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US Treasury's FX Report preview: Four countries to meet manipulation criteria

We estimate that Switzerland, Vietnam, Taiwan and Malaysia all met the three criteria set by the US Treasury to be labelled as FX manipulators. However, we think the Treasury will refrain from tagging any country as a manipulator in the October FX Report. Elsewhere, China's current account exceeded the UST threshold, but its FX interventions did not.

Source: shutterstock

Waiting for the October FX Report

Twice a year, generally in mid-April and mid-October, the US Treasury publishes a report to Congress, commonly known as the FX report, aimed at identifying potentially unfair FX practices among the US's major trading partners. The report attracted increasing interest during Trump's protectionist period, and saw some tweaks after Janet Yellen took office as Secretary of the Treasury.

Criteria	Benchmark	Threshold
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: US Treasury, ING

We analysed the the most recent FX Report in "Three takeaways from the Treasury's April FX Report". In short: the first edition under Yellen saw a softening in the Treasury's stance on FX interventions. Regulation provides that three quantitative criteria should be met to name a country an FX manipulator (as shown in the table above): (1) at least $20bn in bilateral goods trade with the US; (2) a current account surplus worth more than 2% of GDP; and (3) persistent and unilateral FX interventions worth at least 2% of GDP.

Switzerland's and Vietnam's manipulator tags were dropped in the April Report, and Taiwan was also spared the designation

The report analyses data on 4Q rolling basis (January to December and July to June). In the period Jan-Dec 2020, Switzerland, Taiwan and Vietnam met all three criteria to be designated currency manipulators. The first two had already received the designation in the previous Report (under President Trump). However, Switzerland's and Vietnam's manipulator tags were dropped in the April Report, and Taiwan was also spared the designation.

The Treasury did, however, indicate that it would have started bilateral discussions with the three countries' monetary authorities about their FX practices. There have been some developments on this front since April, but before getting into them, we look into our estimates for the upcoming October FX Report.

Our estimates: Malaysia to have joined Switzerland, Vietnam and Taiwan in "manipulator" zone

We attempt to replicate with our estimates the Treasury calculations that will be included in the FX Report, assuming that the criteria and the thresholds have been left unchanged. The estimates refer to the period July 2020 – June 2021.

It is important to note that the method used to calculate FX interventions (the third criterion) leaves significant room for discretion. The Treasury staff normally adjusts the changes in a country's FX reserves by a valuation factor, in an attempt to isolate the amount of FX purchases that were effectively directed at curbing domestic currency appreciation. However, it has often been the case that the local central bank has unilaterally disclosed the amount of FX interventions to the Treasury (as in the cases of Vietnam and Thailand in recent reports).

We try to apply a similar discounting factor as the one used by the Treasury to the increase in FX reserves as we estimate FX interventions but, considering the wide room for discretion, we assume a margin of error. In the case of some countries FX interventions are reported as null despite an increase in FX reserves, simply because the local central bank does not engage in interventions.

We may also see some divergence between our current account estimates and the ones in the FX Report, as the IMF does not report quarterly C/A data, but only yearly. This can be used for the Spring report but not for the Autumn one. Our C/A estimates come from domestic sources.

In line with the new format of the latest FX Report's summary table, we report FX interventions in the first two columns.

	Foreign Exchange Intervention		Current Account	Bilateral Trade
	Net Purchases (% of GDP, Trailing 4Q)	Net Purchases (6 of 12 Months)	Balance (% of GDP)	Goods Surplus with US (USD bn)
Singapore	20.3	Yes	18.8	-1
Taiwan	5.1	Yes	15.2	34
India	4.6	Yes	0.5	29
Vietnam	3.8	Yes	2.5	84
Switzerland	3.6	Yes	3.0	43
Malaysia	2.0	Yes	4.7	38
China	0.0 - 1.4*	Yes	2.1	338
Thailand	1.0	No	0.2	31
Korea	0.4	Yes	5.7	26
Japan	0.0	No	3.8	62
Canada	0.0	No	-0.5	28
UK	0.0	No	-2.3	-7
Mexico	0.0	No	3.1	121
Brazil	-1.4	No	-1.3	-13
Germany	-	-	7.5	64
Ireland	-	-	15.1	31
Italy	-	-	4.1	35
France	-	-	-1.2	21
Belgium	-	-	1.8	-9
Netherlands	-	-	8.9	-19

