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Treasury's Recent Report on Foreign Exchange Rate Policies

November 3, 2016 (IN10601)

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Treasury Reporting Requirements

In October 2016, the U.S. Department of Treasury released its semi-annual report, "Foreign Exchange Policies of Major Trading Partners of the United States." This report responds to the new reporting requirements on exchange rates mandated in the Trade Facilitation and Enforcement Act of 2015 (P.L. 114-125), passed by Congress and signed by the President in February 2016. The legislation aims to strengthen mandated Treasury reporting and engagement on the exchange rate policies of major U.S. trading partners in force since 1988. The new reporting requirements were passed as part of a broader debate in the 114th Congress about the impact of other countries' exchange rate policies on the U.S. economy and the appropriate response, if any, to concerns about "currency manipulation," or using exchange rate policies to get an unfair trade advantage. (For more on exchange rates and the debate over currency manipulation, see CRS Report R43242, *Current Debates over Exchange Rates: Overview and Issues for Congress*, by Rebecca M. Nelson and CRS In Focus IF10049, *Debates over "Currency Manipulation"*, by Rebecca M. Nelson.)

October 2016 Assessment

The Trade Facilitation and Enforcement Act of 2015 requires Treasury to submit a semi-annual report that examines various economic criteria for major U.S. trading partners. The report is to focus on the country's bilateral trade balance with the United States, the country's current account balance (the broadest measure of a country's overall trade balance), and the country's foreign exchange holdings. An "enhanced" analysis is required for major trading partners that have (1) a significant bilateral trade surplus with the United States; (2) a material current account surplus; and (3) engaged in persistent, one-sided interventions in foreign exchange markets. Some economists contend that, together, these three indicators suggest interventionist policies are being used to undervalue a nation's currency. The act also outlines actions to be taken by the Administration for major trading partners that meet all three criteria.

The October 2016 report is the second issued by Treasury since the new reporting requirements have been in force. The Treasury Department found that no economy satisfied all three criteria, and thus no major U.S. trading partner was manipulating its currency against the U.S. dollar to prevent effective balance of payments adjustment or gain an unfair trade advantage. Treasury has not cited a country for currency manipulation in over two decades.

Although not mandated by law, the Treasury Department has developed a new "Monitoring List" in the report, which includes major trading partners that meet two of the three criteria. Once added, economies remain on the Monitoring List for at least two consecutive reports to help ensure that any improvements in performance versus the criteria are durable, and not due to temporary one-off factors. The Monitoring List for October 2016 includes the five countries on the April 2016 list—China, Germany, Japan, South Korea, and Taiwan—and adds Switzerland, whose trade was sufficiently large as of June 2016 to be included as a major U.S. trading partner (**Table 1**).

Table 1. Treasury's Monitoring List: October 2016

	Significant bilateral trade surplus with the United States?	Material current account surplus?	Persistent, one-sided intervention in the foreign exchange market?	On the April 2016 Monitoring List?
China	√			√
Germany	√	√		√
Japan	√	√		√
South Korea	√	√		√
Switzerland		√	√	
Taiwan		√	√	√

Source: CRS compiled from Treasury Department, "Foreign Exchange Policies of Major Trading Partners of the United States," October 14, 2016.

The report cautions that dynamics in the global economy over the past year have limited the appeal of or need for interventions in foreign exchange markets to depress the value of currencies, which critics label currency manipulation. Capital outflows from emerging markets have reached historically high levels, which puts downward pressure on emerging-market currencies. In response, a number of economies, including China, have engaged in foreign exchange interventions in the opposite direction—interventions that seek to prevent market forces from pushing the value of the currency too low. The report cautions that as capital outflows from emerging markets slow, more countries may revert to interventions that push down or keep depressed the value of their currency, and that more economies may trigger the threshold going forward.

Policy Questions

The new report raises a number of policy questions for Congress.

- **What is the international reaction to Treasury's new Monitoring List?** Because the Treasury Department has stressed it prefers to address currency manipulation through bilateral and multilateral engagement and diplomacy, some analysts were surprised that it initiated and developed a public Monitoring List. How have countries put on

the list responded? How has the list shaped Treasury's engagement on currency issues with other countries?

- **What are the implications for the U.S. economy of emerging-market interventions to prop up their currencies?** Debate about currency manipulation focuses on policies that are used to undervalue currencies. In response to capital outflows, however, more countries like China are using policies to do the opposite; they are intervening in foreign exchange markets to prop up the value of their currencies. What are the net and distributional effects of different types of interventions in foreign exchange markets for the U.S. economy? When do interventions promote stability and when do they create distortions in the global economy that could be destabilizing in the medium or long term?
- **Does the lack of transparency on foreign exchange interventions complicate the analysis?** A key indicator is interventions in foreign exchange markets by central banks. Although some central banks, like the Federal Reserve and the European Central Bank (ECB), publicly disclose this information, not all central banks do. For example, in the report, the Treasury Department encourages South Korean and Taiwanese authorities to provide greater transparency on interventions in foreign exchange markets. Does Treasury have sufficient information to adequately assess countries' policies? How does Treasury handle situations where it is unclear whether countries are intervening in foreign exchange markets?
- **How should the report analyze countries that are members of currency unions?** Treasury includes Germany on its Monitoring List, but exchange rate policies for Germany and the other 18 European Union countries that use the euro as their currency (the Eurozone) are set by the ECB, not by the individual countries. Does it make sense to assess whether Germany is intervening in foreign exchange markets, when such action would be taken by the ECB rather than a German entity? What are the trade-offs involved in listing individual Eurozone countries on the Monitoring List?