CNY With A Seven-Handle

Overnight, the People's Bank of China (PBOC) let CNY cross the 7.00 threshold. With markets already on the back foot at the end of last week as the US escalated its trade posture, this move has had a predictable effect on risk markets.

How weak Beijing allows the yuan to get is yet to be determined, and there is a good argument to make that today's fixing was as much a signal to the US as it was a policy decision on its own merits. The message was that China has - and is willing to use - policy tools to both offset pressure on capital flows as well as punish the US if needed.

The chart shows spot CNY and our estimate of the Countercyclical Adjustment Factor (CCAF) which the PBOC employs daily to manage to the CNY fix. While the details of the CCAF are not publicly available, we can estimate it by examining today's fix versus yesterday's close (plus a momentum factor incorporating previous RMB fixings).

This mechanism, in place for the past two years, gives us some idea of where CNY would be if the market were to price the currency by itself.

We can see earlier this summer how much of an effort the Chinese made in May and June to keep CNY from weakening past 7.00. This followed a period of gradual appreciation between February and April during which there had been a brief interlude of relative calm in the trade dispute.

After the recent move past 7.00, the CCAF for Monday's fix shows the PBOC leaning against pressure to weaken the currency even more than the 7.037 level at which it was fixed. This suggests that China actually set a cap to how weak it is willing to see CNY
go. Letting the yuan go past 7.00 but not much beyond that underscores this was a signal and not a policy intended to effect a sustained deviation.

We can only note the irony of US leaders decrying China as a currency manipulator, when it actually appears that a market-determined CNY would be significantly weaker than the PBOC sets it.

**CNY and Countercyclical Adjustment Factor**

![Graph showing CNY and Countercyclical Adjustment Factor](image)

**SOURCE:** BNY Mellon Markets, Bloomberg, data for 5 August 2019

Please direct questions or comments to:

AerialView@BNYMellon.com

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