The International Monetary Fund is caught in a stand-off between members over whether to label China's currency as "fundamentally misaligned", a politically explosive move that could stoke global tension over economic imbalances.

The issue is so controversial the IMF's executive board has not discussed the Chinese economy since 2006, in spite of rules saying it should regularly assess member economies.

The decision touches directly on one of the most divisive issues among governments worldwide: the extent to which huge current account deficits and surpluses and artificially managed exchange rates have contributed to the financial crisis. Washington has long pressed Beijing to let the renminbi rise.

The present dilemma comes after a decision by the IMF in 2007 to step up surveillance of its member countries' exchange rates, under heavy pressure from the US. Tim Geithner, President Barack Obama's designate as Treasury secretary, has said that China was "manipulating" its currency and promised that all diplomatic avenues would be pursued to make Beijing change course. The IMF is almost certainly one such avenue.

Eswar Prasad, professor of trade policy at Cornell University and former head of the IMF's China division, said IMF economists had concluded China's exchange rate was "fundamentally misaligned", defined as creating "a risk of disruptive adjustment", but that it was not deliberately manipulating it to gain a trade advantage.

But he said the IMF's management, led by Dominique Strauss-Kahn, the managing director, decided not to bring the issue to the fund's executive board and start a "special consultation" with China on currencies because of disagreements among member countries.

"The board has now not had a discussion on China since 2006," Prof Prasad told the FT. "If it can't even have consultations with its members, this is a very serious issue. To some extent I suspect this is why [Tim] Geithner has decided to draw a line in the sand."

Fred Bergsten, director of the Peterson Institute think-tank in Washington, said: "The IMF's idea of starting a special consultation seems to have collapsed. The MD [managing director] has backed off."

Both the IMF and a spokesman for the Chinese embassy in Washington declined to comment.

The IMF's decision to focus on exchange rates in 2007 proved deeply controversial. At the IMF's annual meetings last October Raghuram Rajan, the IMF's former chief economist, now at the University of Chicago, said the focus on exchange rates from 2007 was "an unmitigated disaster".

Because China is not borrowing from the IMF and appears unlikely to do so in the near future, the fund has no direct instruments to force Beijing to change policy and allow the renminbi to appreciate. But for the IMF to designate its currency as "fundamentally misaligned" would undoubtedly strengthen Washington's hand in its campaign for a freer-floating renminbi.

China hit back again over the weekend at Mr Geithner's comments, with the central bank rejecting the accusation that China "manipulates" its currency and warning on the risks of protectionism.

"These comments are not only out of keeping with the facts, even more so they are misleading in
analysing the causes of the financial crisis," Su Ning, a deputy governor of the People's Bank of
China, was quoted as saying by the Xinhua news agency. "The international community must
avoid exploiting different excuses for renewing or encouraging trade protectionism, because these
are of no help in withstanding the financial crisis." Additional reporting by Geoff Dyer in Beijing

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