FOREX FOCUS: The End Of The 'China Shine' Story Is Nigh

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-- China's external imbalances show signs of correcting

-- Inflation appears to be doing the trick

-- Global PMI data show accelerating growth while China's PMI falls

LONDON (Dow Jones)--After several heavy doses, inflation may finally have done the trick.

There are now signs that the huge external imbalances between China and the rest of the world are shifting and that the 'China shine' story is coming to an end.

For the U.S., this will be good news as it means the battle to make the Chinese yuan more competitive is finally over.

For the dollar, this will be even better news as the prospect of a U.S. recovery has more room to improve.

For the last couple of years, strong Chinese growth, combined with Beijing's reluctance to let the yuan rise rapidly, has been a dominant issue in the world economy, as Chinese exports have soared at the expense of those of many other countries.

As the imbalances pushed China's trade surplus to record highs and as the country attempted to diversify its growing reserves out of the dollar into the euro, the U.S. currency came under increasing selling pressure. A rocky recovery in the U.S. and the need to adopt an extremely easy monetary policy made matters worse.

However, as inflation has taken hold both in China and the rest of the world, driving food and other commodity prices sharply higher, Beijing has been forced to not only raise interest rates and increase bank reserve requirements to curb lending but also to start allowing the yuan to rise a little more rapidly.

Signs are this is now working.

Data this week showed that manufacturing growth outside China is now growing much more rapidly, while manufacturing within the Eastern behemoth is finally slowing.

According to Barclays Capital, 85% of all purchasing managers' indexes last month were above expectations and 56% showed an increase.

In the case of the U.S., the index not only rose to its highest level since May 2004, but also its new orders component showed a strong increase. With gains in employment and price measures, it wasn't surprising that Fed Chairman Ben Bernanke appeared to edge his policy stance in a slightly more hawkish direction with a warning that the Fed is willing to "respond if necessary" to signs of inflation.

Compare this with the news out of Beijing, where last month's PMI fell to a seven-month low, where the new orders index fell and where pressures for further monetary tightening may finally be starting to ease.

Greg Anderson, a G-10 strategist with Citigroup, said anecdotes that ships are leaving Chinese ports half empty contribute to the impression that the trade imbalance that has so long been tipped in China's favor is finally correcting itself.

Suggestions that more companies are now shifting production away from China and back to the U.S. and the euro zone will also increase hopes that exports from other countries will now be more competitive.

For the moment, of course, there is still talk of further tightening of Chinese monetary policy and an admission by a leading Chinese economist that the yuan is still undervalued by at least 8% against the dollar.

Also, until there is actual evidence of a turnaround in trade data coming out of China and the U.S., Washington will probably continue to complain.

But the figures out this week could prove to be the beginning of the end of a long battle between Washington and Beijing and the start of a brighter future for the dollar.

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