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CAPITOL REPORT

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Geithner gets passing grade for China trip

Tensions remain just below surface

By [Greg Robb](#), MarketWatch

WASHINGTON (MarketWatch) -- Treasury Secretary Timothy Geithner did a good job in carefully handling Chinese leaders during a two-day visit to Beijing, even though worrisome tensions remain just below the surface, U.S.-based policy experts said Tuesday.

"Geithner did very well in terms of setting the right tone for constructive discussion," said Eswar Prasad, a senior fellow at the Brookings Institution.

Geithner was "nicey-nicey" in his dealings with the Chinese, said Richard Baum, director of the UCLA Center for Chinese Studies.

"And it is appropriate. They've done a better job handling their economic problems than we have," Baum said.

As expected, Geithner set a conciliatory tone in his discussions. He praised China's efforts to offset the global economic crisis.

And while he didn't shy away from the touchy issue of China's currency exchange rate, he couched it in terms of much broader framework of economic reforms.

6.95 The U.S. wants China to allow its currency to strengthen, but Beijing has resisted such calls. China has been piling up U.S. Treasuries to keep its currency low, and as of March, holds over \$760 billion of Treasury paper, making it the biggest customer of U.S. debt.

6.85 Geithner couched the discussions in such a way that Chinese officials would be comfortable with, Prasad said.

6.80 Both the U.S. and Chinese officials want to tone down the acrimony over the currency issue.

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But many experts believe that tensions will re-emerge later this year, because the U.S. economy is starting to stir and China is still betting that the U.S. consumer will regain its appetite for low-cost Chinese goods.

Any spike in the bilateral trade deficit is sure to attract attention in Congress, especially if the unemployment rate continues to climb towards double digits.

"The currency issue will come bubbling back to the surface," Prasad said.

Desmond Lachman, an expert on emerging economies and a fellow at the American Enterprise Institute, warned that "nothing is being done about external imbalances."

If Congress retaliates against Chinese goods, the Chinese will be tempted to respond. "This could lead to a train wreck," Lachman said.

Geithner also reassured China that the U.S. has a strategy for bringing its budget deficit under control.

Experts said the U.S. and China are essentially stuck a bad marriage with no hope of near-term divorce. [Read Capitol Report.](#)

"The U.S. and China are getting locked into an increasingly tight embrace -- not necessarily one that either side is thrilled about," Prasad said.

Prasad also said that the U.S. may have left itself without enough leverage in the relationship.

"I have a serious concern that the balance may have shifted to the point where it seems the U.S. needs China more than China needs the U.S. The truth is that the two countries need each other," Prasad said.

A key moment of the trip that crystallized this new relationship came during Geithner's speech at Peking University, when students there snickered as Geithner said Chinese holdings in the U.S. were safe.

Geithner not to blame

But many analysts also said it isn't fair to blame Geithner for the lack of fundamental progress in U.S.-Chinese relations.

"Geithner can't have a plan unless China lets him have a plan," said Robert Brusca, a former top economist for Nikko Securities and now head of FAO Economics.

For instance, China is not ready to end its policy of maintaining a weak currency.

"China cannot easily detach themselves from the soft dollar peg at a time when external demand is weak and their export industries are already suffering," Prasad said.

The Obama administration is hoping that China will shift away from concentrating on exports. Some economists believe that China is making progress on this front, but most are skeptical.

Prasad said that China is sincere in its desire to create a robust domestic market, but added that the country needs time to accomplish its strategy.

"They are on the path, but there is no chance they can accomplish it in next two or three years. It is going to take a while," Prasad said.

Brusca explained that in China there is a massive developed economy but also a massive amount of poverty.

If the public believed that a "Great Wall" had been put up around its developed economy, and no more poor people would be able to find good jobs, there would be unrest, Brusca said.

This limits the options that Chinese officials will consider.

Prasad said he was not concerned that Geithner was hammered in the state-run media during his visit. [See full story on Chinese media reaction to Geithner visit.](#)

Chinese political culture can no longer be described as monolithic, he said, and many of China's officials are suspicious about U.S. intentions.

The media criticism of Geithner shows that "one very powerful faction of the government is expressing serious concern about the relationship between the two countries. I think it is less about economics than political issues," Prasad said.

Washington is also divided about China.

In a speech on Tuesday, Ron Kirk, the former mayor of Dallas who is now the Obama administration's new trade czar, said that he wouldn't hesitate to see punitive sanctions against China if a new trade dispute arises. [Read Kirk's speech to U.S. China Business Council.](#)

The next hurdle for the U.S.-China marriage will come in late July, when Chinese officials travel to Washington for closed-door talks on economic and political matters hosted by Geithner and Secretary of State Hillary Clinton. ■

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