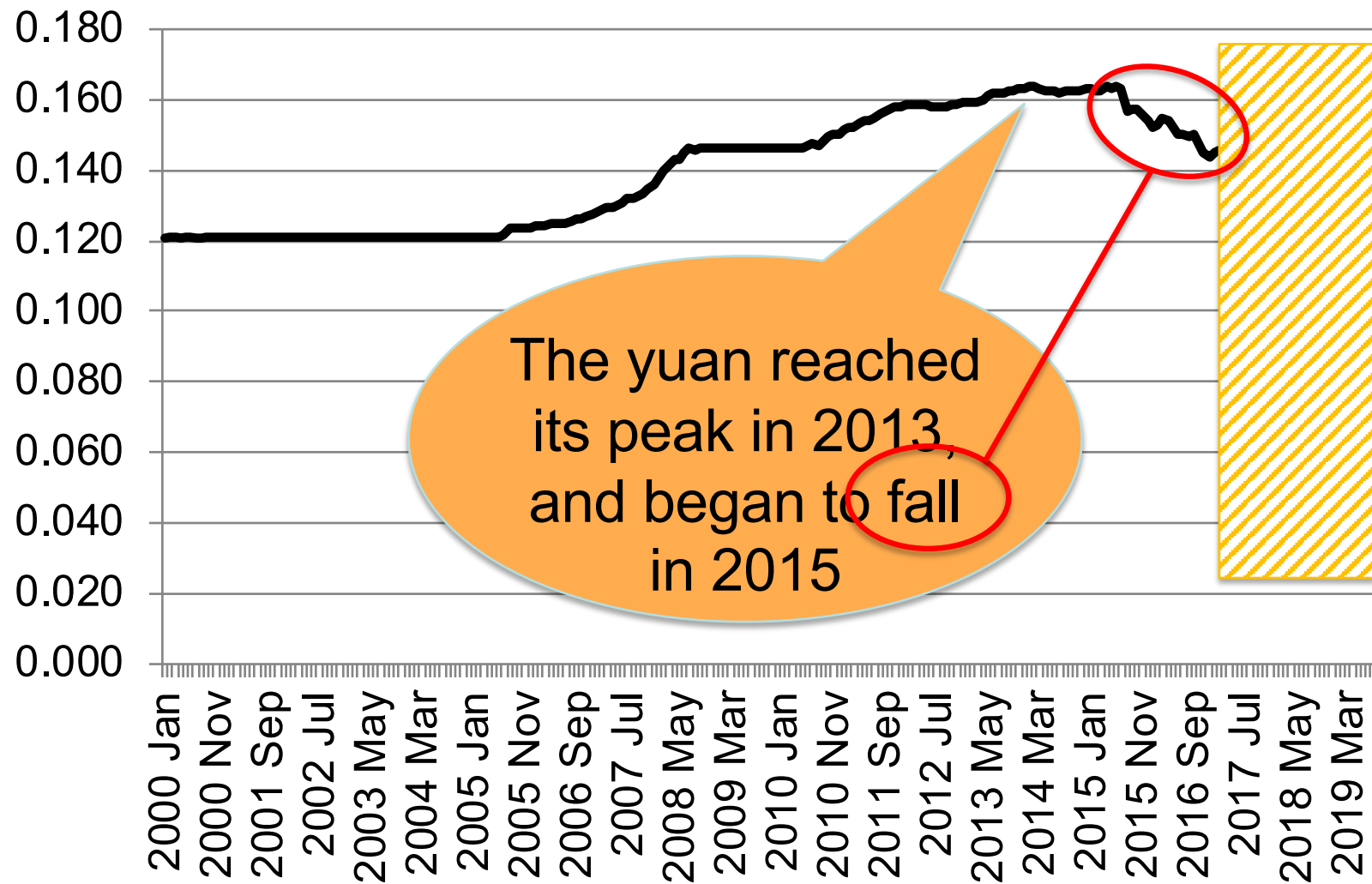
Chinese Currency Manipulation

- 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 \$

