Geithner gaffe on China plan drags on dollar

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The dollar fell briefly yesterday after Tim Geithner, US Treasury secretary, said he was open to exploring a Chinese proposal to reduce reliance on the US dollar as the world's reserve currency.

Mr Geithner told the Council for Foreign Relations that he had not studied the proposal by Zhou Xiaochuan, Chinese central bank governor, for greater use of special drawing rights in international reserves, but said "we are quite open to that".

He said increased use of SDRs should be thought of as an "evolutionary" step rather than a step towards "global monetary union".

The SDR is a synthetic currency unit maintained by the International Monetary Fund that represents a basket of actual currencies.

The dollar fell 1.3 per cent against the euro as headlines saying "Geithner open to SDR currency" flashed across traders' screens.

With the currency falling, Mr Geithner's interviewer - Roger Altman, a deputy Treasury secretary in the Clinton administration - gave Mr Geithner the chance to clarify his remarks.

Mr Geithner said: "I think the dollar remains the world's dominant reserve currency." The dollar recovered much of its losses.

In a subsequent interview with CNBC, Mr Geithner repeated the standard mantra that "a strong dollar is in America's national interest".

Although Mr Geithner had said the dollar would remain the dominant currency providing the US put its fiscal house in order once the crisis was over, analysts were quick to chide him.

"It's been a tough few weeks for Mr Geithner, but if there is a lesson from today, it is that the dollar is on thin ice and any loose talk will be quickly punished," said Chris Turner, a strategist at ING Capital Markets.

Experts remain uncertain as to how seriously to take the Chinese proposal.

Eswar Prasad, a professor at Cornell, said that while the Chinese were genuinely concerned about the value of their dollar holdings, the SDR proposal was more a tactical play to "redefine the debate going into the G20" and minimise criticism of China's own exchange rate regime.

"This is obviously not something that is going to happen for quite a long time," said Morris Goldstein, a fellow at the Petersen Institute.

"The crisis does raise a lot of fundamental issues about the architecture of the global financial system, and the reserve currency is one of them."

The Short View, Page 17 Currencies, Page 33