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INTERNATIONAL BUSINESS

China’s Central Bank Allows Its Currency More Volatility

By DAVID BARBOZA MARCH 15, 2014

SHANGHAI — In the latest sign that China is loosening its tight grip over the economy, the government said on Saturday that the value of its currency would now be allowed to fluctuate more widely against the United States dollar.

China’s Central Bank said in a statement on its website that beginning on Monday, the daily trading band on the Chinese currency, the renminbi, would double to 2 percent on either side of a government-set parity rate, a move that could lead to wider daily price fluctuations. The announcement is the latest indication that Beijing is determined to make the renminbi an international currency and to give market forces a larger role in what is now the world’s second-largest economy after the United States’.

Although the government still maintains tight control over large aspects of the economy, including interest rates and the exchange rate, there appears to be a growing recognition among policy makers that the state’s heavy-handed role is distorting prices, intensifying inefficiencies and giving an unfair advantage to state-run enterprises, government banks and exporters.

Widening the daily trading band on the currency is likely to reduce the government’s control over the price of the renminbi and to signal to investors and businesses that even bolder moves are imminent.

"This is a fairly significant indication of the government's commitment to market-oriented reforms," said Eswar S. Prasad, a professor at Cornell and a former head of the International Monetary Fund's China division. "The government has been intervening in the currency markets for some time, but this means they will probably intervene less."

Although China's economy is growing at close to 7 percent, the rate of growth has fallen sharply over the last few years, and there are concerns that banks and local governments are masking huge liabilities. To lower the risk of a serious downturn, and to strengthen the country's long-term prospects, Beijing is trying to push through market reforms without severely damaging those who have benefited most from state dominance of the economy.

Under President Xi Jinping, the government has stepped up plans to liberalize interest rates; to open the country's capital account, allowing more capital to flow in and out of China; and to reform the financial system.

The government recently said that it planned to allow more private banks to operate in the country. One official also said that within two years, China planned to free up bank deposit rates, which for years have punished savers with returns sometimes below the rate of inflation. By widening the daily trading band, the government is signaling it plans to reduce its role there, too.

The government still has the power to set the daily parity rate, and it could prevent big swings in the value of the renminbi.

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