

China Policy

To overcome the fear of floating

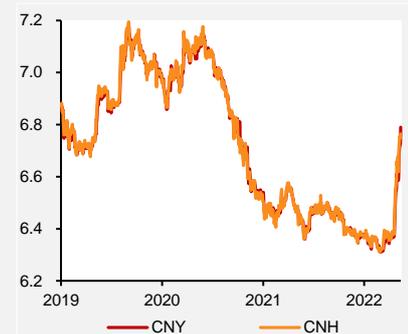
Recent renminbi depreciation is China's pro-growth signal as it would boost exports and provide room for domestic policy easing. Renminbi may slump in 2Q22-3Q22 with US\$/RMB spot rates possibly over 7 again, and a rebound from 4Q22 with a shift of relative strength in the two largest economies. Renminbi depreciation would pave the way for further policy easing including possible loan prime rate cut in the next few months.

- **China has to overcome the fear of floating to support growth with independent monetary policy.** China faces the traditional policy trilemma that one can only choose two from the three options of free capital flow, independent monetary policy and fixed exchange rates. Amid the Fed tightening, fixed exchange rates imply strong renminbi and leave no room for domestic policy easing. But China's economy slumped sharply in April and the country faced increasing pressure to loosen its monetary policy. Therefore, it had to make exchange rates more flexible to support growth with independent monetary policy.
- **Renminbi may slump in 2Q-3Q22 and rebound from 4Q22.** From March to September, China economy is weaker than the US economy as there should be further divergence of monetary policy in the two largest economies. Meanwhile, the Biden administration faces the pressure of mid-term elections and may use pressure on China as a means to boost the people's support for Democratic Party. Those factors point to a further weakening of renminbi in the next few months. It is possible to see US\$/RMB spot rates to rise to above 7 again after almost three years. In August 2019, US\$/RMB rose above 7 with the peak at 7.18 after a round of depreciation amid the Sino-US trade war. The wind may change after 3Q22 as China economy gradually rebounds and US economy slows with rising recession risk.
- **Renminbi depreciation paves the way for further policy easing in next few months.** The renminbi depreciation would provide room for further policy easing ahead. We expect addition liquidity easing and possible LPR cut in next few months. Broad credit growth would moderately rebound. China would tackle Covid first and then gradually resume economy.
- **Exchange rates have some influence on renminbi internationalization, but there are factors that are more important.** Exchange rates reflect economic fundamentals. It is positive economic prospect to support confidence about renminbi and its wide use. In addition, Chinese companies' bargaining power in global supply chain, renminbi's convertibility freedom, China's financial market competitiveness and openness and the yield and safety of renminbi assets are also important factors for renminbi internationalization.

