FINANCIAL TIMES

April 10, 2012 6:02 pm

IMF set to recognise shrinking Chinese surplus

By Simon Rabinovitch in London and Jamil Anderlini in Beijing

The International Monetary Fund will "be significantly reducing" its medium-term outlook for China's current account surplus, according to people familiar with the matter, a move which will give Beijing ammunition against critics who say that it keeps the renminbi artificially cheap to support its exporters.

China's once-mammoth trade surplus is shrinking more quickly than anticipated as domestic demand grows and this will prompt the IMF to recognise that the economy is better balanced than in the past.

A change in the IMF's forecast "would certainly erode the analytical underpinning for the case that the renminbi is substantially undervalued", said Eswar Prasad, a former senior IMF official in China who is now a Brookings Institution scholar.

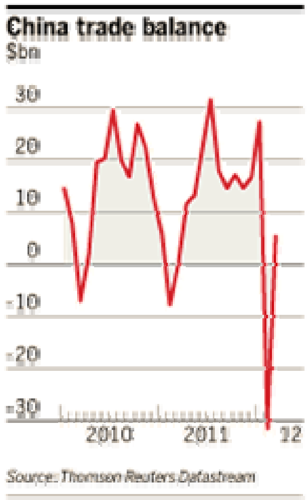
The IMF forecast adjustment, which is set to be included in the next instalment of its World Economic Outlook on April 17, will reflect the vastly altered state of China's trade relations since the global financial crisis and catches up with forecasts made by other economists.

China's trade surplus peaked at nearly $300bn in 2008, but has consistently fallen since then as the US and European economies have weakened, while Chinese domestic demand has expanded quickly. Its trade surplus was $155bn last year and most analysts expect it to decline again this year.

The Chinese government on Tuesday reported that the country's trade surplus in the first quarter, when it is traditionally weak, was a mere $670m. This "supports our view that the days of one-way appreciation of the renminbi are close to being over," said Shen Jianguang, economist with Mizuho Securities.

After rising 31 per cent against the dollar since 2005, the renminbi's upward march has come to a standstill this year and has effectively been flat against the dollar in 2012.

Even more remarkable than the absolute decline in China's trade surplus has been the narrowing of its current account surplus as a percentage of gross domestic product.



This is an important development since the current account balance as a percentage of GDP is one of the most widely used gauges of whether a currency is fairly valued. China's current account surplus hit 10.1 per cent of GDP in 2007, extremely high for a large country and held up as evidence that Beijing's currency policy was a cause of the global economic imbalances.

However, the surplus fell to only 2.7 per cent last year. The IMF last forecast that China's current account surplus would be 7.2 per cent in 2016 – it is this figure that it will revise down next week.

"Now that China's current account surplus has dropped below 3 per cent of GDP and is likely to stay down, it is difficult to argue that the renminbi is much undervalued anymore," said Wang Tao, economist with UBS, in a recent note. "More importantly, this point has been seized by China's senior policy makers and the market seems to be increasingly convinced."

Premier Wen Jiabao said last month that the renminbi was approaching "equilibrium value", in comments which reflected the drop in the surplus.

The weaker trade surplus, though providing Beijing with diplomatic leverage, is also a cause for concern as the economy slows. Chinese exporters have been hit hard by Europe's economic woes as shipments to their most important market dropped 3.1 per cent in March from a year earlier.

"[Tuesday's] trade data confirms the weakness in both China's external and domestic fronts," said HSBC economist Qu Hongbin. "This reinforces the need for further easing measures."

Beijing is scheduled to publish GDP data on Friday that is expected to show growth slowed to about 8.4 per cent, down from 8.9 per cent in the fourth quarter of last year.