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G-20 Seeks To Forge Currency Consensus, But Deal Elusive

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GYEONGJU, South Korea (Dow Jones)--Finance ministers from the Group of 20 nations are under pressure to reach a truce in what's being called a global "currency war," but they will struggle to produce anything substantive this week.

G-20 finance ministers and central bankers are seeking consensus at meetings Friday and Saturday on steps that could calm foreign-exchange markets, but they will likely leave any concrete measures to the leaders of the big industrial and developing countries, who meet in Seoul next month.

Despite deep divisions over currencies, there is consensus that it is critical to address the issue, as China's policy of restricting the yuan's rise poses a risk to the nascent global economic recovery.

Some G-20 officials say the ministers, meeting in Gyeongju, South Korea, might hammer out a cooperative agreement on current-account imbalances and exchange-rate volatility that goes beyond historically bland G-20 pronouncements--but leave it to leaders to announce the accord.

"The risk is that unless agreement on a common path of adjustment is reached, conflicting policies will result in an undesirably low level of world output, with all countries worse off as a result," Bank of England Gov. Mervyn King said this week.

Markets are unlikely to be assuaged by a mere reiteration of the G-20 commitment to "rebalance" the global economy, which implicitly includes addressing greater rises in the currencies of China and other export-reliant Asian countries.

The G-20 will "move towards more market-determined exchange rate system, and refrain from competitive undervaluation of our currencies while minimizing adverse effects of excessive volatility and disorderly movements in exchange rates," an early draft communique viewed by Dow Jones Newswires said.

Drafts are often subject to revision, particularly provisions that address controversial issues such as currencies. But a G-20 official Thursday said Saturday's G-20 communique is likely to retain the reference to currencies. A senior U.S. Treasury officials said such wording was "relevant to today's circumstances."

But widely differing approaches on the currency issue and the need to preserve domestic interests--underscored by a recent raft of unilateral foreign-exchange interventions--may stand in the way of a forceful agreement to coordinate currency policies.

Some emerging G-20 economies like South Korea, Brazil and Indonesia, which have recently taken actions to curb their currencies, have blamed loose U.S. monetary for the massive capital inflows that have pushed the value of their currencies up.

Beijing, which has said repeatedly a rapid appreciation of the yuan would damage the country's economy, has even branded U.S. monetary policy "irresponsible." The U.S. defends itself by saying that strong U.S. growth is in everyone's interest and that an undervalued yuan is exacerbating capital flows. At the same time it's calling on nations with large current-account surpluses like China and Germany to boost domestic demand to help global growth. European G-20 nations, already suffering from sovereign debt woes, have a high stake in the debate as the recent rise of the euro to around $1.40 threatens to hurt the bloc's exports.

"We would like countries to move toward a set of norms on exchange-rate policy," U.S. Treasury Secretary Timothy Geithner said in an interview with the Wall Street Journal this week.

G-20 officials have shot down the idea of a dramatic agreement like the 1985 Plaza accord to push the dollar down, and it's yet unclear how precise the parameters or tough a language the G-20 will use when drafting the leaders' statement in Seoul.

One way leaders may be able to approach the currency problem less controversially would be to include more concrete targets under the G-20 "framework for strong and sustainable growth," which aims to engineer more balanced global growth.

"We're encouraging our partners to put a little more flesh on the skeleton of the rebalancing commitment," Geithner told The Wall Street Journal.

Korean officials, according to a local media report, have proposed limiting current-account surpluses and deficits to 4% of gross domestic product in the coming years and say they're confident of agreement on the targets. People's Bank of China Deputy Gov. Yi Gang said this month that Beijing would aim to cut its surplus below 4% of GDP within three to five years from last year's of 6%.

Beefing up financial safety nets is another, more subtle way to counter currency misalignments. Korea, as chair of the G-20 this year, is keen to reinforce regional financial liquidity facilities such as the Chiang Mai initiative, a $120 billion Asian currency-swap agreement. Safety nets are intended to provide countries with assurance of access to emergency funds in crises to help them avoid hoarding excessive forex reserves that exacerbate currency volatility.

Eswar Prasad, a former China division economist at the International Monetary Fund, said while there may be some trumpeted announcement, he doesn't expect much in terms of substance specifically on forex policy in the finance ministers' communique.

Instead, Prasad, a Princeton University professor, says China may make some sort of subtle statement outside of the G-20 that it will "enhance the formation of the exchange-rate mechanism" or something similar, indicating a slight acceleration in appreciation--and back it up with a 1%-2% move over the next couple of weeks before the Seoul summit. The U.S. would commit to pulling back from "quantitative easing" and fiscal stimulus once recovery is secured, he said.

"I think the Koreans have come to the realistic expectation that all they can get the two sides to agree is a general sort of statement that they will not engage in competitive currency devaluation," Prasad said.

China unpegged the yuan from the dollar in mid-June. The currency fluctuated both ways for a time, but since early September, Beijing has let the yuan rise about 2.5% against the dollar. Geithner has called this "a pretty significant pace" of appreciation and pressed China to keep letting its currency rise "at a gradual but still significant rate," noting that the yuan rose some 20% between 2006-2008.

The Gyeongju meeting will also discuss progress on financial reform and the overhaul of the global regulatory framework. Ministers will likely prepare the groundwork for leaders to endorse new bank capital rules known as Basel III when they gather in Seoul.

Basel-III standards require banks to have fatter capital buffers and tougher liquidity ratios, and will be gradually phased in from 2013. Europeans are keen to obtain pledges that all G-20 nations will implement these rules on the same timetable, as they resent that the U.S. failure to implement the previous set of Basel rules helped trigger the global financial meltdown.

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