Mnuchin's mission

By Jeffrey Frankel
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US Treasury Secretary Steven Mnuchin is hemmed in on all sides. Domestically, he's trapped between the promises he has made (such as the "Mnuchin rule" that taxes wouldn't be cut for the rich), the actions of President Donald Trump (whose tax plan includes cuts for the rich), and simple arithmetic (which makes the administration's conflicting pledges impossible to fulfill). But even on the international stage, where US treasury secretaries typically enjoy more latitude and esteem, Mnuchin is likely to have a hard time.

After all, the Trump administration has made it clear that it does not intend to fulfill the global leadership commitments that Mnuchin's predecessors have overseen. Given Trump's belief that international negotiations are just a forum for making unilateral demands, how could Mnuchin – who, like his boss, lacks government experience – persuade other countries that adherence to common rules and norms, such as open trade, is in everyone's interest?

Trump's entire administration is surely expected to adhere to his "America first" approach. As a senior Treasury official recently declared, Mnuchin will be "pushing hard" to ensure that the G20 plays "a helpful role in advancing US interests."

Fortunately, Mnuchin has so far avoided fulfilling one of Trump's irrational promises: to label China a currency manipulator on his first day in office. The next opportunity to take that step comes in April, when the biannual Treasury report to Congress is due. Mnuchin should let it pass.

Mnuchin has requested from the International Monetary Fund a "frank and candid analysis" of member countries' exchange-rate policies, to determine whether China is deliberately keeping its currency undervalued. That's a good thing; such surveillance is the IMF's responsibility. But one hopes that Mnuchin recognizes what the answer will be.

China no longer qualifies as a currency manipulator under any of the three internationally accepted criteria: exchange rate, trade balance, or foreign-exchange reserves. The renminbi was undervalued in 2004. But it appreciated 37% in the subsequent decade. After China's trade surplus peaked at 9% of GDP in 2007, it adjusted to the receding price competitiveness: it has been less than half that level each year since 2010.

In 2014, as the Chinese economy slowed relative to the US, capital flows reversed, sending China's overall balance of payments into deficit. Reserves peaked in July of that year, and have been falling ever since.

Far from devaluing the renminbi, the People's Bank of China has spent $1 trillion of its reserves over the last three years trying to support it (by far the largest such intervention in history). The Chinese authorities have reinforced this effort by tightening controls on capital outflows. Thanks to these measures, the renminbi remains one of the world's more appreciated currencies.

None of this information is new. It is true that it took a while for most American commentators and politicians to notice the sea change in China's foreign-exchange market. But, three years after it began, most observers have figured it out. Now someone needs to explain it to Trump.

Mnuchin should be the one to do it – ideally, before Trump's April 6-7 meeting with Chinese President Xi Jinping. Trump has already lost face with China, by challenging, with his trademark bluster, the "One China" policy, only to reverse course meekly in a February 9 phone call with Xi. The US will not benefit from another awkward climb-down by its leader.

But China is not the only supposed currency manipulator on the Trump administration's radar. Peter Navarro, director of Trump's new National Trade Council, has accused Germany of exploiting its trading partners, with an "implicit Deutsche Mark" that is "grossly undervalued." It is a uniquely foolish charge.

True, Germany's trade surplus is 8% of GDP, and its current-account surplus is close to 9% of GDP, which is excessive. But Germany has not had its own currency since 1999. Any intervention in currency markets would be carried out by the European Central Bank, not the Bundesbank. And, as it happens, the ECB has not intervened in the foreign-exchange market for many years. (When it did, it worked to support, not devalue, the euro.)

Of course, a central bank can take steps to devalue its currency indirectly, by expanding the money supply. But central banks have every right to use monetary policy to respond to domestic economic conditions, and it may well require a mind reader to know whether monetary stimulus is aimed specifically at currency devaluation. Moreover, successful monetary stimulus would raise income through domestic channels, thereby boosting imports, so the net effect on the trade balance could go either way.

Given all of this, the ECB was entirely justified in responding (belatedly) to the 2008-2009 global recession by lowering interest rates and undertaking quantitative easing, regardless of those efforts' contribution to a depreciation of the euro. And, in this case, no mind-reading is needed to determine intentions: Germany opposed the ECB's monetary stimulus.

If Trump is wondering why so many currencies are weakening against the dollar, perhaps he should look at his own actions over the last five months. He has threatened to impose tariffs against Mexico, China, and other trading partners. He has talked of a border adjustment tax. And he has promised tax cuts that would imply a rapid accumulation of national debt, forcing up interest rates and thus the dollar's value.

"Alternative facts" apparently served Trump well during his campaign. But, at the G7's meeting in Sicily in May and at the G20's meeting in Hamburg in July, they will only get him – and the US – into trouble. Mnuchin's unenviable task is to acquaint Trump with reality.

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