China using its currency to soften worst effects of trade war

By letting renminbi 'crack seven', Beijing has signalled near-term deal with US is unlikely

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The depreciation of the renminbi is a reminder to Washington that when it comes to managing China's increasingly state-led economy in tumultuous times, Xi Jinping has far more levers to pull than Donald Trump does with the US economy. © Reuters

If the renminbi had "cracked seven" — or po qi, as falling through seven to the dollar is known in Chinese — in late 2016, it would have been a sign that Beijing was losing its grip on the carefully managed currency and possibly the world's second-largest economy as well. But when that line was finally crossed on Monday morning, after flirting with it for almost three years, all was calm in Beijing.

It was no coincidence that the move came just days after US president Donald Trump threatened to impose punitive tariffs on all Chinese imports next month. Allowing the renminbi to crack seven is a carefully calculated gamble by the Chinese government that it can use the currency to ameliorate the worst effects of its trade war with the US without triggering capital flight.

The main difference between late 2016 and now is that three years ago Beijing was struggling to shore up domestic and international confidence in the renminbi, after a prolonged bout of market and currency turmoil.

But as bad as that turbulence was, strict capital controls imposed in late 2016 worked, stemming capital flight and keeping the country's foreign exchange reserves above $3tn. The Chinese central bank also gained confidence in its ability, working in close conjunction with state-owned financial institutions, to steer the renminbi's value in its most important offshore market — Hong Kong — as well as onshore.

The trade showdown between Mr Trump and his Chinese counterpart, Xi Jinping, has demonstrated Beijing's ability to manage the currency.

After the US president first demonstrated his determination to pursue — and escalate — an unprecedented trade war with America's principal geopolitical rival in the middle of 2018, the renminbi slowly but steadily declined from about 6.4 against the dollar to a low that year of 6.97.

Why renminbi fall is the latest salvo in US-China trade war

This took some of the sting out of Mr Trump's initial tariffs. But Beijing was also careful not to let the currency crack seven for fear of damaging the prospects of a trade deal with the US.

That pattern has held this year as well. At times when the two countries seemed to be nearing a deal, Beijing steered the renminbi towards a stronger exchange rate against the dollar. Yet whenever there were relapses, as occurred most dramatically in May, it weakened back down towards seven. Chinese authorities believe they can now manage similarly modest movements on the other side of the red line that they chose not to cross for so long.

The sequence of events leading to Monday's *po qi* made it quite clear this was yet another countermove by Mr Xi in response to yet another provocation by Mr Trump.

In the early hours of Friday morning Beijing time, Mr Trump threatened another round of tariff increases on Chinese imports. Later that same day, the

People's Bank of China revealed its first ever Wechat account — the country's most popular messaging app.

According to PBoC governor Yi Gang, the central bank was finally jumping on to the Wechat bandwagon to "post official information, interpret financial policy and introduce financial knowledge".

On Monday morning it did just that via the app by posting a commentary which, as Commerzbank Hao Zhou noted, signalled the move was "probably a deliberate policy action showing a hard line in the trade talks".

Eswar Prasad, a China financial expert at Cornell University, added that the renminbi was a "useful weapon" for Beijing. "China is clearly signalling its readiness to unleash a full range of overt and covert economic and trade hostilities against the US," said Mr Prasad. "Controlled depreciation of the renminbi would at least modestly help cushion the effects of . . . what is now likely to be a broad and protracted trade war."

The renminbi's move through seven is therefore a sign that Beijing now sees little hope of reaching a near-term trade settlement with the US. More importantly, it is also a reminder to the US president that when it comes to managing China's increasingly state-led economy in tumultuous times, Mr Xi has far more levers to pull than Mr Trump does in the US.