FOREX FOCUS: Growing China Threat To Global Risk

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A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--Slower growth in China will almost certainly bring a nasty reassessment of global risk sentiment.

Moreover, fears of a hard landing in that country will bring an even more violent shift in risk.

Fears of a hard landing emerged over the weekend as Chinese inflation soared to 5.1%, its highest level in two years.

This happened despite repeated attempts by Beijing to cool the country's overheating economy this year with a combination of limited rate rises and a succession of six increases in bank reserve requirements that are now close to 20%.

The strong inflation numbers, combined with sharp rises in retail sales, import growth at the fastest rate in six months and a rapid increase in money supply in the past few days suggest that past policies haven't worked.

All the same, there is little sign that the People's Bank of China is in a hurry to accelerate the pace at which it is tightening monetary policy.

On the contrary, the central bank failed to increase interest rates again as expected over the weekend with officials suggesting that they will continue to pursue a "cautious" policy.

As far as financial markets are concerned, China's decision to keep rates unchanged for now means that global growth prospects will continue to improve.

After all, as long as Chinese demand for U.S. and European goods remains strong and commodity prices remain high, global investors will remain more relaxed about putting their funds in riskier, higher-yielding, markets.

This was evident in a rise in commodity currencies, such as the Australian dollar, and a rally in Asian stocks.

However, any sign that the PBOC is becoming more aggressive about tightening rates and that China's economic expansion is about to slow even more rapidly could bring an immediate change of investor heart.

The key problem is whether any slack in global growth prospects created by a slower China can be taken up by the recovery in the U.S. and the euro zone.

If not, then the overall global outlook will be downgraded once again, driving investors back into safe havens as they reassess their appetite for more risky markets.

There is, though, another scenario that could prove even more damaging for risk--a Chinese central bank that continues to dither for fear that higher rates will accelerate capital inflows and make matters worse.

If that is the case, continued overheating will raise the risks of a so-called hard landing, in which the PBOC is forced to raise rates at a more rapid pace to stop inflation getting out of hand.

The consequences for Chinese growth, as well as that of the global economy, could be even more alarming.

As investors downgrade their outlook, they could lose their appetite for risk even more rapidly, putting currencies such as the safe-haven dollar firmly back in favor.

Bloomberg	TNI FRX POV
Reuters	USD/DJ
Thomson	P/1066 or P/1074

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