China's long march to currency reform takes a step forward

AFP, *Shanghai*

China's currency devaluation is a step in the long march to a more open regime for the yuan, analysts say, but authorities will need to further loosen their controls to promote long-term growth.

The central bank on Tuesday unveiled a near two percent devaluation of the yuan, saying the move was part of broader economic reforms aimed at moving towards a more flexible exchange rate.

The suddenness and scale of the devaluation in a normally stable unit rocked global financial markets, as investors took it as a sign the world's second-largest economy is performing worse than revealed, and sparked worries China had fired the first shot in a currency war.

It also compounded jitters over China's financial health after a debt-fuelled stock market bubble burst in June, following a 150 percent surge in the previous 12 months.

China's central bank soothed markets by setting the daily reference rate of the yuan -- also known as the renminbi (RMB) -- against the US dollar marginally higher on Friday, ending an almost five percent fall over three days.

Analysts cheered the move towards a more market-based Chinese currency, but said other reforms had become more urgent as the Asian giant seeks a more sustainable growth model in the face of a slowing economy.

"Reducing overvaluation of the RMB is a welcome change that eliminates one source of unnecessary self-inflicted pain," the Asian Development Bank's chief economist Shang-Jin Wei said Friday.

ANZ Banking Group's chief economist for Greater China, Liu Ligang, hailed the move as "very important" but said more reforms, such as freer capital flows, liberalising interest rates and more allowing financial products to hedge against risk, were still needed.

If the bank had acted sooner, the impact on the economy would be "more obvious", he told AFP.

The People's Bank of China (PBoC) used to decide its daily yuan refence rate by polling market-makers, but will now consider the previous day's close, foreign exchange supply and demand and the rates of major currencies.

The yuan is restricted to trading up or down two percent from the daily rate, although the State Council, the cabinet, has signalled it does intend to broaden the trading band.

China is currently bidding to join the International Monetary Fund's basket of reserve currencies, but the Washington-based lender has said more reforms are needed for membership.

AFP

A man changes foreign currency into Chinese yuan at a currency exchange office in Hongqiao airport in Shanghai on Friday.

Beijing is "killing two birds with one stone: it can release depreciation pressure to help the economy grow and meet the IMF's requirement of letting the yuan be more market-oriented", Zhang Ning, a Hong Kong-based economist for UBS, told AFP.

The yuan devaluation has also been seen as a means for authorities to help the slowing economy by boosting exports -- a key driver of China's extraordinary rise in the past three decades.

For the Henry Parts company in the eastern city of Ningbo, the devaluation means more orders from foreign customers for its machinery components. "The devaluation will increase our revenue and we can get the orders we couldn't get before," manager He Zhanyong told AFP.

China's economy expanded 7.4 percent last year, its weakest since 1990, and has slowed to 7.0 percent in each of the first two quarters. The government wants growth of around 7.0 percent for all of 2015.

Still, there are worries the move could set off a "currency war" as regional neighbours and other emerging market countries face pressure to devalue to stay competitive.

"To some extent, the PBoC has served as an anchor in the region and the move now allows other currencies to weaken further," Societe Generale Group said in a research report.

Asia-Pacific currencies this week suffered their biggest two-day selloff since 1998, during the Asian financial crisis, while Russia's ruble slid to a six-month low.

A disorderly devaluation could hamper Beijing's push for greater global stature for the yuan and the government's pursuit of a bigger say in world finance, typified by its role setting up two new multilateral banks for Asia and the BRICS nations, which also include Brazil, Russia, India and South Africa.

Argentina has nearly $34 billion in foreign exchange reserves but about a quarter are denominated in yuan and their value declined after the Chinese devaluation, Bloomberg News reported.

Chinese central bank officials have denied a currency war was the intention, but have been more cagey about the timetable for further reforms to the yuan.

Asked if China was on track to open its capital account to investment flows this year, as previously pledged, one official said the process would be orderly.

China's FX move raises question: where's the inflation?

REUTERS, *London*

China's currency devaluation bombshell this week blew apart the growing consensus that global inflation had bottomed out and was slowly moving higher, forcing investors to reconsider their assumptions on a wide range of financial markets.

The devaluation of the yuan makes China's goods cheaper on world markets, a deflationary impulse that comes just as the Chinese and other emerging economies were already slowing and commodity prices falling to the lowest level in years.

The 2 percent one-off devaluation on Tuesday and subsequent 1 percent fall in the yuan weren't big in themselves, but further depreciation might be.

What has really unnerved markets, however, is the fear that central banks around the world could be hamstrung by persistently weak inflation, and unable to counter growth or financial shocks that might be coming down the road.

"As China cuts the selling price of exports and as emerging market countries face new perils, the failure of the world's central bankers to reflate their economies will be the dominant force in markets," said Russell Napier, an independent investment strategist.

