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## Analysts bet against dive in US dollar

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Caught out by China in 2005 after betting on a strong yuan and by the US Federal Reserve on interest rates, analysts are wary about next year and, even if they persist in seeing a dollar decline, they don't expect a collapse.

No longer are the markets expecting a dramatic rise in the yuan, which some had seen triggering a 20 percent drop in the dollar in Asia this year. And forecasters have renewed respect for the US economy, especially in comparison with Europe and Japan.

Standard Chartered was one of the few banks to warn against betting on a big yuan revaluation this year and it sees no reason to expect a sharp rise in the currency in the next either.

"Talking to officials and people in China one thing became crystal clear to us - the mistakes that Japan made in the 1980s and 1990s by letting the yen rise sharply are not going to be repeated by China," said Standard Chartered currency strategy head Callum Henderson. "So we did not see the need for such a massive revaluation of the yuan as the market was expecting."

He expects more of the same next year - the yuan will perhaps gain just 2.2 percent to 7.9 per dollar by the end of next December.

Yuan non-deliverable forward markets were projecting a 4 percent rise Friday.

As for the rest of Asia, people should focus on individual dynamics rather than expect all Asian currencies to move as a "China play".

At the start of 2005, the betting was that China would revalue the yuan by 5-10 percent. That, analysts predicted, would trigger a fourth year of decline in the dollar in Asia and bring a much-needed reduction in the US current account deficit.

Instead, China has let the yuan rise a paltry 2.5 percent after removing its dollar peg in July and Asian currencies are among the worst performers in emerging markets this year, while the dollar has risen 13 percent in trade-weighted terms.

Growth and inflation concerns in the world's largest economy prompted the Fed to raise rates by 175 basis points to 4 percent, on top of the 125 basis points in 2004, making US yields more lucrative for global investors.

"Insufficient attention was paid to growing yield differentials between the US and the rest of the world," said Ramkishan Rajan, associate professor at George Mason University.

The momentum from the rising US rates is so strong it could support the dollar through the first half of next year.

"It's hard to see Asia rising up against the dollar in the next six months or so," said Jan Lambregts, head of research for Asia at Rabobank in Singapore.

Another lesson learned from 2005, says Rajan, was the fact that many Asian countries are biased against stronger currencies and are quite happy buying dollars to hold their currencies down.

"They intervene directly in the forex markets to prevent an appreciation, but when there are concerns about depreciation, as happened this year, they raise interest rates to support the currency," he said, meaning dollar-selling intervention is limited.

At the start of 2005, many banks predicted a "paradigm change" for Asia, the biggest transformation in the region since the 1998 financial crisis, with sharp currency appreciation, robust domestic demand and narrowing current account surpluses.

Traders and analysts were also optimistic ballooning US current account and budget deficits would lead global investors and Asian central banks to stop bankrolling the shortfalls through purchases of US Treasury bonds.

Most analysts anticipated higher US interest rates but still projected a weaker dollar. But those rate increases - plus a rush by US companies to repatriate overseas profits to take advantage of a one-off tax benefit under the Homeland Investment Act - fueled a surge in the US currency against the euro, the yen and other Asian currencies.

Goldman Sachs sees the rise as postponing a slump. Sticking to the call it made at the start of 2005, it added: "Once HIA-related flows are over in December and the market prices in 5 percent for the Fed, it is tough to see anything new that can help the dollar, and we remain steadfastly negative." REUTERS