Yu Yongding, the Chinese economist whose calls for liberalizing the yuan heralded its 21 percent gain since 2005, said the government should reduce sales aimed at keeping the currency weak so it can someday float freely.

“The People’s Bank of China should try to reduce intervention on the exchange rate as much as possible,” Yu, a member of the central bank’s monetary policy committee from 2004 to 2006, said in an interview. “Eventually, the yuan should be demanded as a reserve currency, and we are far away from this stage.”

The government needs to encourage more overseas investment, reduce exports and promote sales of yuan-denominated debt by foreign companies as part of a transition from managing the currency and piling up U.S. dollar assets, Yu said. China’s foreign reserves rose 9.1 percent in the second quarter, climbing a record $178 billion, and totaled $2.13 trillion on June 30, according to central bank data.

China, America’s largest creditor, has been buying more Treasuries and increasing sales of yuan to keep its value near 6.83 per dollar since July 2008, a policy that helps exporters by making their products cheaper overseas while exposing China to losses if the dollar falls. The central bank reiterated its goal on Aug. 5 of keeping the yuan stable at a “reasonable and balanced” level. Policy makers intervene in currency markets by arranging purchases or sales of foreign exchange.

Twelve-month non-deliverable yuan forwards gained 0.2 percent to 6.7935 per dollar. Forwards are agreements to buy and sell assets at current prices for delivery at a specified date. Non-deliverable contracts are settled in dollars. The dollar fell 0.4 percent to $1.43 per euro.

Not ‘Easy’

“Yu is pointing the right direction for China’s policy,” said Wang Qian, an economist with JPMorgan Chase & Co. in Hong Kong. “The government should continue the reform to make the yuan rate more flexible and adjust the economy’s structure once growth stabilizes.”

Solving China’s dilemma “won’t be easy,” Yu, 60, said in the Aug. 6 interview, citing a Chinese saying. “We never give up trying to cure a dying horse,” he said. “At this moment, we have to think carefully about all possible alternatives.”

China’s $776.4 billion in Treasuries, up 45 percent in the past year, “are not safe, and we should be worried about that,” Yu said. The current strength of Treasuries, which returned 16 percent in two years according to a Merrill Lynch & Co. index, is “a temporary phenomenon, because I think the U.S. economy is not healthy” and there are no alternative investment havens, he said.
Dollar Trap

“Why should we continue to pile up those reserves?” Yu said. Once the U.S. recovers from the deepest global recession since World War II, the dollar will weaken and Treasury prices will fall, he said. The 10-year yield of about 3.39 percent is below its five-year average of about 4.20 percent, according to data compiled by Bloomberg.

China’s reserves are so large that it is hard to sell the greenback without triggering a drop in its value, a dilemma Yu dubbed the “dollar trap” in April.

“Mr. Yu can combine theory with good understanding of China’s reality,” said Pan Xiangdong, the chief economist at Everbright Securities Co. in Beijing. “His views and comments had impact on government policies as well as investors’ choices, and his influence has never weakened.”

Grilling Geithner

Yu’s views have received official backing before. In February, he called for China to seek guarantees that its investments in Treasuries won’t be eroded by “reckless policies.” A month later, Premier Wen Jiabao did just that during an annual session of parliament. Yu was picked by the China Daily to grill U.S. Treasury Secretary Timothy Geithner in Beijing in June about risks that the record U.S. fiscal deficit would undermine the value of its debt.

“I worry about details,” Yu told Geithner. “We will be watching you very carefully.” Geithner said in the June 2 interview with the newspaper that Chinese officials had expressed “justifiable confidence in the strength and resilience and dynamism of the American economy.”

In 2005, Yu’s January call for a revaluation of the currency presaged an end to the yuan’s dollar peg that July. That October, he urged China not to “be afraid” of yuan gains, and the currency’s appreciation accelerated over the following months. In an interview last August, he urged policy makers to avoid “backtracking” on allowing the yuan to strengthen.

Born in 1948 in Nanjing, a year before the Communist Party took power, Yu spent a decade working at Beijing Heavy Machinery Factory during the Cultural Revolution from 1969. He joined the Chinese Academy of Social Sciences researching Western economies in 1979 and received a Ph.D from Oxford University in 1994. Yu is now a member of the academy.

Obama’s Needs

U.S. President Barack Obama is counting on nations such as China to help fund his $787 billion economic stimulus and separate programs to aid financial firms and homeowners amid a downturn that has cost the U.S. about 6.7 million jobs. China decreased its total holdings of U.S. government securities by $25.1 billion in June. Japan, the second-biggest international investor, raised its total by $34.6 billion to $711.8 billion, according to Treasury Department data.

Change in the U.S.-China political and economic relationship is inevitable, Henry Kissinger, the former secretary of state who helped re-establish ties between the two countries under President Richard Nixon, said in an interview yesterday with Bloomberg Television.

Kissinger’s Outlook
“I think the center of gravity of the economic world is beginning to shift towards Asia,” he said.

Chinese economists and leaders are beginning to feel “that the global financial system should not be determined primarily by one country,” and that “a new alternative or companion currency to the dollar would be created, built around the Chinese currency,” Kissinger said. That change won’t happen for several years because the yuan isn’t yet convertible, he said.

Premier Wen said on July 20 more of the nation’s reserves should be used to help companies invest abroad. China Development Bank Corp., the state-run bank for public works projects, agreed in May to lend $10 billion to Brazil’s state-controlled oil company in return for guarantees of fuel, helped finance a fund in Africa and extended loans in June to Russia’s development bank.

“If China can translate its trade surplus into outbound investment, then there won’t be so much pressure on the yuan to appreciate, even if the central bank stops intervening in the foreign-exchange market.” Yu said.

A People’s Bank spokesman said the central bank never comments on economists’ viewpoints.

Balance of Payments

China’s current-account surplus, the broadest measure of trade, widened 15 percent to $426 billion last year before shrinking 32 percent to $130 billion in the first half from a year earlier, according to the State Administration of Foreign Exchange. The capital account, which measures investment flows, fell 54 percent to $33.1 billion in the six months ended June, according to the agency’s data.

The current account gap may decline to $400 billion this year as overseas sales slow, said Stephen Green, the head of China research in Shanghai at Standard Chartered Plc.

“Yu doesn’t speak for the government and I am sure the Ministry of Commerce will have a different view about reducing exports,” Green said. Even so, “policy makers are on board with the broader goal of rebalancing the current account,” he said.

Yu said he expects it will take more than five years for the yuan to become “very internationalized” and used widely for trade settlements and ultimately as a reserve currency.

“Internationalization is a process, piece by piece,” he said. “This will take a long time. But, step by step, we have to try our best.”


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