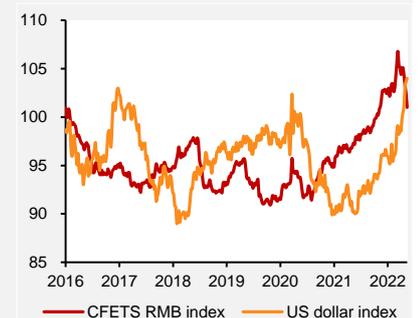
Bingnan YE, Ph.D

(852) 3761 8967

yingbingnan@cmbi.com.hk



Source: Wind, CMBIGM

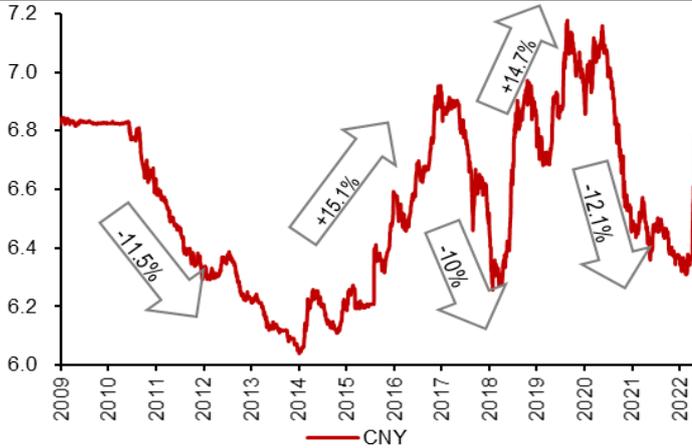


Source: Wind, CMBIGM

Related Reports

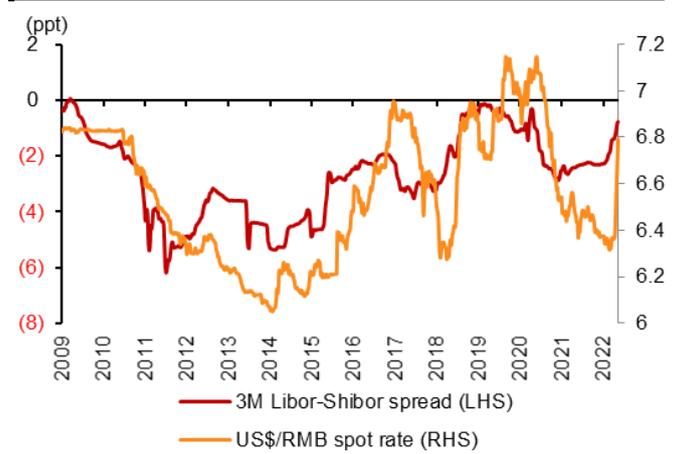
1. "RMB depreciation as the pro-growth signal" – 25 Apr 2022
2. "Impact of Renminbi depreciation; stocks with positive and negative impact" – 26 Apr 2022

