Back to the CNY

- China has made enormous efforts to cut excess production capacities
- A retreating tide of global growth has undone a lot of the good work
- A weaker CNY is a suitable tool to help counter industry's deflationary threat

The Fed "put" and upbeat Chinese data have kept some downward pressure on medium-term forward outrights in USD/CNY. But the greater risk over the period in question is still a weaker CNY.

In meeting market expectations, China’s Q2 GDP (with growth of 6.2% y/y) was a source of relief for a market that also witnessed the added bonus of accelerating industrial production and retail sales growth. Clearly some of the Herculean efforts to support growth are paying off.

However, aside from the 27-year low that the GDP growth figure constituted, the data release with arguably greater potential resonance to Chinese policymakers has been June’s PPI.

China has made enormous efforts to cut excess production capacities across industry since 2016 and such efforts are ongoing.

For example, plans to streamline steel output were announced in May whilst the China Building Materials Neil Mellor
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Newswatch

1. President Trump says “To the extent that we make significant progress [in talks with China over the phone], I think there’s a good chance we’ll go there later.” >

2. Treasury Secretary Steven Mnuchin says
Federation has since released plans to cut cement production capacity by 70 million tonnes this year.

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However, old habits die hard and as the South China Morning Post also points out, in the effort to meet growth targets, local governments attract new manufacturing facilities by offering all kinds of financial subsidies. More significantly, however, a retreating tide of global growth has simply undone a lot of the good work.

As a result, annual producer prices stalled in June, thereby maintaining a two-year long trend of disinflation; and the trend, notably reminiscent of the scale, if not the duration to the post-2010 downtrend, is the source of much talk that outright deflation is in the pipeline.

But while this threat is for the moment confined to industry, the issue is not just one of pricing. More than CNY 55bn of local note defaults took place in the first half of 2019, including 20 first time defaulters.

And although delinquencies are coming from a wider range of sectors, in 2016 most of the company failures and debt defaults were in industries with excess capacity such as coal and steel.

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The question is what China is, or is not prepared to do over and above existing measures. In 2015, with producer price inflation of around -5%, Beijing unleashed one of its largest phases of stimulus since 2008 and at one point unveiled a “pro-growth” measure every two days.

This served to turn deflation around (with prices growing by

3. Mnuchin also says “to the extent that we can agree on the debt ceiling and a budget deal ... I think that we’re getting closer.”

4. RBA minutes affirm that rates will be cut "if needed"

5. New Zealand’s inflation rate picks up in Q2

On the Radar

July 16, 2019

- UK May ILO unemployment (0930 GMT+1)
- US Jul retail sales (1330 GMT+1)
- Jerome Powell (1800 GMT+1)
5.5% at the end of 2016); but in 2019, China has largely turned its back on the monolithic packages of the past. However, at this point, it is worth reminding ourselves of comments made in the SCMP in early June.

The SCMP noted that while Beijing agreed to the principle that it should not use currency depreciation to gain trade advantages, it wanted “more flexibility and control in how it managed the CNY”. PBOC Governor Yi Gang has also clarified that there is no 'line in the sand' when it comes to the currency's performance against the USD.

Clearly, the potential influence from the ongoing US-Sino trade spat cannot be separated from any inferences that are drawn here.

But either way, in a slowing global economy that is anathema to export-leaning nations, the idea that Beijing is not only averse to currency strength, but tempted by a weaker CNY as the most suitable tool to counter a deflationary threat in its traded sector, is hardly controversial.

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