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China Appears Set to Make Currency Policy More Flexible

By KEITH BRADSHER

HONG KONG — The Chinese government is preparing to announce in the coming days that it will allow its currency to strengthen slightly and vary more from day to day, a move being taken for domestic policy reasons in China but likely to please the Obama administration, people with knowledge of the emerging consensus in Beijing said on Thursday.

While any announcement could still be delayed, China's central bank appears to have prevailed with its arguments within the Chinese leadership for a stronger but more flexible currency, known as [the renminbi](#) or yuan, these people said.

Insisting on anonymity because of the sensitivity of the issue in Beijing, they predicted that China's policy shift could easily come before President [Hu Jintao](#) arrives in Washington next week for discussions with [President Obama](#) and other world leaders on improving nuclear security.

Many members of Congress and many economists say that by spending several hundred billion dollars each year to hold down the value of the renminbi, China has made its exports extremely competitive in foreign markets and taken away sales from manufacturers in the United States and other countries.

But administration officials, especially [Treasury Secretary Timothy F. Geithner](#), have kept quiet to avoid giving the impression that a currency policy shift by China was the result of American pressure, instead of a decision

based on what was best for the Chinese economy. Mr. Geithner maintained that silence on Thursday, holding meetings with senior officials in Hong Kong before flying in mid-afternoon to Beijing for a brief stopover and a meeting with Vice Premier Wang Qishan.

A terse Treasury statement after the meeting with Mr. Wang only noted that the two men “exchanged views on U.S.-China economic relations, the global economic situation and issues relating to the upcoming economic track dialogue of the second U.S.-China Strategic and Economic Dialogue, to be held in Beijing in late May.”

A more market-oriented currency policy in Beijing, with a trend toward a stronger renminbi, could help the American economy in several ways, according to economists. A stronger renminbi would make Chinese goods more expensive in the United States and make American goods cheaper in China, which is currently exporting more than four times as much to the United States as it imports.

Even more important, a Chinese decision to strengthen the renminbi would make similar moves possible by many other countries, particularly in Asia, that informally link the value of their currencies to [the dollar](#). Exporters like Japan, South Korea and Taiwan are leery of letting their currencies appreciate for fear that their exports would lose out to Chinese exports in the American market.

Full of confidence after the Chinese economy weathered the global financial downturn better than the West, Chinese officials have opted to allow more fluctuations in the currency after determining it would be in China’s interest, and not because of Western pressure, said the people familiar with the emerging consensus in Beijing, who are close to the Chinese side on the currency issue, not the American side.

Allowing wider variation in the currency will also make it easier for the central bank to fight inflation, which Mr. Wen, the premier, identified last month as a top concern for the leadership. Consumer prices were 2.7 percent higher in February than a year earlier, after prices were falling as recently as last October. Inflation is accelerating in China faster than most Western economists expected.

A stronger renminbi helps hold down prices by making imports cheaper, and gives China’s central bank more room to raise interest rates and brake economic growth without lessening the risk of drawing more speculative investments into the country.

Holding down the value of the renminbi through huge currency market intervention has also become an

enormous expense for China. The central bank spent 9.2 percent of the entire country's economic output last year on the purchase of foreign reserves, mainly Treasuries that pay extremely low interest right now.

A stronger renminbi could prove a mixed blessing for the United States. If China cuts back sharply on purchases of Treasuries, then the Obama administration could find it harder to finance American budget deficits.

But with the Chinese economy booming, a small move in the renminbi may still leave the central bank struggling with trade surpluses and a tide of speculative investment into China. That could force it to continue buying Treasuries with the extra dollars.

A slightly stronger renminbi that fluctuates each day against the dollar will mainly hurt low-margin, labor-intensive industries in China like shoes and textiles, they said. Many Beijing officials have been worried about job losses in these industries if the currency appreciates.

Much of this production is already starting to move out of China, notably to Vietnam and Bangladesh, where labor costs have stayed low. And Chinese factories producing these goods have been struggling to find enough workers in the last two months as the economy grew powerfully this winter, stoked by heavy bank lending, strong demand for workers in the retail sector and rising government spending on [high-speed rail](#) lines and other infrastructure investments.

More high-tech industries, like the production of computers, have tended to favor a stronger renminbi. Further migration of labor-intensive industries to other countries could free up more workers for high-tech work, making it cheaper for these industries to import materials that are priced in dollars. Such a development would create more Chinese competition for high-tech operations in America, however.

In 2005, China allowed the renminbi to jump 2 percent overnight against the dollar and then trade in a wider daily range, with a trend toward further strengthening against the dollar. For its coming policy shift, China may follow a similar pattern but officials may emphasize much more in public remarks that the value of the renminbi can fall as well as rise on any given day. That would help discourage a flood of speculative funds into China from investors betting on rapid further appreciation in the currency, said people with knowledge of the emerging consensus in Beijing.

Forward contracts on the value of the renminbi surged by the most in six weeks on Thursday in response to a report on the Web site of The New York Times that China was close to a shift in currency policy, according to Bloomberg. One closely watched contract strengthened to 6.62 renminbi to the dollar for transactions a year from now; the spot rate is still 6.82.

Xia Bin, a member of the monetary policy committee of the Chinese central bank, hinted at the new policy for the currency while attending a forum in Shanghai on Thursday.

“Whether to let the yuan slowly appreciate or let it rise to a tolerable range after careful calculation, I think it is better to have that quick, prompt appreciation,” he said, according to wire services.

Mr. Xia later added that, “At a certain point, when necessary, it is better to have a quick, prompt appreciation in a bid to fend off speculative capital.”

Mr. Xia also said that it was important to restore “as soon as possible” the system of managed but daily fluctuations in the renminbi that prevailed from July 2005 to July 2008. The renminbi rose 20 percent against the dollar during that period.

But Mr. Xia cautioned that no one should expect a “large, one-time” appreciation of the renminbi of the sort that many members of Congress have sought.

The central bank declined to comment on its plans for the currency.

Michael Wines contributed reporting from Beijing and Li Bibo contributed research from Beijing.

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