

In China, US Treasury Secretary Geithner Likely To Reassure, Placate

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WASHINGTON -(Dow Jones)- U.S. Treasury Secretary Timothy Geithner is off to China at a time when the financial crisis has arguably left the U.S. with less leverage to push China for meaningful economic changes, making it more likely the secretary's tone will be mostly reassuring and conciliatory.

Experts say former Treasury Secretary Henry Paulson had more maneuverability to push China on currency and financial-sector changes important to U.S. manufacturers and financial firms.

But with China recently expressing fears about its substantial investments in U.S. debt, Geithner is likely to have to spend a good amount of his first trip to China as Treasury chief reassuring Chinese leaders on the U.S. plan for controlling the deficit.

"I think they [Chinese officials] are very keen to hear preliminary thinking on that issue. They're terrified of what could happen if there's a surge in inflation and they lose a significant value in their bond portfolio," said Brookings Institution senior fellow Eswar Prasad, who also teaches at Cornell University.

"What's tricky is that China seems to have a little more leverage at the moment...in terms of the guiding sentiment in the U.S. currency and bond markets," he continued. Prasad added that China will be looking for U.S. officials to give specifics on how they plan to tackle discretionary spending as well as entitlements.

China is the world's largest holder of U.S. Treasury securities; it surpassed Japan last year. But top Chinese officials recently have voiced concern about the safety of their investments. They're fearful the value of the dollar will take a hit as the U.S. government's borrowing needs rise. Already, foreign investors in Treasuries have shifted their asset holdings to more short-term paper, suggesting diminished confidence in the market. The concern is that China might decide to reduce its purchases of Treasury bills, just when U.S. borrowing needs are growing in order to pay for new bank rescue programs and stimulus measures aimed at reviving the economy.

Deficit Details

According to a senior Treasury aide, Geithner is prepared to address the U.S. deficit when he meets with Chinese leaders Monday and Tuesday. Geithner plans to meet with Chinese Premier Wen Jiabao as well as Chinese President Hu Jintao and Vice Premier Wang Qishan. He also plans to deliver a speech on U.S.-China economic relations at Peking University, where he studied Mandarin, and to participate in an event at the Beijing Capitol Museum to highlight the role U.S. companies can play in the areas of clean energy and climate change.

Geithner and his aides will stress that while the deficit is likely to increase sharply as the U.S. implements new measures to stem the crisis, they see it falling once the recovery stabilizes and those measures are scaled back. Geithner will also note that he sees the dollar playing a very important role for a very long time.

"We are attuned to the interests of our investors and plan to listen closely to what they have to say," said the Treasury aide, who requested anonymity. "If the deficit issue comes up, we're fully prepared to discuss it."

Still, Eurasia Group China analyst Nicholas Consonery said he doesn't expect discussions about the U.S. bond market to turn contentious.

"I think they're going to talk about it, but I don't think it's going to be a divisive discussion," he said.

Consonery also doesn't see China making any abrupt changes to its U.S. bond holdings.

The Chinese are "sort of in a fix where there's nowhere else for them to really meaningfully put all of their money," he said. "I do think the Chinese leadership understands that."

Overall, experts see Geithner taking on a reassuring, conciliatory tone with Chinese officials next week, possibly adding in some gentle nudging on currency issues.

In addition to discussing the U.S. deficit, Chinese officials will want to hear Geithner's thoughts on international financial regulatory changes, an area where U.S. and China may have substantial agreement. International Monetary Fund changes are another subject where they could share common ground, experts say.

Chinese officials will also aim to get a sense of Geithner's position on currency. While Geithner plans to continue to encourage China to pursue a flexible exchange rate, he's expected to approach the issue carefully to prevent it from becoming a dominant issue.

"The currency issue will be there. It'll be somewhat in the background, but the U.S. cannot afford to ignore it," said Prasad of Brookings. He pointed out that frustrated lawmakers on Capitol Hill, who argue that China is hurting U.S. firms by artificially undervaluing its currency, are looking to take legislative action.

The Chinese are also anxious to hear what Geithner will have to say on yuan appreciation. "They don't quite have a feeling yet for how strongly the administration is going to push on the currency issue," Prasad added.

Meanwhile, Treasury has said that one of the main goals of Geithner's trip is to discuss China's plans to boost domestic demand through changes in education, welfare, financial services and health care. Experts say that while talk of domestic demand is pretty safe and non-contentious, the currency issue could be intertwined given that yuan appreciation against the dollar would strengthen domestic consumption.

Still, the tone of these meetings are expected to be fairly neutral.

"I don't think this particular trip is going to be the time where some fundamental difference emerges," said Consonery, who specializes in Chinese banking and financial policy. "Geithner's going to be pretty well-received."

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