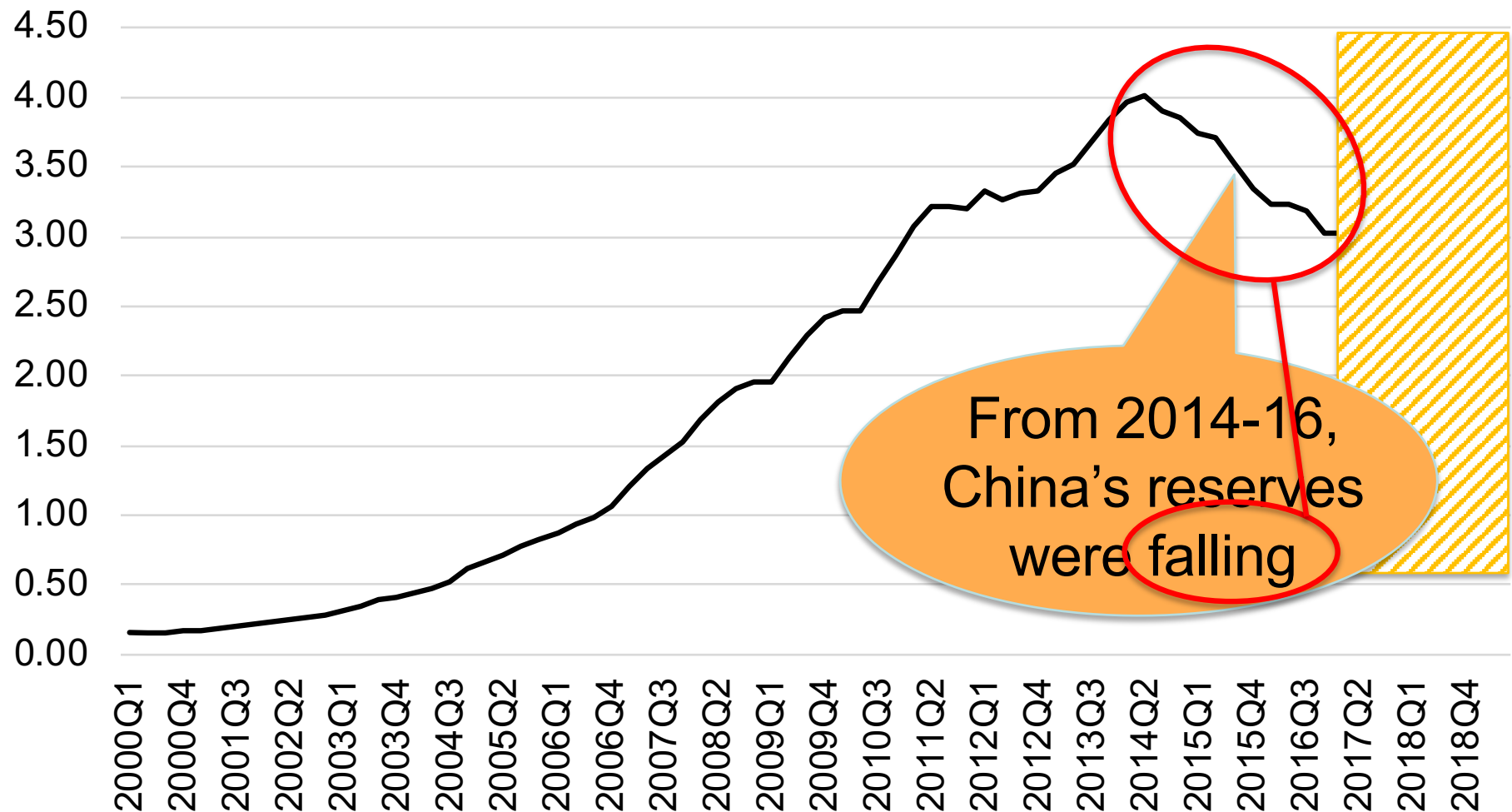
Chinese Currency Manipulation

- Then all changed in 2014

China's Exchange Rate, US\$/Yuan, 2000-2017



China's Reserves, \$ trillions, 2000-2017



