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China slams U.S. Federal Reserve's low interest rates

By David J. Lynch, USA TODAY

U.S. gripes about [China's](#) currency policy are now matched by Chinese complaints that the [Federal Reserve's](#) low interest rates are inflating new asset bubbles.

But as President Obama meets Tuesday with Chinese President [Hu Jintao](#), both nations' crisis-fighting policies are having effects far from their own shores. Low U.S. interest rates and the weak dollar invite investors to use borrowed dollars to buy assets in higher-yielding developing countries. And China's decision to link its currency to the dollar costs other developing countries exports.

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"Low interest rates for the U.S. certainly do create problems for the rest of the world. ... There's a very strong temptation for money to flow out of the U.S. and into other countries," says economist Eswar Prasad, a former [International Monetary Fund](#) official.

In China, foreign currency borrowing has risen eight consecutive months and now totals \$360 billion – 40% more than a year ago, says Marc Chandler of Brown Bros. Harriman. The so-called carry trade is driving some stock and property markets to new, potentially unsafe heights.

The [Shanghai](#) exchange is up 79% this year. And housing prices in China's 70 largest cities rose 3.9% last month, their fastest rate of increase in a year, according to JPMorgan.

Any eventual bubble in China, however, may owe more to domestic policies than U.S. interest rates. To spur its economy during the global downturn, the Chinese government directed its state-owned banks to issue a flood of new loans. More than \$1.3 trillion in new lending resulted through October, more than one-quarter of China's annual economic output.

The impact isn't limited to Asia. In dollar terms, Brazil's benchmark stock index is up more than 139% this year. Worried Brazilian officials last month slapped a 2% tax on foreign purchases of stocks and bonds, trying to stem capital inflows that are driving up the value of the *real*.

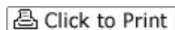
Such capital controls may spread to other countries, reversing a trend toward easing cross-border flows, says Antoine van Agtmael, chairman of Emerging Markets Management.

Since China pegs its currency to the dollar, the falling greenback has dragged the yuan with it.

The weaker currency acts as an effective price cut for Chinese products shipped abroad, enabling China's exporters to benefit at the expense of producers in countries with floating currencies. Since March, the Brazilian *real* is up more than 38% against China's yuan, while South Korea's *won* has risen 37%.

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