The Daily Dish

Is China Undoing the Trump Tariffs?

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Eakinomics: Is China Undoing the Trump Tariffs?

News that "China Sets Official Yuan Rate at Weakest in a Decade" immediately raises suspicions (at least in some circles) that the Chinese are gaming the international trading system. After all, if Trump Administration tariffs make Chinese goods more expensive in the United States, a weaker yuan has just the opposite effect.

There is a fairly simple explanation, however. U.S. growth has continued to accelerate — year-over-year growth in the third quarter was 3.0 percent, up from 2.8 percent in the second quarter and well above the recent low of 1.6 percent in the second quarter of 2016 — while the remainder of the globe, China included, has seen its prospects weaken. The rising interest rates that automatically accompany accelerating growth (abetted by the Federal Reserve's normalization of interest rates) has pushed U.S. rates well above rates elsewhere. The inflow of capital in search of the higher U.S. yield tends to raise the value of the dollar — the flip side of weaker currencies around the globe. *The Wall Street Journal* article hints at this phenomenon: "The yuan's move against the dollar this year has partly been driven by the broader strength of the greenback: against a basket of 24 currencies, the yuan has declined by just 2.7% this year, compared with a fall of 6.7% against the dollar." In short, this is the dollar getting stronger and the Chinese acknowledging reality but trying to limit the fall in the yuan.

That does not mean that this is immaterial for U.S. trade. Other things being the same, the decline in the yuan offsets over one-half of the additional costs from 10 percent tariffs — for those goods subject to tariff. Note, however, that for those goods not subject to tariff, the prices have simply declined and are more attractive to U.S. purchasers. This is the classic manner by which taxes and tariffs distort the pattern of purchases, imports, and products in the United States and elsewhere.

The mismatch between U.S. growth and world growth has set up a differential between rates of return here and abroad. The concomitant increase in the value of the dollar makes every transaction that other countries do in dollars more expensive and everything that U.S. purchasers do less expensive. This will increase the size of the overall trade deficit — to the Trump Administration's chagrin — in a way that reflects the economic fundamentals and not China gaming the system.