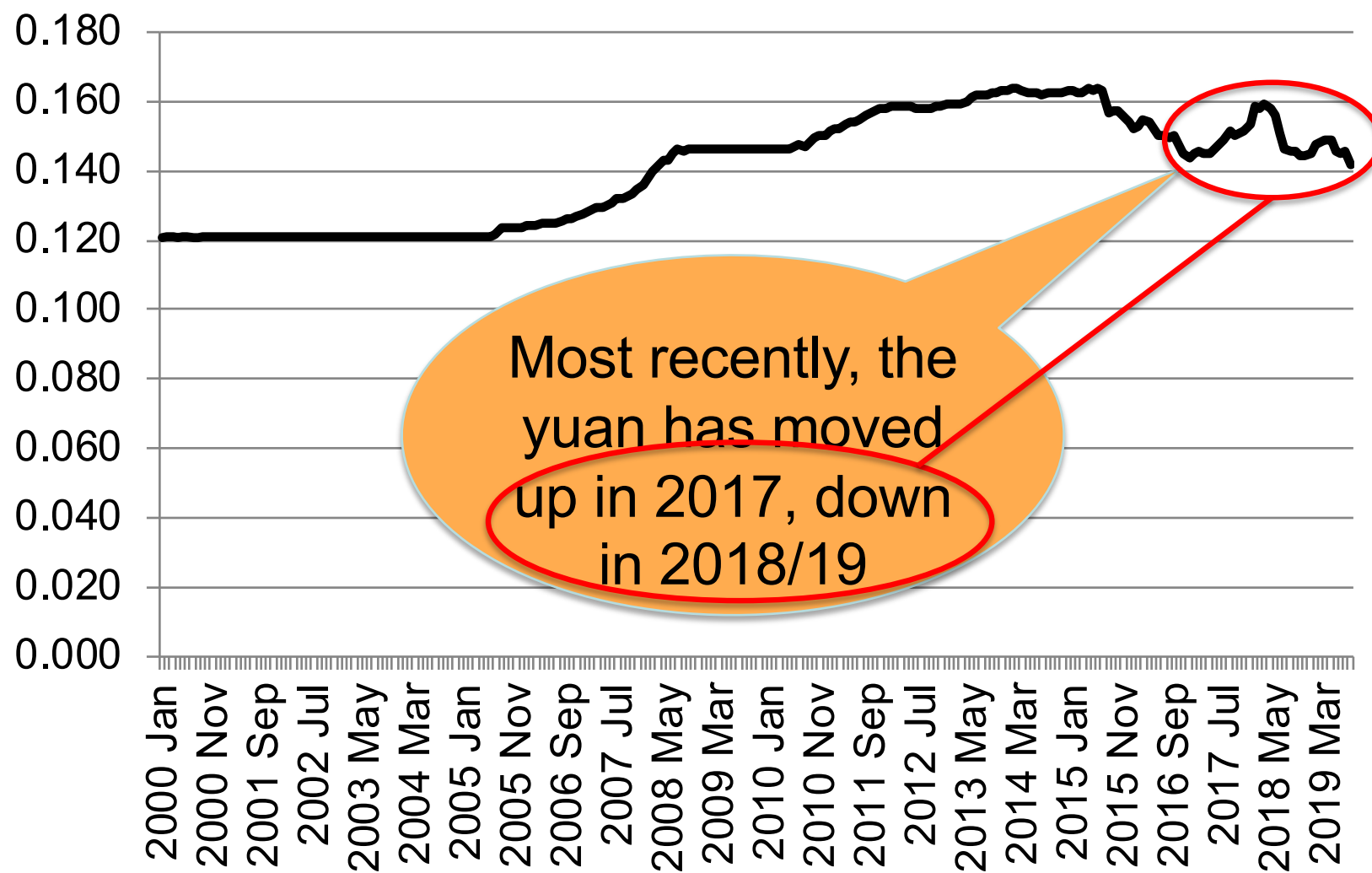
Chinese Currency Manipulation

- 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)

