Matthews Asia

Matthews Asia Perspective
Management, Not Manipulation

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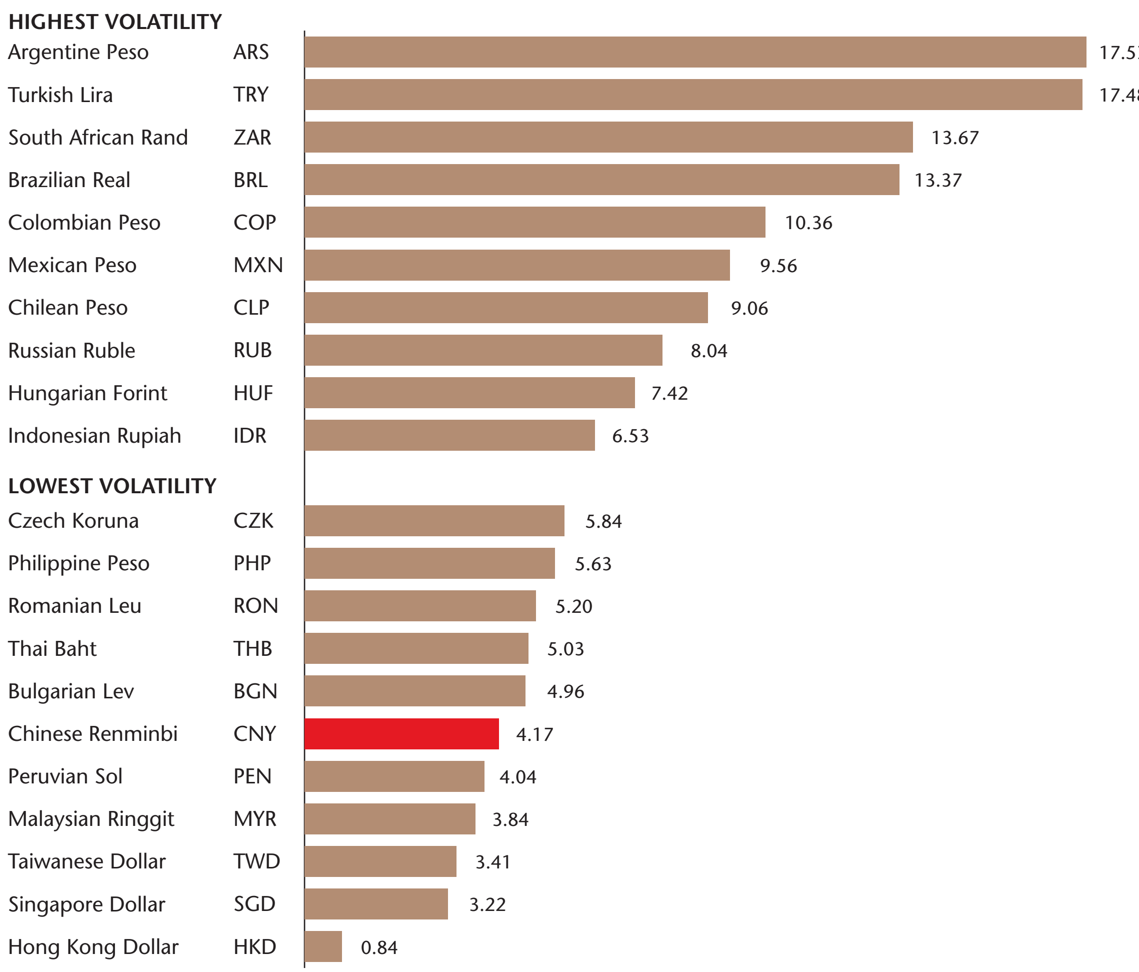
The Trump administration labeled China as a currency manipulator after the Chinese renminbi (RMB) fell in value below 7 per U.S. dollar recently. We disagree and believe China was managing rather than manipulating its currency.

