CNY Policy Back in Focus

• Debate over significance of CNY 7.00 re-emerged ahead of the weekend

• PBOC governor downplayed significance of any one "numerical number"

• Previous summers have seen significant shifts in CNY policy

Beijing has a history, since the summer of 1998, of stepping in to minimize currency market volatility when there has been a concern it could feed through into broader asset market turbulence.

Given that the authorities held the line at CNY 7.00 in Q4 of last year (the USD hasn’t traded above there since 2008) it seems reasonable to assume they were concerned that a rapid move beyond this level might lead to heightened volatility in a range of markets and that this was worth defending against.

The question that remains however, is why not just let the CNY weaken?

“"The trade war would have a temporary depreciation pressure on renminbi"”

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Newswatch

1. US/Mexico: President Donald Trump (@realDonaldTrump) tweets: “I am pleased to inform you that the United States of America has reached a signed agreement with Mexico. The tariffs scheduled to be implemented by the US on Monday, against Mexico, are
The key issue remains asset market volatility and investor confidence. As a secondary factor it seems reasonable to assume, based upon past actions, that the authorities would be unhappy should speculative CNY short selling emerge.

However, the former concern could presumably be moderated by the authorities judiciously leaning in to the move when required. Equally, the latter issue could be discouraged by the occasional use of bear traps.

Moreover, while Beijing has made it clear that it does not intend to use the CNY as a weapon in the trade dispute, it’s harder to see why they should stand against a move that might be justified by economic circumstances.

Beijing might also recall that the US seemed to have few concerns in the period between 2002 and 2011 with allowing the USD to weaken at a steady pace (one of the key reasons why China’s FX reserves stand at current levels).

“A little bit of flexibility of RMB is good for the Chinese economy and for the global economy because it provides an automatic stabilizer”

This question began to come back into focus last week after it emerged that US Treasury Secretary Steven Mnuchin was scheduled to meet with PBOC Governor Yi Gang at the G20 finance leaders meeting in Japan.

Given this, the timing of an interview given by Governor Yi to Bloomberg TV on Friday therefore seemed interesting - doubly so given it was a market holiday.

As well as highlighting that China has “tremendous” room to adjust monetary policy if the trade war with the US deepens, Governor Yi made some telling comments about the CNY.

Firstly, he noted (when asked if there was a red line for the exchange rate) that no “numerical number” was more important than another.

Having effectively downplayed the significance of CNY hereby indefinitely suspended.”

2. US/China: Treasury Secretary Steven Mnuchin (@stevenmnuchin1) says in a tweet that he had a "constructive meeting" with People's Bank of China Governor Yi Gang, including a "candid discussion" on trade issues. >

3. China: Exports in May rise 1.1% y/y. This compares to a Reuters consensus forecast of a 3.8% y/y decline and a 2.7% y/y drop in April. Imports fall 8.5% y/y (Reuters consensus forecast -3.8% y/y; previous 4% y/y) >

4. China: Data from the General Administration of Customs of China show that exports of rare earths fell 15.9% m/m in May. (via Reuters) >

5. Eurozone: Reuters (citing two sources) reports that European Central Bank policymakers are open to cutting the policy
7.00 he then noted that “the trade war would have a temporary depreciation pressure on renminbi, but... after the noise, renminbi will continue to be very stable and relatively strong compared to emerging market currencies, even compared to convertible currencies”.

He added that “a little bit of flexibility of RMB is good for the Chinese economy and for the global economy because it provides an automatic stabilizer”.

It remains to be seen whether these comments presage a shift in stance. However, it is worth remembering that June, July and August have often proved key turning points for CNY policy since the 2005 de-pegging.

Please direct questions or comments to:

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On the Radar

June 10, 2019

- UK Apr manufacturing output (0930 BST): Reuters consensus forecast -0.8% m/m; previous 0.9% m/m

- CA May housing starts (1315 BST): previous 235.5 k m/a

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