2021.1.18 (nle2021.1)

Newsletter

Institute for International Monetary Affairs
公益財団法人 国際通貨研究所

The US Determines Vietnam and Switzerland as Currency Manipulators

The December 2020 Treasury Report on Macroeconomic and Foreign Exchange Policies of Major Trading partners of the United States

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＜Summary＞

- The US Department of Treasury, in its Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States (hereinafter referred to as the FX Report or the Report) released in December 2020, concluded Vietnam and Switzerland as currency manipulators and newly added Thailand, Taiwan and India to the Monitoring countries list.
- The dollar continued to depreciate in the backdrop of sharp deterioration of the world economy, which tended to strengthen the inclination of the US trading partners to rely to foreign demands to support their economies by offsetting the appreciation pressure on their currencies against the US dollar by market interventions. It is likely that this has increased the number of cases where countries fall under the conditions of a currency manipulator.
- Essentially, it is desirable that the Report diagnoses and encourages to correct the distortions of economic policies of the US trading partner countries by examining their international imbalances as symptoms of the distortions, thus trying to realize sustainable growth of both the United States and its trading partners. Therefore, it is expected that under the next administration of president-elect Mr. Biden who emphasizes an international cooperation the Report is used for purpose of correcting the policy distortions not only of the U.S. trading

partners but also of the United State itself.

＜Full Text＞

1. US Treasury released the December 2020 FX Report

The US Treasury Department released on December 16, 2020, the “Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States” that evaluated the macroeconomic and foreign exchange policies of its major trading partners. The FX Report examines not only foreign exchange policies but also related macroeconomic policies including their systems to determine if the major trading partners manipulate their foreign exchange rates against the dollar to prevent effective balance of payments adjustments or to gain unfair competitive advantage in international trade. If any partner economy meets the criteria on this examination, the Treasury Department designates the country as a “currency manipulator” and demands the country to correct their policies with a view to ultimately introducing such sanctions as imposition of customs duties. The FX Report is semiannually provided to the Congress and released to the public, usually in April and October. The timing of the release has been often postponed reflecting the political and economic circumstances of the time, and the Report for October 2019 was released in January 2020 in relation to the trade talks between the United States and China. Since then, the release was delayed (possibly) due to the outbreak of the COVID-19 pandemic as well as such events as the presidential election until the current one, the first almost in a year.

The FX Report was originally required pursuant to the Omnibus Trade and Competitiveness Act of 1988, Sec.3004 (the 1988 Act) and later pursuant to the Trade Facilitation and Trade Enforcement Act of 2015 (the 2015 Act) enacted in the days of the Obama administration. Under the 2015 Act, three objective thresholds were established to determine a country with currency manipulation. They are (i) bilateral trade surplus with the United States of at least $20 billion over a 12-month period, (ii) current account surplus of at least 2% of gross domestic product (GDP) over a 12-month period and (iii) persistent, one-sided intervention occurs when net purchases of foreign currency are conducted repeatedly, in at least 6 out of 12 months, and these net purchases total at least 2% of an economy’s GDP over a 12-month period. A country will be determined that it manipulates its currency when it meets all three criteria, and when it meets any two of the three it will be placed on the Monitoring List. Further, a country or an economy could be determined as a currency manipulator by qualitative standards identified in the 1988 Act without meeting three criteria identified in the 2015 Act. In fact, it was pursuant to the 1988 Act that China was determined as a currency manipulator in August 2019.

2. Essence of the December 2020 FX Report

（1） Overview of the Report

The previous Report released in January 2020 removed the designation of China as a currency manipulator which the Department of Treasury had determined in an emergency statement in August 2019 but there was no designation for China in the recent Report, and this time Vietnam and Switzerland were newly designated as currency manipulators as they met all three criteria identified in the 2015 Act (Table 1). The Report continued to include in the Monitoring List Japan, China, Korea, Germany, Italy, Singapore, Malaysia and newly added Taiwan, Thailand and India to the list while removing Ireland from it. The current Report is basically based on the data for period ending at the end of the second quarter of 2020.

Table １ : Top 20 US Trading Partners and Currency Manipulators /Countries on the Monitoring List

	Goods Surplus with the US （$billion）	Current Account Balance （% of GDP）	FX Intervention		Designated as Currency Manipulator	On the Monitoring List
			Net Purchases （% of GDP）	Net Purchases 6 of 12 months		
China	310	1.1	-0.1	No		○
Mexico	96	-0.2	0.0	No		
Germany	62	6.8	-	-		○
Vietnam	58	4.6	5.1	Yes	○	
Japan	57	3.1	0.0	No		○
Ireland	55	-5.5	-	-		
Switzerland	49	8.8	14.2	Yes	○	
Italy	30	3.0	-	-		○
Malaysia	29	2.5	1.1	Yes		○
Taiwan	25	10.9	1.7	Yes		○
Canada	24	-1.9	0.0	No		
Thailand	22	6.3	1.8	Yes		○
India	22	0.4	2.4	Yes		○
Korea	20	3.5	-0.6	Yes		○
France	15	-1.6	-	-		
Singapore	-1	16.1	21.3	Yes		○
United Kingdom	-8	-2.8	0.0	No		
Belgium	-11	0.6	-	-		
Brazil	-13	-2.8	-2.3	Yes		
Netherlands	-18	9.4	-	-		
Euro Area	152	2.1	0.0	No		

(Note) Data are based on the 12 month period preceding the end of the second quarter of 2020. The red ink indicates that the country meets the criterion in the relevant item to determine a currency manipulator.

