‘Currency manipulation’ furphy a distraction from real crisis

“It is the height of absurdity to call China a currency manipulator…. The rest of the world is telling China it needs to open up its markets, yet when it allows a minor drop in its currency, it is accused of manipulation by a country that has a freely floating exchange rate”, wrote China correspondent Glenda Korporaal in *The Australian* on 7 August.

On Monday 5 August the yuan reached an 11-year low against the US dollar, triggering market crashes. Days earlier US President Donald Trump had announced a 10 per cent tariff on all Chinese goods not yet taxed. This minute change in the dollar-yuan exchange rate should not have caused panic, but markets are poised on the cusp of a blowout and awareness is high that the slightest of shifts, even a psychological one, could trigger it.

The US Treasury officially labelled China a “currency manipulator”, the first time it has done so to any nation in 25 years. According to a 5 August Bloomberg article, the Treasury acted unilaterally, and announced its decision outside of its usual semi-annual report to Congress. Cornell University economist Eswar Prasad, who previously worked for the China division of the IMF, told Bloomberg: “Treasury has made what seems like an arbitrary determination of currency manipulation since China hardly meets all of the relevant criteria and despite the dilution of those criteria over time.”

The People’s Bank of China (PBOC), which has actually *reduced the scale of its usual interventions*, allowing the currency to move more than usual, reported that the yuan remains relatively stable against a basket of currencies, and that its depreciation against the US dollar was much smaller than that of the currencies of Korea, Argentina, Turkey and others. China has always managed its currency within a certain band, keeping it undervalued at various times but boosting it in recent years. The USA has made similar interventions over its history, and was denounced in the years following the global financial crisis for quantitative easing and interest rate cuts that depressed the dollar to its advantage. Trump has been talking recently about an explicit intervention to devalue the dollar.

International agreement

Allianz Chief Economist and former IMF official Mohamed A. El-Erian pointed out in a 9 August article for Project Syndicate that trade tensions are but a symptom of the world’s “underlying economic and financial malaise”. Low and insufficiently inclusive economic growth and distortionary central-bank liquidity since the 2008 crisis puts us at a “T-junction”, he said, which will either lead to a crisis, or to solutions yielding general growth and stability. El-Erian urged the USA and China to “resolve their differences in the context of a more comprehensive policy compact that also involves other leading economies”.

A bigger issue for the USA, which it cannot solve alone, is that US dollar supremacy is declining. In the first half of 2019, central banks—with China’s and Russia’s in the lead— purchased a record amount of gold in what is being touted as a move to reduce exposure to the US dollar. London’s *Financial Times* reported 1 August that central banks purchased US$15.7 billion of gold in just six months, building upon last year’s effort when they “hoovered up more gold than at any time since the end of the gold standard”.

Head of market intelligence at the World Gold Council, Alistair Hewitt, told *FT* in January that “A lot of emerging-market central banks have had significant dollar exposure; they need to manage that risk through having an allocation to gold.” A veritable sea of offshore US dollar lending—worth some US$12 trillion—was unleashed by America’s easy monetary policy, and many countries are keen to be free of it. Those nations are moving towards trade settlement in local currencies, which is gaining traction among Brazil, Russia, India, China and South Africa (BRICS) and other Belt and Road Initiative collaborators. For this to succeed, however, it must be backed by an architecture of fixed, stable currencies, backed by national economies collaborating on economic reconstruction. The international Bretton Woods agreement initiated by US President Franklin D. Roosevelt in 1944, provides a model. This was the solution—albeit imperfectly implemented, due to FDR’s untimely death—to the 1930s currency wars, of which numerous pundits are warning we are in danger of a rerun. (“The world needs a New Bretton Woods agreement”, AAS, 26 June.)

Is China’s banking system in trouble?

Since May three Chinese banks have either been taken over by financial authorities or bailed out by state bodies. Following the takeover of Baoshang Bank in May by the Chinese regulator, in July three state-owned financial firms which handle distressed assets acquired large stakes in the Bank of Jinzhou, under guidance of regulators. In early August, a subsidiary of China Investment Corporation, China’s sovereign wealth fund, took over and recapitalised HengFeng Bank.

Bank regulators, who have been cracking down on mid-sized urban and rural lenders that are considered risky or have delayed disclosing financial statements, had announced in June they were proceeding to restructure HengFeng. Baoshang and HengFeng were both affected by close ties with

Chinese-Canadian billionaire Xiao Jianhua's investment conglomerate Tomorrow Group, which is currently being pursued for financial crimes.

UBS China expert Jason Bedford, who has warned that 9.2 trillion yuan of Chinese assets are distressed (equivalent to 4 per cent of China's commercial banking system), told Bloomberg in a 30 July interview that in fact the Chinese banking system is sounder that some years ago, as regulators are running a major cleanup. "It's going to be quite a long road, and not an easy process to go through. But it's hard to argue that much of what is being done isn't the right thing to do."

It is important to note that China's banking system is relatively free of the derivatives gambling scourge that has trapped Australian banks into big-time speculative pursuits. Its commercial banks are forbidden from any form of speculation by Glass-Steagall-modelled bank separation laws, meaning that if they collapse they will not set off contagion in the way a bank here would.

Australian Alert Service 14 August 2019
