US currency manipulation report: Vietnam on thin ice

Despite revising the criteria and expanding the watchlist, the US Treasury report hasn't labelled any country as a currency manipulator. While China seems to be safe, Vietnam could soon be labelled as a currency manipulator

The US Treasury department finally published its semi-annual report "Macroeconomics and Foreign Exchange Policies of Major Trading Partners of the US" late Tuesday, which summarises the department's assessment of possible currency manipulations to support a country's trade balance.

It seems unlikely the Trump administration will be able to use this report or further Treasury reports as a supporting tool for its protectionist trade policies

A country must meet three criteria simultaneously to be labelled as a currency manipulator, although the Treasury has the power to amend both the benchmark and the thresholds of these rules. A country that meets only two criteria or holds a disproportionate share of US trade deficit is included in the so-called ' monitoring list' and will be subject to more severe scrutiny. Since the introduction of the report in 1988, only three countries have been labelled as currency manipulators, which include Japan (1988), Taiwan (in 1988 and 1992) and China (from 1992 to 1994).

In all these cases, the findings of manipulations led to negotiations, which generally resulted in some readjustments in foreign exchange regimes and appreciation of domestic currencies.

Read the full report US Treasury report here

Despite new thresholds, no one is a currency manipulator

In this latest report, no trading partner has been labelled a currency manipulator, although a few changes have been made to the thresholds and the 'monitoring list' has been expanded. The Treasury has expanded the pool of countries covered by the report, switching to a quantitative measure - $40 billion of total bilateral trade, which is currently met by 21 trading partners. At the same time, the 'material' current account surplus threshold was lowered to 2% of GDP from 3% and persistent net FX purchases for just six months rather than 12 will be enough to be called out.

The revision of the threshold means the 'monitoring list' has expanded with Italy, Ireland, Singapore, Malaysia and Vietnam joining, but India and Switzerland taken out.

Revised Treasury thresholds

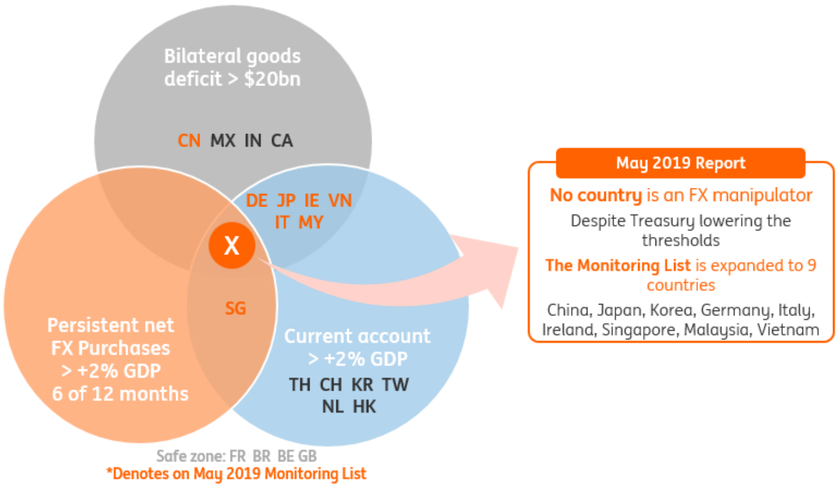
Criteria	Benchmark	Previous threshold	New threshold
Major Trading Partner Coverage	Total Bilateral Goods Trade (Imports plus Exports)	12 largest trading partners	$40 billion
Significant Bilateral Trade Surplus with the United States	Goods Surplus with the United States	$20 billion	$20 billion
Material Current Account Surplus	Current Account Balance	3% of GDP	2% of GDP
Persistent One-Sided Intervention in Foreign Exchange Markets	Net FX Purchases	2% of GDP	2% of GDP
	Persistence of Net FX Purchases (months)	8 of 12 months	6 of 12 months

Source: US Treasury Department

In our view, it would be fair to say the report has adopted an increasingly political inclination and the adjustments of the thresholds to include more countries and extend the 'monitoring list' all support the recent rhetoric by the Trump administration about the disadvantaged positions of the US when it comes to global trade practices.

