China's sinking currency causes tensions with U.S.

By David J. Lynch, USA TODAY

The Chinese currency's steady ascent against the dollar appears to have ended, dealing a blow to already cloudy prospects for U.S. exporters and complicating ties between Washington and Beijing.

In three years from July 2005, when China first allowed the yuan to rise, the Chinese currency gained almost 20% against the dollar. That made Chinese products more expensive in dollar terms and effectively cut the price of U.S. goods in China.

But the yuan plateaued against the greenback starting in mid-July and earlier this week had its sharpest one-day drop since 2005. The sudden dip came just days before Treasury Secretary Henry Paulson and other Cabinet members arrived in Beijing for twice-yearly economic talks.

With Chinese officials publicly worrying about the global recession's impact upon their factories, authorities are likely to prevent further currency moves that would raise exporters' costs. "The way they see it is: Enough is enough for now," says Eswar Prasad, a former International Monetary Fund economist now with the Brookings Institution.

Paulson said before arriving in Beijing on Thursday that he would press Chinese officials for additional yuan gains. But he was greeted by Chinese officials more interested in lecturing than being lectured. Wang Qishan, China's vice premier, urged U.S. officials to tackle their own economic problems and said China would focus on continuing to grow amid the global downturn.

China's economy already has slowed sharply from a near 12% annual growth rate in mid-2007, and the World Bank forecasts 7.5% growth next year. With both Europe and the USA facing prolonged recessions, Chinese officials are increasingly fearful of job-killing fallout from the global recession. "Prospects are for a sharp reduction in export growth as the impact of the international turmoil deepens," the World Bank said this month in its quarterly update on the Chinese economy.

Morgan Stanley currency specialist Stephen Jen says China could engineer a "temporary" 5% to 10% drop in the yuan's value to ward off the worst effects of the slowing global economy. And investors in futures contracts known as non-deliverable forwards are forecasting a 4% to 4.5% fall in the yuan over the next year, says Marc Chandler, senior vice president for currency strategy.

That would be certain to inflame U.S. manufacturers, who've long complained that China manipulates the yuan to gain a trade edge. "This is an indication that China intends to look out for itself," says Scott Paul, executive director of the Alliance for American Manufacturing.