

Geithner and Beijing hold talks on recovery

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Tim Geithner, US Treasury secretary, begins two days of top-level economic talks in Beijing today amid a tightening focus on the need for the US and China to co-ordinate their exit strategies from the financial crisis.

With the US and China expected to lead the world out of recession, much rests on their ability to manage financial, trade and currency tensions while laying out mutually consistent frameworks for recovery.

The China talks follow recent weakness in the dollar and a surge in bond yields that partly reversed on Friday.

While en route to Beijing yesterday, Mr Geithner said: "I will make it clear that we are committed to a strong dollar, that we are committed to bringing our fiscal deficits down over the medium term." The Federal Reserve sees the rise in yields as part of a bumpy normalisation process, and is not inclined to be bounced into any immediate policy reaction, but is monitoring market developments carefully.

"The two countries are getting locked into an increasingly tight embrace," said Eswar Prasad, a professor at Cornell University.

"The Chinese still need the US export market and do not have much of an alternative to continue putting a large fraction of their reserve build-up into US Treasuries."

The US wants China to boost domestic demand in a way that will ultimately make it easier for the US to withdraw fiscal and monetary stimulus.

China is worried about the value of its roughly \$1,400bn (€989bn, £864bn) in dollar assets and wants reassurance on US fiscal discipline as well as protectionism. "We have lent a huge amount of money to the United States," Wen Jiabao, China's premier, said earlier this year. "Of course we are concerned about the safety of our assets."

China has continued to buy US government debt but is believed to have shifted from longer term to shorter term securities - though some insist this is only talk.

Any overt discord in the talks could rattle the bond and currency markets. Even if this can be avoided, the two nations face a tough challenge agreeing how to reconcile short-term counter-cyclical policies with the longer-term need for both countries to change their growth models. These are characterised by a focus on consumer spending in the US, and exports and infrastructure investment in China.

This will be a key theme of Mr Geithner's speech in Beijing. But it is easier said than done. Chinese anxiety about US deficits creates tension over fiscal consolidation.

Both nations face the temptation to revert to their old economic models. Many US-based analysts see China's stimulus plan as offering more of the same. However, Nicholas Lardy, a fellow at the Peterson Institute, disagrees. "They have become more serious about rebalancing," he said. "But it is a long-term process."

The financial crisis has jolted Beijing's faith that running a giant trade surplus is the way to guarantee stability.

China has vented its frustration over its exposure to the US - and pushed back against criticism - by floating suggestions to reduce reliance on the dollar.

Mr Geithner will stress the US desire for China to gain influence in multilateral economic debates in the hope this will assuage China's dissatisfaction at the current economic order.

Charles Dallara, managing director of the Institute of International Finance, which represents global banks, said: "The interdependence of the relationship has become so strong it can either become a source of constant friction or a source of strength."

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