



BANKING ON KNOWLEDGE

Changing currency market dynamics

By Dr R Seetharaman

The Chinese yuan fell below 6.25 against the dollar last week and touched a 16-month low. The yuan has been weakening in recent months and has fallen by more than 3% year to date. It was near 6.05 against the dollar at the beginning of the year. At the beginning of this year, the yuan's weakness was attributed to investors' concerns about China's slowing economy and risks in its financial system. Such risks do persist as the Chinese economy slowed in the fourth quarter of 2013 to 7.7% year-on-year and in the first quarter of 2014 to 7.4%. However the recent drop indicates that depreciation is a deliberate move by People Bank of China (PBOC) to target speculative funds betting on continued rises. The policymakers have pledged to move gradually towards full convertibility of the yuan, allowing it to be freely bought and sold.

Recently, China allowed exchanges for iron ore, metals and energy in its free-trade zone as China pushes for more influence in raw-material pricing and developing the yuan as an international currency. The PBOC had earlier removed the peg of the yuan against the dollar in June 2010. The use of the yuan has been increasing with China having a programme to internationalise its currency by allowing the yuan to be used to settle cross-border trade. Since then, China's trading partners have increasingly been able to use the yuan when paying for imports or receiving payments for exports. Yuan-denominated transactions are accounting for around 18% of trade with Chinese companies and it is emerging as a major currency in global trade. According to the Society for Worldwide Interbank Financial telecommunication (SWIFT), in December 2013 the yuan overtook the euro as the second most used currency



in trade finance. The bilateral trade is expanding between Gulf Co-operation Council and China and we can expect increase in the usage of the yuan. Russian rouble has fallen by more than 9% this year against the dollar on account of political stand-off in Ukraine and is above 36 against the dollar.

Brazil's real has fallen by more than 6% this year against the dollar and is below 2.25 against the US dollar. Brazil has concerns of high inflation and slowing growth. The Indian rupee has strengthened by close to 2% against the dollar this year and is below 61 against the dollar. The surge in inflows in Indian stock market on hopes of stable government in the upcoming election has strengthened the rupee. The dollar index rose last week after data showed that US durable goods orders rose by 2.6% which is much more than expected in March 2014, indicating underlying strength in the US economy. The dollar index was at 79.74 by end of last week. At the beginning of the year it was above 80. Gold prices, which came down last week after US housing data beat expectations, however arose again on account of Ukraine tensions and weak dollar and ended last week above \$1,300/ounce. Silver was close \$20/

ounce and had gained on safe-haven demand. The WTI and Brent have risen recently on account of Ukraine tensions and are at \$100.6/barrel and \$109.58/barrel respectively. The euro was at \$1.3834 by end of last week and remained under pressure after the European Central Bank reiterated warnings last week that the strong euro could trigger additional monetary easing. The euro had strengthened this year on hopes of economic recovery in eurozone. The ECB predicted in March 2014 the euro-area economy will expand 1.2% this year, 1.5% in 2015 and 1.8% in 2016. The euro was close to \$1.38 at the beginning of the year. However it had fallen below \$1.35 in January 2014 on account of tapering by US Federal Reserve. The British pound was at \$1.6803 by end of last week and has recovered on hopes on recovery in UK economy. In April 2014, the Bank of England maintained the official bank rate at a record-low 0.5%. Policy makers

met amid signs the recovery was strengthening, with recent data showing industrial production rose more in February 2014 than expected. The pound was close to \$1.66 at the beginning of the year. It had fallen near \$1.63 in January 2014 on account of tapering by the Fed. The Japanese yen was at 102.16 against the dollar by end of last week. The yen made its gain against dollar as increasing tensions in Ukraine and weaker-than-expected economic data out of China weakened demand for riskier assets and bolstered demand for safe haven currencies. It also gained as the Bank of Japan held off its additional monetary easing this month as it assesses the impact of a controversial sales tax. The yen was above 105 against the dollar at the beginning of the year.

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