**What is currency manipulation, anyhow?**

By Annalyn Censky, staff reporterNovember 11, 2010: 10:31 AM ET

NEW YORK (CNNMoney.com) -- Accusations of currency manipulation are causing tension, and world leaders are hoping the contentious topic won't turn this week's G-20 gathering in Seoul into an all-out global brouhaha.

But a fiery debate may be unavoidable, now that the world's two largest economies, the United States and China, are in an international spat over the issue.

The United States has accused China of keeping its currency, the yuan, artificially low by hoarding foreign reserves, in order to give Chinese exports an advantage over competitors.

Meanwhile, China is punching back, claiming the Federal Reserve's $600 billion bond-buying spree [**announced last week**](http://money.cnn.com/2010/11/03/news/economy/fed_decision/index.htm) does little to help the global recovery.

**So what is currency manipulation? And why does it matter?**By selling its own currency and buying up foreign reserves like the U.S. dollar, China has essentially pegged the yuan's value to the dollar instead of allowing it to move freely in foreign exchange markets.   
  
While the Chinese government agreed to loosen that chokehold in June, and allow the yuan more [**"flexibility"**](http://money.cnn.com/2010/06/19/news/economy/china_exchange_rate/index.htm?postversion=2010062108) to appreciate, the currency hasn't appreciated much -- only about 2% since then.

**What's so great about a cheaper currency?**

A weak currency cheapens the price of a country's exports, making them more attractive to international buyers by undercutting competitors.   
  
China's economy is primarily export-driven, so having a leg up on the international competition has allowed its economy to grow at [**staggering speed**](http://money.cnn.com/2010/10/20/news/economy/china_gdp/index.htm).

Its economy is on track for 10.5% growth this year, compared to measly 2.7% growth in the United States, and 4.8% for the world overall.

**What's wrong with that?**

Several industrialized nations, including the U.S., think China's explosive growth is unsustainable, and bad for the global economy. They fear its rapid inflation could ripple through the rest of the world, driving up the price on goods at a time when other economies are still struggling to get back on their feet.

Rapid growth has also led to fears that China's economy could overheat, and then crash land into a massive slowdown, hindering the world recovery.

As a result, Treasury Secretary Timothy Geithner [**has been urging**](http://money.cnn.com/2010/10/24/news/international/geithner_china/index.htm) G-20 nations to take strong action against currency manipulation, and change economic policies in countries running large trade surpluses to reduce dependence on exports.

**How do global trade imbalances affect American jobs?**

The U.S. is running a trade deficit -- meaning it imports more goods than it exports. China, on the other hand, has a [**trade surplus**](http://money.cnn.com/2010/11/09/news/international/china_trade_balance/index.htm). In October, China shipped $25 billion in goods to the U.S. but bought only $7 billion in return.

That keeps American manufacturers from creating jobs at home -- which is exactly why President Obama is hoping to double American exports in the next five years.

Meanwhile, the Federal Reserve is trying to promote domestic job growth through a program called [**quantitative easing**](http://money.cnn.com/2010/11/03/news/economy/fed_decision/index.htm), announced last week.The policy aims to lower interest rates and encourage consumer spending, by pumping another $600 billion into the U.S. economy through the purchase of long-term Treasuries. In turn, the Fed hopes a boost in consumption will generate growth and create more jobs domestically.

**How might other countries respond to currency manipulation?**  
While the United States has promised not to deliberately weaken the dollar, some [**critics say**](http://money.cnn.com/2010/11/08/news/international/quantitative_easing_global_criticism_g20/index.htm) that by printing money and flooding the U.S. economy, the Fed's quantitative easing plan is essentially doing just that.   
  
"It's inconsistent for the Americans to accuse the Chinese of manipulating exchange rates and then to artificially depress the dollar exchange rate by printing money," Germany's Finance Minister Wolfgang Schäuble told *Der Spiegel* magazine last week.  
  
And other countries like Japan and Brazil had already [**started to follow China's example**](http://money.cnn.com/2010/10/22/news/international/G20_currency/index.htm), with attempts to devalue their currencies to keep up their competitive edge.

Those moves have heightened fears of an all-out trade war, where countries start competitively devaluing their currencies, just to keep up with each other.

Despite the G-20 finance ministers [**pledge last month**](http://money.cnn.com/2010/10/23/news/international/g20/index.htm) not to engage in currency wars, the stage is set for a confrontational meeting