MARKETS

Yuan's 2018 Gain Disappears as Dollar Rallies

Chinese currency slips against a resurgent greenback

China's yuan is slipping against the greenback. **PHOTO:** THOMAS WHITE/REUTERS

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The Chinese yuan dropped to its weakest level against the dollar this year, continuing a recent slide that could add to economic tensions between the U.S and China.

The dollar bought 6.5240 yuan at the close of trading in China, meaning the yuan fell 0.4% on the day, reaching its lowest level since Dec. 28, according to Wind Info. The Chinese currency weakened further on Tuesday morning in Asia, hitting 6.5409 against the U.S. dollar.

The yuan's latest drop came after China's central bank said Sunday that it would reduce the amount of cash it requires banks to hold in reserve, freeing up more than $100 billion for them to boost lending. That easing move followed recent data suggesting China's growth rate started slowing in the second quarter.

The fact that the U.S. economy is gathering strength—with the Federal Reserve on track to raise interest rates two more times this year — would normally argue for a weaker yuan against the greenback. The dollar has been gaining broadly in global markets too: The WSJ Dollar Index, which measures its value against 16 other currencies, is up roughly 3% in the past two months.

But the yuan's slide could increase nerves already frayed by a ratcheting up of trade friction in recent weeks. Following a round of tit-for-tat tariff threats, President Donald Trump is now planning new curbs on Chinese investment in U.S. technology firms, according to people familiar with the administration's thinking.

"Undoubtedly, even if the yuan were driven down by market forces, any depreciation related to the dollar is going to further inflame trade tensions with Washington," said Eswar Prasad, an international trade professor at Cornell University.

A yuan devaluation—which would in theory make Chinese exports cheaper—is one way in which Beijing could retaliate against the U.S. in an all-out trade war, some analysts say. Others point to the pain China could cause for the U.S. economy by selling some of its holdings of U.S. Treasurys, which make up a large proportion of its $3.11 trillion foreign-exchange reserves.

Mr. Trump repeatedly accused China of manipulating its currency during his presidential campaign in 2016, arguing that the country deliberately keeps the yuan weak to gain an advantage in global trade. Even so, the yuan is up more than 5% since his inauguration in January 2017.

And Beijing does appear to have been trying to slow the yuan’s current drop in recent days. China’s central bank sets a daily reference rate for the yuan against the dollar around which it can trade, largely determined by where the pair closed the day before and other overnight currency market movements.

However, this system allows the central bank some discretion: some analysts say their models have been forecasting an even steeper slide for the yuan in the so-called daily “fix” in recent days.

That nuance may not be enough to soothe concerns in Washington, especially as the yuan’s fall has gathered pace since the U.S. and China stepped up mutual tariff threats in mid-June: It has fallen 2% against the dollar since June 14.

Market participants expect the yuan to keep falling. “People aren’t really stepping in [to buy the yuan] at these levels,” said Cynthia Wong, head of emerging markets trading for fixed income and currencies in Asia Pacific at Société Générale in Hong Kong. “They’re waiting for the pair to run further, to around 6.6.”

To be sure, a sustained fall for the yuan could cause problems for China, even if it were to help boost exports. If the yuan tumbles too much, that could spur capital outflows that in turn could exert even more pressure on the Chinese currency—exactly what happened when the country’s central bank carried a surprise yuan devaluation in August 2015. That would strain China’s financial system at a time when regulators have already been trying to cool the country’s high levels of debt.

“The last thing they want is capital outflows,” said Eric Liu, portfolio manager of Asia fixed income at Manulife Asset Management in Hong Kong, referring to Chinese policy makers—adding that he’s not bracing for a major depreciation in the yuan for that reason, even though he does expect the Chinese currency to weaken further against the dollar.

With its latest tumble, the yuan is down 0.2% against the dollar for the year. That stacks up favorably compared with many other currencies: The euro has dropped 2.9% against the greenback in 2018, while the British pound has declined 2% and the Korean won has lost 4.5%.

The yuan also on Monday fell 0.5% in the offshore market—where it trades more freely—with one dollar trading at 6.5460 yuan.

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