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Brazil Is Poised to Pressure Beijing on Currency Policy

By JOHN LYONS And MATTHEW COWLEY

SÃO PAULO—Brazil's overvalued currency may be turning the South American giant into a U.S. ally on a key economic issue: Pressuring China to let its own currency strengthen to address global trade imbalances.

Brazil's newly appointed Trade Minister Fernando Pimentel said Monday that President Dilma Rousseff, who took office Jan. 1, intends to put Chinese currency weakness on the agenda when Ms. Rousseff travels to Beijing in April. U.S. officials have long accused China of keeping its currency, the yuan, artificially weak to gain an unfair advantage in international commerce.

Roberto Stuckert/DPA/Abacausa

Dilma Rousseff was inaugurated Saturday as the first female president in the history of Brazil.

Brazil has criticized governments that it claims manipulate their currencies, including knocking China over its weak yuan. Recently, Brazilian officials have directed their harshest comments at the U.S., which is printing dollars to lower long-term interest rates, while sparing China, an increasingly important export market for commodity-rich Brazil. But that may be changing.

"This is a subject that speaks not just to Brazil but to all emerging markets," Trade and Industry Minister Pimentel told reporters in Brasília.

The yuan recently has begun appreciating as a Jan. 19 meeting of Chinese President Hu Jintao and U.S. President Barack Obama draws closer. Since Dec. 15, the yuan has risen about 1% against the dollar. Overall, it has risen more than 3% since mid-June, when China said it would allow the currency to float more.

Brazil has flirted with both sides of the U.S.–China fight over currency, sometimes lining up with Washington in its criticism of Beijing, and at others lining up with Beijing to criticize U.S. monetary policy that both Beijing and Brasília say disadvantages their economies. At the Group of 20 leaders meeting in Seoul in November, Brazil focused more on U.S. currency moves than China's.

Brazil has economic clout in the conflict. Hungry for Brazilian raw materials such as iron, China surpassed the U.S. recently as Brazil's biggest trade partner. In turn, Chinese companies are seeking access to Brazil's fast-growing industries, such as oil.

China has sought to brush off Washington's criticism of its currency as the unwarranted carping of a rich industrialized nation—something it won't be able to do with Brazil.

"China may be more sensitive to what the other major emerging market countries think about its currency," says William Cline, a senior fellow at the Peterson Institute for International Economics. "It undermines their moral high ground when it's Brazil criticizing them instead of the U.S."

The policy shift underscores concern in the Rousseff government about a Brazilian currency, the real, that has risen nearly 35% since the beginning of 2009 and is now considered the world's most overvalued by Goldman Sachs. A strong currency hurts exporters and makes it harder for domestic manufacturers to compete with less-expensive imports from China. Brazil recently raised import duties on toys to protect local producers from Chinese goods.

Eswar Prasad, a former International Monetary Fund China expert now at Cornell University, says the split in Brazilian thinking reflects divides between Brazilian export constituencies.

Brazilian manufacturers, like U.S. ones, worry that China's undervalued yuan makes them less competitive internationally.

But Brazil's commodity exporters look to China as a huge market and are loath to upset Beijing. Over the past year, Mr. Prasad said, the commodity lobby had the upper hand, as Brazil tamped down its criticism of China's currency practices.

In separate comments on Monday, Brazil's new Planning Minister Miriam Belchior said that Brazil also would begin to address what economists say is a key reason behind the overvalued real: soaring government spending.

Annual spending increases on the order of 20% have helped to fuel economic growth.

But rising government spending also has forced the central bank to maintain some of the world's highest interest rates in order to keep inflation under control in an overheating economy. The high interest rates have attracted a flood of speculative foreign investment and sent the real soaring.

In a news conference, Ms. Belchior said Brazil would trim some plannedspending from the 2011 budget approved by Congress, which amounted to a 15% increase over 2010. Some economists were skeptical that the Rousseff government would be able to control spending in a meaningful way.

In recent weeks, for example, Congress has raised the national minimum wage by 6% and approved a 60% salary increase for itself. Ms. Rousseff also intends to spend hundreds of millions on a new presidential jet to replace one purchased in 2005. Meantime, the government will find it impossible to cut in some areas, such as welfare spending or planned infrastructure projects to ready the nation to host the soccer's 2014 FIFA World Cup and the 2016 Olympic Games.

"I am skeptical that the Rousseff government will be able to make any impressive cuts," said Douglas Smith, an economist who follows Brazil at Standard Chartered Bank.

But Ms. Belchior suggested that Brazil may have other ways to economize, including giving private companies a bigger ownership stake in infrastructure projects, such as building stadiums, ports and river dams as well as a high-speed train connecting São Paulo and Rio de Janeiro. "We're going to accelerate initiatives in the direction of public-private sector partnerships. I think we can do more in this area," Ms. Belchior said.

—Bob Davis in Washington contributed to this article.

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