"The investment lessons are clear: get long cash in general and get long dollars in particular."

On Thursday, the breakeven rate on 10-year US Treasury inflation-protected bonds, essentially a measure of where investors expect inflation to be over the next decade, fell to 1.59 percent, the lowest since January.

The euro zone one-year inflation swap rate, a market-based measure of inflation expectations over the next 12 months, fell to 11 basis points on Thursday. It was around 100 basis points in June and 25 basis points a week ago.

The scale of the decline this week is significant because it takes the rate back below where it was on March 9 when the European Central Bank began its 1 trillion-euro bond-buying "quantitative easing" programme to ward off deflation.

The latest US and UK inflation figures will be released next week. They are for July, when oil prices plunged 20 percent and Chinese stocks slumped 14 percent, powerful deflationary forces compounded by this week's devaluation.

Even if they don't fully capture the latest shifts, upcoming measures will. Economists at Barclays on Thursday lowered their outlook for US inflation out to the end of 2016 from their previous forecasts a month ago.

"Since then, energy futures prices have moved sharply lower as the price of crude oil has plummeted," they said in a note to clients on Thursday.

"The seasonally-adjusted energy component of the consumer price index will drag on monthly headline CPI readings through the first quarter of next year."

Stocks, commodities, emerging market currencies and the yields on safe-haven government bonds all fell this week, too, in some cases to levels and by magnitudes not seen in years. Germany's two-year bond yield hit a record low of -0.29 percent.

The solid and widely held belief only a few months ago that the Federal Reserve would raise US interest rates in September and that the Bank of England would follow shortly after have been chipped away.

This unexpected shift in the global policy and inflationary landscape prompted some of the world's biggest currency players to change their forecasts, mostly for key Asian exchange rates.

Bank of America Merrill Lynch was among several investment banks to say Beijing's move represented a fundamental, secular shift that will prompt "regime change" in Asian currency rates.

It expects the yuan itself to fall as much as 10 percent by the end of next year, the Indonesian rupiah to lose 8.7 percent, the Malaysian ringgit 6.2 percent and the Korean won 5 percent.

"The unprecedented events over the past three days ... will have far reaching consequences for Asia," BAML's Asia strategists wrote in a note on Thursday.

Many analysts say China's devaluation was the latest salvo in the global "currency wars", in which competing countries explicitly or implicitly weaken their exchange rates to boost exports, have intensified in recent years.

As interest rates have fallen to zero in some developed economies and money printing has proliferated, exchange rate policy has become one of the few remaining levers to stimulate business activity and in some cases avoid deflation.

French bank Societe Generale said Beijing's move represented a "tectonic" shift, and raised concerns over the outlook for European stocks exposed to the slowing Chinese economy.

REUTERS/FILE

An auto worker screws a component into a cab in Missouri, the USA.

Autos buoy US industrial output

REUTERS, *Washington*

US industrial output advanced at its strongest pace in eight months in July as auto production surged, another bullish sign for third-quarter economic growth that boosts the prospects of a Federal Reserve interest rate hike next month.

While other data on Friday showed a dip in consumer sentiment early this month, households were upbeat about their personal finances, a good omen for consumer spending. July employment and retail sales data also struck an optimistic note on the economy.

"It adds to the steady drum-beat of solid indicators that suggest the economy is getting off to a much better start in the second half of the year and further increases the odds toward a September rate hike by the Fed," said Sal Guatieri, a senior economist at BMO Capital Markets in Toronto.

Industrial production shot up 0.6 percent last month after a downwardly revised increase of 0.1 percent in June, the Fed said. Economists polled by Reuters had looked for a rise of 0.3 percent in July. The gain in output reflected a 0.8 percent increase in factory production that was spurred by a 10.6 percent surge in motor vehicle output, the largest increase since September 2009.

Auto manufacturers typically shut down production lines in summer for retooling, but economists speculated they probably had done so for only a short period, leading to the jump in vehicle production. Apart from autos, manufacturing rose 0.1 percent last month.

Mining production edged up 0.2 percent as oil and gas well drilling output grew for the first time in 10 months, suggesting the energy sector was starting to stabilize after being undermined by last year's plunge in crude oil prices. Despite the surge in July, industrial production remains constrained by a strong dollar and lower oil prices.

"We continue to see a stronger dollar and lower energy prices as posing headwinds for industrial output and do not look for a strong rebound in the sector this year," said Jesse Hurwitz, an economist at Barclays in New York.

US stocks were trading marginally higher, while the dollar was little changed against a basket of currencies. Prices for US government debt fell. In a separate report, the University of Michigan said its consumer sentiment index slipped to 92.9 in early August from a reading of 93.1 in July.

Still, it was the highest nine-month average since 2004 and consistent with a 3 percent annualized rate of increase in consumer spending.

