Every Man *a* Currency Manipulator

But in the game of foreign exchange intervention, China always comes up the biggest winner.

BY JOHN M. BERRY

Just before the final debate between President Barack Obama and his Republican challenger, Mitt Romney, Bill Keller, a *New York Times* columnist, gave the latter some foreign policy advice: "The stridency of your protectionist rhetoric—your promise to formally label China a currency manipulator, clearing the way for a tariff war—makes many of your supporters cringe. Okay, blaming China is a time-tested applause line. But you'll sound smarter if before you start the spanking you try this: 'A prosperous China is good for America. It is a market for our exports, a source of capital, a moderating force.'"

Is it a moderating force these days? Perhaps, but it is still taking advantage of the rest of the world by keeping its currency undervalued—albeit not nearly as much as in the past—while it's still allowing theft of intellectual property and subsidizing exports. True moderation wouldn't involve any of those things.

What is clear is that China achieved its "miraculous" growth as a result of blatant currency manipulation that effectively stole growth from many of its trading partners. Between 1978 and 1993, China's government pushed down the value of the renminbi by nearly two-thirds, in what Surjit S. Bhalla, an Indian economist and hedge fund manager, calls "the fastest and largest real devaluation anywhere, anytime." In his new book, *Devaluing to Prosperity,* Bhalla says the value of the currency then nearly halved again between 1994 and last year.

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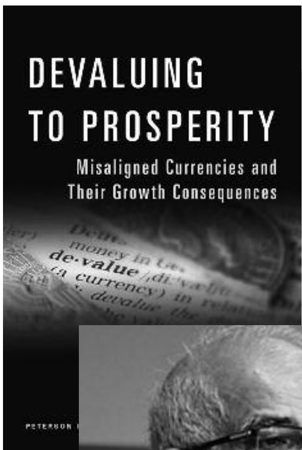
China's behavior and its neighbors' currency over-valuations, Bhalla further suggests, were "most likely" a key cause of the Asian financial crisis of 1997–98.

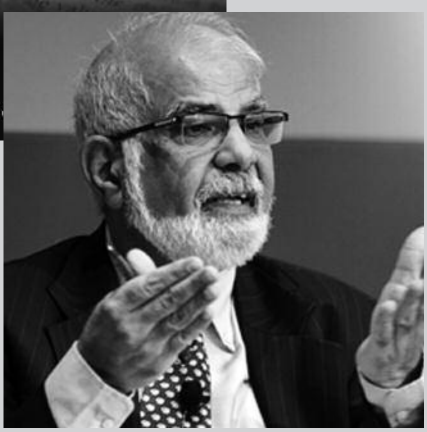
It wasn't just the amount of the devaluation that mattered. "If a small or even a medium-sized country achieves miraculous growth by undervaluing its currency, it will upset some neighboring countries, particularly its competitors, but it will have only a marginal impact on the global economy. It is another matter altogether when the country that achieves miraculous growth through large currency devaluations accounts for more than one-fifth of the world's population," writes Bhalla, who has also worked at the World Bank and several financial institutions.

"It may be true that China's growth helped neighboring countries supply extra inputs, much like England's colonies benefited from supplying cheap imports to England in the nineteenth century. But the counterfactual may be more important: what would the growth rates of these countries have been if China (or colonial England) were not practicing extreme undervaluation?" Bhalla asks. His answer: the other countries' currencies would have been cheaper and they probably would have had higher growth rates. China's behavior and its neighbors' currency over-valuations, he further suggests, were "most likely" a key cause of the Asian financial crisis of 1997–98.

Bhalla's analysis found that for the 1995 to 2011 period, each 1 percentage point increase in the annual rate of change in depreciation of the renminbi led to about a 0.2 percentage point decline in an average country's economic growth rate. "This is the strongest proof that currency undervaluation, especially for a large country, is a beggar-thy-neighbor policy," he says.

Some economists, including Paul Krugman of Princeton University, who is also a *New York Times* columnist, question whether an undervalued renminbi is still a problem. Under the headline, "An Issue Whose Time Has Passed," Krugman wrote last month, "In 2010 an undervalued renminbi was a significant drag on advanced economies, including the United States. Since then, however, two big things have happened: relatively high inflation in China, and some appreciation of the renminbi against the dollar." As a result, the real exchange rate of China against the United States (based on consumer prices), has appreciated about 30 percent, and its current account deficit, which was 10 percent of GDP in





Hey China, What Gives?

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Surjit Bhalla *is author of* Devaluing to Prosperity: Misaligned Currencies and Their Growth Consequences *(October 2012, Peterson Institute).*

2007, is down to about 2 percent, he noted.

Others are not so sanguine. After all, over the first eight months of this year, the U.S. trade deficit with China was over $200 billion—40 percent of this country's total deficit of half a trillion dollars. Last year over the same eight months the deficit with China was a bit smaller, $189 billion, according to the U.S. Census Bureau.

