Opening for US-China renminbi action

Neither country wants to deal with complications of weaker currency

by Mark Sobel in Washington

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Since early April, the renminbi has fallen 10% against the dollar, largely reflecting dollar strength. The causes lie in the cyclical and monetary policy divergence between the US and China.

However, there is an alignment of interests. Neither the US nor China wants the renminbi to fall against the dollar. Both want to pursue their domestic economic agendas without the complications of a falling renminbi. This could create an opening for unexpected co-operative action by the US Treasury and the People's Bank of China – a joint foreign exchange intervention operation to strengthen the renminbi – which might in turn facilitate co-operation in trade discussions.

US growth is firming on the back of a strong job market and tax cuts, and the Federal Reserve is raising interest rates. Chinese growth is slowing due to deleveraging and the effects of trade disputes between Washington and Beijing. In the light of this, China is now running accommodative monetary policies.

Thus, shifts in interest differentials between the US and China over the past months have favoured dollar placements. US trade rhetoric also exacerbates downward renminbi pressures.

While China wants to maintain monetary accommodation to support growth, Chinese words and actions also demonstrate a wish to curb renminbi depreciation. China has altered renminbi fixings to back appreciation, squeezed short sellers, called repeatedly for stability and intervened to support the currency.

Recently, the renminbi has come close to falling below Rmb7 per dollar. This level is perceived by some as psychologically critical – in this view, a sharp depreciation below that mark might trigger a surge in capital outflow and large downward renminbi move. It is also perceived by some as holding political significance – a rapid fall through that level could exacerbate trade frictions and claims China is engaged in currency manipulation or competitive devaluation.

At the same time, the PBoC has not drawn a line in the sand at Rmb7 per dollar, partly because the central bank wishes to avoid reserve drawdowns. Moreover, its focus is not just on the dollar but also on how the renminbi trades against a basket of its trading partners.

On the US side, bilateral deficits with China remain high, contrary to President Donald Trump's stated goals. Trump is frustrated by the renminbi's depreciation, seeing it as offsetting tariffs, further stoking trade threats.

US/China co-operation is not in vogue. The president has legitimate grievances with Chinese treatment of intellectual property rights and foreign investors, state ownership of the economy and large-scale subsidisation. But where the US and China share common interests, there can be potential benefits from co-operation.

On the plus side, given tensions between the US and China, a positive example of co-operation could help create a better climate between the two countries, particularly for trade discussions. It could underscore that China is not engaged in currency manipulation or competitive devaluation, thus reducing market volatility. The US could begin adding renminbi to its reserves, which will perhaps be needed in the future as China's financial markets become more internationalised. Signs of co-operation would send a positive signal to financial markets.

On the minus side, the proposal does not address the fundamental drivers of current renminbi/dollar developments. The pressure for the renminbi to depreciate – including below Rmb7 per dollar – may be inexorable given continuing cyclical and policy divergence between the US and China, regardless of such intervention. Putting additional tariffs on China would further drive the renminbi down. Beijing could perhaps avert a renminbi fall with huge Chinese intervention or a tightening in monetary policy, but neither is seen as in its self-interest. Any operation might have only a short-lived impact and prove symbolic.

This idea is different than the 'countervailing currency intervention' proposal of Fred Bergsten and Joe Gagnon, both senior fellows of the Peterson Institute for International Economics. That proposal assumed a lack of US/China currency co-operation. But in the CCI approach, China could print renminbi to offset US purchases of the renminbi, it can control the main actors in the renminbi market (whether on the mainland or in Hong Kong), and the sight of two financial authorities blatantly at odds with one another would foster market volatility.

In addition to these considerations, any intervention would need to address key technical modalities. How much renminbi would the US and China buy? Would this be a one-time operation for the US? Would it be a joint Treasury-Fed operation? Usually, a public statement accompanies joint country action – how would the US and China articulate the operation's rationale?

There may be a window for unexpected US and Chinese foreign exchange co-operation to strengthen the renminbi. This might help promote broader co-operation, including on trade. This out-of-the-box proposal has obvious positives and negatives. Still, it is worth consideration by both sides, at least for a moment or two.

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