Figure 1: US\$/RMB Rate Cycle



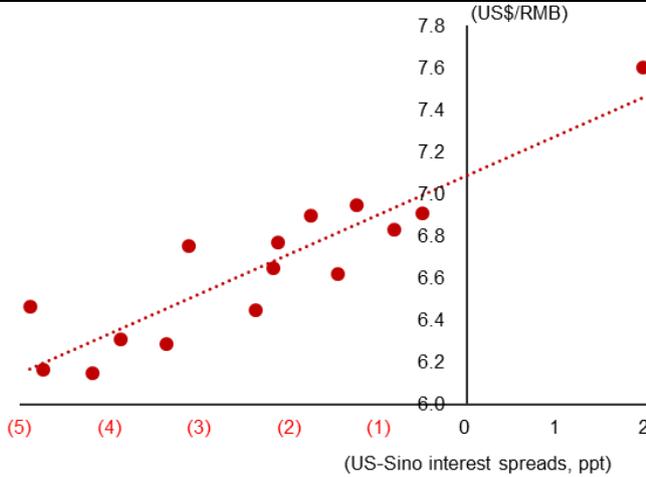
Source: Wind, CMBIGM

Figure 2: US\$/RMB Spot Rates & Interest Spreads



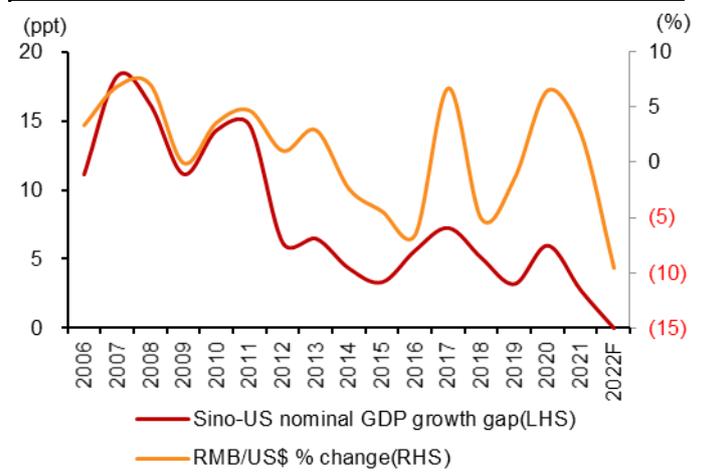
Source: Wind, CMBIGM

Figure 3: Yearly US\$/RMB & Interest Spreads



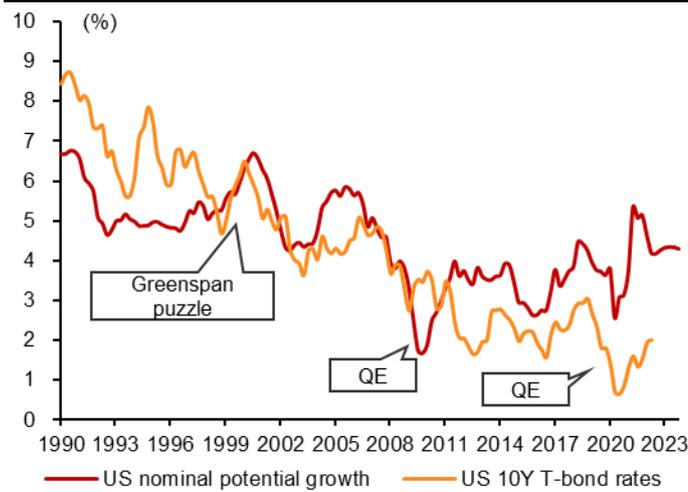
Source: Wind, CMBIGM

Figure 4: Growth Divergence & Exchange Rates



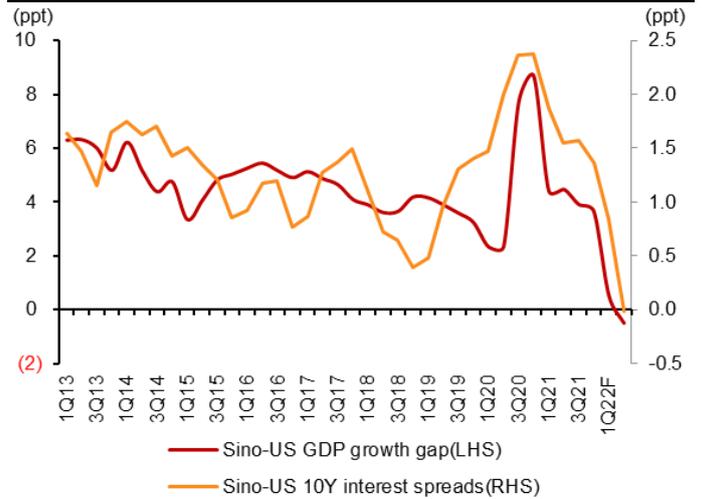
Source: MoF, CMBIGM

Figure 5: US Nominal Growth & 10Y T-bond Rates



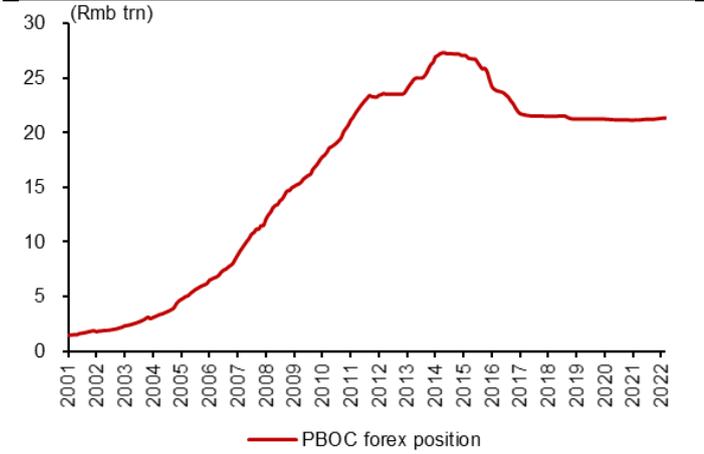
Source: Wind, CMBIGM

Figure 6: Growth Divergence & Interest Spreads



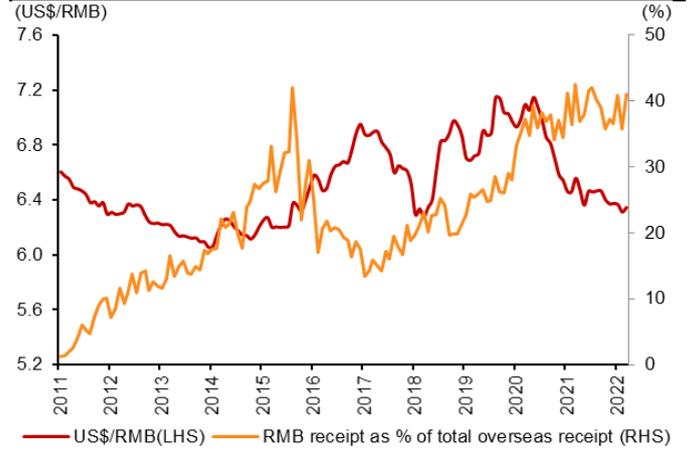
Source: Wind, CMBIGM

