Australia backs US in currency conflict with China

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Australian Prime Minister Julie Gillard was one of the few leaders to publicly side with Washington against its rivals, especially China and Germany, at last week's G20 summit in South Korea. She followed that up by reaffirming her strong commitment to the US alliance during her first formal meeting with US President Barack Obama at last weekend's Asia-Pacific Economic Cooperation (APEC) meeting in Japan.

The Obama administration's aggressive campaign to counter China's growing economic and military power in the Asia-Pacific region has exacerbated the dilemma facing Canberra. Australia has been strategically dependent on the US alliance since World War II, but its key mining industries are heavily reliant on China's rapid economic expansion.

In the lead-up to the G20 summit, Australian Treasurer and Deputy Prime Minister Wayne Swan signed a joint article with US Treasury Secretary Timothy Geithner and Singaporean Finance Minister Tharman Shanmugaratnam, published in the *Australian* newspaper, that argued for a rapid revaluation of the Chinese yuan. While not actually naming China, the article insisted that "emerging economies need to allow their exchange rates to reflect the substantial growth they have achieved in their economies over the last decade and to respond more flexibly to underlying market forces".

At the G20 summit itself, Gillard voiced support for Obama's calls for China's currency to be determined by market forces. "Australia believes that currencies should be market-based," she declared in her address to the summit. "That is our position, that is what our economy has and it has served our economy well."

Apart from Australia's backing, the US was substantially isolated at the G20. Obama faced criticism from a range of countries that America was weakening its own currency, while demanding that China revalue. Even US allies such as Japan and South Korea, both of which have intervened to depreciate their currencies to maintain export competitiveness, tentatively complained about the weak US dollar.

Gillard's performance at the G20 meeting was no doubt a major test of Canberra's renewed commitment to the US alliance, following the earlier AUSMIN meeting of US and Australian defence and foreign ministers in Melbourne. The US delegation, led by Secretary of State Hillary Clinton and Defence Secretary Robert Gates, arrived as part of Washington's campaign to strengthen its military alliances in Asia to encircle China. The AUSMIN decisions unequivocally placed Australia in the US camp, with escalating military cooperation between the two countries, particularly in satellite-based surveillance and greater US use of Australian military facilities.

After Gillard passed her G20 test with flying colours, Obama met with her in Japan and declared that Australia was "a central player" in the region. At a joint media appearance, Obama emphasised that the US "does not have a closer or a better ally than Australia" and expressed his appreciation for the "enormous sacrifices that have been made in Afghanistan by Australian troops". He reiterated that "the United States is here to stay" in Asia, which has become the watchword of his administration's drive to aggressively reassert US dominance in the region.

After cancelling visits to Australia twice this year, Obama's meeting with the Australian prime minister was a reward for Canberra's emphatic pro-US line since last June, when Gillard ousted former Prime Minister Kevin Rudd in a backroom coup. Washington had become increasingly concerned over Rudd's efforts to act as some kind of mediator between the US and China.

Gillard's unconditional political backing of Washington has, however, generated fears within layers of the ruling elite at home, most immediately that it could place the huge mining industry at risk. Australian National University Professor of Strategic Studies Hugh White, a former defence official, sounded the alarm in the *Australian Financial Review* this week. White, who reiterated an earlier call for the US to accommodate some of China's ambitions for a bigger share of regional power, commented:

"Clinton and Gates were in town to make us choose, and we chose. But next week, if China pushes back and subtly, or not so subtly, threatens our economic future, what will Gillard and her colleagues do? Will they reconsider their choice, or will they turn their back on China? Either way, their new turn to America may prove either very short-lived or very costly."

Michael Stutchbury, economics editor of the *Australian*, wrote last Saturday: "Though not a non-combatant, Australia risks getting caught in the crossfire as the currency war destabilises our China boom. Our aim is to resolve the dispute by talking, not fighting."

Stutchbury also raised the destabilising impact of the US "quantitative easing" policy, which this month saw the electronic printing of $US600 billion, and historically low interest rates. He pointed out that these actions had unleashed a flood of liquidity into world markets, especially in Asia, sowing the seeds of another financial meltdown, and warned that Australian Reserve Bank governor Glenn Steven "might be forced to lift interest rates further as the greenback flood inflates Asian demand and commodity prices, only to see the bubble burst and process reverse".

The Australian dollar's rise to near parity with the greenback, partly as a result of the "quantitative easing" policy, has already caused a significant downturn in Australian exports. This includes revenue from education services, which are expected to fall, along with the number of international students, by 20 percent next year.

If China were to acquiesce to Washington's demands and sharply revalue its currency, it could cause a wave of closures of export factories, with layoffs of millions of workers. Such economic turmoil would have a roll-on effect in Australia, which exports hundreds of millions of tonnes of iron ore, coal and other raw materials to China and other Asian economies each year.

Partly due to these concerns, Australia, like most other G20 members, opposed Geithner's proposal to set a general target of no more than 4 percent of gross domestic product (GDP) for current account surpluses or deficits. The proposal was aimed at curbing exports from "surplus countries"—particularly Germany, China and Japan—in order to make room for American exports. Australian Treasurer Swan politely welcomed the US proposal as "constructive," but pointed out: "From our perspective when it comes to current accounts, not one size fits all."

Over the past decade, Australia has often run current account deficits exceeding 4 percent—including 5.7 percent in 2007-08—mainly due to its heavy dependence on foreign borrowing. In the June quarter of this year, the gap fell to 1.6 percent—the lowest in 10 years—courtesy of rising commodity exports, but any collapse of the "China boom" would produce a rapid reversal.