Dollar discomfort thrust onstage for Italy summit

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By Brian Love

Reuters - U.S. dollar bills are displayed in Toronto in this posed photo, March 26, 2008. REUTERS/Mark Blinch ...

PARIS (Reuters) - World leaders are bound to express the hope that the worst of the global economic crisis is passing when they meet this week, but they are now under pressure, too, to manage a Chinese challenge to dollar supremacy.

Beijing, which has floated the idea of an alternative to the dollar as world reserve currency, wants the matter -- sensitive in financial markets wary of risks to U.S. asset values -- broached at a July 8-10 summit in Italy, officials say.

Leaders from the Western economic powers and Russia meet in Italy on Wednesday and are joined the day after by leaders from China, India, Brazil and others to discuss global challenges -- chief among them the worst recession in living memory.

German Chancellor Angela Merkel says not to expect any grand initiatives in Italy, largely because governments are already pumping trillions of dollars into bank stabilization and economic stimulus, and also because they have their eyes on a bigger G20 summit in the U.S. city of Pittsburgh in September.

The best the Italians can expect from the meetings in the quake-hit town of L'Aquila, economists say, is a batch of statements that commit the old and new economic powers to keep working together to contain the crisis and, once that is done, envisage new rules for a better regulated global economy.

Carl Weinberg of High Frequency Economics in New York says genuine coordination beyond carefully negotiated communiques is hard to have when governments are spending so much money to tend to their own voters and industries right now.

"In a time when fiscal budgets are stretched and deficits are reaching historic proportions, few governments will be able to find the cash to support foreigners' standards of living. Resources are need to buy jobs at home," he said.

STORM PASSING?

Summit host Silvio Berlusconi, Italy's prime minister, may find it easy enough to broker what the leaders can say about the state of the economy right now, namely that the situation may be stabilizing but the world is far from out of the woods.

The Organization for Economic Co-operation and Development raised its economic forecasts on June 24 for the first time in two years, predicting 4.1 percent GDP contraction in the 30 mostly industrialized countries of the OECD as a whole rather than the 4.3 percent previously envisaged. It forecast a minor 0.7 percent rise in GDP next year instead of further dip.

The tension may rise in L'Aquila though, if, as sources say, Germany's Merkel presses others leaders to say in very explicit terms that they are committed to reverse quickly out of all the heavy spending and debts they have run up once the recovery starts.

Budget deficits are forecast to rise six-fold in the OECD group of countries by 2010, from 2007 levels, to 8.8 percent of GDP from 1.4 percent, the OECD's latest forecasts show.

Washington, London, Paris and Japan, to name just some, do not want to commit so hard and fast to such an "exit strategy," even if they agree to the principle. According to information gleaned from sources, Germany will push the issue but face stiff resistance to anything beyond vague commitment.

Japanese officials cited the OECD latest commentary as a pointer to the potential tenor of the statements that would be issued by G8 leaders. The OECD says fiscal stimulus should not be withdrawn at a pace that jeopardizes recovery.

The most delicate issue leaders will face in economic terms is probably China's push for alternatives to the dollar as the world's reserve currency.

The dollar lost a cent versus the euro at one stage last week when Reuters reported sources as saying Beijing wanted the matter debated.

One official, speaking anonymously, went as far as to say China might push for a reference to the matter in the published statements from the meetings.

Other sources involved in preparation of the meetings said Brazil and India backed Beijing's call for debate but there was consensus among the G8, at least, that nothing of significance could or should materialize at this stage.

If China insisted on something being put into a statement, it would surely be with references worded obscurely enough to be "meaningless," one official who spoke to Reuters said.

"In the midst of what is still a significant global recession, it's important that we aim for stability, and stability has been based on the U.S. dollar as the global currency," Canadian Finance Minister Jim Flaherty said on Friday.

Beijing, equally, has reason to move carefully, even if Zhou Xiaochuan, head of the Chinese central bank, launched the debate last March when he said the SDR, the International Monetary Fund's unit of account, might one day displace the dollar.

Some diplomats and bankers suggest Zhou's primary aim was to highlight attention on concern expressed by Premier Wen Jiabao about the safety of China's huge dollar holdings -- at risk if U.S. policy turns to greater tolerance of inflation.

Bankers reckon China holds perhaps 70 percent of its $1.95 trillion in official currency reserves in the dollar.

Marco Annunziata, economist at UniCredit bank, feels Beijing may want the issue discussed in Italy but will not push to hard.

"FX markets will of course wonder till the last minute whether the BRICs or China alone will mount a serious challenge to the dollar, but are bound to be disappointed," he said.

In L'Aquila, Italy is also pressing leaders to back a global charter for business and finance, a sprawling compendium of best practices in labor, taxation, investment and myriad other domains where international organisations have produced thousands of mostly voluntary guidelines over the decades.

Germany's Merkel wants something of the same sort but it is far from clear, officials say, that the gathering will reach anything amounting to a definitive decision on the charter the Italians calls the Lecce Framework.

(With reporting by Reuters reporters worldwide; editing by Simon Jessop)