» **Print**

Analysis: IMF bound by politics in Chinese yuan debate

Thu, Jul 29 2010

By Lesley Wroughton

WASHINGTON (Reuters) - Substantially.

That single word, left out of the International Monetary Fund's assessment of China's undervalued currency, laid bare the tricky IMF internal politics that govern even its most routine interactions with the world's newest economic power.

IMF staff, under pressure for years from member countries to tell it like it is when assessing a country's economic health, said China's yuan was "substantially" undervalued.

But by the time the final assessment passed through the IMF's 24-member board of shareholder countries on Monday, that word had fallen victim to disagreements between those who put faith in Beijing to let its currency rise more rapidly and those among the Group of Seven rich nations who doubt much progress would be made.

The board statement simply called the yuan "undervalued" with several countries questioning the accuracy of IMF staff projections of a major increase in China's current account surplus over the next several years.

On the one side are emerging market economies, like Brazil, who stood behind China, and on the other the G7 old-line powers who believe the yuan is still too cheap but did not say so.

"The G7 wants more flexibility in how the currency is managed but at the same time they want to do that diplomatically," said Domenico Lombardi, a former IMF board member now at Brookings Institution.

Still, Lombardi said calling the yuan undervalued, regardless of whether it is substantial or not, sent a strong signal to Beijing that it needs to revalue the currency.

"It is clear the board adopted a diplomatic stance. They tried to do their best not to upset the Chinese authorities but in the end preserved the substance of the IMF staff's message by concurring the exchange rate was undervalued," he added.

SOFTER ONE FROM WASHINGTON

The outcome reflects not only muscle-flexing on the part of China but some softening of the U.S. position.

The Obama administration has toned down some of the rhetoric the previous Bush administration used when describing the extent to which China's yuan is undervalued.

Treasury Secretary Timothy Geithner has said repeatedly it is "China's choice" to decide how and when to let market forces play a larger role in determining the yuan's value, even as he emphasized it was in China's interest to do so.

As recently as Sunday, he praised Beijing's recent move to free the yuan from a dollar peg and described that as a helpful move toward easing global trade imbalances even though the yuan has risen less than one percent since China did so.

"What matters to us is how fast and how far they let it go," Geithner said, a gentle reminder that while Washington likes Beijing's policy direction it is also monitoring its effectiveness.

In contrast, the Bush administration grew frustrated with efforts to convince China to let its currency rise faster and pressured the IMF unsuccessfully to label China a currency manipulator.

While the IMF never bowed to that pressure, it did change its currency surveillance rules to say that member countries should stay away from policies that result in "external instability," in addition to avoiding currency manipulation and intervention.

Beijing accused the IMF of not being even-handed and stalled the IMF's process for reviewing its economy for two years. Current IMF Managing Director Dominique Strauss-Kahn has overturned that rule, saying it made discussions with member countries less open.

DISAPPEARING FOOTNOTE

In another twist, China -- supported by other emerging market economies -- took umbrage with a footnote in the IMF staff report stating that staff estimated the yuan was undervalued by somewhere between 5 percent and 27 percent.

The footnote was removed at China's behest before the staff documents were published on Thursday.

Such estimates are not unusual and fall under the IMF's expertise. They have, however, always been a thorny issue because of the broad disagreement among economists on how best to determine whether currencies accurately reflect a country's economic fundamentals.

To be fair, all IMF member countries have a say in what is published and what is not in reviews of their economies.

"The Chinese looked at the whole report to assess whether it's a fair and balanced report and also if we had reflected their views correctly in the report," IMF mission chief to China Nigel Chalk told reporters on a conference call.

Eswar Prasad, a former IMF official and trade professor at Cornell University, said China's surprisingly quick agreement to release the report reflected Beijing's growing confidence it is control of the global debate over its currency.

While the staff report had some tough language on the need for further currency reforms, it also praised Beijing's recent announcement to move to a more flexible exchange rate, even though there has been little actual movement in the yuan.

China was further emboldened by the board's at best lukewarm support for the IMF staff's relatively hard-line position on the currency issue, said Prasad, a senior fellow at Brookings. He said the staff report, which contains the authorities' views, shows Beijing pushing back on all of the staff's analysis and assertions used to support the finding of a substantially undervalued exchange rate.

(Reporting by Lesley Wroughton; editing by Tim Ahmann and Todd Eastham)