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China Debt Sale Fails for First Time in 23 Months on Cash Crunch
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By Bloomberg News

June 14 (Bloomberg) -- China's Finance Ministry failed to sell all of the debt offered at an auction for the first time in
23 months owing to a cash squeeze that threatens to exacerbate a slowdown in the world's second-largest economy.

The ministry sold 9.53 billion yuan ($1.55 billion) of 273- day bills, less than the 15 billion yuan target, according to Chinabond, the nation's biggest bond-clearing house.
Agricultural Development Bank of China Co. raised 11.51 billion yuan in a sale of six-month bills last week, less than its 20 billion yuan goal.

Banks are hoarding money to meet quarter-end capital requirements at the same time as capital inflows are easing amid a worsening economic outlook and speculation the Federal Reserve will rein in monetary stimulus. The seven-day repurchase rate, a gauge of interbank funding availability, has more than doubled in the past month and the Hang Seng China Enterprises Index of shares slid today for a record 12th day in Hong Kong.

"The cash crunch is curbing demand for bonds," said Chen Ying, a fixed-income analyst at Sealand Securities Co. in Shenzhen. "The crunch may persist if the central bank doesn't come out to inject more capital into the financial system. If it lasts longer, it may affect issuance of both government and corporate bonds."

The average yield at today's bill sale was 3.76 percent, according to two traders who are required to bid at the auctions. That compares with a 3.14 percent rate yesterday for similar-maturity existing securities, according to data compiled by Chinabond. The ministry's last failed auction was a sale of 182-day bills in July 2011.

Outlook Dims

The cash shortage comes after China's economic expansion held below 8 percent for the past four quarters, the first time that has happened in at least 20 years. Morgan Stanley, UBS AG and Royal Bank of Scotland Group Plc are among at least eight global banks and brokerages that cut 2013 growth estimates for the nation this week. The World Bank slashed its forecast to 7.7 percent from 8.4 percent, a June 12 report showed.

The People's Bank of China added a net 92 billion yuan to the financial system this week, down from 160 billion yuan in the five days through June 7, according to data compiled by Bloomberg. The monetary authority refrained yesterday from draining cash for the first time in three months as money markets reopened after a three-day holiday. The last time it used reverse-repurchase agreements to inject funds was Feb. 7.

Swaps Climb

"If the central bank doesn't conduct reverse-repurchase agreements or short-term liquidity operations to inject capital, cash supply will stay tight for the rest of the month," said Cheng Qingsheng, a bond analyst at Evergrowing Bank Co. in Shanghai.

The one-year interest-rate swap, the fixed cost needed to receive the floating seven-day repurchase rate, climbed 13 basis points, or 0.13 percentage point, to 3.79 percent as of 4:30 p.m. in Shanghai, according to data compiled by Bloomberg. It touched 3.85 percent, the highest level since September 2011.

Yuan positions at local lenders accumulated from sales of foreign exchange, an indication of capital flows into China, rose 66.86 billion yuan in May, the central bank reported today.
That is the smallest gain since November.

Capital Flows

The State Administration of Foreign Exchange last month stepped up scrutiny of flows to prevent speculative funds from entering the country disguised as trade payments. Cash is also flowing out of developing nations as investors bet the Fed will scale back quantitative easing, a policy that spurred demand for riskier assets. Investors pulled $5.8 billion from emerging- market equity funds in the week ended June 12, Citigroup Inc.
reported today, citing EPFR Global data.

The yuan rose less than 0.1 percent today and this month to
6.1308 per dollar in Shanghai. It strengthened 1.5 percent in the January-May period and has retreated 0.2 percent since reaching a 19-year high of 6.1210 on May 27.

The seven-day repo rate jumped 51 basis points today to
6.90 percent, a weighted average by the National Interbank Funding Center shows. The yield on the 2.62 percent government bond due April 2014 dropped five basis points to 3.12 percent.

"We are still bearish on the liquidity outlook because banks will turn more cautious toward the end of June due to the need to fulfill loan-to-deposit requirements and we will also head into another tax payment season in July," said Pin Ru Tan, an interest-rate strategist at HSBC Securities Asia Ltd. in Hong Kong.

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