Source: ING estimates, local sources, US Census, IMF, Macrobond

*reporting estimates for China's FX interventions both as change in PBOC net FX assets and as adjusted change in net FX settlements

We estimate that for a second consecutive report Switzerland, Vietnam and Taiwan will meet all three criteria. Malaysia's FX interventions were, according to our calculations, worth 2.0% of GDP in the reference period, which also means Malaysia met all three criteria. However, with the amount of FX interventions so close to the 2.0% threshold, the Treasury may have requested the Malaysian monetary authority to unilaterally communicate the amount of FX interventions, which may be less than 2% of GDP.

Vietnam has already made concessions to the US

Dropping the manipulator tags for Switzerland and Vietnam in April did not have major implications, as the Treasury still claimed they would have engaged in bilateral talks with the countries meeting all criteria. This is what regulation provides for the first year after a "manipulator" designation. Only after unsuccessful bilateral talks would the possibility of duties/tariffs normally be explored.

We think the Treasury will not label Vietnam an FX manipulator

Such talks led to an agreement in late July between the US and Vietnam, where the latter pledged to refrain from devaluing its domestic currency (the dong) for competitive purposes. As a consequence, the USTR dropped the threat to impose tariffs on Vietnam. As shown in the chart below, the dong did indeed start to appreciate after the bilateral agreement, which is surely a welcome development at the Treasury.

Accordingly, we think the Treasury will discuss such developments in the report and will not label Vietnam an FX manipulator, despite the country hitting the thresholds in the 12 months through June 2021.

Source: Refinitiv, ING

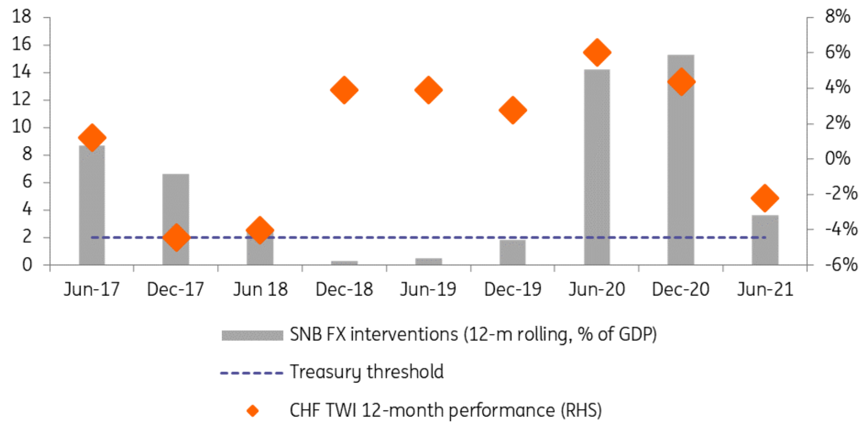
Switzerland, Taiwan and Malaysia likely to get a "free pass"

Both Switzerland and Taiwan significantly reduced their FX interventions in the first half of 2021 but, given the size of interventions in 2H20, we estimate they will still exceed the 2% of GDP threshold in this report. So, what would be the implications?

We think the Treasury will merely seek more enhanced bilateral talks with Switzerland, Taiwan and Malaysia

As a general rule, anything in the FX report should be filtered through a political/geo-political analysis. Vietnam was a blatant example of re-routing of China's exports to avoid US tariffs and its FX practices had indeed piqued the USTR's interest. When it comes to Switzerland and Taiwan, we doubt there is much interest in changing the approach to label them as FX manipulators.

