The Market Oracle

U.S. Currency Wars With China—Past And Present

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In a purely political move, the Trump administration (read: the U.S. Treasury) has branded China as a currency manipulator. This is an act of war. After President Trump announced that even more tariffs would be imposed on China, the markets took the value of the Chinese yuan down a notch or two. So, who was "manipulating" the yuan, Beijing or Washington? Well, it looks like Washington is engaging in yet another Asian currency war.

As it turns out, the United States has a long history of waging currency wars in Asia. We all know the sad case of Japan. The U.S. claimed that unfair Japanese trading practices were ballooning its bilateral trade deficit with Japan. To "correct" the so-called problem, the U.S. demanded that Japan adopt an ever-appreciating yen policy. The Japanese complied and the yen appreciated against the greenback from 360 in 1971 to 80 in 1995 (and 106, today). But, this didn't close the U.S. trade deficit with Japan. Indeed, Japan's contribution to the overall U.S. trade deficit reached almost 60% in 1991. And, if that wasn't enough, the yen's appreciation pushed Japan's economy into a deflationary quagmire.

Today, the U.S. is playing the same baseless blame game with China. And why not? After all, China's contribution to the overall U.S. trade deficit has surged to 47%.

America's recent declaration of economic war against China isn't the first time the U.S. has used currency as a weapon to destabilize the Middle Kingdom. In the early 1930s, China was still on the silver standard, and the United States was not. Accordingly, the Chinese yuan-U.S. dollar exchange rate was determined by the U.S. dollar price of silver.

During his first term, President Franklin D. Roosevelt delivered on his Chinese currency stabilization "plan." It was wrapped in the guise of doing something to help U.S. silver producers and, of course, the Chinese.

Using the authority granted by the Thomas Amendment of 1933 and the Silver Purchase Act of 1934, the Roosevelt Administration bought silver. This, in addition to bullish rumors about U.S. silver policies, helped push the price of silver up by 128% (calculated as an annual average) in the 1932-35 period.

Bizarre arguments contributed to the agitation for high silver prices. One centered on the fact that China was on the silver standard. Silver interests asserted that higher silver prices — which would bring with them an appreciation of the yuan against the U.S. dollar — would benefit the Chinese by increasing their purchasing power.

As a special committee of the U.S. Senate reported in 1932: “silver is the measure of their wealth and purchasing power; it serves as a reserve, their bank account. This is wealth that enables such peoples to purchase our exports.” But, things didn’t work as Washington advertised. They worked as “planned,” however. As the dollar price of silver shot up, the yuan appreciated against the dollar. In consequence, China was thrown into the jaws of the Great Depression. In the 1932-34 period, China’s gross domestic product fell by 26% and wholesale prices in the capital city, Nanjing, fell by 20%.

In an attempt to secure relief from the economic hardships imposed by U.S. silver policies, China sought modifications in the U.S. Treasury’s silver-purchase program. But, its pleas fell on deaf ears. After many evasive replies, the Roosevelt Administration finally indicated on October 12, 1934 that it was merely carrying out a policy mandated by the U.S. Congress. Realizing that all hope was lost, China was forced to effectively abandon the silver standard on October 14, 1934, though an official statement was postponed until November 3, 1935. The abandonment of silver spelled the beginning of the end for Chiang Kai-shek’s Nationalist government. America’s “plan” worked like a charm — Chinese monetary chaos ensued. This gave the communists an opening that they exploited — one that contributed mightily to their overthrow of the Nationalists.

Today’s currency war with China promises to deliver what currency wars always deliver: instability and uncertainty. And with that, it’s becoming clearer with each passing day that President Trump will not be the 2020 “Peace and Prosperity” candidate.

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