

What could a US-China currency deal look like?

American and Chinese policymakers meet in Washington today to talk trade. One suggestion is that a partial deal could involve an agreement on FX markets. If so, it will probably echo G20 FX language to avoid competitive devaluations but will compel China to be more transparent on FX intervention



Whether or not either side is prepared to accept a partial trade deal remains to be seen, but one suggestion emerging today is that any partial deal could involve a currency agreement. This had been mooted back in April by US Treasury Steven Mnuchin, but few details were provided at the time.

However, there is speculation that the FX language used in the partially ratified [USMCA provides the blue-print](#) for any US-China trade deal. This basically borrows the wording from G20 FX Communiqués that parties should 'avoid manipulating exchange rates or preventing effective balance of payments adjustment for trade gains'.

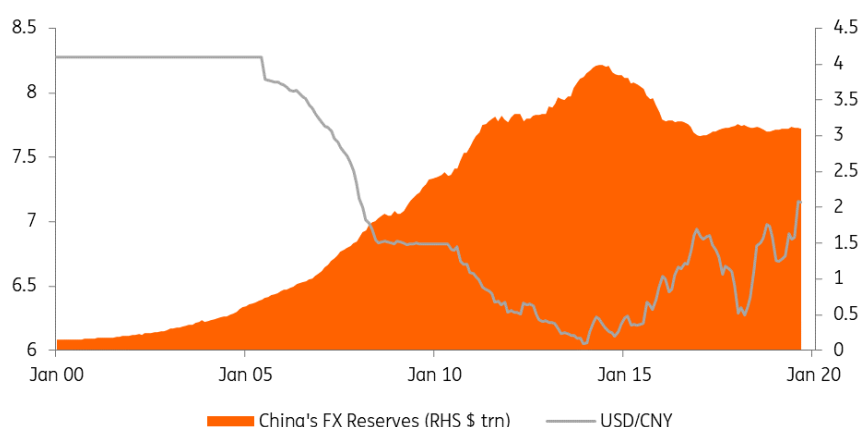
Of most interest here is the need for public and regular reporting of international reserves and most importantly FX intervention. Here the [US Treasury's semi-annual FX report](#) has long focused

on Asian nations preventing exactly those balance of payment adjustments – primarily by preventing their currencies appreciating in a dollar bear trend. Full disclosure of FX intervention figures could discourage Asian nations from keeping their currencies artificially weak.

As an aside, Korea has for the first time this year started reporting FX intervention data – reporting half-year activity in aggregate with a three month lag. Incidentally, Korea sold \$187mn of FX reserves in 2H18 and another \$3.8bn in 1H19.

USMCA: Where we stand and why it matters

USD/CNY versus China FX Reserves



Source: Bloomberg, ING

What could a currency deal mean in practise?

Any agreement in Washington this week would be welcomed by markets. But away from the short term impact, the longer-term impact of increased transparency of FX intervention would in theory make it more difficult for countries to engage in a sustained build-up of FX reserves to avoid local currency appreciation. In theory, it would have been more difficult for Chinese FX reserves to grow to \$4trn into 2014 and could have meant that USD/CNY was trading closer to five than six during 2013/14.

How the US Treasury treats the recent decision to label China as a currency manipulator remains to be seen. However, that did seem a very political decision (as China didn't fulfil all three of the US Treasury's criteria) and we imagine it will be a political decision to reverse it – if that day ever arrives.

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