- **Switzerland** is openly using FX interventions as a monetary policy tool to curb gains in the already highly valued CHF, and is very transparent when it comes to the amount of its FX operations. When adding that the Swiss central bank (the SNB) reduced interventions in 1H21 – although that depended on CHF weakness cause by rising US yields, not by a reaction to the FX report – we think the Treasury will merely signal they will seek more bilateral talks with Switzerland. Should Yellen opt for a tougher line – so, put the manipulator's tag back on Switzerland – we could see some pressure on EUR/CHF as some investors speculate that the SNB will be less aggressive when it comes to FX interventions. However, it is likely the SNB would rapidly intervene (verbally) to signal that the designation will in no way discourage FX interventions or cause any change in the policy mix, something which would likely curb bullish CHF bets.

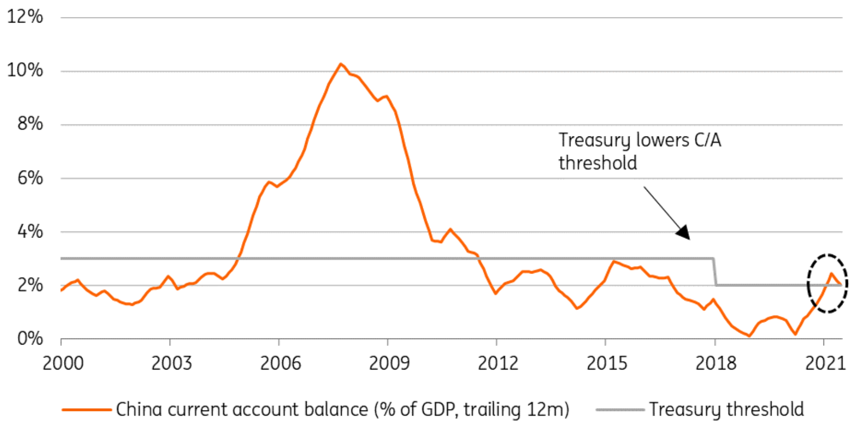


Source: SNB, US Treasury, ING

- We think **Taiwan** will also be spared the FX manipulator tag. Only last week, Taiwan's central bank governor told lawmakers that the country will remain in enhanced bilateral talks about FX practices with the US Treasury, likely an acknowledgement that Taiwan has indeed remained in the "manipulator's zone" into June 2021. From a purely FX perspective, the Treasury will likely welcome the TWD appreciation seen in 2021, but political considerations will likely play a bigger role. We doubt the Treasury will target Taiwan on the trade side, given the increasingly delicate geopolitical situation in the region.
- As mentioned above, **Malaysia**'s FX interventions are around 2% and - unless the Treasury estimates are "rounded" to 1.9% - this would mean that Malaysia will also meet all three manipulation criteria. In this case, we would expect a similar approach to that used for the likes of Switzerland, Vietnam and Taiwan: Malaysia would only face enhanced bilateral talks and should be spared the FX manipulator tag.

China's C/A surplus exceeds threshold, but interventions don't

China has been quite central in the recent FX Reports. In this edition, we estimate that China will meet two criteria (current account and bilateral trade) but not the FX intervention one. China's current account surplus edged above the 2.0% threshold (according to our estimates) in the 12 months to June 2021, for the first time in five years.



Source: Macrobond, ING

When it comes to China's FX interventions, the Treasury introduced two different measures in its latest Report. The first uses the change in the PBOC FX assets, which we estimate were null in the 12 months through June 2021. The second (considered as a more comprehensive measure by the Treasury) looks at net FX settlements data adjusted for the change in outstanding FX forwards, which we estimate was worth 1.6% of GDP, below the Treasury threshold.

Small changes to the Monitoring List

We estimate that all countries already in the Monitoring List will remain there, with the exception of Malaysia, which should join Switzerland, Vietnam and Taiwan in the group of countries that meet all three criteria but are not officially named FX manipulators. Thailand met only one criterion (bilateral trade), but the Treasury requires that this has to be the case for two consecutive Reports before a country can be removed from the watchlist.

> We therefore expect the Monitoring List - which merely implies a deeper scrutiny of FX practices by the Treasury - to include China, Japan, Korea, Germany, Italy, Singapore, India, Thailand, Mexico, and Ireland.

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