

China Economy

PBOC raises foreign debt ceiling to support RMB

The People's Bank of China (PBOC) announced yesterday it would raise the macro-prudential parameters (MPP) for cross-border financing of enterprises and financial institutions from 1.25 to 1.5. It marked the continuous effort from PBOC to defend a weakening currency by relaxing rules to allow more borrowings from overseas. The hike sent a clear message to the market that the PBOC intends to slow the depreciation process of RMB.

- **The policy shows China's effort to encourage US dollar fund inflow.** The PBOC sets a ceiling for the risk-weighted foreign debt of a domestic enterprise or financial institution. The ceiling for the risk-weighted foreign debt = capital or net assets * foreign debt ratio * MPP. The hike of the MPP will increase the ceiling for foreign debt, showing the attitude of encouraging US dollar fund flow into China.
- **PBOC uses the policy as a signal to stabilize RMB exchange rate.** MPP adjustment is one of the tools used by the PBOC to influence forex market expectations ("Don't fight against the central bank"). Since the inception of this tool in April 2016, the central bank has lowered it for once when RMB was strong and hiked it three times when RMB was weak.
- **The policy can influence the short-term fluctuation of RMB exchange rate, but has limited impact on its medium-term trend.** The hike of MPP can influence market expectations and therefore may cause short-term fluctuations of RMB exchange rate. However, it has no impact on US dollar supply in the global market, which is determined by the US Fed based on the US economic condition. Meanwhile, it has limited impact on renminbi supply, which is determined by the PBOC based on China's economic condition.
- **We expect RMB to rebound moderately against the US dollar in 2H23 with US\$/RMB spot rate likely to reach 7.05-7.10 at end-2023.** There are two factors. First, China economy may moderately improve with an alleviation of deflation. The 2Y CAGR of GDP is expected to rebound from 2%-3% in April-May to 4% in 4Q23. GDP deflator is expected to narrow its YoY declines from 1.4% in 2Q23 to 0.3% in 4Q23. Second, the US economy and inflation is expected to gradually decline. The YoY growth of CPI may further decrease in 4Q23 after possible slight pick-up in July-August.

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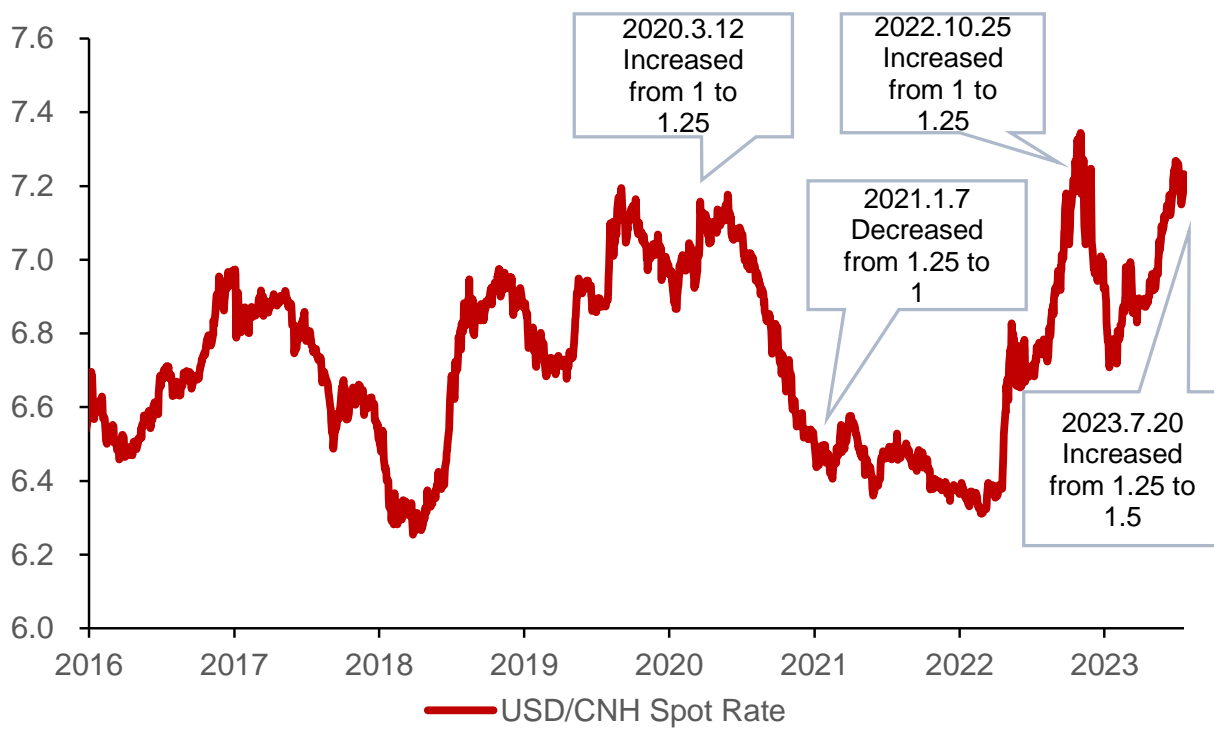
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Figure 1: USD/CNH Spot Rate



Source: Wind, CMBIGM estimates

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