U.S. Declines to Say China Is Manipulator in Yuan ‘Quarrel’

December 29, 2011, 10:52 AM EST

By Cheyenne Hopkins and Ian Katz

(Updates with comment from Chinese government in seventh paragraph.)

Dec. 28 (Bloomberg) -- The Obama administration declined to brand China a manipulator of its exchange rate while calling the yuan undervalued and vowing to press for further appreciation of the currency.

The Treasury Department, releasing its semi-annual report to Congress on the currency policies of major trading partners, said yesterday it will “press for policy changes that yield greater exchange-rate flexibility” in the yuan. The report also criticized Japan for unilaterally selling the yen in August and October, adding that the U.S. didn’t support those interventions.

The U.S. contends that China uses an undervalued currency to give its exporters an unfair advantage in overseas markets and boost growth. At the same time, the administration of President Barack Obama has sought to avoid actions that could cause friction with the world’s No. 2 economy and the second-largest U.S. trade partner.

“The administration has probably decided it would be counter-productive to pull the trigger at this stage on the charge of currency manipulation,” said Eswar Prasad, a senior fellow at the Brookings Institution in Washington and a former International Monetary Fund economist. “Given the fragility of its economic recovery, the U.S. cannot afford a broader trade war with China at this juncture.”

The Chinese government is unlikely to respond “constructively” to pressure on its currency policy and therefore the administration “prudently decided to save its powder for future battles,” Prasad said.

‘Strong’ Pressures

The Treasury said in the report that China “has resisted very strong market pressures” over the past decade for appreciation of the yuan. “China’s real effective exchange rate has exhibited persistent and substantial undervaluation, although the estimated range of misalignment has narrowed over the course of the past 18 months.”

The U.S. should move beyond the “useless, meaningless” quarrel over the yuan’s exchange rate and look to new areas for bilateral and global trade cooperation, China’s state-run Xinhua News Agency said in a commentary today. The nation is making the currency more flexible, and gradually moving toward more balanced trade, Hong Lei, a spokesman for the foreign ministry, said at a briefing in Beijing today.

China often bristles at criticism that its exchange rate is undervalued. It disputed an IMF staff assessment in July that the currency is “substantially below the level consistent with medium-term fundamentals,” citing reasons including faulty current-account projections.

Criticism on Japan

The Treasury also criticized Japan, which unilaterally sold the yen twice in the foreign-exchange market after Group of Seven economies jointly intervened after the March earthquake. The operations in August and October took place when market conditions were orderly and global economic developments were affecting other major currencies as well, the report said.

“The United States did not support these interventions,” the Treasury said, adding that the impact of the unilateral yen sales was temporary. “Rather than reacting to domestic ‘strong yen’ concerns by intervening to try to influence the exchange rate, Japan should take fundamental and thoroughgoing steps to increase the dynamism of the domestic economy.”

‘Deeply Disturbing’

The criticism marks a contrast with last year when Treasury Secretary Timothy F. Geithner refrained from joining U.S. lawmakers in criticizing Japan’s decision to intervene in September 2010. Geithner said Oct. 6, 2010, that Japan didn’t fuel international tensions when it sold the yen even as Sander Levin, then head of the House Ways and Means Committee, had called the move “deeply disturbing” and then Senator Christopher Dodd said it violated international accords.

In China, the yuan appreciated about 7.5 percent against the dollar as of Dec. 16 since it decided to loosen controls on the yuan in June 2010. Because inflation in China is higher than in the U.S., the yuan has risen by about 12 percent against the dollar in real terms, the Treasury said.

“While China’s real exchange rate has appreciated, the process of appreciation remains incomplete,” the Treasury said. It cited China’s accumulation of $3.2 trillion in foreign exchange reserves as of September and a persistent current- account surplus as evidence the yuan “is persistently misaligned and remains substantially undervalued."

Moving More Quickly

"It's time for them to go ahead and move towards a market- based system for their currency," Obama said in Hawaii at the Asia-Pacific Economic Cooperation summit last month. "We recognize they may not be able to do it overnight, but they can do it much more quickly than they've done it so far." Obama said that "most economists" estimate the yuan is 20 percent to 25 percent undervalued.

The yuan weakened yesterday to 6.3219 per dollar. It touched 6.3160 on Dec. 26, the strongest level since the country unified the official and market exchange rates at the end of 1993.

China will maintain a "prudent" monetary policy and a "proactive" fiscal policy next year, the official Xinhua news agency reported Dec. 10, citing a meeting of the Communist Party's Politburo led by President Hu Jintao.

The Senate voted 63-35 on Oct. 12 for legislation that would let U.S. companies seek duties to compensate for "misaligned" currencies. House Speaker John Boehner said he has "grave concerns" with the bill because it might start a "trade war," casting doubt on whether it will become law.

Romney's View

Republican presidential candidate Mitt Romney said Nov. 12 he would make a case against China at the World Trade Organization for manipulating its currency to artificially lower prices and run a trade surplus. The U.S. had a $273 billion trade deficit with China last year.

The Treasury has taken the "right approach" by negotiating with China directly and at international forums, John Frisbie, president of the U.S.-China Business Council, told reporters in Washington last month. The council's members include JPMorgan Chase & Co., Coca-Cola Co., Boeing Co. and General Motors Co.

The Treasury's stance isn't shared by other corners of the government. The U.S.-China Economic and Security Review Commission, a body created by Congress in 2000, said in its annual report last month that China "continues to manipulate the value of its currency," keeping the yuan low to reduce export prices and increase the cost of imports.

"This policy also reduces U.S. exports to China while it encourages U.S. consumers to purchase Chinese exports," the commission said. "The result has been lost production and jobs in the United States."

Under a 1988 law, the Treasury is required to report to Congress twice a year on international economic conditions and exchange-rate policies. The Treasury is required to enter direct talks with a country deemed to be manipulating its currency, and also seek redress through the International Monetary Fund. The last country labeled a manipulator was China, in 1994.

--With assistance from Aki Ito in Tokyo and Paul Panckhurst in Beijing. Editors: Ken McCallum, Paul Panckhurst

To contact the reporters on this story: Cheyenne Hopkins in Washington at chopkins19@bloomberg.net; Ian Katz in Washington at ikatz2@bloomberg.net

To contact the editor responsible for this story: Chris Wellisz at cwellisz@bloomberg.net