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Business

China's move to devalue currency could reverberate globally

By Joe McDonald and Christopher S. Rugaber | AP August 11 at 4:25 PM

BEIJING — China's surprise move Tuesday to devalue its currency has intensified concerns about a slowdown in the world's second-largest economy, whose growth rate has reached a six-year low. It is also fanning tensions with the United States and Europe, whose exports could become comparatively costlier.

China's central bank said the yuan's devaluation was a result of reforms intended to make its exchange rate more market-based. The yuan is linked to the dollar, which has jumped in the past year. Tuesday's move will mean the yuan will more fully reflect market fluctuations, Chinese officials say.

A close peg between the dollar and the yuan has hurt Chinese exporters by keeping their goods expensive overseas, thereby threatening jobs in key manufacturing industries. Exports in July plummeted by an unexpectedly steep 8.3 percent from a year earlier. A cheaper yuan will lower the prices of China's exports.

"The move signals that (China) is willing to use all available tools, including a weaker currency, to prop up exports and its domestic economy," said Eswar Prasad, an international economist at Cornell University.

Yet many economists cautioned against seeing Beijing's move mainly as an effort to benefit its exporters at the expense of overseas competitors. They note that China's currency, left to market forces alone, would have declined in value in recent months.

"It is a small step forward to accommodating market forces," said Sung Won Sohn, an economics professor at the California State University's Smith School of Business.

China's currency move unnerved global investors. U.S. stocks tumbled Tuesday, with the Dow Jones industrial average closing down 212 points.

The yuan, also known as the renminbi, is allowed to fluctuate in a band 2 percent above or below a rate set by the People's Bank of China based on the previous day's trading.

The bank said that starting Tuesday, the daily target will be based on where the yuan closed the previous day, a change that gives market forces a bigger role in determining the currency's level. The center of Tuesday's trading band was set 1.9 percent below Monday's level. The yuan quickly fell 1.3 percent against the dollar and was down 1.9 percent by afternoon.

China's economic growth has slowed to an annual rate of just 7 percent — healthy for most countries but far below the double-digit pace it has enjoyed for decades. The country's leaders fear that growth below that pace will raise the unemployment rate and possibly lead to social unrest.

Still, China's action Tuesday sparked complaints in Washington, where members of Congress have long complained that Beijing manipulates its currency to gain a trade advantage.

"For years, China has rigged the rules and played games with its currency," said Sen. Chuck Schumer, a New York Democrat. "Rather than changing their ways, the Chinese government seems to be doubling down."

The Treasury Department's response was more measured.

"While it is too early to judge the full implications of the change... China has indicated that the changes announced today are another step in its move to a more market-determined exchange rate," a department statement said.

China becomes the third major economy to act to lower its currency value. Initiatives by Japan and the European Union over the past two years depressed the yen and euro.

Those moves contrast with action foreseen from the Federal Reserve, which is expected to boost the short-term interest rate it controls later this year. A Fed rate hike would likely raise the value of the dollar, which has already jumped about 14 percent in value in the past 12 months against a basket of foreign currencies.

The rising dollar has hurt U.S. exporters by making their goods costlier abroad, and China's move to devalue its currency could further complicate the Fed's decision on when to raise rates. By making Chinese goods comparatively cheaper in the United States, a weaker yuan would push already-low U.S. inflation even lower.

The Fed wants to be "reasonably confident" that inflation is returning to its 2 percent target before raising rates. Inflation has risen just 1.3 percent in the past 12 months.

Michael Feroli, an economist at JPMorgan Chase, suggested that the dollar's rise poses a concern for some Fed officials, known as doves, who have been reluctant to raise rates. Should the U.S. economy stumble in the coming weeks, "dollar strength would only further embolden the doves at the next meeting" in September, Feroli said.

Still, Feroli said, "we think this a minor stumbling block for a September" rate increase.

USB economist Tao Wang said Beijing would likely move cautiously, but investor expectations of further weakening "could quickly become entrenched" and cause the yuan to "depreciate quite quickly and significantly."

She said that would represent a "sea change in China's exchange rate policy" but would help to support flagging economic growth.

Rugaber contributed from Washington. AP Economics Writer Paul Wiseman in Washington and AP Writer Teresa Cerojano in Manila contributed to this report.