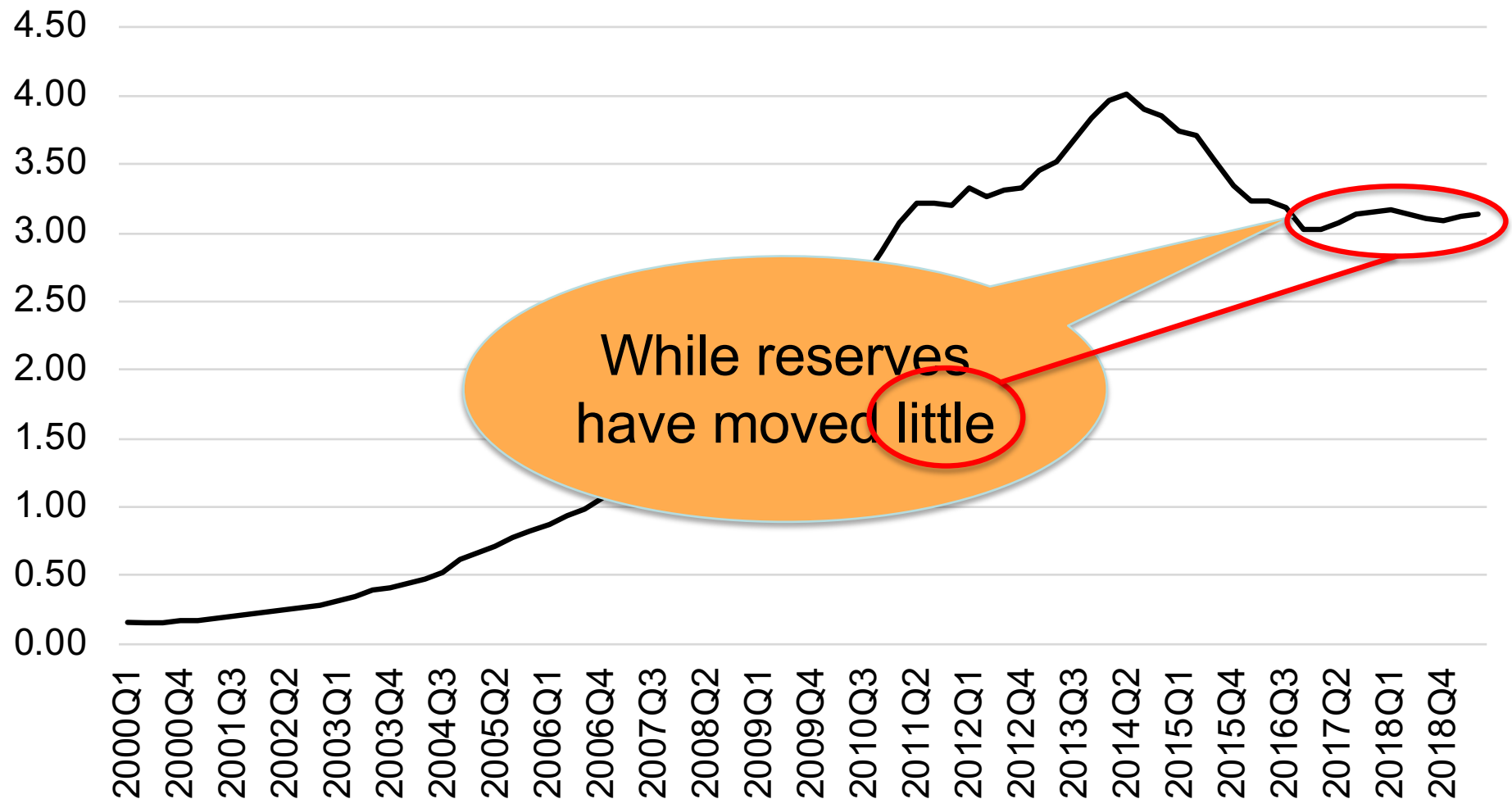
Chinese Currency Manipulation

- 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 to 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

Clicker Question

