Currency manipulation report: Vietnam to join China?

The semi-annual Treasury report has had a strong political connotation of late. The October release, due soon will need to explain why China was labelled an FX manipulator in August, while the risk is Vietnam might also join its ranks

Source: shutterstock

Twice a year, the US Treasury department publishes the “Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States” report. The latest report gathered particular attention as the Treasury overhauled the criteria that needs to be met to be labelled a currency manipulator (Fig. 1).

The latest Treasury report

Fig 1. Three criteria to label an FX manipulator

Criteria	Benchmark	Threshold
Major Trading Partner Coverage	Total Bilateral Goods Trade (Imports plus Exports)	$40 billion
Significant Bilateral Trade Surplus with the United States	Goods Surplus with the United States	$20 billion
Material Current Account Surplus	Current Account Balance	2% of GDP
Persistent One-Sided Intervention in Foreign Exchange Markets	Net FX Purchases	2% of GDP
	Persistence of Net FX Purchases (months)	6 of 12 months

Source: U.S. Department of the Treasury, ING

A China-centered report

When a country meets two of the three criteria, it is included in the “monitoring list”, which implies deeper scrutiny of its trade and currency-related practices by the Treasury staff. In May, that list included nine countries: China, Japan, Korea, Germany, Italy, Ireland, Singapore, Malaysia and Vietnam, but the Treasury did not label any country a currency manipulator.

However, in August, in the wake of USD/CNY breaking above the 7.00 threshold, the Treasury labelled China a currency manipulator. According to the press release, “China has a long history of facilitating an undervalued currency through protracted, large-scale intervention in the foreign exchange market”.

The new “currency manipulation” report is expected to be published in the next few days, and will most likely contain a major section on the reasoning behind that decision, given that China still only meets one of the three criteria. We think the Treasury will particularly stress the transparency issue when it comes to FX interventions, and as we've written before, we would expect this to be a key point in a possible US-China currency deal.

Last Friday, US Treasury secretary Steven Mnuchin indicated he will consider removing the FX manipulator label from China on the back of improved Sino-American relationships after “phase one” of the trade deal has been outlined. But it remains to be seen whether the US administration will use the October report to open the door to de-labelling.

The semi-annual report has had a strong political undertone, with its relevance rising along with President Trump’s confrontational approach with its major trading partners. For this reason, we are inclined to believe that most of the content of the report will be highly correlated to the US foreign-policy agenda. For that reason, we can't rule out the possibility that the Treasury might delay the release of the report until "phase one" of US-China negotiations hasn't been signed.

It will be interesting to analyse the updated numbers for the other 20 countries included in the report. As the report was last published in May, we highlighted the risk of Vietnam being labelled a currency manipulator: as we see in our estimates below, these risks seem to have amplified.

What could a US-cHina currency deal look like?

Our estimates: Vietnam at risk of being labelled too

We have attempted to replicate the table included in every report that includes all the numbers for the three different criteria (Bilateral trade, Current account balance, FX intervention), estimating what figures will be included in the October update (which refers to the July 2018- June 2019 period).

The goods surplus is derived from the non-seasonally adjusted figures published by the US Census Bureau. The current account balance data are extracted from national statistics data as well as IMF data, attempting to respect the sources selected by the Treasury in previous reports. There is a substantial limitation for estimates on FX interventions due to lack of available data as only a few central banks disclose their interventions.

In turn, the estimates in this field have been calculated from the variation in FX reserves (as reported by the IMF), adjusted for valuation. For simplicity, we have computed the valuation adjustment as if all reserves were held in USD and in the form of short-term Treasury notes (3m). FX intervention numbers are heavily influenced by internal estimations and assumptions by the Treasury staff. As a consequence, the table below should only be considered as indicative and the figures are likely to be different in the official report.

Fig 2. ING estimates for the three criteria

	Bilateral Trade	Current Account	Foreign Exchange Intervention	
	Goods Surplus with US (USD bil.)	Balance (% of GDP)	Net Purchases (% of GDP, Trailing 4Q)	Net Purchases (6 of 12 Months)
China	401	1.2	0.1	Yes
Mexico	93	-0.9	0.0	Yes
Japan	69	3.4	0.0	No
Germany	67	7.1	-	-
Ireland	50	9.1	-	-
Vietnam	47	3.0	2.6	Yes
Italy	33	2.8	-	-
Malaysia	26	3.1	-1.4	No
Switzerland	22	10.7	0.9	Yes
Canada	21	-2.2	0.0	No
India	21	-2.0	0.2	No
Korea	20	4.6	-0.4	Yes
Thailand	19	7.0	0.6	No
France	19	-0.6	-	-
Taiwan	18	11.5	-0.5	No
UK	-4	-5.0	0.0	No
Singapore	-4	17.3	-5.9	Yes
Brazil	-9	-1.5	-0.3	No
Belgium	-14	-1.3	-	-
Netherlands	-24	10.5	-	-
Hong Kong	-29	5.6	0.7	Yes

Source: IMF, national statistics institutes, Bloomberg, ING

If our estimations prove accurate enough, Vietnam should be named a currency manipulator as, along with having a consistent goods surplus with the US and a large current account surplus to the world, has likely engaged in currency interventions to cap the value of its currency, the dong.

The “persistent one-sided FX interventions” criteria requires that net FX purchases for at least 2% of GDP must be carried out for at least 6 of the 12 months under consideration. According to our estimates, Vietnam did it for seven months. Should this number be lowered to five by the Treasury as different assumptions are made (especially on the valuation adjustment), then Vietnam could be spared the unwanted label.

