China Gives Markets Just Enough Support, Lets Yuan Strengthen
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By Bloomberg News
(Bloomberg) -- China's central bank signaled it will provide just enough support to ensure stability in its financial markets, while stopping short of encouraging further gains.
The People's Bank of China on Tuesday deployed the biggest cash injection of its kind since 2018, helping offset a liquidity shortage in its banking system. But it did so without cutting interest rates, limiting gains in the bond market. The central bank also showed it will allow for currency strength by setting the daily fixing at the strongest since May 2019, though it was merely tracking the yuan's spot rate. The currency rose as much as 0.45%.
China's central bank is striking a balance between maintaining its supportive policy stance and avoiding a bubble in asset prices. Data Tuesday also showed the economic recovery gaining traction, suggesting aggressive stimulus measures aren't needed for now. Retail sales grew in August for the first time since Covid-19 hit early in the year, while industrial output accelerated.
"The PBOC is sending a signal that it will not tighten monetary policy quickly, but also it's less likely to use broad easing measures such as a reserve ratio cut," said Xia Le, chief economist at PingAn Digital Economic Research Center. "This will benefit government bonds in the short term. But in the longer run, the performance of the debt is more dependent on China's economy and the U.S. election."
The yield on 10-year government bonds dropped 4 basis points to 3.11% as of 4:15 p.m. in Shanghai. The yuan last traded at 6.7815.
The PBOC offered 600 billion yuan ($88.1 billion) of one-year funding with the medium-term lending facility, according to a statement. That will more than offset the 200 billion yuan in loans that come due on Thursday, implying a net injection of 400 billion yuan, the largest monthly addition since July 2018. It kept the interest rate on the funds unchanged at 2.95%.
Chinese lenders -- the main buyers of government debt -- are compelled to buy 1.13 trillion yuan of new debt this month and repay 1.7 trillion yuan of short-term interbank debt. Financial institutions are also hoarding funds for quarter-end regulatory checks. Adding to the liquidity strain is the authorities' crackdown on high-yielding financial products, which has limited their ability to attract deposits.
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The yuan’s two-day advance of 0.7% is set for the biggest in two months. The gains come after Oracle Corp. edged out rival Microsoft Corp. in negotiations for the U.S. operations of TikTok, removing a point of uncertainty in China-U.S. tensions.
The yuan will advance to stronger than 6.7 in the coming months, as China’s economy recovers and foreign capital flows into onshore markets, Citigroup Inc. strategists led by Sun Lu wrote in a note.
The Chinese currency has rallied 4.2% so far in the third quarter, set for its best performance since early 2008, on a sliding dollar. Potential inclusion of some onshore debt into a global bond index next week, and a wide yield differential between China and U.S. government notes also helped boost demand for the yuan.

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