19 August 2019

The US-China Trade War and How it Affects the Forex Market?

It's been more than a year since the US-China trade war began, showing no signs of coming to a halt. Since 2018, the United States has already imposed tariffs on $250 billion worth of Chinese goods and has threatened to levy further tariffs, on goods worth another $325 billion, starting September 2019.

On the other hand, China has slapped tariffs on $110 billion worth of US products and is planning to impose qualitative measures that can harm US businesses operating on Chinese shores.

The world is looking at a full-blown trade war; the biggest in the history of the global economy, with both sides showing no signs of backing down. The global markets continue to take a toll. If tariffs are raised further to cover all aspects of US-China bilateral trade, the global GDP will suffer losses worth $600 billion by 2021, according to a report by Bloomberg. How will the forex market fare in this intense dispute between two of the largest nations in the world? Let's find out.

Trade War Escalating into Currency War

Volatility in the forex markets has become a norm over the past year. This is especially true whenever important news releases, from either Washington or Beijing, are expected. This becomes more pronounced in the days leading up to important events like the G20 summit, when the country leaders decide to meet and resolve conflicts.

However, on August 5, 2019, the Chinese Yuan fell to its lowest level in 11 years. The People's Bank of China allowed the CNY to fall below the key threshold level of 7.0 against the US Dollar, in retaliation to US threats of imposing additional 10% tariffs on more than $300 billion worth of Chinese goods. This decline was sudden and drastic, and affected the currency markets worldwide; particularly the 11 regional currencies.

Experts suggest that further declines would be bad for the Chinese economy, as a weaker Yuan will make it harder for China to repay its Dollar-denominated debts, pushing its economy further down.

The US-China trade war has intensified into a currency war, which has caused extreme volatility in the markets. It is causing a decline in global equities and could harm the global economy over the long term. To remain competitive, countries could begin to weaken their respective currencies, in order to gain an advantage in global trade. If the US also decides on a weaker Dollar, as President Trump seems to desire, experts predict a rise in global inflationary and recessionary trends.

Forex Volatility Likely to Continue

Currency wars, which are expected to continue into 2020, would negatively impact market sentiment. Markets would become increasingly sensitive to every news release associated with trade negotiations. This volatility will not remain restricted to the US Dollar and Chinese Yuan alone. All over the world, Central Banks are already lowering interest rates. The Central Banks of Thailand, New Zealand and India are some of the most recent ones do so. This devaluation has impacted emerging market currencies hugely, which are usually alternatives for investors, when the US Dollar weakens. However, with the impact on emerging market currencies, investors are likely to flee towards assets like gold, oil and even cryptocurrencies.

Some Safe Haven Currencies

Surprisingly, currencies of countries like Australia, Switzerland and Canada have been stable through this trade war. Following the increase in US tariffs on Chinese goods, countries like Brazil, Mexico, Japan and Canada have increased their exports to the USA. Australia, Switzerland and Hong Kong, on the other hand, have found new markets on Chinese shores. With China increasing tariffs on US imports of gold and petroleum gases, Australia has been serving as an alternative for the supply of such products, providing a boost to the Australian Dollar.

With the US-China trade war increasingly becoming focused on currencies, it is essential for forex traders to remain prepared for all market eventualities. Diversification and risk management measures are extremely important now.

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