

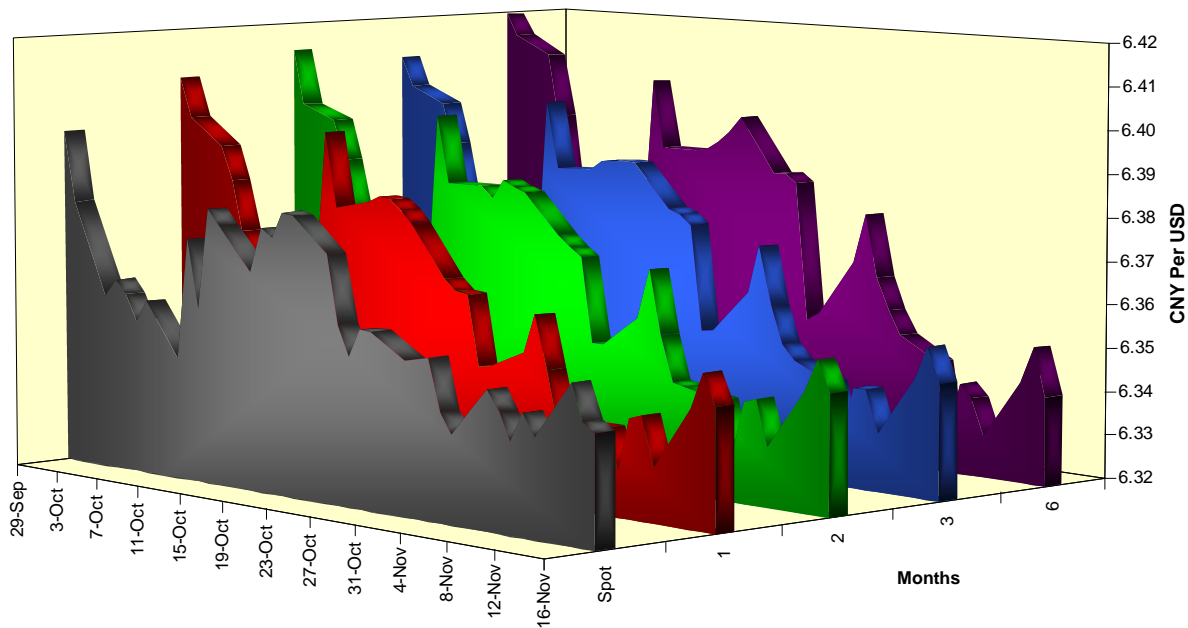
Yuan Plea Falls On Deaf Ears

One of the things that marks everyone's passage from a squalling, selfish infant to a squalling, selfish adult is acceptance of a concept I shall refer to as, "The cost of doing business." We all suffer little indignities in our daily lives and hopefully suffer them better than did the Malibu police chief in [The Big Lebowski](#).

Let's say, just for the sake of argument you are China, you have been piling up \$3.2 trillion in reserves, 31.97% of the world's total, the way everyone else has been piling up debt. And then POTUS, bureaucratic slang for the President of the United States (yes, there's a FLOTUS and a VPOTUS; you figure them out) pulls up in Hawaii and starts giving you a lecture on how you should be running things, particularly in regards to the yuan. You need this like cold moo goo gai pan on top of a bad mai tai, but the cost-of-doing-business thingie clicks in your head and you resist telling POTUS what you really think and, more important, you retain control of your coffee-mug imprinted with "I went to the APEC Summit and all I got was this stupid mug" rather than launching it, Lebowski-style.

