MARKETS

China's Currency Takes a Twist Ahead of Trump-Xi Meeting

While the yuan is down against a large basket of currencies this year, it has gained versus the dollar

China's currency has gained about 1% against the dollar in 2017. PHOTO: © PETAR KUDJUNDZIC / REUTERS

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As China's leader prepares to head to the U.S. this week, there's a new twist in the persistent argument that China is keeping its currency artificially low against the dollar. The yuan has recently been rising.

The gains have been small—the yuan is up 1% against the dollar so far this year—but began shortly before Donald Trump was inaugurated as president. The rise could complicate a central criticism that Mr. Trump has leveled against China: that it is manipulating its currency downward at the expense of the U.S. to help bolster exports and its economy.

Mr. Trump and Chinese leader Xi Jinping are due to meet Thursday.

China for years had been criticized by other countries for its heavy-handed efforts to keep the yuan undervalued, even while it made moves to open its markets to free trading. Then came a period of appreciation which led to the government to suddenly devalue the currency in August 2015, causing a global market selloff.

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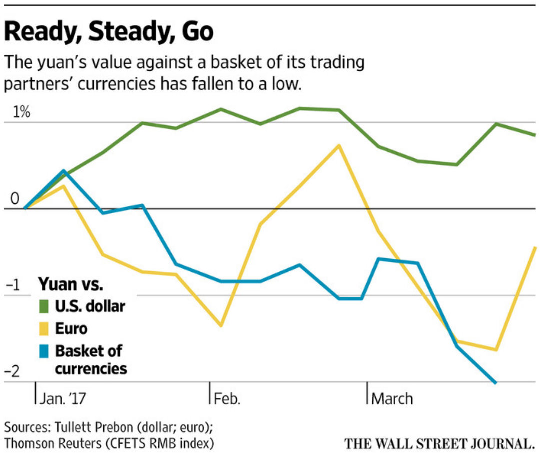
Since Mr. Trump took office, Chinese authorities have relied on capital controls and a broadly weakening dollar to keep the yuan in a narrow range against the U.S. currency.

China achieved the recent calm with relatively mild nudges. In late 2015 and early 2016, the People's Bank of China heavily intervened in the foreign-exchange market by selling its dollar reserves to support the yuan. This year the authorities resorted to a combination of measures, including heightened capital controls and increases of domestic interest rates, analysts and investors say.

The yuan's decline against major trading partners other than the U.S. suggests an effort to maintain global trade advantages while reducing political friction with the U.S., China's second-largest partner in goods trading behind the European Union, analysts said.

The yuan has fallen more than 2% against a basket of China's major trading partners, which include the U.S., the EU and numerous Asian countries including Hong Kong, Japan and South Korea, according to data published by the EU.



Letting the yuan strengthen against the dollar while weakening against other currencies helps China "achieve the objective of export competitiveness and reflation in the economy while at the same time avoiding that negative spillover effect," said Roland Mieth, emerging-markets portfolio manager for Pacific Investment Management Co. in Singapore.

China's currency practices have long been a source of tension between the two biggest economies.

Throughout his campaign for the presidency, Mr. Trump and his surrogates repeatedly accused China of manipulating the yuan in a way that boosted the U.S. trade deficit and destroyed U.S. jobs. Global investors feared new U.S tariffs.

But the administration's tone on trade has been more conciliatory in recent weeks. Last month, U.S. officials signaled they would accept only modest changes to the North American Free Trade Agreement, which Mr. Trump previously blasted as "the worst trade deal" ever.

Accordingly, financial markets have been buoyed by wagers that Mr. Trump won't follow through on tough talk that only a few months ago sparked fears of a global trade war.

"The relative stability or even mild strength against the dollar certainly provides for a less contentious backdrop for the Trump-Xi meeting coming up later this week," said Eswar Prasad, a Cornell University professor and a former head of the International Monetary Fund's China division.

In mid-April, the Treasury Department is set to release its semiannual report on foreign-exchange policies of the U.S.'s major trading partners, and China is on its monitoring list, which tracks countries that run large trade surpluses with the U.S.

Many economists and investors say that China doesn't meet the Treasury's criteria to be named a currency manipulator because its current-account surplus has shrunk and it has been burning through its reserves to prop up the currency, rather than letting it fall. China's currency was undervalued until 2013, some analysts say, but its recently economic and trade weakness has led the currency to a more overvalued position.

An index of the yuan against a broad group of currencies published by a branch of China's central bank is at its lowest since the basket was introduced more than a year ago, as China pledged to decouple the yuan from the dollar and let it move on market forces.

The White House is exploring a new tactic to discourage China from undervaluing its currency to boost exports by designating the practice of currency manipulation as an unfair subsidy.

By keeping the yuan from falling further against the dollar, the Chinese want Mr. Trump to "know that they're willing to play ball on currency and trade issues so that the bilateral economic relationship can be maintained," Mr. Prasad said.

China’s exchange rate is a major concern in the U.S., while issues such as excess capacity in the global economy are “multilateral issues” that matter more to other countries, former Treasury secretary Jacob Lew said last week at a panel in New York held by the National Committee on U.S.-China Relations, a nonprofit organization.

Among its major trading partners, China runs a trade deficit with Japan, South Korea and Taiwan, suggesting that China imports more goods from these economies than what they buy from China. China runs a surplus against the EU, Vietnam and Singapore, but to a lesser extent than its surplus with the U.S.

For much of 2017, the yuan’s value against the dollar has been higher in offshore markets, where it trades more freely, than in domestic markets, suggesting that broader market expectations of yuan depreciation have receded for now.

“It’s politically induced stability,” said Claire Dissaux, head of global economics and strategy at Millennium Global Investments Ltd., a London-based currency investment firm.

However, over the long run, economists say the Chinese currency is still under pressure to weaken against the dollar, as China’s current-account surplus continues to narrow along with its slowing economy. Chinese households and companies are still eager to find ways to swap their yuan-denominated savings into overseas assets.

Ms. Dissaux said: “Capital controls are never sustainable.”

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