Economics

U.S. Push for Stable Yuan May Unwind China's Move Toward Markets

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February 19, 2019, 11:00 PM EST

Updated on February 20, 2019, 4:49 AM EST

- Request for currency stability made in ongoing trade talks
- Currency pledge runs counter to a decade of global pressure

Ben Simpfendorfer, CEO of Silk Road Associates, talks about the spats between the U.S. and China.

President Donald Trump may finally get to deliver on his campaign promise to address China's management of its currency for what he has insisted is its trade advantage. But it would mean an about-face on almost a decade of global economic policy.

The U.S. is said to have asked China to keep its currency stable as part of a new trade deal, a move aimed at discouraging officials in Beijing from devaluing the yuan to offset the impact of American tariffs. That request is at odds with years of global pressure on China, from the Group of 20 economies in particular, to move toward a free-floating currency.

Under such a shift, China's exchange rate and bilateral trade surplus would serve as a way to monitor that promises are being kept, with tariffs as the threat should the Chinese falter. Adopting a U.S. request to prevent big swings in the yuan's value would turn back the clock on progress China has made in recent years toward letting the forces of supply and demand have a bigger influence on the currency's level.

"After years of asking China to become a more market-driven economy, the Trump administration would be explicitly asking the Chinese to set aside market forces when it comes to exchange-rate determination," said Eswar Prasad, a Cornell University trade professor and former International Monetary Fund economist. "That's a worrying precedent."

Bloomberg Economics' Take: Pact Would Only Mean More Flash Points

By removing the risk of a sharp yuan depreciation, the U.S. would help ensure that a trade truce between the two nations will shrink the bilateral trade imbalance, according to former U.S. Treasury official Brad Setser.

A weaker Chinese currency reduces the cost of goods manufactured in China and entices U.S. firms to buy more from Chinese suppliers. That means that even if the Asian nation agreed to buy more U.S. goods, a weakening yuan could negate the benefits to the U.S., Setser said.

Weaponized Yuan

The rift between the world's two largest economies saw the offshore yuan weaken over 5 percent in 2018, drawing Trump's ire and raising speculation that China was deliberately weakening its currency. The yuan has rebounded about 2 percent so far this year.

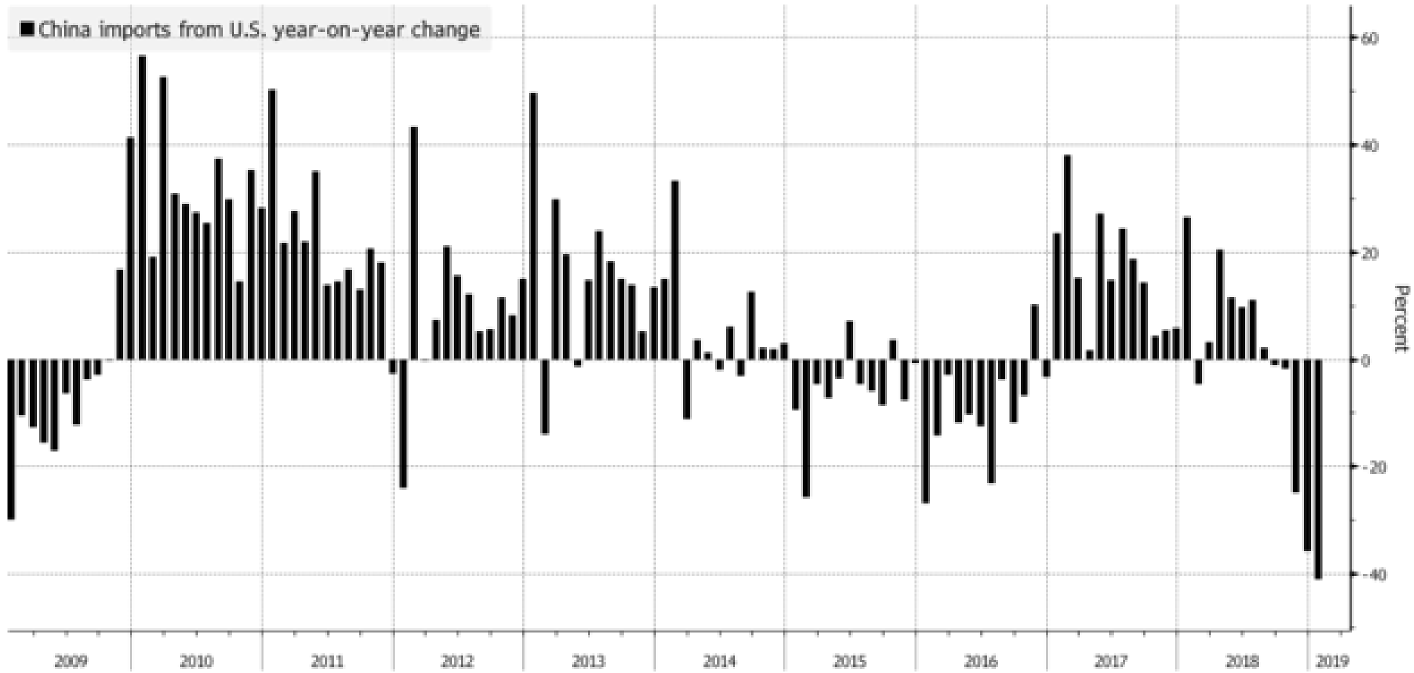
"It's definitely a way of keeping the pressure on China -- forcing them to keep the renminbi stable, while also making the removal of 10 percent tariffs contingent on implementation," said Robin Brooks, an economist at the Institute of International Finance in Washington.