(Source) Report on Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States, US Department of Treasury, December 2020.

(2) Evaluations of major trading partners

a) Japan

Japan continued to be included in the Monitoring List as it met two of the criteria with the bilateral (goods) trade surplus with the United States standing at $57 billion, exceeding the $20 billion threshold, and the ratio of the current account surplus to GDP at 3.1%, also exceeding the threshold of 2%. In the previous Report, Japan's bilateral trade surplus with the Unites States stood the third largest, following those of China and Mexico, but this time Japan receded to the fifth as those of Germany and Vietnam surpassed Japan. This situation may have affected the removal of the indication that "Treasury remains concerned by the persistence of the large bilateral trade imbalance between the United States and Japan". However, the Report continued to point out that "the real effective yen remains weaker than average historical levels", and that "intervention should be reserved only for very exceptional circumstances." The Treasury Department also demands the Japanese authorities to continue to pursue structural reforms to reduce macroeconomic imbalances, increase productivity, and raise potential growth.

b) China

China was determined to remain on the Monitoring List because of its outstanding large bilateral trade surplus with the United States at $310 billion, despite China met only this criterion of the three. In the previous Report, the Treasury Department intensified its criticism on China, citing that China had been maneuvering unfair devaluation of the RMB to gain competitive advantage, which led the Treasury to designate China as a currency manipulator in a statement of the Secretary of Treasury issued in August 2019. However, there was no such reference found in the current Report. In the current Report the Treasury Department acknowledges that China has made enforceable commitments to refrain from unfair competitive devaluation following the Phase One agreement reached by China and the United States in January 2020 and admits that the trade surplus has tended to contract recently while the RMB exchange rates appreciating both against the dollar and in terms of the real effective exchange rate. Still, the Treasury Department continues to demand China to improve the transparency regarding key features of its exchange rate mechanism, since the mechanism for setting the central parity rate (the "daily fix") that the Chinese authorities announce every morning is unclear, and China does not publish foreign exchange intervention data, as well as there is a possibility that de-fact intervention has been made through the state-owned banks. In addition, the Treasury Department says that China needs to take additional policy measures to strengthen the role of the market-oriented mechanism in its economy and further rebalance its economy by implementing structural reforms to reduce the dependency on investment and exports.

c) Germany

Germany remained on the Monitoring List as it met two criteria with its bilateral trade surplus with the United States standing at $62 billion against the threshold of $20 billion, and current account ratio to GDP at 6.8%, much higher than the threshold criterion of 3%. The Treasury Department again pointed out as in the previous Report that the real effective exchange rate of the euro continues to be relatively undervalued compared to Germany's competitiveness. While Germany's COVID-19 response measures increased the fiscal expenditures, the Treasury Department urges Germany to reduce external imbalances through more domestically driven growth by constantly addressing the overly conservative budget processes and implementing structural reforms to unleash robust domestic investment and consumption.

d) Vietnam

Vietnam had been placed on the Monitoring List in the previous Report, but this time it was designated as a currency manipulator as it met all three criteria. The Vietnam authorities manage to limit the daily fluctuation of the exchange rate of the dong against the dollar within the bands of ±3％ from the reference rate that the State Bank of Vietnam (SBV), its central bank, announces every day. However, the Treasury Department points out that the dong has been maneuvered to a cheaper level, citing that the Vietnamese authorities have strictly controlled the exchange rate of the dong against the dollar given that the actual exchange rates have seldom reached the edge of the band and also citing the IMF finding that the real effective exchange rate of the dong was undervalued by 8.4% as of 2018. The Treasury Department is concerned that the Vietnamese bilateral trade surplus with the United States has rapidly increased recently, partly due to a surge of exports from Vietnam to the United States affected by the US-China trade frictions. While referring to the need from monetary and macroeconomic management point of view to stabilize the exchange rate of the dong as a nominal anchor of prices, the Treasury Department points out a need for Vietnam to strengthen its monetary policy framework to facilitate a greater movement of the dong exchange rate against the dollar, with a view to the possibility of introducing inflation targeting policy. Further, the Treasury Department urges Vietnam to improve transparency of foreign exchange policy and its regime including the publication of foreign exchange intervention data. It also urges Vietnamese government to take measures including various economic structural reforms to raise its domestic demand and expand access for U.S. companies to the Vietnamese domestic market.

