

ANALYSIS-Dollar/yuan spike seen as temporary, not a trend

By Jamie McGeever

NEW YORK, March 13 (Reuters) - The dollar's rise against the yuan last week may have been its biggest weekly jump since Beijing loosened its currency controls in July, but it probably was only a speedbump on the path to a stronger yuan.

China and currency watchers say Beijing's commitment to further foreign exchange flexibility, which many equate with a stronger yuan, is so entrenched that there's simply no returning to a non-convertible currency. Still, as China opens up its economy and financial markets further, moves such as this could become more common. More flexible foreign exchange trading means the yuan is going to be susceptible to periods of decline in what most analysts believe will be a broader uptrend.

"I don't think we ought to make too much of this (dollar spike) but it does represent what we're going to see more of, which is China gradually accommodating its behavior to the wants of globalization and the global marketplace," said Donald Straszheim, vice chairman at Roth Capital Partners and a long-time China watcher.

China wants to take its place at the forefront of the global economic stage "... and to be a real player they're going to have to adopt policies that are more in tune with the global marketplace," Straszheim said.

Last week, the dollar jumped 0.17 percent against the yuan <CNY=CFXS> to its highest level in a month. That sounds negligible by almost any measure but given that the yuan has appreciated only 0.74 percent against the greenback in the entire eight months since last July's one-off revaluation, it was notable.

On July 21 last year Beijing unveiled a one-off 2.1 percent revaluation of the yuan against the dollar. The shake-up also included scrapping the yuan's peg to the dollar and moving the referencing of the yuan to a basket of currencies.

Since then, the dollar has had bouts of strength against the yuan, although not as sharp as last week's. That spike coincided with its biggest weekly rise in four months against a basket of its most heavily traded counterparts.

That said, the dollar's move against the yuan may also have been a result of heavy intervention from the People's Bank of China, a warning sign that Chinese authorities will not tolerate too fast a rise in the yuan's value.

YUAN EVENT RISK BUILDS

Jeff Young, head of global currency research at Citigroup in New York, said any strong dollar-buying intervention would "undercut" the spirit of greater exchange rate flexibility the PBOC professes to be following.

But Young also said there may have been hefty outflows from China last week and that, in any case, markets are meant to be two-way. Dollar/yuan's spike up in no way suggests China is "digging its heels in" on further yuan flexibility.

In his estimation, the yuan actually appreciated a little last week against a broader basket of currencies.

"It's not a dollar peg in a basket's clothing," Young said.

What's more, the yuan's slow, steady appreciation since July and lack of volatility is to be welcomed.

"Would you trade that for a 10 percent move against the dollar and a (potential) emerging market crisis?" Young said. "Why make a sudden lurch away from incrementalism?"

Beijing has said repeatedly that it will continue to liberalize its currency over time. In addition to last July's measures China is taking steps to strengthen its trading infrastructure, bolster its derivatives and futures markets, and preparing its financial system for more deregulation down the line.

Still, Washington wants more to be done on the exchange rate, arguing that the yuan remains severely undervalued and a major contributor to the widening U.S. trade deficit and global economic imbalances.

With Chinese President Hu Jintao due to visit Washington in April and speculation mounting that the U.S. Treasury will name China as a currency manipulator in its upcoming biannual report on foreign exchange practices, pressure on China to further liberalize its FX regime is growing.

Dismissing the dollar's relatively sharp spike higher last week as "market noise," Nouriel Roubini, professor of economics at New York University, expects a "meaningful" move from China on the yuan in the coming weeks, such as a 2-3% revaluation, widening of the yuan's trading band and a signal of more to come.

"That defuses the pressure coming from Treasury and the protectionist noises coming from Congress," Roubini said.

Reporting by Jamie McGeever; editing by Ted d'Afflisio; Reuters Messaging:
jamie.mcgeever.reuters.com@reuters.net; email jamie.mcgeever@reuters.com; Tel: 646 223-6316)) Monday, 13
March 2006 14:54:16RTRS [nN13167368]