China "will not use the renminbi exchange rate as a tool to deal with trade disputes," Chinese Foreign Ministry spokesman Geng Shuang said at a Wednesday briefing in Beijing.

"We will not engage in a currency depreciation," Geng said. "We hope the U.S. can respect market rules and objective facts and not politicize the exchange rate issue."

Chinese Demand

Imports from U.S. slump by record amid trade war



Source: China General Customs' Administration

Pressuring China to anchor its currency is against their interests, Brooks pointed out. Chinese policy makers have been encouraging a flexible exchange rate since 2015, when it was agreed that the yuan would be added to a basket of currencies that IMF member nations can count on toward official reserves -- a move toward global prestige.

"It goes against the grain of where China wants to go on monetary policy," said Mark Sobel, a former U.S. executive director at the IMF and longtime Treasury official who is now a chairman at the Official Monetary and Financial Institutions Forum, a think tank in Washington.

Officials from the two countries are discussing how to address currency policy in a "Memorandum of Understanding" that would form the basis of a deal that ultimately will have to be approved by President Donald Trump and his Chinese counterpart Xi Jinping, Bloomberg News reported.

The U.S., Not China, Is the Real Currency Manipulator: Shuli Ren

While the precise wording remains unresolved, a pledge of yuan stability has been discussed in multiple rounds of talks in recent months and both sides have tentatively agreed it will be part of any final deal. Negotiations resume this week in Washington and are scheduled to continue through Friday as a March 1 deadline for higher U.S. tariffs approaches.

U.S. Treasury officials, including Secretary Steven Mnuchin and Undersecretary of International Affairs David Malpass, have participated in trade talks with China, with currency policy a key interest to oversee. China's central bank Governor Yi Gang has also attended some meetings.

While a currency pledge and enforcement of it could be an important piece of any trade deal, Sobel said it's a difficult mechanism to design. If the yuan depreciates, for instance, the U.S. Treasury Department would have the unenviable task of determining the culprit.

"The easiest way to resolve this is for China to do the genuine structural reforms that the U.S. is pushing for," Brooks said. "The U.S. in effect wants appreciation of the renminbi and tariffs are one way to enforce that."

– With assistance by James Mayger

(Adds China Foreign Ministry comment in ninth paragraph.)

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