The Labor Department also reported on Friday that its producer price index for final demand increased 0.2 percent last month as the cost of services rose. The PPI gained 0.4 percent in June. In the 12 months through July, the PPI fell 0.8 percent after declining 0.7 percent in June. It was the sixth straight 12-month decrease in the index.

But inflation pressures are likely to remain benign due to the strong dollar, falling oil prices and China's recent devaluation of its currency. Inflation has been persistently running below the Fed's 2 percent target.

"Looking ahead there appears to be further downward price pressure in the pipeline as a result of slowing global demand, and of course the recent devaluation of the yuan is likely to only exacerbate that pressure on commodity prices," said Lindsey Piegza, chief economist at Stifel Fixed Income in Chicago.

India taps private sector for two state bank bosses in industry shake-up

REUTERS, *New Delhi*

India has brought in private sector executives to run two of its largest state-owned banks, the first such appointments in a broad reform plan to shake up the country's dominant but often inefficient government-backed lenders.

Earlier this year, the government announced steps to overhaul its state banks, including the appointment of five new chief executives, with applications welcome from both public and private sector candidates.

The government hopes these changes can help the banks to improve governance and boost earnings, important measures as they prepare to tap the markets for capital to strengthen their balance sheets.

The move also fits with Prime Minister Narendra Modi's preference for modernising the management of state-run firms, rather than privatising them, a policy he honed in his home state Gujarat where he made failing state industries profitable.

India had previously always picked bosses for public sector banks from the state sector, which makes up more than 70 percent of the country's banking assets but has lagged private rivals in profitability and has amassed bad loans at a faster pace.

India's banking sector, dominated by more than two-dozen state-run lenders, has been hobbled by its highest bad-loan ratio in a decade as slower economic growth hurt companies' ability to service debt.

The government on Friday named Rakesh Sharma, head of private sector bank Laxmi Vilas Bank, as chief executive of Canara Bank Ltd, and appointed P.S. Jayakumar, chief executive of real estate developer VBHC Value Homes Pvt Ltd, as head of Bank of Baroda.

It also named chief executives for Bank of India, IDBI Bank Ltd and Punjab National Bank from within the state sector.

In addition to senior jobs, financial services secretary Hasmukh Adhia said that the government was also considering allowing public sector banks to hire mid-level executives from outside the state banking sector.

"We are very hopeful as the process unfolds that we will have other really, really good people coming in and being part of the public sector," junior finance minister Jayant Sinha told CNBC TV18 network.

The bank reforms, expected to help to revive India's sluggish growth, also included more details of a so-called bank board bureau that will help state banks with strategies for growth and development.

They were announced following a parliamentary session in which Prime Minister Modi's reform agenda suffered a setback on important tax and land reforms.

The finance ministry on Friday also reiterated its plans to provide public sector banks with more capital. These include providing 250 billion rupees ($3.9 billion) each in the current and next fiscal year, while 200 billion rupees would be provided during 2017/18 and 2018/19.

Of 250 billion rupees allocated for this fiscal year, about 200 billion rupees will be allocated to 13 state lenders soon, a ministry statement said. The allocation of remaining 50 billion rupees would be decided in the March quarter.

REUTERS/FILE

A pedestrian walks past a Bank of Baroda advertisement in Mumbai.

Indonesia president lowers expectations in budget

AFP, *Jakarta*

Indonesian President Joko Widodo lowered economic expectations Friday with a more modest initial growth forecast for next year, as he unveiled a proposed 2016 budget that also highlighted his government's focus on improving infrastructure.

Widodo took office in October last year promising to boost Southeast Asia's biggest economy but he has faced criticism for failing to revive growth, which fell to a six-year low of 4.7 percent in the second quarter. Analysts say Widodo has made insufficient progress in pushing his economic agenda due to red tape and a lack of coordination between ministries, while unfavourable global conditions have also put pressure on the economy.

Jet Airways swings to profit in June quarter on lower fuel costs

REUTERS, *New Delhi*

Jet Airways Ltd said on Friday it made a profit in the June quarter compared to a loss in the year-ago period, helped by a drop in fuel expenses and a one-time gain on sale and leaseback of engines.

Mumbai-based Jet, India's second largest carrier by market share, said net profit in the April-June quarter was at 2.21 billion rupees ($33.80 million), compared with a loss of 2.18 billion rupees the same quarter last year.

Despite rapidly rising demand for air travel in India Jet has not made an annual profit since 2007, dragged into the red by high operating costs and fierce competition for passenger fares.

A drop in fuel prices has, however, eased the squeeze on Indian airlines this year - low-cost rival SpiceJet Ltd swung to a small net profit in the last quarter - but analysts say ticket prices are still too low and costs too high for sustained profitability.

Jet, 24 percent owned by Abu Dhabi's Etihad, last year announced a cost-cutting plan and said it expected to make a full-year profit in 2017.