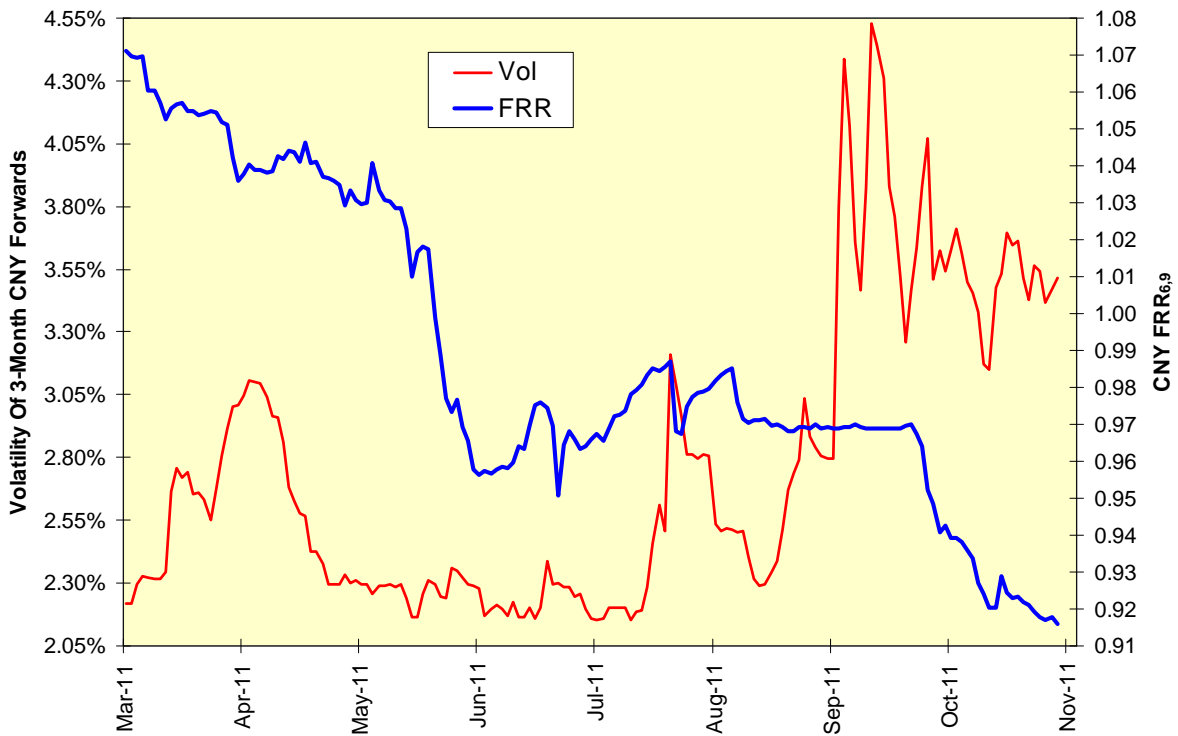
But please, do not rely on my word that Peoples' Republic of Moolah listened politely and did nothing. Let's look at the data. The CNY had been firming somewhat from late September on, but then it weakened in the immediate aftermath of the APEC summit over the weekend of November 11-13, 2011. More important, yuan forwards are not pricing in any firming over the next three months; they are pointing lower by 0.4%, 0.4% and 0.2% for one, two and three months, respectively. The six-month forward is pointing up by 0.07%, but mark my bold words, the actual rate six months from now will be something different.

Forward Yuan Rates



Second, key monetary indicators in China did not ripple a bit. The volatility of three-month forwards, a measure of demand for insurance against a stronger CNY, has been coming down since late September and did not even ruffle a feather over the APEC meeting. More important, the Chinese interbank money-market yield curve as measured by the forward rate ratio between six- and nine-month deposits in Shanghai has continued to flatten. As I discussed in February 2010's [Chinese Monetary Policy and US Fixed-Income](#), a flatter yield curve in China indicates they are exporting excess banking-system funds to the U.S. and elsewhere and are receiving interest in so doing. As a direct side-benefit, the CNY remains weaker than it would be otherwise.

Yuan Monetary Indicators Did Not Ripple



If yuan forwards are not pricing in appreciation and volatility is not pricing in the risk of appreciation and if monetary conditions remain consistent with a heavily managed yuan, then we can conclude all of the importuning in Hawaii was more for domestic political consumption than for international monetary management.

Restated, everyone went through the motions, accepted the costs of doing business with each other and then went back to doing whatever they were doing before. This is why everything we do now goes from a small problem to a major crisis.