Figure 7: PBOC Forex Position



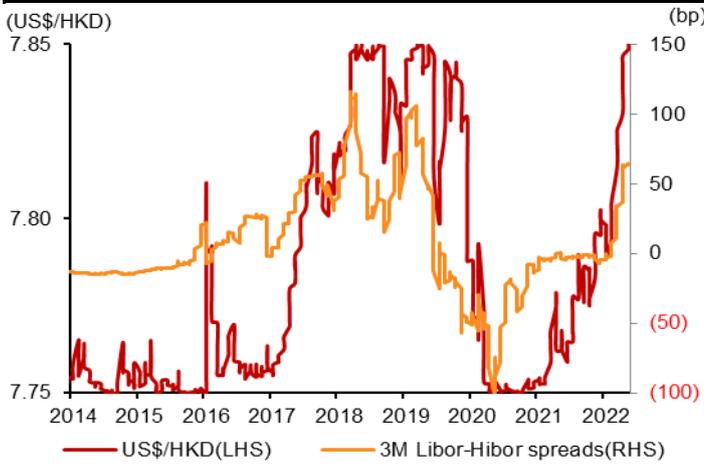
Source: Wind, CMBIGM

Figure 8: US\$/RMB and RMB Internationalisation



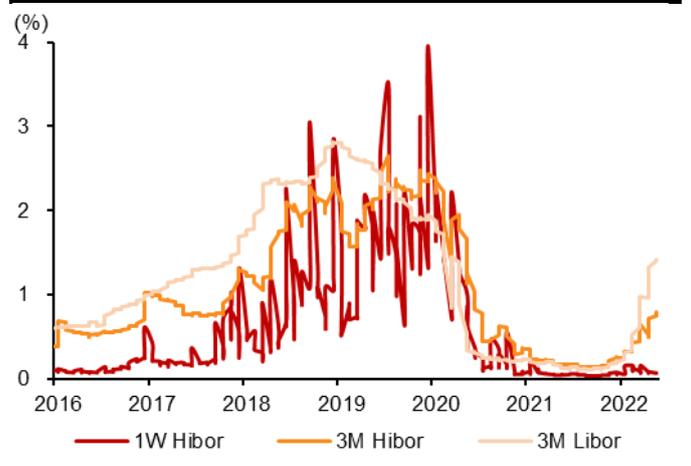
Source: Wind, CMBIGM

Figure 9: US\$/HKD Rates & Interest Spreads



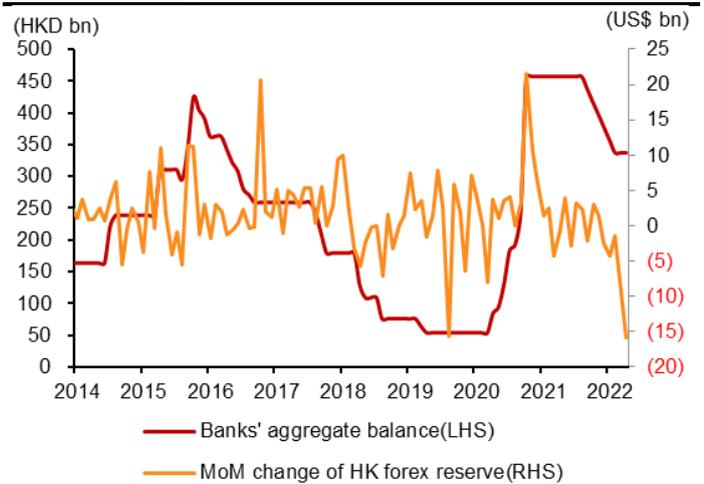
Source: Wind, CMBIGM

Figure 10: HKD Hibor and US\$ Libor



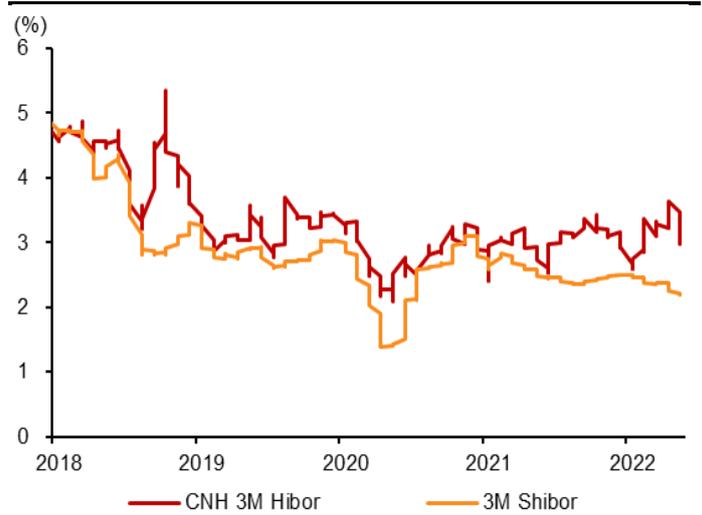
Source: Wind, CMBIGM

Figure 11: HK Banks' Aggregate Balance & Forex Reserve Changes



Source: Wind, CMBIGM

Figure 12: CNH Hibor and Shibor



Source: Wind, CMBIGM

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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