FINANCIAL TIMES

March 20, 2015 10:29 am

China central bank supports currency in bid to staunch outflows

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Central bank intervention propelled the renminbi to its biggest weekly gain on record on Friday, as authorities sought to prevent recent currency weakness from eroding confidence in the economy and inciting capital flight.

While intervention by the People's Bank of China can never be directly confirmed, traders suspect the PBoC of drawing on its $3.8tn in foreign exchange reserves to support the renminbi in recent weeks.

China's currency lost 2.4 per cent in 2014, its first significant full-year loss since authorities ended the strict dollar peg in 2005. Strong gains in the dollar globally, along with monetary loosening by China's central bank, were key factors behind the renminbi's losses.

Depreciation continued in early 2015, with the renminbi touching a 28-month low of 6.2763 per dollar on March 3. But the currency gained 0.9 per cent this week to close at 6.2062, a huge swing by the standards of China's tightly controlled currency. It touched a three-month high of 6.1805 in intraday trade on Friday before retreating slightly in the afternoon session.

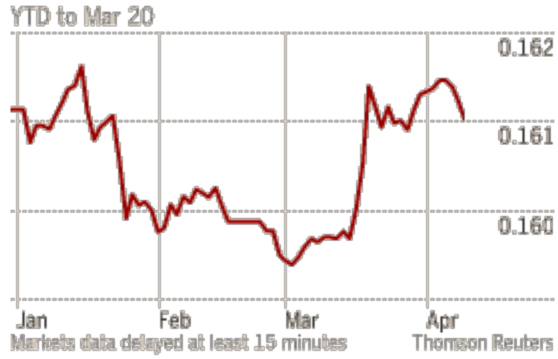
"The PBoC doesn't want expectations of renminbi weakness to get too strong. That's not good for the economy. So they want to keep the renminbi relatively stable," said a trader at a midsized bank in Shanghai.

Analysts say that if renminbi depreciation expectations become entrenched, it could lead the moderate capital outflow that China has experienced in recent months to turn to full-fledged capital flight.

Recent data also points toward central bank intervention. Chinese commercial banks and their corporate clients bought more dollars than renminbi for the seventh straight month in February, according to data from the foreign exchange regulator released on Wednesday.

Unless banks and corporates suddenly reversed

Renminbi vs US dollar 1 CNY = 0.161 USD their forex buying patterns in the early weeks of March, central bank renminbi purchases are the most likely explanation for the renminbi's abrupt reversal.



The slight recovery of the euro against the dollar partly explains the renminbi's gains this week. The Chinese currency's decline in 2014 and early this year broadly tracked falls in the euro and Japanese yen, though the magnitude of the renminbi's loss was much smaller.

Indeed, even as the renminbi fell versus the dollar before this week, its relative stability — coupled with the dollar's world-beating run — propelled the Chinese currency to an all-time high in trade-weighted terms in February, recent data from the Bank for International Settlements shows.

The renminbi's trade-weighted strength had led some analysts to worry that China might intentionally weaken its currency to prevent the loss of its export competitiveness.

But traders say the central bank has apparently calculated that the financial risk associated with waging a currency war would outweigh the benefits to trade.

"The PBoC believes that soft external demand means that weakening the currency wouldn't actually do much for exports," said Eswar Prasad, former head of the International Monetary Fund's China division, who was in Beijing this week for an IMF-PBoC conference on renminbi internationalisation and financial reform.

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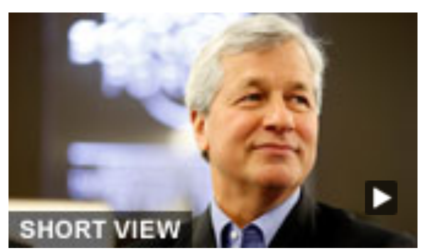

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