e) Switzerland

Switzerland had been listed on the Monitoring List in the previous Report, but in the current Report it was designated as a currency manipulator as it met all three criteria identified in the

2015 Act. Switzerland is highly dependent on external demand reflecting the authorities' conservative fiscal policy approach, high household savings rate and underinvestment. Also helped by the primary income surplus that accrues from a large accumulation of net external assets, the ratio of the current account surplus stood at 8.8% in the current Report. Against the backdrop of a high level of current account surplus, Switzerland has long suffered from a synergetic appreciation of its currency and deflationary pressures. In addition, the Swiss franc has been one of the typical safe haven currencies together with the Japanese yen, and therefore it is liable to get an upward pressure especially on a risk averse phase like at a time of financial crisis, which has made difficult the policy management of the Swiss authorities. The Swiss National Bank (SNB, central bank) has lowered its policy rate well into the negative territory to -0.75%. Switzerland is a small, open economy with significant impact from external transactions and foreign exchange rates on the economy and inflation rate and as a tool for additional monetary easing the SNB has intervened in the foreign exchange market by selling the Swiss franc. The U.S. Treasury Department urges the Swiss government to modify its policy management heavily relied on external demand toward more balanced mix by shifting the monetary policy to more conventional quantitative easing through buying Swiss-franc-denominated securities as well as by promoting structural reforms that lead to expanded domestic demand, including review of its conservative fiscal approach and reduction of high savings rate.

3. Conclusion

The current FX Report gives an impression that the pressures on the currency policy of Japan and China have been somewhat weakened against the backdrop of emergency conditions under COVID-19 pandemic and recent trend of rising exchange rates of the Japanese yen and Chinese RMB against the dollar. Especially regarding China, the Treasury Department seems to be in the stage of assessing China's implementation process of the Phase One agreement of the U.S. Trade Negotiations made in January 2020.

On the other hand, the Report designated Vietnam and Switzerland as currency manipulators and newly placed Taiwan, Thailand and India on the Monitoring List. In the circumstances that the world economy deteriorated sharply affected by the COVID-19 shock, the dollar had been depreciating due to a large scale of monetary easing by the FED, which strengthened the inclination of the U.S. trading partners to rely more on external demands to stimulate domestic economy while offsetting the impact of appreciating domestic currencies against the dollar through market intervention. It seems that this has resulted in the increase of the cases where countries meet the conditions of currency manipulation. Moreover, regarding Vietnam and Taiwan, as a result of a kind of external shock from the U.S.-China trade frictions, it seems they have faced a growing need to act as China's alternative export bases to the United States, which caused them to meet the criteria for currency manipulation, including an increase of their bilateral trade surpluses with the United States.

The two countries of Vietnam and Switzerland that were designated as a currency manipulator in the current Report have a history of using intervention in the foreign exchange markets as a tool of macroeconomic policy management. Therefore problems will not be solved simply by changing such currency policy but these countries will be needed to review their whole macroeconomic policies. It is desired that the FX report of the U.S. Treasury is used not simply for putting pressure on the U.S, trading partners to promote depreciation of the dollar or to require a cosmetic correction of trade imbalances, but for diagnosing distortions in their macroeconomic policies from the "symptoms" that appear in the external imbalances , encouraging them to correct the distortions and trying to realize sustainable economic growth in both the United States and its trading partners. In this regard, it seems that the U.S. Treasury Department unilaterally publishes the content of the Report with no prior consultation with its trading partners[1]. Thus, depending on circumstances, there arise cases where the markets receive the message as the U.S. pressure on the trading partners to promote the depreciation of the dollar /appreciation of their own currencies. In addition, the distortions of the macroeconomic policies that generate such external imbalances could also be found on the side of the United States, such as its structural budget deficits. Moreover, as is seen in the case where the Trump administration designated China as a currency manipulator in 2019 without a very clear evidence, there is an aspect that the Report is sometimes utilized politically.

The Biden administration that takes office in early 2021 and the next Treasury Secretary Jannet Yellen are expected to maintain so called "strong dollar policy" where the decision of the exchange rate of the dollar is left to the market unless there is a substantial turmoil in the market. In the background of their stance, there seems to be a recognition that the market has a certain level of adjustment mechanism over external imbalances in the long run. Under the next administration which places more emphasis on international cooperation, it is hoped that the FX Report will be used for purpose that it encourages the countries including the United State itself to correct policy distortions that hamper such adjustment mechanisms.

[1] For instance, Asakawa, Masatsugu and Shimizu, Isaya: "Currency and Tax Diplomacy—Truth of its Cooperation and Battle", Nikkei Publishing, 2020.

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