Implications for Vietnam

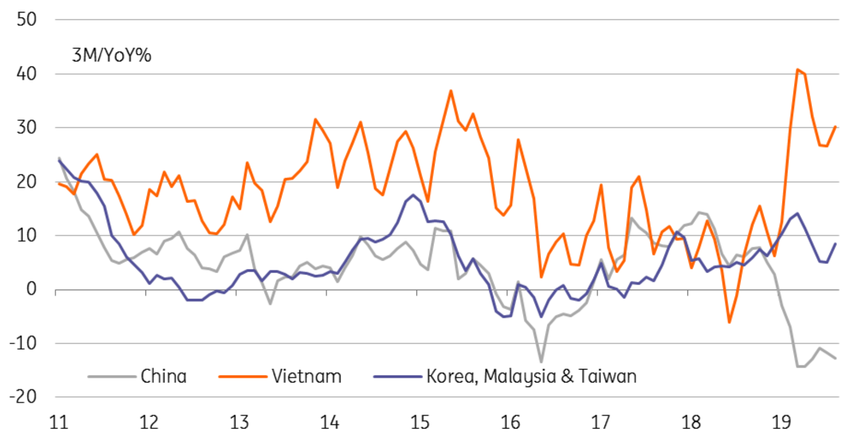
If we assume that Vietnam will be labelled a currency manipulator, regulation suggests the US government must engage in negotiations before taking action. In other words, it doesn't automatically allow to trigger retaliatory actions such as tariffs.

However, President Trump has often found a different basis (for instance, national security) to impose tariffs on a country. Vietnam seems particularly at risk of being hit by US tariffs and the Trump Administration may consider using the fx manipulator label to threaten tariffs.

Including Vietnam in the tariff zone may fit well in the US trade agenda. As highlighted by our economics team, Vietnam has massively benefitted from US tariffs on China, with the country’s exports to the US (Fig. 3) booming in 2019 (currently, growing by around 30% YoY) and not matching a relatively flattish manufacturing output (10% YoY). These numbers tend to suggest that Chinese companies are re-routing some of their products to Vietnam, most likely, only for very final stages of the productions, or simple repackaging. The “made in Vietnam” label allows many products to dodge President Trump’s tariffs, but the President has already warned Vietnam of retaliation. The question is: can a currency manipulator label be the trigger to tariffs?

The answer to this question will drive most of the market's reactions to a possible labelling of Vietnam. Indeed, the risks seem skewed to the downside for Vietnamese assets and the dong, at least in the short term. Sentiment around the whole Vietnamese sphere is already quite soft after Moody’s announced it has started a review of the country’s Ba3 rating on “institutional deficiencies”.

Fig 3 - Vietnamese exports have boomed in 2019



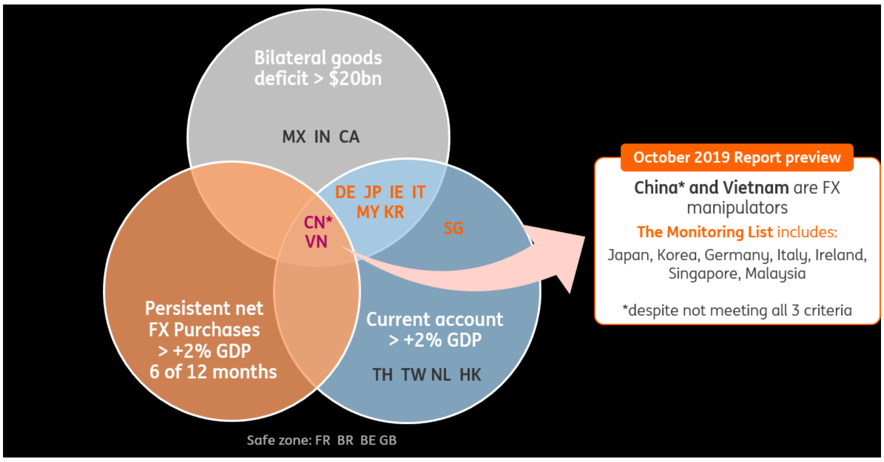
Source: Macrobond, ING

A look at the other countries

According to our estimations, Japan, Korea, Germany, Italy, Ireland, Malaysia (and Vietnam, if not labelled a manipulator) will all remain in the monitoring list as they continue to meet two of the three criteria.

Singapore quite likely has not hit the FX intervention threshold (as their FX reserves actually shrank), but will anyway remain in the monitoring list as the Treasury provides for a country to remain in the list at least for two reports. Switzerland, instead, maybe added back to the watch list.

Three eurozone countries remain in the monitoring list. Obviously, the ECB is not engaging any currency intervention to devalue the euro, so the risk for those countries of meeting all three criteria and being labelled a manipulator are non-existent. However, President Trump has been extremely vocal at pointing out how the recent monetary stimulus from the ECB helped keep the EUR weak and has helped euro area exports. While we expect the report will stress the "unfair" trade practices of eurozone countries, it would need to consider quantitative easing as a means of FX interventions (quite a stretch, to say the least) to label them as manipulators.



Source: U.S. Department of the Treasury, ING

The markets resonance of the October update of the semi-annual Treasury reports on FX manipulation will depend heavily on what justifications will be given around the labelling of China as a manipulator in August and whether Vietnam will also join the list.

The strong political connotation of the latest reports suggests that the conclusions drawn by the report will heavily depend on how they fit into the US administration's trade agenda. In turn, removing China as an FX manipulator may be a premature move for the US given that a fully-fledged trade deal with China is still quite far and President Trump might like to use that as leverage to push for a currency deal. Around this point, expect large sections of the report to focus on the importance of transparent FX interventions reporting, especially in Asian countries.

Our estimates suggest Vietnam has all the prerequisites to be labelled an FX manipulator. The country has been used to reroute some Chinese exports to avoid US tariffs, so President Trump would not lack the reasons to target the country with hostile trade policy.

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