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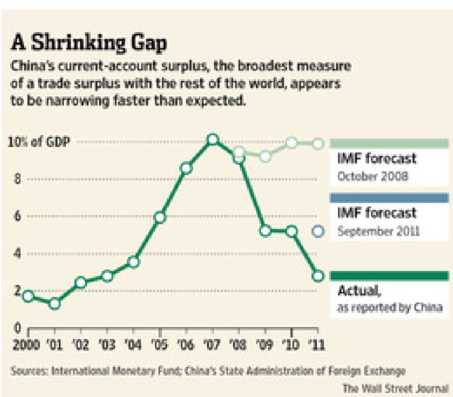
IMF to Shift Its View of China's Trade Surplus

Forecast Expected to Be Sharply Reduced, Underpinning Beijing's Defense Against U.S. Accusations Over Yuan

By BOB DAVIS and TOM ORLIK

BEIJING—The International Monetary Fund is poised to sharply reduce its long-term forecast of China's current-account surplus, the broadest measure of a nation's trade, which would strengthen Beijing's defense against the U.S. argument that the Chinese currency is "substantially undervalued."

Several individuals informed of the debate said the IMF would significantly lower its long-term current account surplus in the update of its flagship publication, the World Economic Outlook, to be released April 17, from the forecast of more than 7% of gross domestic product in the September WEO. The final number has been the subject of ongoing debate within the fund, reflecting the difficulty of the political and technical issues involved.



A reduction to 5%, which has been discussed, "would markedly weaken the case" that the yuan is undervalued," said Brookings Institution China scholar Eswar Prasad, who is a former senior IMF China official.

Since at least 2009, the IMF has been describing China's currency as "substantially undervalued"—and before that it sought to use the term "fundamentally misaligned," though Beijing blocked that designation. China's government intervenes in the market to keep the currency from rising and thus endangering China's exports. The higher the exchange rate, the more costly a country's exports to foreign customers.

According to individuals closely monitoring the debate within the IMF, the fund isn't likely to issue a new judgment on the yuan in the WEO. That's because the IMF is revamping the way it assesses currencies and the new methodology isn't scheduled to be made public until June. Instead, the IMF is likely to argue, as it has done in the past, that continued appreciation of the yuan would give Chinese consumers a lift and help shift China's growth model so it depends less on exports and investment.

The WEO is set to forecast current-account balances for major economies through 2017. Those estimates become the fodder for assessments of undervaluation and overvaluation; the larger the current-account surplus, the stronger the case that a currency is undervalued.

As the IMF was debating Chinese currency policy, China's General Administration of Customs reported Tuesdaythat China posted a trade surplus in March after a hefty deficit in February, though analysts said the numbers didn't reflect much strengthening of the Chinese economy. China recorded a $5.4 billion trade surplus in March, sharply reversing a $31.5 billion deficit in February, and compared with a median $3.2 billion deficit forecast of 15 economists polled by Dow Jones Newswires.

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Still, China's exports managed just 7.6% year-to-year growth in the first quarter, markedly down from 20.3% growth in 2011. Weakness in exports reflects a slowdown in demand from China's major trade partners, especially Europe. Exports of textiles grew just 1.4% in the first three months of the year. "We're seeing fewer orders and much fluctuation in the markets," said Liang Sheng, sales manager of Defang Textile in the southern Chinese city of Shenzhen. "The situation is more or less as bad as people imagine," he added.

Import growth in the first quarter was also lackluster. The volume of iron ore imports grew just 6% compared with a year ago, the result of the slowdown in construction in China's real-estate sector.

Since 2008, the IMF has consistently overestimated how large China's current-account surplus would remain. IMF officials say that's because the fund overestimated how quickly U.S., Europe and Japan would recover from the global financial crisis of 2008 and 2009 and underestimated how much China's economy would change so it relied less on exports.

In 2007, China's current-account surplus as a share of GDP peaked at 10.1%. In 2008, the IMF forecast it would stay close to 10% in the years ahead. That formed the basis of the argument that the yuan was "substantially undervalued" and years of diplomatic pressure on China to allow more rapid appreciation. In fact, China's current-account surplus in 2011 came in at just 2.8% of GDP.

Politicians in the U.S., Europe, Latin America and elsewhere used the IMF designation of the yuan to press China to let its currency rise. In June 2010, shortly before a summit of the heads of the Group-of-20 leading nations, China agreed to let the yuan appreciate somewhat. Since then, it has risen 8.3% against the dollar.

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A Chinese bank teller counts stacks of Chinese 100-yuan notes.

But the criticism of the yuan has hardly abated, particularly in the U.S. where the Senate passed a bill last year threatening sanctions against China for its currency practices, and where the value of the yuan has become a big issue in the presidential campaign. Recently, though, China's premier and central banker have suggested that the currency's rise is likely to halt, or slow sharply because it is reaching an "equilibrium level." Since January, the yuan has fallen 0.3% against the dollar.

A further reduction in the IMF's estimate of China's current-account surplus is bound to add to China's argument that it needn't let the currency appreciate much further. The IMF and China's central bank didn't comment on the IMF's WEO estimates.

Harvard economist Kenneth Rogoff, a former IMF chief economist, said it is especially tough to forecast the current account because of the rapidity with which markets and investment patterns change and because trade data, especially in services, may not be accurate. He added that the IMF has been correct to warn China that it needs to make deeper changes in pattern of its economic growth, so it relies less on investment. A rising yuan could help in that process because it makes imports cheaper in dollar terms and could give a boost to Chinese consumer spending.

"Overall, the IMF is right to continue to sound the alarm on Chinese imbalances" in economic growth, Mr. Rogoff said.

—Yoli Zhang contributed to this article.

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