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US declares China a currency manipulator

On Monday afternoon, the Trump administration formally designated China as a currency manipulator. In our view, the China-US trade war is rapidly escalating with no end in sight, and the two countries are potentially headed for a currency war. We will continue to closely monitor developments in this regard.

US labels China a currency manipulator

The US Treasury Department on Monday (5 August) declared China a currency manipulator[1], the first such move by the US since the Clinton administration in 1994.

The formal designation came after China on Monday allowed the Chinese yuan weakened below 7 to the US dollar and announced that it would halt the purchases of US agricultural products. Before the Treasury announcement, US President Donald Trump accused China of manipulating its currency in a tweet: 'China dropped the price of their currency to an almost a historic low. It's called "currency manipulation".'

The Treasury Department justified the designation by citing China's 'concrete steps' in recent days to devalue its currency while maintaining substantial foreign exchange reserves. 'The context of these actions and the implausibility of China's market stability rationale confirm that the purpose of China's currency devaluation is to gain an unfair competitive advantage in international trade', it said

[1] https://home.treasury.gov/news/press-releases/sm751

in a statement. The Treasury Department added that it will work with the International Monetary Fund (IMF) 'to eliminate the unfair competitive advantage created by China's latest actions'.

Officially, the currency manipulator label requires the US government to resolve the situation through negotiations with the Chinese government. Therefore, there will be no immediate sanctions against China. However, if there is no progress after one year, China could face sanctions including its companies being prohibited from competition for US government contracts and being excluded from getting financing from a US government agency for development projects.

The People's Bank of China (PBoC) has denied that it deliberately devalued the Chinese yuan. In a statement, PBoC Governor Yi Gang said that China will 'not engage in competitive devaluation, and not use the exchange rate for competitive purposes and not use the exchange rate as a tool to deal with external disturbances such as trade disputes'.

China does not meet technical criteria for currency manipulation

Under the *Trade Facilitation and Trade Enforcement Act of 2015*, there are three thresholds for identifying currency manipulation[2]: a bilateral trade surplus with the US of US$20 billion or more; a global current account surplus of more than 2% of GDP; and persistent foreign exchange purchases equal to 2% of GDP over 12 months.

In fact, China has met the first criterion only, with a trade surplus with the US of US$419.5 billion in 2018. Meanwhile, China's current account surplus only amounted to 0.4% of its GDP over the past four quarters, much lower than the 2% threshold. Moreover, in recent years, China's interventions in the foreign exchange market have been aimed at driving up, not driving down, the value of the Chinese yuan. Thus, China does not meet the technical criteria for currency manipulation.

However, the *Omnibus Trade and Competitiveness Act of 1988* gives the Treasury Secretary broad discretion to make a decision. Treasury Secretary Steven Mnuchin determined that China is a currency manipulator based on this law.

[2] https://home.treasury.gov/system/files/206/2019-05-28-May-2019-FX-Report.pdf

Our take

On its own, listing China as a currency manipulator would not lead to immediate sanctions, and the potential punishments are minor compared with the steps the US administration has already taken against China. However, with the currency move, the trade war between China and the US has entered a new phase, with the two countries potentially headed for a full-scale currency war.

The US latest move also further increases the likelihood that the two countries will be locked in a protracted trade war for years. In our view, even if China and the US can reach a comprehensive trade agreement to end the trade war, broader uncertainties and tensions (such as an escalating technology war) between the two countries are likely to remain for a long time, as the key issue between China and the US is geopolitical rivalry instead of trade.

Implications for our sourcing business: We need more diverse and flexible supply chains

The ever-escalating China-US trade war has caused disruptions in the global trade landscape, bringing fresh challenges and greater unpredictability to our sourcing business. Under such circumstances, production and supply chains now need to be even more diverse, agile, and technology-driven. Businesses with a strong global supplier network and deep relationships with suppliers will be in the best position to meet the new challenges. To navigate the challenging situation, businesses should continue to carry out strategic planning and re-planning for their supply chains, through diversifying sourcing base, nearshoring and onshoring production, and digitizing supply chains.

FUNG BUSINESS INTELLIGENCE

Fung Business Intelligence collects, analyses and interprets market data on global sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to track and report on these issues with a particular focus on business trends and developments in China and other Asian countries. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments around the world through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consultancy services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

About Fung Group

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