China Weighs Modest Currency Change

By KEITH BRADSHER

HONG KONG, June 9 - China's political leadership is actively considering breaking the 11-year link between the dollar and China's currency, the yuan, and tying its value instead to a group of currencies, current and former senior Chinese officials said in interviews. The proposal being weighed at almost daily meetings of the Standing Committee of the Chinese Communist Party's Politburo would use a so-called basket of currencies to set the yuan's value. The yuan would move up and down in currency markets in relation to the average values of the dollar, yen, euro and possibly other currencies like the British pound.

But the initial value of the yuan under the new system could, in dollar terms, be very close to its current value of 8.277 to the dollar. The Standing Committee's members, the nine most powerful men in China, are wary of letting the yuan rise sharply in value at the same time it is linked to the basket of currencies, the current and former officials said.

Linking the yuan to a basket of currencies, and not just the dollar, would make it a little more flexible and less susceptible to the swoops and swoons of the dollar in recent years. If the dollar fell against the euro, yen and any other currencies in the basket, the yuan's value would creep up in dollar terms. If the dollar rose, as it has for much of the last month, then the yuan might fall in dollar terms, making Chinese exports even cheaper in the United States than they already are.

The Bush administration and many members of Congress have urged China to let its currency appreciate and are unlikely to be satisfied with a policy shift that effectively leaves it at its current value for the time being.

Finance ministers from the Group of 8 - seven leading industrial nations as well as Russia - are to meet in London on Friday and Saturday. They are expected to issue a statement, possibly with greater urgency than at previous meetings, encouraging China to allow greater flexibility in the yuan.

If the Beijing authorities were to push up the yuan's value, making Chinese goods more expensive in the United States and American goods cheaper in China, economic theory suggests that this would cause the American trade deficit with China to narrow somewhat.

The Politburo's Standing Committee - which includes President Hu Jintao, Prime Minister Wen Jiabao and seven other top officials - has made no decision yet on when or whether to act, and may decide soon or wait as long as next year, the officials said. But the deliberations have...
taken on a pressing quality, with the Standing Committee meeting almost every day last week to review currency policy. Senior economic officials have been told to be on hand for consultations at any moment.

In a telling instance, Yang Weizhe, the mother of Zhou Xiaochuan, the governor of the Chinese central bank, died at 6:30 a.m. on May 31, but Mr. Zhou was still required to attend a Standing Committee meeting on the currency an hour and a half later.

The yuan has been linked to the dollar since 1994. After starting at a rate of 8.7 to the dollar then and gradually appreciating for nearly four years, the yuan was locked in at 8.277 to the dollar in 1998 during the Asian financial crisis and has been there ever since. Officials have allowed it to vary by only one-hundredth of 1 percent from that level above or below. Wider variations have occurred for only a few minutes or, on April 29, for 20 minutes.

Alan Greenspan, the Federal Reserve chairman, warned at a conference on Monday that other low-wage countries might export more to the United States even if an appreciation of the yuan priced Chinese goods out of the American market.

"It certainly is not going to be a major impact" on the overall trade deficit, Mr. Greenspan said.

Some economists in China have been calling for combining a shift to a basket of currencies with an immediate appreciation of 3 percent to 5 percent in the yuan, which would make imports cheaper and help control inflation. But it is not clear how much attention this idea is receiving in what has become an essentially political decision by China's leaders.

The leadership has been deeply concerned that the yuan not rise far enough to make Chinese goods uncompetitive overseas. China's economy needs to grow at least 7 percent a year just to create jobs for all the former peasants now pouring into the cities, and exports have been the main engine of growth and job creation. China's textile and apparel industry now employs 19 million people, mostly low-wage seamstresses, compared with fewer than 50,000 in the United States, and Chinese apparel executives said in interviews that even an appreciation of 5 percent could cause some jobs to move to lower-wage countries, like Vietnam.

A stronger yuan could not only cause some factories to lay off workers, but also make imported food even cheaper. This would depress prices for rice and other staples grown on Chinese farms, potentially sending more peasants into the cities even as urban unemployment rises.

Well-connected advisers in Hong Kong to the Chinese government agreed with the current and former officials that the next move by the leadership was likely to be a link to a basket of currencies, though they were unsure when this might occur.

Victor Fung, a Hong Kong tycoon who is chairman of one of the world's largest garment companies and heads the territory's airport authority, said, "They recognize the need to go away from a peg and move toward a basket."

Mr. Fung said each currency's percentage in the basket should match the percentage of China's
trade conducted in that currency, an approach favored by many economists. He also said that China should reveal the relative weightings of the currencies in the basket.

But other advisers said Chinese officials were leaning strongly toward switching to a basket without disclosing the currency weightings. Singapore has long done this with its dollar.

Such an approach would allow China's leaders more discretion in pushing the value of the currency up or down. But it could also open China to accusations from the United States and Europe that it is secretly manipulating the yuan to gain a commercial advantage for its exports.

The current and former Chinese officials said the Standing Committee was conducting a very detailed review, and did not provide the currency weightings under discussion. The officials said that some in the leadership were well aware of the benefits of making the weightings clear and public.

Also uncertain is whether Chinese officials would peg the yuan tightly to the basket, allowing it to vary only a tiny fraction of a percent, or whether a wider band might be tolerated.

Any move by China is likely to be greeted with great attention by world financial markets. Of particular interest will be whether China continues to buy dollar-denominated assets at a brisk pace after a shift to a basket of currencies; a slowing of Chinese purchases could hurt not only the dollar's value but also American stock and bond prices.

China's foreign exchange reserves increased by $200 billion last year and $49 billion in the first quarter of 2005, to $659 billion on March 31. Chinese officials have gone to great lengths to conceal how they allocate their reserves among currencies, by using accounts in London and elsewhere, but bankers say a substantial portion of the reserves is in dollars.