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For U.S., yuan talk is good, action is better

Sat, Jun 19 2010

By Emily Kaiser

WASHINGTON (Reuters) - China's unexpected pledge on Saturday to allow its currency to rise more rapidly will probably make for a less contentious meeting with Group of 20 world leaders in Toronto next week.

Unless Beijing swiftly follows up talk with action, however, the vow will not defuse a fight brewing in the U.S. Congress over whether to penalize China for what some lawmakers see as unfair trade practices.

China's central bank said it would gradually make the yuan's exchange rate more flexible, indicating it was ready to break a 23-month-old dollar peg that had become a growing source of friction with the United States.

Washington wants a stronger yuan to make its own exports more competitive with China's. Many economists say the yuan is undervalued by as much as 40 percent, giving China a trading advantage and swelling its reserves to more than $2 trillion.

"This is an important step but the test is how far and how fast they let the currency appreciate," U.S. Treasury Secretary Timothy Geithner said in a statement.

Some private analysts doubted China would act quickly.

"Just these words are not going to be enough to satisfy the U.S. Congress and Treasury," said Marc Chandler, head of global currency strategy at Brown Brothers Harriman & Co in New York.

"I am skeptical. I am not convinced that these words mean what they seem to mean."

U.S. Democratic Senator Charles Schumer, who has led a congressional charge to get tougher on China, called the move "vague and limited" and typical of China's response to pressure.

"Until there is more specific information about how quickly it will let its currency appreciate and by how much, we can have no good feeling that the Chinese will start playing by the rules," Schumer said in a statement e-mailed to Reuters.

STEALING G20's THUNDER

Just one day earlier, it appeared the yuan dispute was nearing boiling point after Beijing said its currency had no place on the agenda at the G20 meeting.

U.S. President Barack Obama released a sharply worded letter to his G20 colleagues saying that free-floating currencies were "essential" for global economic stability.

"China has once again stolen the thunder from the international community by timing its announcement of a move toward greater exchange rate flexibility right before the G20 meeting," said Eswar Prasad, a senior fellow at the Brookings Institution think tank in Washington.

"The big question is whether this is a symbolic move or a true shift in China's currency policy that will result in significant currency appreciation in the near term.

On Saturday, Obama called China's decision a "constructive step" that can help safeguard the recovery and contribute to more balanced growth.

The International Monetary Fund called the yuan announcement a welcome development that would help China reorient its economy toward domestic demand.

A stronger yuan would promote U.S. exports to China and "strengthen what is already a positive and beneficial trade relationship between the two nations," said Rich Lavin, group president for emerging markets at heavy equipment maker Caterpillar Inc.

The US-China Business Council, whose members do business in China, said it supported allowing the exchange rate to better reflect market influences.

"China's growing exports and inflation concerns suggest that China's exchange rate should strengthen," USCBC President John Frisbie said in a statement. "We look forward to seeing how the People's Bank of China will implement their statement of today."

NO MORE MR. NICE GUY

Obama's administration has relied on quiet diplomacy to nudge China into unpegging its currency, much to the frustration of some lawmakers who thought the White House was too soft on an increasingly aggressive competitor.

Geithner delayed a report to Congress due in April in which Washington had to decide whether it would label China a currency manipulator, a step that could trigger an IMF review and no doubt anger Beijing.

Geithner had essentially offered China a grace period through the Toronto G20 meetings, and many economists thought he would affix the label in the coming weeks.

It appeared that Washington and Beijing had at least an implicit agreement earlier this year that China would allow the yuan to rise more rapidly, said Menzie Chinn, a China policy scholar who teaches economics at the University of Wisconsin.

Europe's worsening debt troubles put that on hold. Europe is China's largest trading partner, so China had no desire to do anything that would further harm demand.

"The impending G20 meeting required at least some sort of indication of impending action," Chinn said.

"Saying that they will allow 'flexibility' means they can also try to occasionally depreciate the yuan on a day-to-day basis, here and there, to discourage speculators gambling on predictable day-by-day appreciation."

But that will probably not be enough to calm tensions among U.S. lawmakers who want to penalize China.

Unless China gets more specific in the next few days, "we will have no choice but to move forward with our legislation," Schumer said.

(Additional reporting by David Lawder, Lesley Wroughton, Andy Sullivan, Doug Palmer, Paul Eckert and John Poirier in Washington; William Schomberg in New York; Editing by Kristin Roberts and Peter Cooney)

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