When has the dollar value of the Chinese currency fallen over time at the same time that China was adding to its reserves?

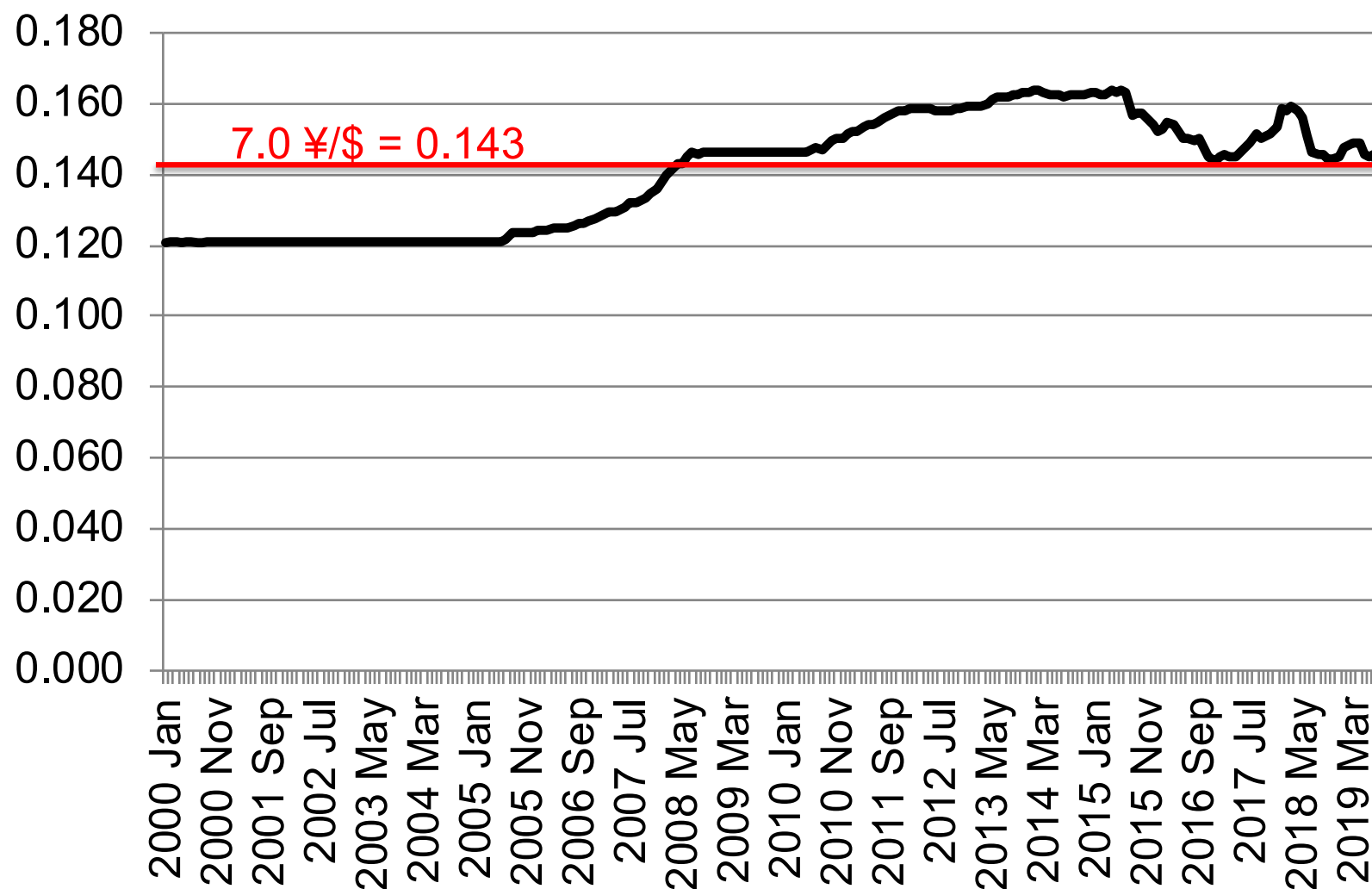
- a) 2000-2005
- b) 2005-2008
- c) 2008-2014
- d) 20014-2019
- ✓ e) Never (within 2000-2019)

