Central Bank of China fights market expectations

Our forecast on CNY was among the most bullish, but still too weak versus spot

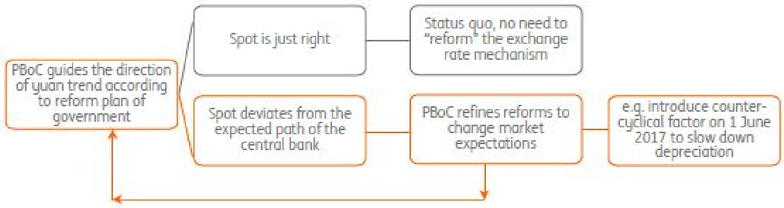
We believe the 0.8 percent appreciation of the Chinese yuan (CNY) in July has changed the expectations trend from depreciation to appreciation for some market participants and this shift is likely to slow down capital outflows.

But the central bank may want to ensure the majority of market participants agree, which might be reflected by changes in trends of market hedging tools. Under this assumption, we expect the daily fixing to be stronger in the coming months. And the yuan may follow the US dollar index (DXY) asymmetrically, more so when the USD is weak, less so when it's strong.

Although market expectations are changing, this doesn't mean regulators will relax administrative measures on capital outflows for the rest of 2017. Foreign companies operating on the Mainland will remain sensitive to this policy change and would act quickly to remit profits to parent companies. On the other hand, regulators will remain cautious, not letting capital outflows trigger yuan depreciation expectations.

The journey from depreciation to appreciation

Reform is the tool to keep markets in check



Appreciation trend develops to stop capital outflows

We therefore revise our forecast to 6.65 from 6.72 for the end of 2017 and 6.45 for the end of 2018, equivalent to 4.5% and 3% appreciation of the yuan in 2017 and 2018, respectively.