Bloomberg

U.S. Says China Shows Some ‘Willingness’ to Let Yuan Rise

By Jeanna Smialek and Ian Katz - Oct 15, 2014

The U.S. said China has shown “some renewed willingness” to let the yuan strengthen while reiterating the currency “remains significantly undervalued.”

In a twice-yearly report to Congress on foreign exchange, the Treasury Department said changes to China’s currency policy remain incomplete and the world’s second-largest economy should allow the market to play a greater role in setting the yuan’s value. The report covering the first half of this year concluded that no country was designated a currency manipulator.

The Treasury reiterated its call for more balanced global growth as the U.S. economy gathers strength, the euro area and Japan struggle, and emerging markets such as China face slowdowns. Countries including Germany, where domestic demand has been “persistently weak,” need to do more to support domestic growth and help the world economy, the report said.

“The report tries to strike a fine balance between encouraging economies that have weak growth and current-account surpluses to boost domestic demand, but to do so using fiscal policy and other responses,” said Eswar Prasad, a professor of trade policy at Cornell University in Ithaca, New York, and a senior fellow at the Washington-based Brookings Institution.

China should build on “the apparent recent reduction in foreign-exchange intervention and durably curb its activities in the foreign-exchange market,” the department said in yesterday’s report.

Korean Won

The Treasury also pushed for changes in South Korea, saying the won “should be allowed to appreciate further.” Treasury Secretary Jacob J. Lew, in a meeting with South Korea’s finance minister last month, emphasized the importance of avoiding currency intervention.

The Treasury said Japanese authorities need to “carefully calibrate the pace of overall fiscal consolidation” to help escape deflation, according to the report. “Monetary policy cannot offset excessive fiscal consolidation nor can it substitute for necessary structural reforms that raise trend growth and domestic demand."

To boost growth, Japan could raise household income through greater labor-force participation and higher earnings to "durably increase" consumers' buying appetite, the Treasury said. The yen has depreciated 23 percent from October 2012 to August 2014 on a real trade-weighted basis, according to the report.

Criticizing Germany

On Europe, the Treasury's report pointed at both the Netherlands and Germany for running a "substantial" current-account surplus. Germany's was 6.8 percent of gross domestic product in 2013 and 7.1 percent in the first half of this year, the department said, adding that the euro area's surplus exceeds China's as a share of global GDP.

Surplus European economies need to nurture consumer demand in order to "help facilitate a durable rebalancing of imbalances" and contribute to global expansion, according to the report. The department pointed to Germany's recent agreement to implement the nation's first economy-wide minimum wage as a step in the right direction and called for other macroeconomic measures to spur household buying, investment and job creation.

With euro-area inflation below the European Central Bank's target, and geopolitical risks becoming a greater threat to global demand, "Europe faces the risk of a prolonged period of substantially below-target inflation or outright deflation," the report said. "This would slow Europe's return to growth."

ECB's Reserves

The ECB will discuss whether to begin laying the groundwork to add the yuan to its foreign-currency reserves, according to two people with knowledge of the matter.

Governing Council members gathering in Frankfurt for their mid-month meeting will consider the move, said the people, who asked not to be named because the discussions aren't public. Should officials eventually decide to buy the currency, initial purchases would be small and might start in a year at the earliest, one of them said.

China's yuan retreated from a seven-month high yesterday as the central bank cut the currency's daily fixing by the most in seven weeks amid a rise in the dollar.

The People's Bank of China lowered its reference rate by 0.08 percent, the biggest reduction since Aug. 21, to 6.1455 against the greenback. The Bloomberg Dollar Spot Index, which tracks the U.S. currency against 10 major peers, rose 0.1 percent yesterday, adding to a 0.32 percent advance Oct. 14.

"Treasury didn't choose to designate China or any other country as a currency manipulator, so that suggests they're not overly concerned about the currency policy statuses in any of the major trading partners," said Vassili Serebriakov, a currency strategist at BNP Paribas in New York.

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