Clicker Question

Many have said that a ¥/\$ exchange rate of 7.0 is significant. Approximately what value of the \$/¥ exchange rate does that correspond to?

- a) 0.10
- b) 0.12
- ✓ c) 0.14 More exactly, 0.143
- d) 0.16
- e) 0.18

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



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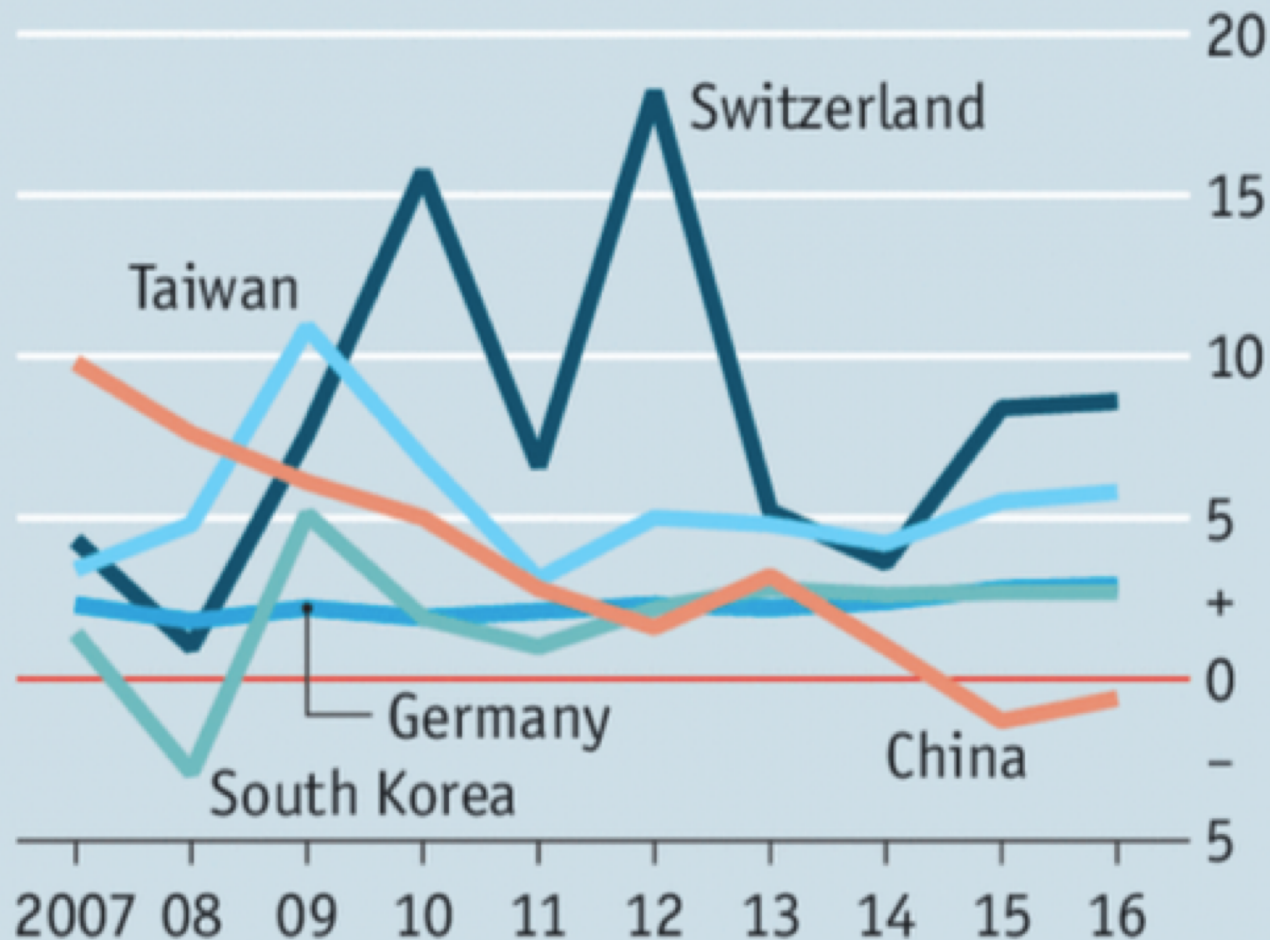
Other Currency Manipulation

