Chinese Currency "Flexibility"

- Comments from Beijing have started to highlight usefulness of currency "flexibility"
- Movement in key indicator for CNY highlights market is taking note of these comments
- G20 summit could prove a key moment

The usefulness of forward outright pricing as an indicator of changing sentiment towards the CNY was made apparent in the run up to the end of 2018 when the USD was consistently pressuring CNY 7.00.

What was interesting at that point was that unlike the period between August 2015 and Jan 2016 or, again, in December 2016, there was little sign of the NDF market becoming particularly excited about the prospect of a significant move higher in USD/CNY in 2019.

To put this into some kind of context, by mid-December the spread between spot and the one-year NDF forward outright was at about the same levels it stood at in October 2012 when the USD downtrend was starting to slow.

This, therefore, was a market that collectively believed the PBOC would be able to carry out a very effective smoothing operation in the months ahead and that any move by the USD above CNY 7.00 would likely prove muted.

In the event, that proved a very accurate read of the...
situation.

"... it wants more flexibility and control to ensure the stability of its financial system"

So why does that matter now?

Between mid-May and late last week the one-year NDF had largely been trading sideways just below CNY 7.00, presumably reflecting a collective view that Beijing would once again defend this level in order both to help minimize financial market volatility as well as dissuade speculators from aggressively shorting the currency.

This pattern shifted on Friday following Governor Yi’s carefully timed comments (see today’s featured article). These comments, in turn, were consistent with some observations that had emerged in an article in The South China Morning Post in late May detailing the breakdown in the negotiations between the US and China.

While a number of sticking points in the negotiations were highlighted by The SCPM (including the need for a monitoring mechanism), one stood out from an FX perspective. This was the pushback on currency manipulation. The article noted:

'The two sides also could not agree on the issue of currency manipulation. Although Beijing agrees to the principle that it should not use currency depreciation to gain trade advantages, it wants more flexibility and control to ensure the stability of its financial system. The US, however, wanted a rigid system that allowed little room to manoeuvre. The source did not elaborate further.'

This suggested that when Governor Yi Gang told Bloomberg 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 for the economy”, this was done to emphasise exactly this point.

“A little bit of flexibility of RMB is good for the Chinese

Hong Kong in late June. The move is aimed at “improving the yuan bond yield curve”. >

3.
Australia: NAB’s business confidence indicator rises to 7 in May from flat the month before. >

4.
Italy: The office of Prime Minister Giuseppe Conte says that coalition leaders have agreed on the need to avert a European Union disciplinary action. (via Reuters) >

On the Radar

June 11, 2019

• UK Apr employment change (0930 BST): Reuters consensus forecast 10k; previous 99k

• US May PPI (1330 BST): Reuters consensus forecast 2% y/y; previous 2.2% y/y
While Beijing's messaging about the need for greater "flexibility" might be clear, it's important to note that all this comes ahead of the G20 meeting in Japan on June 28 and 29. With President Trump clearly stating yesterday that a failure to meet with President Xi at the summit would lead to the imposition of further tariffs it seems reasonable to assume that China would not wish to do anything to disturb the status quo before then.

With this in mind it was interesting to note that the only significant development during the trading session in APAC today was the announcement from the PBOC that it would sell CNH-denominated bills in Hong Kong in late June (a move aimed at "improving the yuan bond yield curve"). On the back of this the downward pressure on both the CNH and CNY (along with related currency markets - including the HKD and KRW) began to ease.

The picture therefore looks an interesting one. In the run up to the late June summit it seems reasonable to assume that Beijing will aim for stability in local currency markets. However, with "a little bit of flexibility" for the CNY being noted as being a good thing for both the Chinese and global economy, it's entirely possible that something reflecting this could emerge post the summit. Presumably, much will depend upon how the meeting between the two presidents goes.

This might go some way to explaining why the USD/CNY one-year NDF outright has only made the most modest of pull backs this morning.
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