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## Renminbi's rise fuels talk of China policy shift

By Robert Cookson in Hong Kong

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A sharp appreciation in the renminbi against the dollar in recent days – at a time when most other emerging market currencies have been falling – has prompted traders to ask whether Beijing has adopted an aggressive new stance on its currency.

Over the past four days the renminbi strengthened 0.7 per cent against the dollar – a small move by the standards of most currencies but a large one for the Chinese currency, which is tightly controlled by the government.

## On the rise

### Renminbi

Against the dollar (Rmb per \$, inverted)

6.4

6.6

6.8

7.0

7.2

7.4

Jan 2008 2009 2010 2011 Aug

### China trade balance

12-month rolling sum (\$bn)

300

200

100

0

2000 02 04 06 08 11

### Foreign currency reserves

\$bn

3000

2000

1000

0

2000 02 04 06 08 11

Source: Thomson Reuters Datastream

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The last time the renminbi moved so sharply over a four-day period was September 2010, when US politicians were about to release a controversial report that could have labelled China a “currency manipulator”.

“The recent behaviour of the dollar-renminbi fix indicates something has changed,” says Daniel Hui, Hong Kong-based currency strategist at HSBC. “The question is why, and if it will last.”

Theories abound. Beijing could be strengthening its currency to help curb stubbornly high inflation, which hit a three-year peak in July and has already led to social unrest.

But the more tantalising possibility is that China has decided to stop accumulating so many US dollars in its foreign exchange reserves, fearing the decline of the dollar and the deteriorating creditworthiness of the US government. The timing is portentous. The renminbi's jump comes a week after the US government lost its triple A credit rating from S&P, and just days after the US Federal Reserve vowed to keep interest rates at virtually zero for at least the next two years amid expectations of further quantitative easing, or money creation.

Dariusz Kowalczyk, Hong Kong-based currency strategist at Crédit Agricole, said China's faith in the west had deteriorated markedly in recent weeks and months.

“The overall sentiment in China may be shifting towards the following: it's a lesser evil to accept faster currency gains – and therefore weaker exports and weaker growth of the economy – than to bear the risk of continued fast accumulation of Treasuries and European government debt.”

Indeed, in recent days a procession of Chinese officials, academics and journalists have called louder than ever for a change to the country's currency regime. By holding down the value of the renminbi, China's central bank has accumulated more than \$3,200bn in currency reserves, about a third of which is invested in US government debt.

Xia Bin, a member of the monetary policy committee of the People's Bank of China, said in a central bank publication on Thursday that Beijing should urgently assess the risks of being the main investor in US debt and accelerate diversification of its reserves.

Writing in the Financial Times last month, Yu Yongding, a former member of PBoC's monetary policy committee, said China must end its dependency on the dollar.

“The People's Bank of China must stop buying US dollars and allow the renminbi exchange rate to be decided by market forces as soon as possible. China should have done so a long time ago. There should be no more hesitating and dithering,” Mr Yu wrote.

The renminbi, which closed at Rmb6.39 against the dollar on Thursday, has appreciated 3.3 per cent this year and almost 30 per cent since the start of 2005. Yet the renminbi is still widely regarded as undervalued against the currencies of its trading partners. To support their view, critics of China's currency regime point to the country's vast trade surplus, which shot up to \$31.5bn in July – the biggest in more than two years.

However, currency strategists caution against reading too much into the renminbi's rapid

appreciation in recent days; after all, there have been jumps of similar magnitude in the past that subsequently reversed. But the recent surge has nonetheless spurred traders into action.

Renminbi non-deliverable forwards, which are traded offshore and reflect market expectations of future appreciation, jumped the most in eight months on Thursday. Even so, the forwards market is pricing in renminbi appreciation of just 1.5 per cent over the coming 12 months, well below analyst expectations of 5 per cent.

Zhang Xiaoqiang, vice head of the National Development and Reform Commission, China's economic planning agency, said in an interview with state radio on Thursday that as exports account for a large part of Chinese gross domestic product and employment, renminbi appreciation should not be overly fast.

Indeed, when the global financial crisis struck in 2008, China moved to protect its exporters by halting the renminbi's appreciation and re-pegging the currency to the dollar. Beijing only ended the peg in June last year, once the global economy had been resuscitated by government stimulus packages.

“In moments of tensions in international financial markets, Beijing's initial default reaction has always been to freeze like a deer in headlights and prevent any currency appreciation at all costs,” analysts at Gavekal told clients in a note on Thursday. “But not this time.”

In the coming days and weeks it will become clear whether Beijing really has decided to accelerate the renminbi's appreciation on a long-term basis – and whether policymakers are willing to press ahead with appreciation even in the face of a global slowdown. If this week's move is more than a temporary blip, the global economy is on the cusp of a great transition.

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