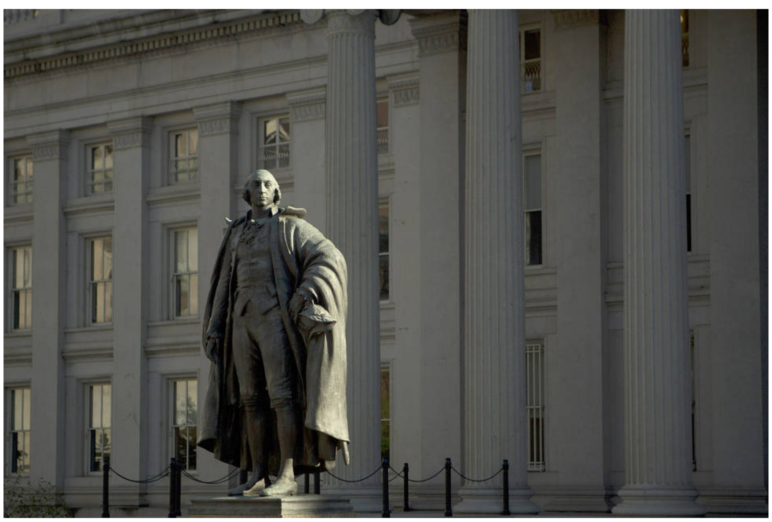
THE WALL STREET JOURNAL.

http://www.wsj.com/articles/obama-administration-softens-criticism-of-chinas-currency-policy-1445286754

U.S. WSJ PRO

Obama Administration Softens Criticism of China's Currency Policy

Treasury Department report cites shift in global economic winds



A statue of Albert Gallatin, former U.S. Treasury secretary, stands at the U.S. Treasury in Washington, D.C.
PHOTO: ANDREW HARRER/BLOOMBERG NEWS

By **WILLIAM MAULDIN**
Updated Oct. 19, 2015 6:35 p.m. ET

WASHINGTON—The Obama administration softened its criticism of Beijing's currency policy, citing a shift in global economic winds as well as China's moves to allow market forces a greater role in setting the value of the yuan.

The U.S. Treasury Department, in its semiannual report on currencies Monday, said the yuan is "below its appropriate medium-term valuation." In the previous report it said the currency was "significantly undervalued."

The shift in Washington's tone comes after Beijing in August adjusted its currency policy to let the yuan, also known as the renminbi, move more easily with the market. That change, accompanied by a sharp depreciation, triggered immediate concern on Capitol Hill and Wall Street, because many worried China would devalue its currency further to gain a trade advantage.

The International Monetary Fund has commended China's recent moves, but officials in Washington said Monday they will watch Beijing's next steps closely. "Treasury is carefully monitoring the implementation of the new exchange-rate policy approach and how it will work in practice—specifically, whether China will allow the renminbi to respond to market forces for appreciation as well as for depreciation," the report said.

Besides China's policy steps, the Treasury Department pointed to the uncertain outlook for the global economy, and the related volatility in markets, as a new, more complicated backdrop against which to judge the yuan. The yuan may have little additional scope for near-term appreciation against the U.S. dollar because both currencies have been appreciating significantly against other currencies, analysts say.

"The near-term trajectory of the renminbi is difficult to assess," Treasury said in the report. "However, our judgment is that the renminbi remains below its appropriate medium-term valuation."

China's latest economic twists have put the Obama administration in a tough spot. On the one hand, the U.S., like the IMF, has been pressing Beijing to let market forces play a bigger role in setting the yuan exchange rate.

But when Chinese authorities did allow more freedom for the yuan in recent months—at a time when investors grew more concerned about slowing economic growth—the currency weakened sharply against the dollar, conflicting with Washington's longtime calls for a stronger yuan.

"A falling yuan and a rising bilateral U.S. trade deficit with China will sharpen congressional criticism of China's currency policies, but the administration has little economic basis for criticizing China's move toward greater exchange rate flexibility," said Eswar Prasad, a China expert at Cornell University and a former senior China official at the International Monetary Fund.

The IMF earlier this year said the yuan was no longer undervalued. But U.S. officials maintain it is still undervalued against the currencies of its trading partners and expect it to strengthen over time—if China allows the same flexibility when the yuan is strengthening as when it weakens. Since June 2010, the yuan has strengthened nearly 30%, based on its inflation-adjusted effective rate.

A weak yuan tends to make Chinese imports more competitive compared with American-made goods. U.S. imports from China in the first eight months of the year were quadruple the level of exports to China, generating a trade deficit with Beijing of $237.3 billion, compared with $216.7 billion in the same period of 2014.

China's surprise move in August to change its exchange-rate policy was followed by currency depreciation in other countries, from Vietnam to Kazakhstan. Japanese officials also discussed the need to weaken the yen, feeding worries that Beijing's depreciation could lead to a dangerous round of competitive devaluations.

Chinese officials expect the yuan to move little in either direction in the near term. A still-healthy growth rate "suggests that the renminbi will be more or less stable at a rate more or less close to its equilibrium level," said People's Bank of China's Deputy Gov. Yi Gang at the IMF's annual meeting this month in Lima, Peru. China's move in August to let the yuan fall against the dollar, then prop up the local currency didn't represent a reversal of market-friendly reforms but rather an attempt to stamp out market volatility, Mr. Yi said.

A spokesman for China's embassy in Washington declined to comment and pointed toward past statements by the country's central bank.

The IMF last month said China had begun reporting its currency reserves to the international organization, a milestone as Beijing seeks to have its currency included in the IMF's basket of reserve currencies.

Not everyone thinks China is ready for reserve-currency status, especially on Capitol Hill, where U.S. lawmakers in both parties blame China for artificially cheapening its currency for years, hurting U.S. manufacturers. "Given their behavior, the IMF should absolutely not allow the yuan to become a global reserve currency," said Sen. Chuck Schumer (D., N.Y.), in a statement.

"They're continuing to have government manipulation, government intervention in the currency market that disadvantages American manufacturers," said Sen. Lindsey Graham (R., S.C.), a candidate for the 2016

Republican presidential nomination. "The facts do not justify this report, let's put it that way."

China, Japan and other Asian countries have generated major criticism from Congress this year, because many lawmakers say a major trade agreement the U.S. concluded this month should have included enforceable rules to punish countries deemed to have manipulated their currencies.

While they didn't agree on enforceable rules that would result in trade sanctions, finance ministers of the dozen countries in the Trans-Pacific Partnership negotiated a currency framework alongside the trade agreement. Under the deal, whose details haven't been released yet, countries would affirm international standards for exchange rates, agree to be more transparent about their interventions in currency markets and set up annual consultations to deal with concerns, officials say.

Those annual consultations would be analogous to the talks triggered when the Treasury Department declares a country a currency manipulator, a rare step it hasn't taken in decades.

The devaluation in China—not a member of the TPP trade bloc—and the congressional consideration of the trade agreement ensure the currency issue will be a sensitive one in coming months and during the 2016 election season.

Beyond China, the Treasury cited economic imbalances—in South Korea, Germany, the Netherlands and other major exporters—that are limiting the ability of other economies to recover. "The adjustment process, both within the euro area and globally, would function much better if countries with large current-account surpluses took strong action to boost investment and domestic demand," the report said.

Oil's sharp drop is boosting some imbalances further in countries that import the fuel in Europe and Asia, the Treasury Department said.

Write to William Mauldin at william.mauldin@wsj.com