

CURRENCY WEAKNESS IS A DOUBLE-EDGED SWORD

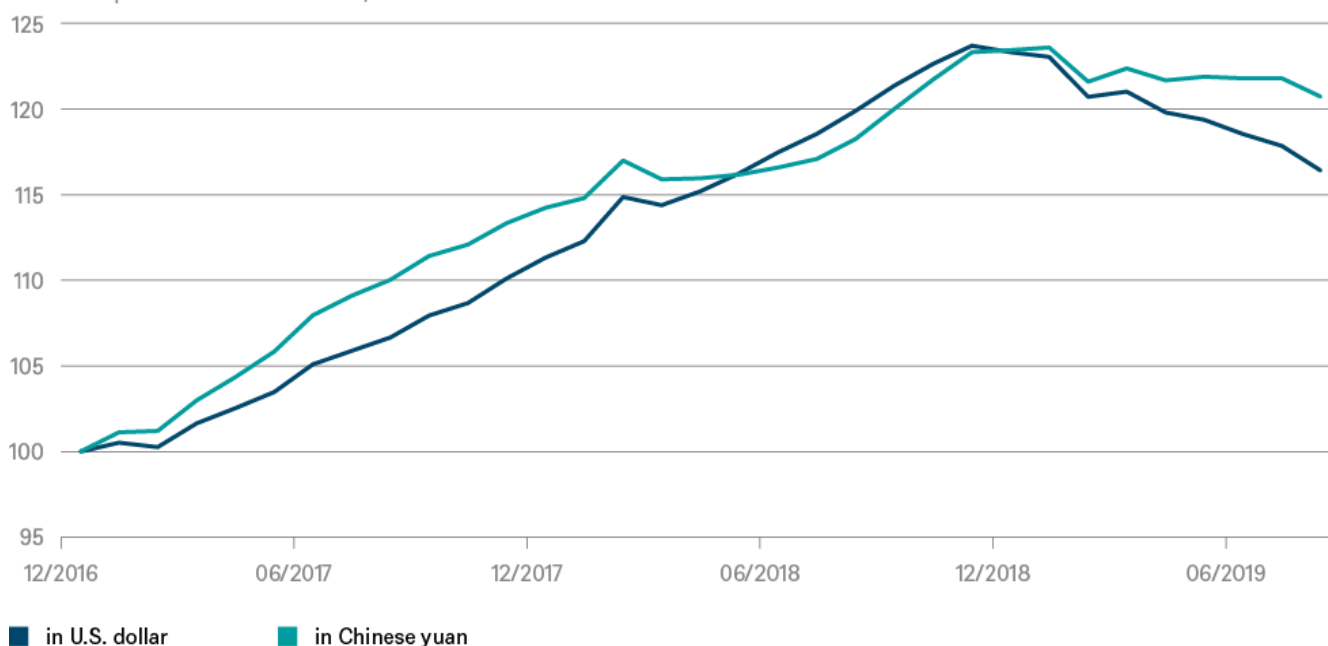
Eventually, the trade conflict between the U.S. and China is more likely to be resolved at the negotiating table than in currency markets

The trade conflict between the United States and China lingers on, without any easing in sight. Washington is still on a path of two steps of escalation, followed by one step of de-escalation. The latter has mainly consisted of postponing punitive measures beyond the dates initially announced. Partly, that is because the longer this conflict drags on, the more visible the negative economic consequences become. And not just for the main protagonists. Some other countries are heavily affected, too; especially those with a high dependence on industry and manufacturing since the main focus of the trade dispute between the U.S. and China has been on tradable goods (see also [Chart of the Week as of 5/17/19](#)).

In the case of China, the exchange rate seems to provide some relief in the short run, at least from the Chinese perspective. In recent weeks, the Chinese yuan has depreciated against the U.S. dollar from 6.7 yuan to 7.15 yuan per dollar, i.e. by about 6%. As a result, the value of Chinese exports to the U.S. fell by 6% in dollar terms, while exports measured in yuan remained almost stable – as can be seen in our "Chart of the Week."

In the long run, however, a currency devaluation is a double-edged sword. A weaker exchange rate increases competitiveness by making a country's products cheaper for foreign customers, while prices for goods and services from abroad become more expensive for domestic consumers. And this is exactly where the crux lies: part of the burden is passed on to domestic consumers and companies via lower purchasing power for imported products, such as oil. Meanwhile, U.S. companies and consumers are also feeling the pain, because the devaluation has not fully offset the recently imposed tariffs. These double-edged effects of the recent, moderate devaluation of the renminbi are part of the reason why we do not expect a more sustained, significant fall in the Chinese currency's value. The combined effects of U.S. tariffs paired with China's devaluation inflicts pain on consumers and companies on both sides. That should increase incentives on both sides to return to the negotiation table. And that, in turn, should reduce pressure on the Chinese renminbi to devalue further.

Chinese exports to the United States; indexed: 12/31/16 = 100



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 9/4/19

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GLOSSARY

Chinese yuan (CNY)

The **Chinese yuan (CNY)** is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

Renminbi (RMB)

Renminbi (RMB) is the currency of the People's Republic of China.

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