ECONOMY

Treasury Calls on Core Eurozone Economies to Do More for Growth

In Semiannual Report, Treasury Also Takes China, South Korea to Task Over Currency Policies

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The U.S. Department of the Treasury issued its semiannual report to Congress on exchange-rate policies of its major trading policies. *Bloomberg News*

WASHINGTON—The U.S. Treasury Department criticized Germany and other economies with trade surpluses for relying too heavily on exports to aid growth, and called for bolder efforts to boost consumer spending and support a flagging global recovery.

In Treasury's semiannual report to Congress on the exchange-rate policies of major trading partners, the Obama administration also took China and South Korea to task over currency policies that it says undermine growth prospects in other economies.

The Treasury also said that while Japan needs to carefully calibrate its budget belt-tightening to avoid depressing growth, it can't rely on the Bank of Japan's stimulus to support its economy. The BOJ's easy-money policies, which weaken the yen, have riled U.S. auto makers.

“Global growth and job creation continue to disappoint, due principally to chronically weak global demand,” the Treasury Department said in a statement accompanying the report, which is mandated by Congress.

The Treasury often uses the currency report as a diplomatic tool to censure major trading partners for policies deemed potentially damaging to the U.S. economy. The last time the U.S. labeled a trading partner a currency manipulator—a technical term that can trigger U.S. trade sanctions—was the Clinton administration’s rebuke of China in 1994. The Obama administration has used the report in recent years to criticize China, Germany, Japan and South Korea for their economic policies that keep exports cheap at the expense of other countries.

“The report’s focus on current-account surpluses in countries such as Germany and deflationary risks in Europe and Japan points to U.S. concerns about the sustainability of its own recovery if the U.S. is the sole engine of global growth,” said Eswar Prasad, a senior fellow at the Brookings Institution and former IMF economist.

Wednesday’s report comes after the dollar recently topped five-year highs against a basket of other major currencies. U.S. officials worry that weakness overseas and the strong greenback could undermine an American recovery that has been showing signs of gathering steam. Federal Reserve officials last week said they were concerned the dollar’s strength could weigh on growth and keep a lid on inflation that remains below their target.

Since then, the dollar has retreated. But the broader drivers of the dollar’s strength remain in place. U.S. officials worry countries will fall back on policies that weaken currencies rather than making politically tough economic overhauls that can boost domestic demand.

“In light of the weakening global backdrop, it is especially important that all G-7 and G-20 countries adhere steadfastly to their exchange rate commitments,” Treasury Secretary Jacob Lew said in remarks at the International Monetary Fund meetings in Washington last weekend, referring to the Group of Seven industrialized nations and the Group of 20 largest economies.

But despite the dollar’s recent gains, the Treasury’s report used a more measured tone than its other recent reports. A year ago, the department blasted Germany for its economic policies, blaming the eurozone powerhouse for dragging down the regional and global economies.

Efforts by some of the hardest-hit countries in the eurozone to trim budgets and cut dangerously high debt levels have “not been matched with accommodative policies in the euro area core,” Treasury said in the report. Mr. Lew and his top lieutenants have pressed Germany to expand its budget to boost domestic demand and allow the European Central Bank to buy the assets of weak member states to help stimulate growth.

Germany has resisted calls to spend more to stave off another potential recession in Europe. Last week, Finance Minister Wolfgang Schäuble said policy makers globally must solve current problems “without falling back to the mistakes that created the crisis.” On Tuesday, economics minister Sigmar Gabriel said there was no cause for Berlin to change its strategy. “We’re not going to help the German economy with some flashes in the pan and more debt,” Mr. Gabriel said.

The International Monetary Fund last week downgraded its outlook for global growth, warning that the Eurozone faces a 40% chance of re-entering a recession and citing a broad slowdown in several major emerging markets.

The administration praised China's gradual appreciation of the yuan in recent years, but said the yuan remains "significantly undervalued." Beijing's currency intervention in the last year raised questions about the government's commitment to move toward a fully market-determined exchange rate.

Geng Shuang, a spokesman for the Chinese embassy, said in an email, "China will continue to forge steadily ahead with the reform of the [yuan] exchange rate formation mechanism and improve the managed floating exchange rate regime.

"This overall direction will remain unchanged," he said.

China's growth rate is falling amid a weaker global outlook and as some of its economic overhauls weigh on output. Beijing has appreciated the yuan nearly 15%, accounting for inflation, since 2010, but restarted exchange rate interventions late last year amid slowing growth prospects.

In April, the administration criticized China's yuan depreciation as an "unprecedented" currency intervention, renewing long-running exchange-rate frictions between the world's two largest economies. But after high-level talks in Beijing over the summer, Mr. Lew said Chinese official committed to reducing currency intervention.

"As China's reform strategy proceeds...it is important that domestic consumption, and not a renewed dependence on external demand, drive China's growth," the Treasury report said.

The Treasury Department warned that Tokyo needs to complete its planned economic overhaul, saying monetary policy can't offset budget tightening "nor can it substitute for necessary structural reforms that raise trend growth and domestic demand," the report said.

Treasury last year pressed Japan into signing a G-7 pact to avoid targeting exchange rates after government officials in Tokyo talked about weakening the yen to give the economy a boost. Washington wanted to prevent a destabilizing global round of currency devaluations as other countries retaliated by pushing down the values of their currencies. Since then, administration officials have been fairly sanguine about the Bank of Japan's easy-money policies that have helped push down the value of the yen.

Treasury also censured South Korea's exchange rate policies, reiterating warnings that Seoul should limit foreign exchange intervention "only to the exceptional circumstance of disorderly market conditions." The department estimated Korean officials spent more $14 billion between May and July keeping a lid on the won's value. A recent rise in Korea's won in recent months prompted Seoul to signal in July it could resume currency intervention to counter the deterioration in the country's export competitiveness.

Officials at the South Korean and Japanese embassies weren't immediately available to comment.

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