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Global Leaders Welcome China's Yuan Plan

By MICHAEL M. PHILLIPS AND IAN TALLEY

Financial and political leaders world-wide hailed China's plans to press ahead with reforming its exchange rate.

Saturday's Chinese central-bank statement, issued ahead of a meeting of the Group of 20 economies next week, didn't announce specific new measures. But it is widely being interpreted as meaning that China will let the yuan resume gradual appreciation against the U.S. currency, after nearly two years of being effectively pegged around 6.83 yuan per dollar.

China's Yuan Reforms

China's central bank pledged to make its tightly-controlled exchange rate more flexible Saturday. See latest reforms of the yuan exchange rate.

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"We welcome China's decision to increase the flexibility of its exchange rate," U.S. Treasury Secretary Timothy Geithner said in a prepared statement shortly after the announcement by the People's Bank of China. "Vigorous implementation would make a positive contribution to strong and balanced global growth."

Japanese Finance Minister Yoshihiko Noda offered a similar reaction. "I hope this will contribute to stability and balanced growth in the Chinese, Asian and therefore global economies," Mr. Noda said in a statement released by the finance ministry.

Meanwhile, the European Union's executive arm said the decision would generate positive effects for the countries that use the euro. "The decision will help achieve more sustainable growth in the global economy, contribute to reduce external imbalances and strengthen the stability of the international monetary and financial system," the European Commission said in a written statement.

In Their Own Words: World Leaders React

> Read more on how U.S. President Barack Obama, Treasury Secretary Timothy Geithner and others reacted to China's move to make its exchange rate more flexible.

Dominique Strauss-Kahn, the managing director of the International Monetary Fund, also welcomed the news, saying a stronger Chinese currency "will help increase Chinese household income and provide the incentives necessary to reorient investment toward industries that serve the Chinese consumer."

Beijing's move may not, however, result in a large appreciation of the yuan. Cornell

European Pressphoto Agency

University economist Eswar Prasad, former head of the International Monetary Fund's China division, cautioned that Beijing is returning to a policy of linking the yuan to a basket of currencies, without identifying the composition of the basket.

About a quarter of China's trade is in euros, a currency that has been in a steep slide against the dollar recently. If the euro composes a large share of China's invisible basket, the yuan could actually weaken relative to the dollar, Mr. Prasad warned.

"If the world now says, 'Let your currency float against the dollar,' the Chinese could say, 'Do you really want it to depreciate?' " Mr. Prasad said, describing Beijing's move as "canny."

Mr. Prasad said China's main concession was therefore not the content of its new policy, a return to the one that was in place before the global financial crisis. Rather, Beijing's principal shift was in the timing, offering at least a symbolic gesture ahead of the summit in Toronto next weekend of leaders from the Group of 20 major industrialized and emerging economies.

"They've actually accomplished two significant objectives," Mr. Prasad said. "They''re taking away the political heat, but without significantly affecting their export competitiveness."

China's announcement gives the Obama administration at least some breathing room, too. U.S. President Barack Obama, like his predecessor President George W. Bush, is under pressure from Capitol Hill to somehow persuade China to allow the yuan to rise. Many in industry and Congress say the weak yuan makes it harder for American companies to compete with Chinese firms. The administration is convinced that China must do something—including allowing a stronger yuan—to increase its consumption of imported goods and services and reduce its reliance on politically sensitive exports. Such a shift could help reduce the U.S. trade deficit.

The Chinese alerted the Obama administration early Saturday, shortly before making the decision public.

In April, Mr. Geithner delayed issuance of Treasury's twice-yearly report on international currency practices to avoid putting too much public pressure on China ahead of high-level economic meetings in Beijing last month and the G-20 summit.

At the time, Mr. Geithner warned the Chinese privately that if they didn't take significant steps to let the yuan strengthen, he would likely use the report to accuse Beijing of manipulating the yuan to gain an edge in international trade. Such a declaration wouldn't have carried any penalties, but is a rhetorical step the U.S. and China have long wanted to avoid.

A few weeks later, Mr. Geithner visited China after a trip to India, and he came away convinced that Beijing was moving toward some action on the currency issue.

Now Mr. Geithner is free to issue a report complimentary of China—or at least not harshly critical of it—without risking as much backlash from Capitol Hill.

With Mr. Obama's Democratic Party facing tough midterm elections in November, however, the political heat could rise again if Beijing's new policy doesn't actually result in a strong yuan in the coming months, Mr. Prasad said.

Indeed, one of the Beijing's sharpest congressional critics, Sen. Charles Schumer, a New York Democrat, issued a statement Saturday calling China's announcement "vague and limited."

"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," Mr. Schumer said.

"China's announcement is long overdue," said. Senator Chuck Grassley (R., Iowa), ranking Member of the Committee on Finance. He added that lawmakers would continue to urge the administration to keep pressure on China until it takes "concrete actions to appreciate its currency exchange rate in a meaningful way."

Sen. Max Baucus (D., Mont.), another vocal critic of China's currency policy from his post as chairman of the Senate Finance Committee, offered a slightly softer tone than Mr. Schumer. But he, too, stressed the importance of seeing Beijing turn stronger words into a stronger yuan.

"Today's announcement is a welcome first step to help keep American businesses competitive and create more American jobs," Mr. Baucus said in a written release. "However China's currency appreciation must be meaningful to ensure American ranchers, farmers and small businesses are competing on a level playing field in the global economy."

Morris Goldstein, a senior fellow at the Peterson Institute for International Economics, said the announcement will deflect criticism ahead of the G-20, buying time as officials wait to see how

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Beijing's rhetoric is proven in practice.

"I wouldn't really expect big changes that have large effects," Mr. Goldstein said.

In the past, China's currency appreciation hasn't been very dramatic. For example, Mr. Goldstein calculates that Beijing only raised its rate by around 7% in two years—adjusted for inflation—between 2005 and 2007.

—Andrew Batson and Matthew Dalton contributed to this article.

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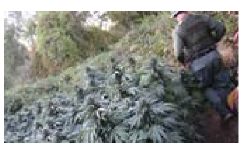

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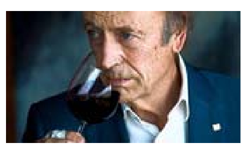

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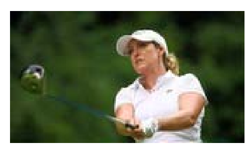

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