Dampening the U.S.-China fireworks

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By Emily Kaiser

WASHINGTON (Reuters) - Chinese President Hu Jintao's visit to Washington this week may be the calm after the storm when it comes to economic relations between the world's two biggest economies.

The last time Hu and President Barack Obama met face-to-face was at the Group of 20 leaders summit in Seoul in November, when Washington was on the defensive because of widespread criticism over the Federal Reserve's $600 billion bond-buying program.

Instead of pressuring China to allow its yuan currency to rise more rapidly, Obama found himself trying to convince allies that the United States was not intentionally devaluing the dollar to gain a trade advantage.

Back then, China's Vice Foreign Minister Cui Tiankai said "they owe us an explanation" over the Fed's bond buying, and admonished the U.S. central bank to "consider the impacts on other countries in the world when they make their decisions, not just their own economy."

The circumstances will look a little different when Hu visits the White House on Wednesday.

Currency tensions have cooled somewhat. China's high inflation means the yuan has appreciated in real terms considerably more than the nominal exchange rate shows.

Republican party gains in Congress suggest there may be less pressure coming from lawmakers to label China a currency manipulator or impose stiff new tariffs.

"There isn't the unified sense that there was before the mid-term elections that the U.S. needs to go after China," said Eswar Prasad, a Brookings Institution economist and former International Monetary Fund official.

As for those fears about the Fed inflicting dollar damage, the dollar has actually strengthened against a basket of currencies since the central bank announced its bond-buying plan in early November.

Hu will also be able to point to China's latest trade data showing December exports were not as strong as most economists expected. Comparable U.S. data is not yet available, but figures for November showed exports to China hit a record high of $9.5 billion, bolstering China's argument that it is doing its part to rebalance global growth.

Cui, the vice finance minister, once again spoke out ahead of this week's summit, but his tone was softer than in November. His most pointed comment was that Beijing would welcome assurances its financial assets in the United States were safe.

Treasury Secretary Timothy Geithner shrugged that off as nothing more than "the kind of things that you typically see ... foreign ministry people say in the run-up to these meetings. It's the typical pattern, nothing exceptional or interesting in this."

SORE SPOTS

To be sure, there are still plenty of trade frictions.

The U.S. trade deficit with China swelled to $252.4 billion through November, up 21 percent from the same period a year earlier. China's foreign exchange reserves climbed to $2.85 trillion in December, much of it held in dollar-denominated assets, making China Washington's largest creditor.

Commerce Secretary Gary Locke called for "more equitable" trade with China in a speech last week and said China does not always follow through on its promises.

Obama will no doubt press Hu to make good on pledges to enforce intellectual property protections and open the doors a bit wider to U.S. businesses, which have long complained about unequal access.

And yes, Obama will renew an oft-repeated call for China to allow the yuan to rise even more rapidly.

Many economists expect that plea to receive a somewhat more favorable reception now because China is struggling to tamp down inflation, and a stronger yuan would be a useful tool. By tying a rise to domestic needs rather than foreign demands, China could do what Washington wants without appearing to bow to outside pressure.

Chinese inflation data, scheduled for release the day after Hu's White House visit, is expected to show a 4.4 percent year-over-year rise in the consumer price index. That would be a modest cool-down from November's 5.1 percent reading, but still uncomfortably high.

Prasad, the Brookings economist, said thanks to the political shift in Congress and the inflation-driven rise in the yuan's real effective exchange rate, both sides feel less pressure now.

"This creates a little bit of space in the short term for them to back off from a confrontation stance and focus on long-term strategic issues," he said.

(Editing by Dan Grebler)