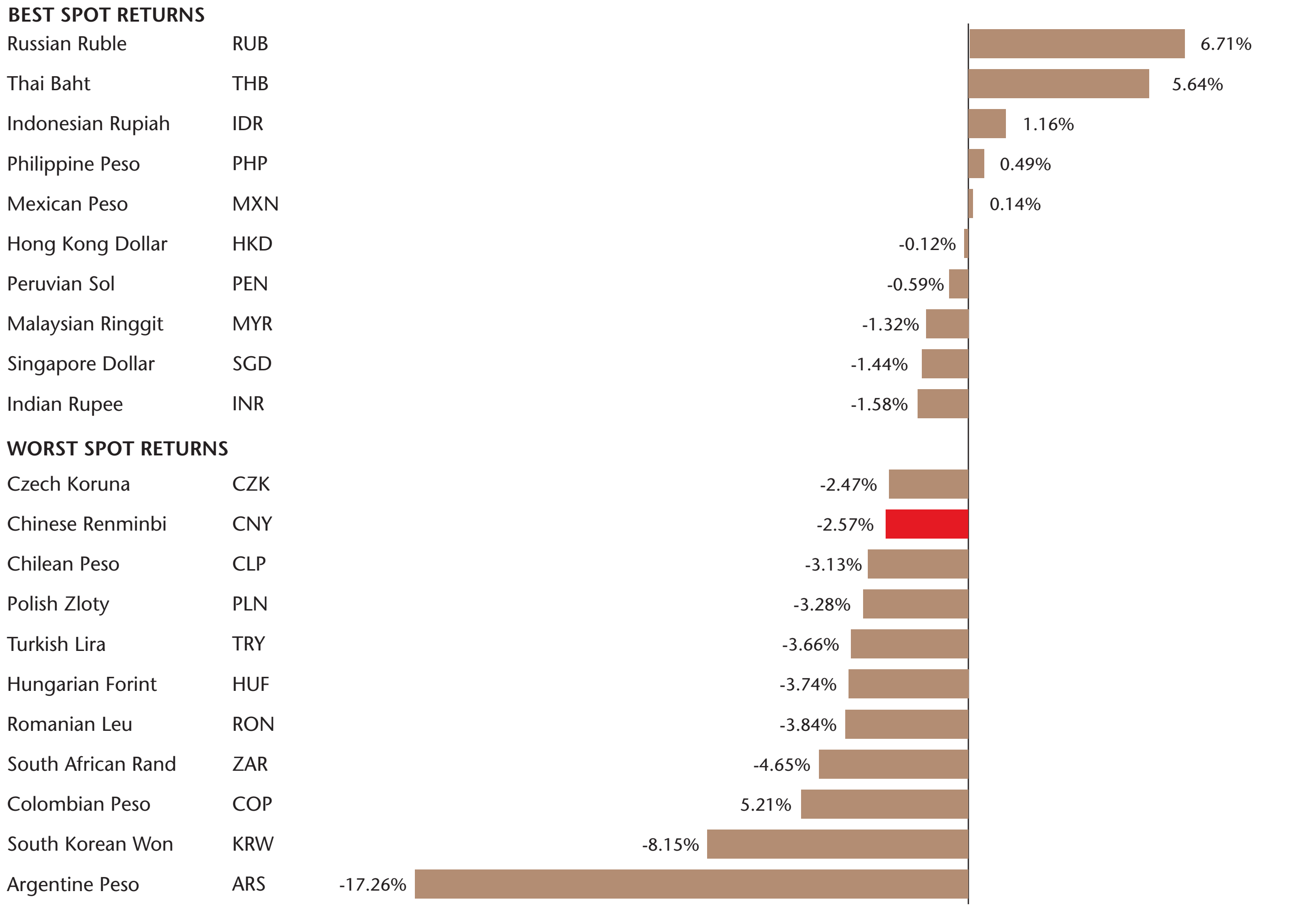
It is important to keep in mind the various currency regimes globally. In any country, the value of the exchange rate fluctuates due to changes in numerous variables. Some economies, such as the U.S., opt for a free-floating exchange rate where the movement is set entirely by market forces. Some economies, for example Hong Kong, fix the exchange rate to a very narrow range. Other economies manage the exchange rate to some degree. The RMB is one of the currencies that is heavily managed to reduce volatility (see Figure 1 below). For example, year to date, the RMB depreciated by roughly 2.5%, in line with the rest of the emerging market (EM) countries (see Figure 2) and with less volatility than most EM countries.

FIGURE 1. EMERGING MARKETS CURRENCY VOLATILITY (6 MONTH ENDED AUG 7, 2019)



Source: Bloomberg

FIGURE 2. EMERGING MARKETS CURRENCY SPOT RETURNS (DEC 31, 2018 to AUG 7, 2019)



Source: Bloomberg

Amid this context, the responsibility of managing the RMB exchange rate falls to China's central bank, the People's Bank of China (PBOC). The PBOC manages the exchange rate through tools such as:

- Outright transactions using foreign exchange reserves (reserves totaling about US$3 trillion)
- Daily fixings of the RMB exchange rate
- Adjustments to daily fixings such as countercyclical factors (CCF)
- Daily maximum trading bands defined as certain percentage away from the fixing
- Reference to a trade-weighted basket of currencies
- Liquidity operations in the market to control borrowing costs of the RMB
- Capital controls for capital account transactions
- Other administrative-control mechanisms such as increased travel documentation requirements

At the same time, market factors affecting the RMB are the same as those for any other currencies. These include but are not limited to:

- Perceived riskiness
- Perceived economic strength/weakness
- Import/export balance
- Risk sentiment
- Economic-related news

The PBOC's task is to manage the currency in light of market-based factors that affect the exchange rate.

What we saw August 5, when the RMB weakened below 7 per U.S. dollar, was one such example. Amid concerns about the negative effect of an escalation in the U.S.–China trade war, market forces caused the currency to depreciate. Given its task is to maintain a relatively stable exchange rate, the PBOC used one of its tools to offset market forces—the aim was not to depreciate the currency but to reduce volatility. As a result, the PBOC acted to *appreciate* its currency relative to where the market was pushing it. And thus, we believe, that it did not represent a "devaluation" or show signs of competitive devaluation.

Regarding whether China is a "currency manipulator," we note the U.S. Treasury's own definition (Omnibus Trade and Competitiveness Act of 1988 Sec 3004b). Accordingly, China doesn't meet the definition of a "currency manipulator" (see Figure 3).

China's current account surplus is less than 1% of GDP , much smaller than those of other East Asian countries such as Singapore, South Korea and Vietnam.

In conclusion, we do not think China meets the definition of a "currency manipulator," nor do we think the country is engaged in a competitive devaluation. On the contrary, we think China is just following its typical modus operandi of managing its currency as it has done in the last few years.

FIGURE 3. OMNIBUS TRADE AND COMPETITIVE ACT OF 1988

(b) BILATERAL NEGOTIATIONS.–The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. If the Secretary considers that such manipulation is occurring with respect to countries that (1) have material global current account surpluses; and (2) have significant bilateral trade surpluses with the United States, the Secretary of the Treasury shall take action to initiate negotiations with such foreign countries on an expedited basis, in the International Monetary Fund or bilaterally, for the purpose of ensuring that such countries regularly and promptly adjust the rate of exchange between their currencies and the United States dollar to permit effective balance of payments adjustments and to eliminate the unfair advantage.

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