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WORLD NEWS | JULY 16, 2010

Early View on China's Currency Overhaul: Little Change

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By AARON BACK And ANDREW BATSON in Beijing and BOB DAVIS in Washington

A month after China announced it would ease its currency's de facto peg to the dollar, the yuan has gained just 0.7% against the dollar, and the stated policy shift has done little to defuse political anger at China in the U.S.



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A shopkeeper counts merchandise in a downtown Beijing mall on Thursday. China's central bank has reaffirmed the benefits of a flexible currency.

Four weeks isn't enough time to judge the full impact of China's intent, but, so far, this doesn't have the hallmarks of a major shift to a more-flexible currency. More than half the appreciation of the yuan thus far came on the first trading day after the announcement. In the past two weeks, movement has largely halted.

But Americans aren't waiting. The currency move thus far is "woeful," said AFL-CIO President Richard Trumka, who says the yuan is undervalued by 40%. "Even if it increased 0.7% a month for a year, it would be woeful," he said.

Frank Vargo, a National Association of Manufacturers' vice president, said, that without a greater appreciation, "there will be a fair amount of pressure to do something" on Capitol Hill to penalize China.

But any substantive move against China in Congress is unlikely until after the November elections because lawmakers are focusing on other priorities, including deficits, taxes and unemployment, said Mr. Trumka.

Sen. Charles Schumer, a New York Democrat, whose legislation would make it easier to take punitive action against Beijing, said in a statement, "There hasn't been an opportunity yet in the last month to bring our proposal to the Senate floor...We continue to push our legislation and are looking for the first available opportunity to offer it."

On Thursday, a deputy governor of the People's Bank of China reaffirmed the central bank's commitment to currency flexibility and pointed out its benefits. The comments by Hu Xiaolian are the first lengthy elaboration of PBOC views on currency policy since the June 19 announcement. The remarks, published on the PBOC web site in both English and Chinese, are noteworthy because they echo much of the criticism of China's tightly controlled exchange-rate regime leveled by the U.S. government and International Monetary Fund.

Ms. Hu said a fixed exchange rate would be dangerous to the nation's economy and that rigid exchange rates had contributed to financial crises in the past, including in Mexico in 1994, Argentina in 2001 and several Asian countries in 1997. "Thus, it is necessary for large countries to have (a) flexible exchange-rate policy," she said.

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The People's Bank of China has been the leading voice for currency reform within the Chinese government, arguing against the Commerce Ministry and others who said letting the exchange rate rise would hurt Chinese exporters by making their goods more expensive in dollar terms. The central bank's argument won out with China's top leaders, who treasure stability but want to strengthen domestic consumption and reduce China's

reliance on exports.

Conditions that preceded both unpeggings in 2005 and 2010 are similar: in China, the economy is surging, and in the U.S., political impatience with Beijing's currency policy is gaining steam.

When China unpegged the yuan from the dollar in July 2005, the currency gained about 2% during the first month of trading—and nearly all on the first day. In the first year, the yuan rose just 3.5%, and over a three-year period, gained a total of about 21%. Beijing re-established the peg in mid-2008 as the global recession took hold. This time around, at the current rate of appreciation, the yuan would rise more than 8% over a year—though there is no guarantee the Chinese plan a steady increase.

The recent change in policy was announced shortly before leaders of the Group of 20 leading and developing nations met in Toronto, taking China's exchange rate off the agenda and making it easier for the U.S. Treasury last week to, again, avoid declaring China a currency manipulator in a congressionally mandated report.

Shortly after Beijing announced its move, President Barack Obama suggested that the U.S. would judge China's progress "over the course of a year," but later, telling reporters about a conversation he had had with Chinese President Hu Jintao, Mr. Obama truncated the time frame to "the months ahead."

The small appreciation thus far has the Obama administration and Congress looking for levers to keep the pressure on China. Treasury Secretary Timothy Geithner has said "what matters is how far and how fast the renminbi appreciates."

The next lever may be IMF review of China's economy, likely to be completed in September. China had blocked the IMF from undertaking a review—generally done annually—since 2007 as the two sides squabbled over China's currency policy. IMF officials regularly describe China's currency as "substantially undervalued." The U.S. is pressing China to permit the publication of the IMF review., which could focus international attention again on China's currency policy.

A widening of the U.S. trade deficit with China amid widespread concern about unemployment is likely to prompt congressional rhetoric—if not action—to act against China. In May, the U.S. trade deficit with China expanded to \$22.3 billion, the widest since October. "I think the knives will come out fairly soon," predicted Cornell University economist Eswar Prasad, a China specialist.

China took pains to signal that movement of the currency would be gradual, and that the yuan could fall as well as rise. Such a strategy is aimed at fending off speculative flows of capital betting on currency appreciation, one of the chief drawbacks of a controlled exchange-rate regime. The fact that the yuan isn't predictably and consistently rising against the dollar thus achieves one of China's main economic goals, even though it worsens political strains with critics abroad.

Chinese officials point out that the yuan has appreciated substantially against the sagging euro this year, even though it has moved little against dollar.

—Liu Li contributed to this article.

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