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China Manipulates Its Currency, but Not in the Way Trump Claims

By NEIL GOUGH SEPT. 30, 2016

HONG KONG — In Monday's presidential debate, Donald Trump repeated one of his frequent criticisms of China: It keeps its currency artificially cheap.

Of all the countries in the world, he said, China is "the best ever" at devaluing its currency, the renminbi. That gives its companies a big — and unfair — advantage when selling its goods abroad, the argument goes.

That's no longer quite the case. Nowadays, China faces the opposite problem: It is shoring up its currency while the rest of the world is trying to push it down.

That change speaks to an enormous shift in China's economic fortunes and to its position in the world. Not long ago, it was still an up-and-coming country looking for ways to nurture an economic boom that was lifting millions of people out of poverty.

Today, China is a world power with ambitions to call more of the shots in world economic affairs. Beijing is no longer content to cede that role to the likes of Brussels, London, Tokyo and Washington.

With that shift in attitude comes a change in the way China thinks about its money. A decade ago, China saw its currency as merely a tool to help its factories sell goods. That meant keeping it weak.

Now, China sees the renminbi as an instrument of its growing power. If more people around the world hold renminbi in their wallets, the thinking goes, then China will have greater say in the decisions they make. Someday, Beijing hopes, the renminbi may even rival the dollar as the world's de facto currency.

With that in mind, China has moved in recent years to make the renminbi more appealing. On Saturday, when the International Monetary Fund is set to formally add the renminbi to its basket of reserve currencies, a move that will lump it in with the dollar, the pound, the euro and the yen, it will take another step in that direction.

But in the year since the monetary fund first said it would bestow that status on the renminbi, the Chinese currency has become less attractive. Despite Mr. Trump's contention — which, like his assertions about Japan, harks back to another era — many economists say they believe the renminbi is overvalued, not undervalued.

Tony Gao, a senior at the University of Southern California, helped found a start-up called Easy Transfer three years ago. The company helps Chinese parents with children going to American schools exchange their renminbi for dollars. But business growth is down this year, he said, because many affluent Chinese have already changed their renminbi for dollars.

“A lot of them already have acknowledged this depreciation,” Mr. Gao said, adding that he was thinking of switching his renminbi to dollars, too. “Now I'm actually on the edge.”

Currency 101

The situation with the renminbi:

Under the traditional rules of economics, the value of a country's currency will go up if the world moves more money there. That is what should have happened in China. People around the world poured money into the country as they bought its products and as companies built factories and invested in China's growth.

Instead, China largely kept its currency at a steady value compared with the dollar. That contributed to imbalances in the country, but it kept the renminbi weak.

For China's manufacturers, a weak currency is ideal. If the renminbi is at, say, eight to the dollar, then a $100 widget translates into an 800 renminbi sale. At a stronger seven renminbi to the dollar, that same $100 widget generates only 700 renminbi in sales.

That is not ideal for the American factories that compete with Chinese rivals. In previous years, China's currency policy angered American lawmakers and took center stage in the United States' dealings with China.

What Changed?

For starters, China's growth rate slowed, and the flow of money into the country moderated. Both factors have led economists to say that the renminbi might be fairly valued, or even overvalued. The verdict, for many investors: China's currency is poised to weaken.

There are other forces at work. China has taken steps over the past few years to relax its hold on the renminbi. That makes it easier for banks and merchants abroad to save the renminbi or to use it in transactions. Manufacturing has also declined as a major growth driver in the country's economy, as the government pushes to build its growing consumer and high-tech sectors.

Since August of last year, when Beijing surprised global markets with a one-time devaluation of its currency, investors have been broadly seeking to unload their renminbi in favor of dollars.

In Hong Kong, the biggest offshore center for renminbi banking, deposits of the Chinese currency peaked in December 2014 and have since fallen by a third.

For five years since 2010, the renminbi had made small but progressive gains as a global payment currency, as measured by transactions processed on the Swift global payment system. But that usage crested in August 2015 at 2.8 percent of transactions, and it has declined steadily since then, to 1.9 percent in August.

China has spent hundreds of billions of dollars from its foreign reserves over the past year to support the value of the renminbi and to prevent it from weakening more drastically. A sharp fall could lead even more people to find ways to convert their renminbi into other currencies, resulting in an exodus of money from the country. More broadly, it could undermine Beijing's case that the renminbi is worth holding.

Under Pressure

Even long-term supporters of the renminbi now seem to see the currency's pause as perhaps inevitable.

"It's been the strongest currency in the world for the last 10 years or so, and anything that strong should consolidate, should have a correction," said Jim Rogers, a Singapore-based investor who is well known for being bullish on China. "Is it a normal market correction or being jiggled? Maybe some of both," he added.

Mr. Rogers, who made his name in the 1970s as a co-founder of the Quantum Fund with George Soros, said he retained a positive long-term view of the Chinese currency. But he said the renminbi could continue to come under selling pressure in the next year or so, as investors flock to the perceived safety of the dollar.

Some of the renminbi's declines, Mr. Rogers added, were "a self-fulfilling prophecy."

"Because it's not convertible, people feel trapped and want to get out," he said.

Longer term, despite the I.M.F.'s planned move, few expect the renminbi to rival the dollar as a haven, or even as a significant reserve currency, unless China pushes forward with dramatic legal and financial changes.

Inclusion in the monetary fund's basket is "a symbolically momentous event but is unlikely by itself to be a game changer in global finance," said Eswar S. Prasad, a professor at Cornell University and a former top I.M.F. official for China. He is also the author of a book called "Gaining Currency: The Rise of the Renminbi."

"Notwithstanding the I.M.F.'s imprimatur, the renminbi will not become a significant reserve currency unless China has better-developed and well-regulated financial markets," Mr. Prasad added.

Correction: October 1, 2016

An earlier version of this article incorrectly reported a statement by Tony Gao, who helped found a start-up called Easy Transfer. Mr. Gao said the business's growth was down this year; he did not say that business was down.

Emily Feng in Beijing and Carolyn Zhang in Shanghai contributed research.

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