BEIJING—China's currency trades at different values inside and outside the country—and that's a problem for Beijing.

The Chinese yuan trades both in the domestic market and in what is known as the offshore market in Hong Kong, a Chinese city that operates under its own laws. In China, authorities strictly limit the way the yuan trades. In Hong Kong,
it can be bought and sold more freely.

Since Aug. 11, when China surprised the world by devaluing its currency, investors in Hong Kong have been pounding the yuan weaker in expectation of more devaluation to come. The offshore yuan currently trades at about a 1% discount to its mainland cousin, a discount that has widened to as much as 2% intraday in recent weeks. By comparison, the two were largely in line before the devaluation.

That widened spread is complicating China’s ambitions to raise the yuan’s global profile. Beijing is trying to persuade the International Monetary Fund to include the yuan in its elite basket of reserve currencies, giving the currency the same status as the U.S. dollar, the euro, the British pound and the Japanese yen. But people familiar with the IMF’s thinking say it is unlikely to deem a currency with two exchange rates “freely usable,” as the organization requires.

The People’s Bank of China is considering ways to narrow the gap between the onshore and offshore yuan, say people with knowledge of the central bank's deliberations. One is to allow the onshore yuan to slide to Hong Kong’s weaker level, they said. But that option has serious potential downsides.

One is politics. The yuan has re-emerged as an issue with China’s trading partners—after its strengthening in recent years lessened the controversy—just ahead of Chinese President Xi Jinping’s trip to the U.S. to meet with U.S. President Barack Obama at the end of September. A decision to weaken the yuan, and so give Chinese exporters an advantage over rivals, wouldn’t occur until after the summit, the people said.

Worse, further devaluation could prompt investors to move funds out of China at a time when more credit is needed to bolster the economy, the people say. According to the latest official data, yuan positions at Chinese banks accumulated from foreign-exchange purchases fell by a record 249.1 billion yuan ($39 billion) between June and July, a sign that more money is leaving China.

“The PBOC faces a significant challenge in allowing for more yuan flexibility in practice without triggering substantial capital outflows and associated large currency depreciation,” said Eswar Prasad, a professor at Cornell University and former China head for the IMF.

Wei Liuzhang is one of the Chinese citizens who have rushed to convert their yuan holdings into dollars since the PBOC’s devaluation. Mr. Wei, a property agent in Shanghai, said he has encouraged “all of my family” to exchange the
maximum $50,000 a person that China allows annually.

“The economy is weak, and renminbi will only get weaker,” Mr. Wei said, using an alternative name for the yuan.

Another option the PBOC is weighing, the people close to its thinking say, is to continue trying to stabilize the mainland yuan by buying the currency and simultaneously selling U.S. dollars, in hopes that market nervousness will ease and the discount will eventually shrink. It also started to deploy a variety of complex financial contracts aimed at taming depreciation expectations for the yuan.

Longer-term, the central bank could make the onshore yuan more responsive to market forces, the people said. It already has said it will extend mainland-trading hours for the yuan to make it better accessed around the globe, though it hasn’t said when. But further loosening faces resistance within China from leaders leery of market disruptions.

Further liberalization of cross-border fund flows should help narrow the discount as that would mean “more entities would have access to both onshore and offshore markets,” said Wei Liao, an assistant portfolio manager at Counterpoint Asian Macro Fund, a hedge fund in Hong Kong.
Part of the depreciation pressure is China’s own doing. For most of the past year, the Chinese central bank kept the yuan largely pegged to the U.S. dollar, effectively pushing up its value against the currencies of China's trading partners and so hurting Chinese exporters. Throughout the year, senior Chinese officials showed little desire to devalue the currency, a normal move for a country such as China that has been gradually loosening monetary policy.

The market turmoil that followed the Aug. 11 devaluation caught officials at the central bank somewhat off-guard, according to people close to the PBOC. After seeing little impact from the statements posted on its website explaining the depreciation, the central bank on Aug. 13 staged a rare stepping-out for its top official responsible for exchange-rate policies, Yi Gang, who spent more than an hour explaining the central bank’s actions and answering reporters’ questions.

In recent days, officials at the PBOC also hinted that the central bank is largely done with guiding the yuan lower and will instead focus on keeping its mainland rate steady at around 6.4 yuan per dollar. Premier Li Keqiang on Friday joined the chorus by saying there was “no basis” for continued depreciation.

Since late last year, the PBOC has been steadily moving toward opening China's markets and revamping its creaky financial system, in part get the IMF to include the yuan in its currency basket, known as Special Drawing Rights, or SDR. The IMF board is expected to make a decision on the matter in November, though the actual implementation of any new basket won’t take place until late next year, according to IMF officials.

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