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Yuan Leads Asia Gains on Inflation, G-20 Pressure: China Credit
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By Bloomberg News

Nov. 12 (Bloomberg) -- China is allowing the yuan to lead Asian currency gains this week as it struggles to contain the fastest inflation in two years and faces calls for more balanced global trade at a Group of 20 nations' summit.

The yuan has advanced 0.2 percent in the last five days to 6.6395 per dollar in Shanghai and hit 6.6173 yesterday, the strongest since 1993, as consumer-price data for October were released. That's the best performance among 25 emerging-market currencies tracked by Bloomberg. China's 12-month swap rate reached the highest level since October 2008 and stocks tumbled as investors stepped up bets the central bank will add to last month's interest-rate increase.

Inflation is gathering pace as funds pour into China, lured by rising returns on local deposits, economic growth that's averaged 10 percent in the past five years and projected gains in the yuan. The currency regulator said Nov. 9 it will force banks to hold more foreign exchange and strengthen auditing of overseas fund-raising, boosting efforts to curb inflows as the central bank seeks to stem gains in consumer prices.

"It's very clear our monetary policy has shifted from loose to prudent," Zhu Jianfang, the Beijing-based chief economist at Citic Securities Co., China's largest listed brokerage, said yesterday in an interview. "If there are big capital inflows, it'll put pressure on the yuan to appreciate.
Tighter monitoring will help ease part of the stress."

The People's Bank of China boosted its benchmark one-year lending rate on Oct. 19 by a quarter of a percentage point to 5.56 percent, the first increase since 2007. Seventeen of 20 economists surveyed yesterday by Bloomberg said there may be another rate rise before the end of this year. The median forecast for end-2011 was 6.31 percent, up from 6.06 percent when Bloomberg last conducted a poll on Oct. 21.

Monetary Tightening

Consumer prices jumped 4.4 percent from a year earlier in October, exceeding all 28 estimates in a Bloomberg survey, according to government data published yesterday. The pace of gains compares with 9.8 percent in India, where interest rates have been raised six times this year. Brazil's inflation rate is 5.2 percent and Russia's is 7.5 percent, latest figures show.

Zhang Ping, head of China's top economic and planning agency, said this week that the government may miss its annual inflation target of 3 percent as excessive global liquidity and a weakening dollar drive raw-materials prices higher. The U.S. and Japan are using near-zero interest rates and money-printing to help avert recessions, spurring demand for higher-yielding assets and commodities.

Credit Growth

The central bank will "flexibly use our traditional monetary-policy tools," Deputy Governor Hu Xiaolian said yesterday at a forum in Beijing. Policy makers guided yields on three-year bills higher at a sale yesterday to help drain cash from the financial system and this week raised banks' reserve- requirement ratios by as much as a percentage point.

New lending amounted to 587.7 billion yuan ($89 billion) in October, bringing this year's total to 6.88 trillion yuan, according to data released yesterday. The government aims to limit credit growth to 7.5 trillion yuan this year and a target of 7 trillion is expected to be set for 2011, based on the median estimate of 10 economists polled yesterday by Bloomberg.

One-year interest-rate swaps, the fixed cost needed to receive the floating seven-day repurchase rate, rose 12 basis points, or 0.12 percentage point, this week to 2.61 percent. The yield on the 3.29 percent bond due September 2020 climbed 12 basis points to 3.98 percent, according to China Interbank Bond Market. The rate on similar-maturity U.S. Treasuries increased 10 basis points to 2.63 percent.

'Overheating'

The Shanghai Composite Index of shares today plunged 5.3 percent, the most since August 2009. The Hang Seng China Enterprises Index slumped 2.9 percent as Goldman Sachs Group Inc.
recommended clients cut their holdings of China's Hong Kong- listed shares, citing concern the central bank will raise borrowing costs to tame inflation.

"China's story is an overheating story and the central bank is stepping up policy tightening because of rising inflation," said Tan Weisi, who oversees about 400 million yuan ($60 million) as head of Fortune SGAM Fund Management Co.'s fixed-income department in Shanghai. "The interest carry trade with the dollar is huge, adding to yuan appreciation."

The yuan has gained 2.7 percent since a two-year peg to the dollar ended in June and non-deliverable forwards show traders expect a 2.4 percent advance to 6.4835 during the next 12 months.

President Barack Obama met yesterday with Chinese President Hu Jintao at the G-20 talks in Seoul, seeking to discuss global imbalances with a country whose record $28 billion trade surplus with the U.S. in August heightened concern it's keeping the yuan undervalued. China will work towards a more flexible yuan, Hong Lei, a spokesman for China's Ministry of Foreign Affairs, said yesterday at a media briefing in Beijing.

'Global Obligations'

Former Federal Reserve Chairman Alan Greenspan, in an opinion piece in the Financial Times today, said that both the U.S. and China are depressing their currencies, fueling the risk of protectionist moves that would harm global trade and economic growth. China's accumulation of a record $2.65 trillion in foreign-exchange reserves is holding down the yuan, he said.

"China has become a major global economic force in recent years," Greenspan wrote. "But it has not yet chosen to take on the shared global obligations that its economic status requires."

Moody's Upgrade

The cost of protecting China's sovereign debt against default for five years is less than that for the U.K. and France, credit-default swaps show. The contracts held at 58 basis points after Moody's Investors Service yesterday upgraded the nation's foreign- and local debt ratings to Aa3, the fourth-highest ranking. The company maintained a positive outlook.

Five-year credit-default swap contracts for top-rated yuan-denominated bonds were little changed yesterday at 88 basis points, according to data compiled by Bloomberg. The contracts pay the buyer face value in exchange for the underlying securities or the cash equivalent should a government or company fail to adhere to its debt agreements.

China's efforts to tackle asset bubbles and avert the spread of bad loans has meant the "likely containment and effective management" of losses from record lending last year to counter the financial crisis, Moody's said in a statement.

That combined with China's "resilient" economic growth were reasons for the upgrade, the ratings company said.

The central bank will become "more aggressive" in increasing rates and may allow faster yuan appreciation to curb inflation, according to Jun Ma, the Hong Kong-based chief economist for Greater China at Deutsche Bank AG. The central bank may raise interest rates by 75 basis points in the coming 12 months, Deutsche Bank said in a report.

"The need to combat near-term inflationary pressures has been escalated sharply by Chinese policy makers," Qu Hongbin, co-head of economics research at HSBC Holdings Plc in Hong Kong, wrote yesterday in a research note. "There's still more room for further quantitative tightening and another 25 basis points of interest-rate hikes before 2010 closes."

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