ISSUE BRIEF

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# STABILITY OF YUAN AMID CHINA-US TRADE TENSIONS

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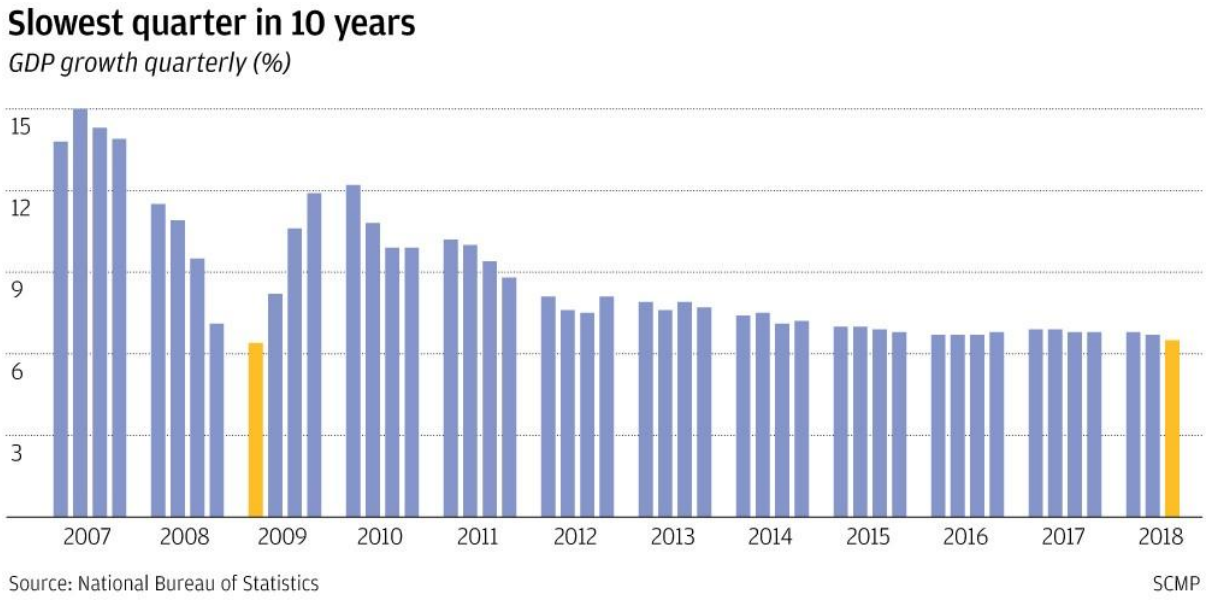
**The Chinese Yuan has depreciated in recent months and its rate is expected to go beyond 7 Yuan per dollar - a key psychological level - for the first time since the financial crisis of 2008. The trade war that was initiated by Donald Trump a few months after taking over the presidency is piling pressure on the China's managed currency as Yuan was valued at 6.3 against the US dollar at the beginning of 2018.[1]**

There are other reasons for the depreciation of Chinese currency. The US economy has grown in the last few quarters and investors are once again showing confidence in the world's largest economy. On the other hand, the growth rate of Chinese economy has been slowing down. As reported by China's National Bureau of Statistics, the Chinese economy grew by 6.5 % from a year earlier in the third quarter of 2018. This is the slowest growth rate since the first quarter of 2009.[2]

[1] https://www.bloomberg.com/opinion/articles/2018-10-08/china-bears-beware-the-yuan-will-weaken-on-beijing-s-terms

[2] https://www.scmp.com/economy/economic-indicators/article/2169239/chinas-third-quarter-growth-rate-slows-more-expected




The growth rate is expected to slow down further as the impact of trade tariffs will be more severe in the upcoming quarters. In fact, there was a rise in Chinese exports in this quarter as US importers placed advanced orders in order to lessen the hit from forthcoming trade barriers. The predicted slowdown of the economy and the eventual negative impact of President Donald Trump's tariffs on Chinese exports is also adding pressure on the Yuan. Meanwhile, the policy makers have been less interventionist in the currency market than usual in order to comfort China's slowing economy.

Another reason for the devaluation of Yuan is the gradual increase in interest rates by the US Federal Reserve since 2015. In September, the benchmark rate was raised to a range of 2-2.5%. [3] Higher interest rates attract foreign investment while weakening the domestic currency of investors. In September 2018, net US$ 15.9 billion were sold by Chinese banks which also reflects the weak performance of Chinese equity market.[4] According to Jackit Wong from Mitsubishi UFJ Financial Group, "With the Chinese equity market still not performing well, I don't think many foreign institutional investors would want to buy Chinese assets at this time, so that's also why we're not seeing much investment demand (for the Chinese Yuan)."[5]

In order to offset the pressure exerted by US on its economy, Beijing has to take tough decisions ahead. Devaluation is helping Chinese exporters at present, but if the Chinese authorities engage in competitive devaluation then US is likely to respond with further barriers. A recent currency exchange report by US Treasury Department has decided against labelling China a currency manipulator despite rumours ahead of its publication as President Trump had been calling for this

[3] https://www.bbc.com/news/business-45657009
[4] https://www.scmp.com/economy/china-economy/article/2170395/beijing-will-not-use-yuan-trade-war-weapon-it-hits-two-year
[5] https://www.ft.com/content/4fa1fbc0-d8d5-11e8-a854-33d6f82e62f8

measure during his presidential campaign. Such a move would have worsened relations with Beijing and prompted trade negotiations. However, US Treasury Secretary Steven Mnuchin said that the US may at some point look at whether the tests that measure whether a country should be labelled a currency manipulator should be changed.[6] The current criteria is a minimum $20 billion trade surplus with the US, a current account surplus that exceeds 3% of the country's GDP and repeated intervention in currency markets.[7]In response, Chen Fengying from China Institutes of Contemporary International Relations said that if the US goes ahead to change its own criteria just so it can label China a currency manipulator, then it becomes very clear that it just wants to target China.[8]

Moreover, the Chinese appear to be unfazed by the trajectory of Yuan-Dollar exchange rate. They contend that due to trade friction, depreciation of Chinese currency is unavoidable and only reflects supply and demand, a situation which is quite controllable.[9]Chinese Ministry of Foreign Affairs responded to US Treasury Department's decision to not list China as a currency manipulator. "China will continue to pursue market-based exchange rate reform, to improve a managed floating exchange rate mechanism based on market supply and demand and with reference to a currency basket, and maintain the Yuan exchange rate basically stable at a reasonable and equilibrium level."[10]

Maintaining a strong currency rate has always been a key component of China's economic policy. Given the economic slowdown in the country and unprecedented pressure exerted by Washington, the loss in value of Yuan is only a minor shock that can be averted by China through its own policy initiatives. China has the means to support its currency and absorb external threats to its economy.

6 https://www.bloomberg.com/news/articles/2018-10-21/mnuchin-open-to-change-in-currency-test-as-u-s-spars-with-china
7 http://www.globaltimes.cn/content/1124064.shtml
8 Ibid.
9 http://www.globaltimes.cn/content/1125192.shtml
10 https://news.cgtn.com/news/3d3d774e7955544f7a457a6333566d54/share_p.html