16 April 2012 - Experts: Yuan Expansion Likely to Have Minimal Impact

Manufacturing Growth Boosts Commodities, Drives U.S. Dollar Down

In an effort to thwart a slowdown of its economy, China made good Monday on its pledge to double the yuan trading band from 0.5 percent to 1 percent in either direction against the U.S. dollar. Observers called it a positive move for China and other economies, but one that will have little impact on currency traders.

Karl Schamotta, senior market strategist at Western Union Business Solutions, told AFP that while the People's Bank of China slightly loosening its tight grip on the yuan is welcome by both financial and political entities worldwide, it is not being permitted to run off-leash. "The PBoC will continue to set the midpoint exchange rate target each day, and it is this anchor that must move in order for the exchange rate to materially change over time," he said.

China currently is experiencing significant downward pressures as economic growth slows, trade balance numbers diminish, and Chinese businesses are looking to invest offshore, Schamotta explained. The PBoC has presided over an astronomical increase in money supply in recent years, and its exchange rate could be approaching an equilibrium level relative to the USD. "This means that exchange rate appreciation is very likely to slow—and potentially reverse in the short term," he said.

Schamotta noted that over the weekend, the yuan dropped against the dollar, as traders acted to drive spot rates into alignment with the forward markets—where positioning remains biased toward depreciation. "Without correspondingly meaningful reform of China's capital account, the yuan will remain fundamentally unable to challenge the U.S. dollar's supremacy as the global reserve currency," he said.

But the yuan's role in trade should continue to grow—and that is where it will have the greatest impact in the months ahead, added Schamotta. "After years spent safely ignoring the yuan's movements, businesses should now be looking at strategies that can protect against, and harness, two-way volatility," he said.

Yuan to appreciate?

Amarjit Sahota, CEO of Klarity FX, also sees minimal impact. "I think we'll probably see the currency appreciate through the year's end," he said. "It's been pretty well received by the marketplace; it hasn't created any major storms since they made the announcement on Saturday. It seems the market is taking it in stride. So I think it just helps create a little bit more transparency and a little more movement in the currency. Will it help with China's economy? To some degree; we're probably looking at somewhere around a 1 percent appreciation for the remainder of the year."

Sahota sees the U.S. benefiting, if only slightly. "They're making their currency more expensive, to the benefit of the U.S. It will help the U.S. export into the marketplace. It's going to be a positive move but I don't think it's going to be a seismic event in the current climate," he said.

Sahota noted that this expansion is a positive step toward the yuan eventually challenging the USD as the reserve currency, though it still has quite a way to go. "When you keep liberalizing, it's going to make it easier for people to justify why they need a greater Chinese yuan weighting in their portfolios," he said. "But I think there's a long way to go before we actually see the U.S. displaced in that framework."

By Andrew Deichler