Two economists at the Peterson Institute for International Economics, William R. Cline and John Williamson, regularly calculate what they call fundamental equilibrium exchange rates. Using average exchange rates for last April, they said the renminbi was still undervalued by about 3 percent. However, they also pointed out that China has very rapid productivity growth in its tradable goods industries. For this reason alone, they estimate that the value of the renminbi must rise about 1.3 percent a year in real terms or the current account surplus will continuously increase.

Bhalla calls this "standing-still depreciation." Just like an overt devaluation, it lowers the dollar cost of production and increases profitability. That encourages investors to respond by adding to their investments which in turn propels growth higher and further improves productivity. Of course, the lower exchange rate does raise the cost of imported inputs, but the reduced cost of labor is likely to swamp that effect, he says.

Altogether, this process has proved too attractive for China and some other countries not to use it to gain at the expense of other nations—despite international rules that forbid it. The question is whether China and the others can be persuaded to abandon the tactic, or alternatively, whether those rules can be strengthened or other ways found to force them to stop.

Economists Fred Bergsten, who will step down as director of the Peterson Institute at the end of 2012, and Joseph Gagnon, a senior fellow there, sharply disagree with the notion that the issue of currency manipulation is an issue whose time has passed. They argue that China and the other countries—including oil exporters, some other developing Asian nations, Japan, Switzerland and still others—are holding down the value of their currencies to the point they are distorting capital flows to the tune of about $1.5 trillion a year. "The result is a net drain on aggregate demand in the United States and the euro area by an amount roughly equal to the large output gaps in the United States and the euro area," Gagnon wrote in an Institute policy brief last summer.

Bergsten and Gagnon believe that aggressive action by the United States and euro nations to stop a large part of the currency manipulation could slash the U.S. trade deficit by an amount equal to 1 percent or 2 percent of U.S. GDP and lead to the creation of up to two million jobs. The impact in Europe would be smaller but still significant, they believe.

Both the International Monetary Fund and the World Trade Organization have rules that are supposed to prevent currency manipulation. The International Monetary Fund rules state that a country is not allowed to move its exchange rate, or to prevent it from moving "for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate in order to increase net exports." But "purpose" in practice is a slippery concept and the rule is effectively toothless.

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A Plan to Stop the Manipulators

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Fred Bergsten

Joseph Gagnon

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If enforcing these rules doesn't work, Bergsten and Gagnon say the Federal Reserve and the European Central Bank could intervene in currency markets to offset the actions by the offending countries. Beyond that, a surcharge could be applied to imports from the manipulators' country or some other type of tax imposed to halt the practice.

Unfortunately, such efforts would be like opening Pandora's box. As Keller correctly said, China is a market, a big one, for U.S. exports. You can be sure that any sort of direct action to try to force a country to appreciate its currency would produce nasty reactions accompanied by outcries that the big boys are bullying poorer countries. While China is running a huge monthly trade surplus with the United States, American companies nevertheless exported just over $100 billion worth of goods to China last year. China, as it has in the past, would undoubtedly take steps to retaliate against those exporters.

That would spawn a political furor as exporters whose products were affected started screaming about specific jobs lost. The broader impact of future job gains that might result from limiting currency undervaluations would be more general in nature and probably not generate much offsetting political backing to support that action. Today, for example, some American jobs related to exports to China are being lost due to the slowdown in Chinese growth. That shows the potential vulnerability of American workers should the Chinese retaliate.

Furthermore, as Chinese growth slowed, the government more or less halted its gradual appreciation of the renminbi as part of its effort to spur growth. Undervaluation is not a tool they are ready to relinquish.

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The IMF's Message to China:

Stop stealing growth from other countries by manipulating your currency; stop saving half your GDP while limiting consumption to only about 35 percent of it.

One way the Chinese would not retaliate is to curb their purchases of U.S. Treasury securities. As long as they maintain an undervalued dollar peg and have a current account surplus, they are going to accumulate dollars that will have to be invested directly or indirectly in some type of dollar-denominated asset, the most risk free of which are Treasuries.

Another country that took to manipulation last year was Brazil, but under very different circumstances. Strong economic growth had caused its currency, the real, to appreciate very sharply, and as a direct consequence, its growth slowed sharply. The government responded both by lowering interest rates and putting policies in place to reduce the amount of capital flowing in from abroad. These actions cut the value of its real by more than 20 percent over the past year, but given the context did not violate the IMF rule.

During the IMF-World Bank annual meetings in Tokyo in October, Brazilian Finance Minister Guido Mantega said the moves have worked. "Brazil today is much more competitive, and I perceive that there was already an increase in manufacturing exports because of the new exchange rate, even with the adverse situation of world trade."

Nevertheless, Mantega renewed quite a different complaint about "currency wars." They are being fueled, he said, by the quantitative easing by some central banks, including the Federal Reserve. Those policies, he maintained, are intended to drive down the value of the dollar and other currencies unfairly. "Advanced countries cannot count on exporting their way out of the crisis at the expense of emerging market economies." He called it a "selfish policy," adding, "Emerging markets and developing economies cannot passively endure the spillovers of advanced countries' policies through large and volatile capital flows and currency movements."

