China, seeking to stop weakening of currency, issues restrictions

By Neil Gough
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Global markets spent most of 2016 adjusting to the reality of a slow but steady weakening of China's currency.

Now, Beijing appears uncomfortable with that state of affairs.

Financial regulators in recent days have introduced new rules to curb the amount of capital flowing out of the country, helping to slow the pace of the renminbi's decline.

They issued stricter rules on the movement of renminbi offshore for conversion into dollars. Analysts also cited worries over reports that authorities were considering restrictions on companies as well.

The collective result: a temporary reverse in the slide of the Chinese currency's value.

The effect has been most pronounced in Hong Kong, where investors trade a small pool of offshore renminbi more freely than in mainland China. After a two-day rally, the offshore renminbi rose as much as 2.5 percent, to 6.7853 against the dollar on Thursday, an exceptional gain for a currency that is usually subject to staid trading.

It has helped that the dollar has stumbled against major currencies. The currency has fallen in value after minutes from the Federal Reserve's latest meeting showed policy makers were concerned over uncertainty caused by the election of Donald J. Trump — in the minutes, Fed officials said they regarded both higher growth and lower growth as more likely since the election.

Beijing's capital controls, and fears that more measures could be on the way, have tightened conditions in a city where the Chinese currency is already in short supply.

"China's effort to curb capital outflow continues," said Frances Cheung, head of rates strategy for Asia outside Japan at Société Générale. She added that "any restrictions that reduce the outflows" of China's currency will further tighten the market for offshore renminbi.

Borrowing costs for offshore renminbi have been edging up for weeks on the interbank market, where lenders and other major financial institutions seek funding. By Thursday, that overnight deposit rate briefly rose as high as 100 percent. By comparison, it hovered between 1 percent and 3 percent for most of October and November.

Some analysts said the sharp swings in offshore exchange rates and borrowing costs appeared to be engineered by the Chinese leadership, as a way to ease depreciation pressure on the renminbi and to discourage speculation — namely short-sellers, investors who bet on declines in the currency, often by using borrowed funds.

"Movements of this speed and magnitude have to be either official intervention or officially directed action by Beijing," said Christopher Balding, an associate professor of finance at the Peking University HSBC School of Business in Shenzhen, China. "The purpose is to remove renminbi from offshore centers like Hong Kong, which had been continuing to be a factor placing downward pressure on the renminbi."

The Chinese central bank, the People's Bank of China, denied that it was behind recent movements in the offshore currency market.

In an emailed response to questions, the central bank's press office said claims that it had directly or indirectly intervened in the offshore renminbi market in Hong Kong were “not true.” It declined to elaborate.

Some economists noted that the tight conditions in the offshore market were enough to set off the squeeze without the central bank having to intervene directly.

“Liquidity had been tight since September, and the market had widely expected tight liquidity conditions to continue,” said Becky Liu, the head of China macro strategy at Standard Chartered Bank in Hong Kong.