UPDATE 4-IMF split in China yuan exchange rate debate

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* Split board doesn't say yuan "substantially" undervalued

* Staff see yuan undervalued by between 5 and 27 percent

* Fund suggests higher interest rates, 2011 stimulus exit (Adds quotes from IMF conference call)

By Alan Wheatley and Lesley Wroughton

BEIJING/WASHINGTON, July 28 (Reuters) - The IMF has softened its criticism of China's currency regime in recognition of Beijing's efforts to free up its exchange rate but the move showed a split among the Fund's member countries.

A summary of an annual review of China's policies described the yuan as "undervalued," a change from "substantially undervalued," which was used by International Monetary Fund chief Dominique Strauss-Kahn as recently as June.

The yuan has been a flashpoint in relations between China and old-line industrial powers, some of whom have complained that an undervalued yuan undercuts their exports.

Without elaborating, an IMF board statement on Wednesday said several countries on the 24-member executive board believed the Chinese currency was undervalued.

But others said a structural reduction in the balance of payments surplus was already unfolding thanks to steps taken to boost consumption, disagreeing with an assessment by IMF staff that the yuan was "substantially undervalued."

"This does reflect a softening in the board's position about the degree of adjustment that is needed in the Chinese exchange rate regime," said Eswar Prasad, a senior fellow at Washington's Brookings Institution and a former IMF official.

IMF economists calculated the yuan was undervalued somewhere between 5 and 27 percent, depending on methodologies used, Prasad said. A diplomat in Beijing confirmed the range.

Beijing dropped the yuan's 23-month-old peg to the dollar and reverted to a managed float on June 19, since which time it has inched up 0.7 percent against the dollar.

Prasad said it was premature for some countries to argue China had made a significant move on its currency regime and was boosting local demand to help rebalance the world economy.

Despite the choice of language used by the IMF's board, the Fund's mission chief to China, Nigel Chalk, said Fund staff economists found the renminbi remained "substantially below the level that is consistent with medium-term fundamentals."

That view was based on staff forecasts that China's current account surplus, which has fallen to around 4 percent of gross domestic product, will rise to about 8 percent in five years as the world economy recovers and net exports pick up again.

Beijing disagreed, arguing the surplus will stay at the new, lower level, Chalk told reporters on a conference call.

Among the constraints in assessing China's economy was the lack of a medium-term policy framework, he said.

DIVISIONS ON VALUE OF YUAN

People familiar with the discussions of the IMF board said representatives of the Group of Seven rich nations, including the United States, supported the IMF staff's review but declined to call the yuan "substantially" undervalued.

"Several Directors agreed that the exchange rate is undervalued. However, a number of others disagreed with the staff's assessment of the level of the exchange rate, noting that it is based on uncertain forecasts of the current account surplus," the IMF board statement said.

In the past, China has been so angry with the Fund's exchange rate views that it withheld cooperation on the annual review from 2007 to 2009.

Beijing has gradually been gaining clout in the IMF. Last year it bought $50 billion worth of notes to beef up the fund's capital and a deputy governor of China's central bank, Zhu Min, has become special assistant to Strauss-Kahn.

The IMF's choice of words is the second qualified recognition this month of the progress China is making in liberalizing its exchange rate.

On July 8, the administration of U.S. President Barack Obama said the yuan remained undervalued but declined to designate China as a currency manipulator. [ID:nN08229303]

The IMF said the scrapping of the dollar peg would increase the central bank's flexibility to tighten monetary conditions.

A stronger yuan rate would also be good for the rebalancing of the domestic and global economies by shifting China's growth from exports and investment to private consumption, it said.

On other issues, the board supported a gradual phase-out of China's massive fiscal stimulus in 2011, provided the current trajectory for the economy is maintained. The IMF expects continued robust growth with benign inflation.

Directors commended China's plan to slow the pace of money growth this year but urged it to raise interest rates. (Additional reporting by Aileen Wang; Editing by Jan Dahinten and Todd Eastham)