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

Exchange controls

Currency-manipulation score*

Selected countries, higher score=more manipulation

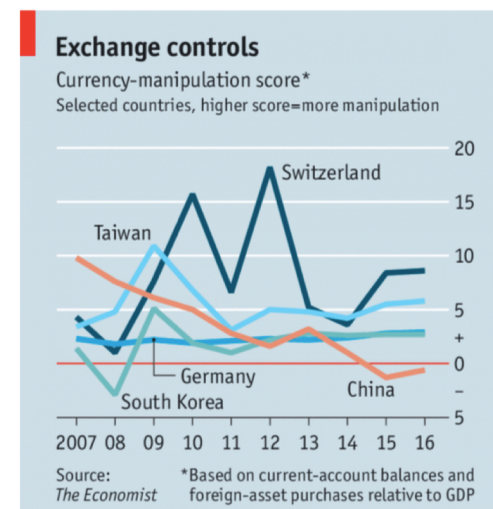


Source:
The Economist

*Based on current-account balances and
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 over-valued, not under-valued.
 - That's why the Swiss were intervening.
 - Manipulation may be justified.



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.

Clicker Question

When, according to the *economist* index, did China cease having a positive currency manipulation index

- a) 2016
- ✓ b) 2015
- c) 2010
- d) 2005
- e) China has never had a positive index



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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 about 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.

Clicker Question

Why, in a currency war, do countries depreciate their currencies instead of appreciating them?

- a) Countries lack the power to appreciate
- b) An appreciation would help other countries
- c) The IMF has rules against appreciation
- ✓ d) A depreciation will help them to export
- e) A depreciation increases their wealth

Clicker Question

Why was US purchase of silver considered and act of currency war?

- ✓ a) China defined its currency in terms of silver
- b) Others needed silver for their coins
- c) The US was trying to monopolize the world's holdings of silver
- d) Countries in Asia needed silver for tooth fillings
- e) Having more silver raised the value of US currency

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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



Clicker Question

Why did President Trump tweet that “We should ... continue being dummies”?

- a) By acting irrational, the US scares other countries into doing what we want
- b) He did not. The “...” in the quotation replaces the word “not”
- c) He was opposing getting into a currency war
- ✓ d) He meant that as the alternative that we should not do

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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

Currency War Effects

- 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

Clicker Question

What harm will it do if all countries depreciate their currencies by, say 20%?

- a) Countries will cease to import
- b) Consumers will prefer domestic products
- c) World wealth will fall by 20%
- d) Stock markets will crash
- ✓ e) No harm.

Next Time

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