The CNY and a Slowing Economy

- Low prospects of a trade deal could reignite speculation about USD/CNY 7 sanctity
- Senior officials have talked up need for "flexible" policy control
- A weaker CNY has direct implications for APAC currencies

We have suggested that although souring US-China relations could see China step up its stimulus as insurance against further economic weakness, we could also be talking once more about CNY 7 to the USD – a subject with clear implications for APAC currencies.

A declared truce lifted risk assets yesterday, but momentum was lacking and sentiment was clearly fragile today in Asia. Confusion over comments from US Treasury Secretary Steve Mnuchin on Wednesday may have induced some skepticism, but then, well-placed sources were also drawing attention to an unusual level of US criticism from Chinese state media.

Ultimately, if the threat of fresh tariffs on Chinese goods is kept alive, there remains every possibility that Beijing could consider a weaker CNY a suitable response – certainly when we consider China’s flagging exports, growth and potential distaste for alternative stimulus policies.

Besides, China is not wedded to the idea of defending the CNY at any particular level – a point that PBOC Governor Neil Mellor

Newswatch

1. Premier Xi said “All this [protectionism] is destroying the global trade order ... This also impacts common interests of our countries”

2. Ahead of talks with Indian POM Modi, President Trump said
Yi Gang sought to emphasize in comments earlier this month.

Yi also noted that “the trade war would have a temporary depreciation pressure” on the CNY – a pointed commented (that saw forward outrights spike higher) which chimed with a South China Morning Post article two days later.

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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”.

All in all, therefore currency matters could feasibly return as a central issue to China if the prospects of a US trade deal fail to improve significantly this weekend. At the very least, we would remind readers that Beijing has something of a history of policy shifts in June, July and August.

And of course, where the CNY goes, other Asian currencies are bound to follow, as with only one or two exceptions, cross-correlations in USD-Asia have been very strong, historically.

Since the start of last year, relative to the USD, the CNY’s daily correlations with the SGD, KRW, THB, IDR, MYR and PHP have ranged from 0.96-0.98%.

Although, clearly, this does not in itself imply causality, China’s economic dominance in Asia has long made the CNY a benchmark against which all regional competitors are measured and stability inferred.

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Hence, as the CNY slipped steadily from 6.4 to the USD from June last year (stoking fears that the US/China trade

spat had morphed into a currency war), a number of Asian central banks were obliged to defend their currencies – including Bank Indonesia, for example, following the IDR’s biggest fall in two years on July 15.

And as the momentum built for a move beyond CNY 6.9 to the USD on August 10-14, regional stocks came under concerted pressure, with the Kospi, Hang Seng and Thai SETI, for example, losing 2.4%, 4.5% and 2.7% respectively.

The fact that the one year USD/CNY NDF outright has fallen below CNY 6.90 shows that investors are not yet concerned about a sustained move beyond USD/CNY 7.

But much rests on the outcome of this weekend’s meetings and limited progress there could well merit more rapid developments elsewhere by way of compensation.

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