Nonetheless, a closer look at the report suggests limited long-term implications for targeted countries.

A growing 'monitoring list'



Source: US Treasury Department, ING

China and EU on the watch list, but not at risk

The report's main focus has been China, despite the fact the country only meets one of the three criteria of currency manipulation. The Treasury noted how the depreciation of the renminbi against the USD is a major cause for concern, along with the widening bilateral trade imbalance and China's adoption of non-market mechanisms.

Surprisingly, there was little mention of the ongoing trade tariffs - arguably, the main driver of recent CNY weakness in the report. But despite the Treasury's concerns, China is quite a way away from meeting the current account criteria (0.4% vs the 2% threshold) and no evidence of currency intervention has been found. We trust this is likely to remain the case in the coming months, particularly in view of recent pledges by the Chinese central bank to prevent USD/CNY breaking the 7.00 level, which should keep net FX purchases negative or close to zero.

There was also some interest in the assessment of European countries' trade practices, particularly in light of the ongoing threat of US tariffs on EU exports. The risk of being labelled a currency manipulator for Germany, Italy and Ireland is almost negligible given the history of no currency interventions by the European central bank since 2001.

Vietnam needs to watch out

The only country significantly at risk of being labelled a currency manipulator is Vietnam because along with a substantial goods surplus with the US ($40 billion) and a highly positive current account balance (+5.4% of GDP), the Vietnamese central bank has been quite active in terms of net FX purchases.

The report only covers data until 4Q18, where the central bank's currency interventions did not hit the 2% threshold. Nonetheless, the central bank reportedly increased its foreign reserves by USD 8.35 billion in 2019, reaching a total of USD 69 billion last April. We have attempted to reproduce the analysis contained in the report considering a 12-month rolling window ending April 2019. So, as things stand, Vietnam is at risk of being labelled currency manipulator in the next report, which is due at the end of 2019.

Foreign Exchange Interventions in Vietnam (May 2018- Apr 2019)*

*the FX net purchases are estimated by calculating the valuation-adjusted change in FX reserves in the selected period.

Net Purchases (% of GDP, Trailing 4Q)	Net Purchases (USD Bil., Trailing 4Q)	Net Purchases (USD Bil., Trailing 2Q)	Net Purchases (6 of 12 Months)
2.9	6.9	7.5	Yes

Source: SBN,IMF, ING

If this happens, the impact on the dong (VND) isn't very easy to prefigure. But in the long term, it's fair to believe the currency may face upside pressure against the USD, in particular, if the negotiations that follow prompt a change in currency intervention practices.

Nonetheless, the short-term impact may involve a sell-off in the dong given concerns about possible trade tariffs imposition on Vietnamese exports. It remains to be seen whether such a move could fit in the US trade policy agenda.

Singapore and Malaysia: FX interventions, not manipulations

Singapore and Malaysia have also been added to the watchlist. A closer look at the specific situations for these economies suggests low risk of negative backlash for the report.

Singapore has indeed been intervening in the foreign exchange market on a consistent basis, but the exchange rate is the primary monetary policy tool for the central bank. Also, Singapore has pledged to publish a detail of its FX interventions starting from 2020, which should keep US Treasury concerns fairly muted. Elsewhere, Malaysia's currency interventions have been on both sides and the central bank has lately sold part of its reserves to tamper the depreciation of its currency.

Expect limited long-term impact

A recurring theme in recent months suggested that the report may have become slightly redundant and that President Trump is leaning in favour of using the Trade department instead of the Treasury to provide support for its protectionist measures. In particular, assuming a country meets all criteria and is labelled currency manipulator, the 1988 and 2015 laws dictate that a 12-month negotiation period should precede any tariff or sanction, and this hardly seems in line with president Trump's fast-acting approach to trade policy.

Overall, it seems unlikely the Trump administration will be able to use this report or further Treasury reports as a supporting tool for its protectionist trade policies, which leads us to conclude that the impact on trade policies in the targeted countries is likely to be extremely limited, both because the Trump administration hasn't shown particular attention to the report and because – with the exception of Vietnam – no country is significantly close to being labelled a currency manipulator in the near future too.

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