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MARKETS

China's Tighter Grip on the Yuan Bodes Well for Markets



China's central bank has reintroduced a mechanism to help guide the value of the yuan. PHOTO: EUGENE HOSHIKO/ASSOCIATED PRESS

By *Mike Bird*

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Most Asian stock indexes rose as trading kicked off Monday, with Hong Kong's Hang Seng up 1.4% and China's Shanghai Composite Index climbing 0.8%.

The dollar was roughly flat against the yuan Monday, at 6.801 in offshore trading in Hong Kong, after a sharp fall from as high as 6.91 Friday.

Monday's Big Theme

The People's Bank of China has reintroduced a mechanism called the countercyclical factor to guide the value of the yuan—which could be good news for global markets.

What's Happening

The PBOC's adjustment is meant to work against sharp moves either way in the yuan, giving the central bank more control over the currency.

The central bank typically uses a handful of elements to calculate the fixing price, a daily trading band in which it lets the yuan trade onshore. These include the previous session's exchange rate against the dollar and changes in the values of a basket of global currencies.

The countercyclical factor allows banks to look past sharp moves in those exchange rates when reporting their yuan fix levels to the PBOC. It was introduced in the first half of 2017, and then junked in January. It has never been clear precisely how banks should determine that factor, adding an element of discretion to the daily price of the currency.

Some analysts had taken the recent stability of the CFETS basket, which monitors the strength of the yuan against 24 currencies, as evidence the PBOC might have already quietly reintroduced the policy, which the central bank confirmed late Friday.

Market Reaction

Slowing the yuan's slide could mollify global markets in two ways.

Firstly, the shift could be a response to reopened trade talks between China and the U.S., according to Brad Bechtel, a managing director in foreign-exchange trading at Jefferies Group.

The yuan's weakness was on the U.S. agenda, according to people briefed on the discussions. If Beijing is indeed acting to address Washington's concerns, that could help reduce the trade tensions that have dominated global investors' concerns this year.

Secondly, while international concern about the yuan is far less pronounced than in 2015, its recent decline nonetheless appears to have upset equity markets abroad. The correlation between moves in the yuan and the MSCI All Country World Index during the past three months has been the highest in at least a decade, according to Mark Haefele, chief investment officer at UBS Wealth Management. If that linkage holds, a steadier currency should support stock prices.

Elsewhere

U.S. stock futures rose 0.3% as trading got under way Monday, after a speech by Federal Reserve Chairman Jerome Powell on Friday contained relatively little new information.

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