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China's central bank says it's ready to free up currency, making trade partners happy

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BEIJING -- Facing growing pressure from around the world, China's central bank announced Saturday that it is prepared to allow the country's currency to float more freely against the dollar and other foreign currencies, potentially raising the cost of Chinese goods.

The statement, from a spokesman for the People's Bank of China, gave no details on when China would allow its currency -- known as the yuan or the renminbi -- to appreciate or by how much. But the timing of its release, just before the leaders of the world's largest economies gather for a G-20 meeting in Toronto, was clearly aimed at taking pressure off Beijing.

Many countries, including the United States, have criticized China's fixed exchange rate, which critics say was keeping the country's exports too cheap and hurting manufacturers and traders worldwide. A group of U.S. senators had even threatened to slap tariffs of as much as 25 percent on all Chinese goods coming into the United States if China did not allow the yuan to appreciate against the dollar.

Whether Saturday's announcement will help the U.S. economy depends on how much Beijing lets its currency rise. A jump of 20 percent, for example, could cut as much as $150 billion off the U.S. trade deficit with China and create as many as 1 million U.S. jobs by making American exports more competitive, according to estimates by C. Fred Bergsten of the Peterson Institute of International Economics. From 2005 to 2008, China let the yuan appreciate 20 percent against the dollar before it stopped the process while it confronted the global financial crisis.

Few economists think China will let the yuan rise by that much, at least not yet. "This is a step in the right direction," said Bergsten, who has advised the Chinese government on the currency issue, "but the question is how far they will let the yuan rise -- and how fast."

A strong yuan, however, is not expected to hit American pocketbooks too hard, because even though Chinese exports -- think Wal-Mart, Best Buy and Toys R Us -- could rise in price, cheap products from other big exporters such as Mexico and India could replace them on store shelves.

China's announcement, communicated in advance to U.S. officials, was immediately welcomed by the White House, which saw it as a vindication of President Obama's nonconfrontational policy of trying to quietly negotiate over the exchange rate. The Obama administration had delayed a report on China's currency that had been due in April, for example, to give Beijing more time.

'Constructive step'

Obama, in a statement, called the announcement "a constructive step that can help safeguard the recovery and contribute to a more balanced global economy." Treasury Secretary Timothy F. Geithner added that "vigorous implementation would make a positive contribution to strong and balanced global growth."

But critics remained skeptical, noting that China has sent signals before about a currency appreciation -- usually ahead of an international meeting or deadline -- and then done nothing. The most recent example came in April, when senior Chinese officials told reporters on the eve of President Hu Jintao's visit to Washington for a nuclear security summit that it was time to allow more flexibility in the currency. Hu attended the summit, and the currency was left unchanged.

"This vague and limited statement of intentions is China's typical response to pressure," said Sen. Charles E. Schumer (D-N.Y.), who has co-authored legislation that would impose tariffs on Chinese goods if the yuan does not appreciate.

"We hope the Chinese will get more specific in the next few days," Schumer said in a statement. "If not, then for the sake of American jobs and wealth, which are hurt every day by China's practices, we will have no choice but to move forward with our legislation."

Benefits at home

Economists say that of all the potential beneficiaries of a stronger yuan, China is at the top of the list.

In Beijing, the central bank statement hinted at this realization, saying that while the fixed exchange rate helped China weather the global financial meltdown that started in 2008, the country's economy has recovered enough to allow the yuan to rise. It means that China's economy, growing at 11 percent, is in danger of overheating and that inflation is increasing. Allowing the yuan to appreciate should slow inflation by making imports cheaper for the Chinese consumer.

Moving away from a cheap yuan policy, designed when China, as the world's factory, relied on its exports for economic growth, would also help China's macro-economic situation, Bergsten said.

China devotes as much as 10 percent of its gross domestic product to buying U.S. Treasury bonds as part of a plan to keep the value of the yuan low. Now, Bergsten said, that money can be freed up to flow into the pockets of China's workers or into more loans for Chinese businesses or into improving health care and education.

China had joined other G-20 nations last year in pledging to help "rebalance" the global economy. For China, the world's fastest-growing economy, that would mean taking steps to boost local consumption, import more and export less. Allowing its currency to appreciate would be one important tool to achieve those ends.

"The big question is whether this is a symbolic move or a true shift," said Eswar Prasad, a Cornell University economist who follows the issue closely. "In any event, it signals recognition by Chinese officials that a more flexible exchange rate is in China's own interest."

Until now, China has been reluctant to change its currency, with the leadership often appearing divided over the issue and making conflicting public statements. Chinese leaders expressed concern about the effect a currency appreciation would have on its export sector and its many small factories, particularly in Guangdong province, which has been hit by a wave of labor unrest as workers demand higher wages.

China's central bank, which is responsible for buying and selling world currencies and thus regulating the yuan's value, is thought to have long favored more flexibility. But the powerful Commerce Ministry has vigorously opposed any currency change, with ministry officials painting the strong currency as a nationalist issue.

Pomfret reported from Washington. Staff writer Howard Schneider in Washington also contributed to this report.