The value of the dollar has not depreciated significantly. And the decline in the euro was not the result of quantitative easing and low interest rates engineered by the European Central Bank, but rather in response to questions of whether the fiscal crises in several euro countries might mean the end of the currency.

In a speech at the Tokyo meetings, Fed Chairman Ben Bernanke defended the Fed's extremely easy monetary policy as not just boosting U.S. spending and growth but also as having "the effect of helping support the global economy as well."

Bernanke also said that when countries choose "to systematically resist currency appreciation as a means of promoting exports and domestic growth," they have to realize the policy also comes with costs. "The perceived advantages of undervaluation and the problem of unwanted capital inflows must be understood as a package—you can't have one without the other."

What will China do about its peg of the renminbi to the dollar in coming years? Bhalla is guardedly optimistic that China will realize that it cannot over the long term have a perpetually undervalued currency now that its economy is so large and playing a major role in the world economy. "It's in their self-interest now to move in that direction," he said in an interview. But it's going to be a slow process as China continues to change internally, he added.

One major change coming soon is that its population is expected to peak in about a dozen years—not just grow more slowly, but peak and begin to decline. The Census Bureau projects that will happen around 2025 when the country's population reaches about 1.4 billion. China's labor force will continue to expand for several years after that but then it too will begin to shrink.

Obviously China's economy won't stop growing at that point, but a stable or declining population should ease the pressure to achieve "miraculous" economic growth in order to provide many millions of additional jobs year after year. And perhaps somewhere along the way, China's focus could finally shift to providing more goods and services to the Chinese people rather than intensive investment to produce exports to the rest of the world.

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At the IMF-World Bank meetings, IMF Managing Director Christine Lagarde was asked by a reporter what advice she would give Chinese leaders for dealing with slower growth. She replied succinctly, "Well, I think the first advice I would give is be a partner in the global economy, full-fledged.

"Second, focus on the domestic market, which is clearly an engine for growth that China should activate and is planning to activate. When I say domestic market, I would divide between investment and consumption. Clearly, the focus going forward should be on consumption, because investment has already been well taken care of in the last couple of years."

In other words, stop stealing growth from other countries by manipulating your currency; stop saving half your GDP while limiting consumption to only about 35 percent of it. Your society would benefit and so would the rest of the world. ◆

Be a Full Partner… and Consume

Christine Lagarde

IMF Managing Director Christine Lagarde was asked by a reporter what advice she would give Chinese leaders for dealing with slower growth. She replied succinctly, "Well, I think the first advice I would give is be a partner in the global economy, full-fledged.

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George Soros is a currency manipulator who made billions on the English pound by spending lavishly on organizations that would have a serious deleterious impact on the stability of the currency, mostly socialistic or communistic. He could see the ...Â The goal is to assist your exports. You pay employees in cheap Yen for example, sell the product made in the US and get more valuable dollars which you convert to even more Yen. Currency control via the Central Banks Monetary policy is a tactic to heat up a slow economy or to slow down an economy that is very hot and growing too fast. This is important because we have observed modest steady continual growth is better than huge boons and crashes. Usually, currency manipulation is a work of large institutions or government bodies. As the supply of any currency in the market is sufficient for normal people and the average trader, they do not stand in the definition of currency manipulation. The reason is simple: its quite impossible for a single person in his/her capacity and dealing through own funds to manipulate a single currency or basket of currencies. However, if the same person has been bestowed powers by the large financial institution, be it private or government can manipulate a single currency or basket of currencies by using ...Â Too some extent yes RBI does currency manipulation but to consider it as a legal or illegal activity is quite complex and not easy to decide. Not that designating a country a currency manipulator has any real teeth. China could be excluded from U.S. government procurement contracts, but only if the U.S. finds insufficient progress by the Asian country to stop manipulating its currency a year after the designation. And as Bloomberg News noted, one potential penalty â€” cutting off new assistance from the Overseas Private Investment Corp., a U.S. government agency that helps development projects â€" had already been in effect since 1990 at the time of the August designation. At the end of the day, the main thing the U.S. got out of design A currency manipulator is an entity that influences the value of a local currency for financial or economic gain. Learn more in this FXCM Insights guide.Â "Countries that manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments or gaining unfair competitive advantage in international trade."[1]. The US declared China a 'currency manipulator' after the yuan suddenly fell in response to a new round of US tariffs. The immediate impact has seen $90b wiped off the ASX's value in two days and commodity prices, such as iron ore, tumble. Friday's fresh round of US tariffs on Chinese imports quickly morphed into a share market rout, then a Chinese retaliation with a sudden devaluation of the yuan and a ban on agricultural imports.Â Rabobank's Michael Every points out the last time the US checked out China's currency manipulating status just a few months ago it didn't tick all three of the necessary boxes. "Large bilateral trade surplus â€" tick; current account surplus as percentage of GDP â€" no tick; persistent intervention to weaken the currency â€" no tick," Mr Every said.