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Analysis: U.S. concern on China currency fades as yuan grinds higher

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By **Doug Palmer**

WASHINGTON (Reuters) - After years of grabbing the spotlight in U.S.-China economic relations, U.S. concerns over the value of Beijing's currency appear to be fading, giving ground to newer issues like cyber-security and trade secret theft.

Some lawmakers continue to argue a weak Chinese yuan is robbing jobs from the United States. But action to force a change is unlikely and the issue will probably remain on the back burner as long as the U.S. economy continues to improve.

An increase in the value of the yuan, a big drop in China's global trade surplus and a rise in labor costs that has made Chinese products less competitive have conspired with a pickup in U.S. job growth to take the wind out of Washington's sails.

On top of that, the United States has faced fury from other countries for an aggressive easing of monetary policy that critics contend seeks to drive down the dollar, a charge that puts Washington in a tough spot to criticize China.

"China's currency regime has ceased to be a flash-point in U.S.-China economic relations," said Eswar Prasad, senior professor of trade policy at Cornell University and a former International Monetary Fund official.

Prasad says the U.S. administration has shifted its attention to issues such as increased market access for U.S. manufacturing firms and financial institutions that want to do business in China, and better protection of intellectual property rights.

U.S. President Barack Obama, attacked during the presidential campaign by challenger Mitt Romney for failing to label China a currency manipulator, did not even address the issue in his recent State of the Union speech.

But he came out swinging on cyber-security concerns in remarks seen directed at China.

"We know hackers steal people's identities and infiltrate private e-mail. We know foreign countries and companies swipe our corporate secrets ... We cannot look back years from now and wonder why we did nothing in the face of real threats to our security and our economy," Obama said.

CONGRESSIONAL ROADBLOCK

In recent years, both the U.S. House of Representatives and Senate have passed bills to give Obama new tools to push China into letting the yuan rise faster in value, but neither made it all the way to his desk to sign into law.

The latest legislative effort was stopped dead in its tracks by House Speaker John Boehner, an Ohio Republican, who said he feared it would start a trade war.

Boehner's opposition and the yuan's strengthening has drained energy in Congress to deal with the issue, said one congressional aide who has worked on the issue for years.

U.S. preoccupation with its own fiscal problems also may have helped push China off the U.S. political agenda, said Nicholas Lardy, an expert on the Chinese economy at the Peterson Institute for International Economics.

"But I hope the most important reason is that China has allowed their currency to appreciate a significant amount, and more importantly their (trade) surplus, as measured by the current account, has come down quite dramatically," Lardy said.

Since mid-2010, China's exchange rate, adjusted for inflation rates in the United States and China, has risen 16 percent against the dollar, according to the U.S. Treasury.

At the same time, China's current account surplus, the broadest measure of its trade with the rest of the world, has fallen from a peak of 10.1 percent in 2007 to a preliminary reading of 2.6 percent in 2012.

That makes it hard for Washington to continue to argue the yuan is significantly undervalued, even if the U.S. trade deficit with China grew to a record \$315 billion last year.

Phillip Swagel, a former Treasury official now at the American Enterprise Institute, said the U.S. Federal Reserve's extraordinary easing of monetary policy is yet another factor cooling Washington's appetite for criticizing Beijing.

"This makes it harder for American officials to criticize other countries," Swagel said.

During last year's presidential contest, Romney blasted Obama for repeatedly deciding not to label China a currency manipulator in a semi-annual Treasury Department report, and promised if elected he would do that on "day one."



But in one measure of the low temperature in Congress now on China currency, new U.S. Treasury Secretary Jack Lew faced only a couple mild questions on the issue during his Senate Finance Committee confirmation hearing last month.

Lew said he believed the yuan was "still undervalued."

But he sidestepped a question from Senator Sherrod Brown, an Ohio Democrat, on whether the United States should slap anti-subsidy duties on goods from countries with undervalued currencies as a Senate bill passed in 2011 would have done.

Later, in a written response to a question from Senator Orrin Hatch, the Finance Committee's top Republican, Lew said "addressing China's exchange rate would be a top priority" and promised to work with Congress on the issue, but he carefully avoided endorsing the 2011 Senate bill.

CAREFUL APPROACH

That carefully calibrated approach is in keeping with the U.S. tack through the first four years of Obama's administration; it never threatened to veto China currency legislation but also offered little or no public support.

Instead, it preferred to press China diplomatically during presidential summits and other high-level meetings.

After four years, it can point to progress.

The IMF, in its first published estimate in July 2012, said China's yuan was undervalued by 5 percent to 10 percent, much less than 25 percent to 40 percent figures touted by many lawmakers for years.

Critics say that was a politically derived estimate since China is a powerful voice on the IMF board. But since then, the yuan has risen further against the dollar and senior Chinese officials last week promised further reforms to allow more exchange rate flexibility.

Altogether, the yuan has appreciated 31.6 percent on a trade-weighted, priced-adjusted basis against major trading partners since July 2005, when it embarked on currency reforms, according to U.S. Treasury Department calculations.

Also, while China still holds trillions of dollars in U.S. Treasury bonds, bought with proceeds from export sales as part of Beijing's effort to manage its currency, it has dramatically scaled back its purchases.

"They are no longer intervening very much in the foreign exchange market," Lardy said. "The criticism in the past was the intervention prevented the currency from appreciating."

"Now the intervention is at such a modest level, you can make the argument the exchange rate is much closer to an equilibrium rate than it was a few years ago."

(Reporting by Doug Palmer; Editing by Tim Ahmann and Tim Dobbyn)

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