

China steps up retaliation and prevents capital outflows

China retaliates with the US raising tariffs from 10% to 25% on \$200 billion of goods. At the same time, the central bank imposes 20% reserves on short yuan derivatives to prevent capital outflows from the escalating trade war



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China's retaliation and shielding from capital outflows

As a retaliation for the US raising the tariff rate from 10% to 25% on \$200 billion worth of goods imported from China, China reacts by imposing tariff rates from 5% to 25% on \$60 billion imported US goods. The effective time will depend on the US' tariff effective time.

At the same time, the Chinese central bank (PBoC) adds 20% reserves on short yuan derivatives activities. This is to slow down the depreciation speed of the yuan against the dollar.

We see both actions by China as a "combo". On one side is retaliation on the US raising tariffs, on the other side, preventing capital outflows from the escalating trade war.

What's next is the more important question

We would like to see the next steps from China, and we ask the following questions:

1 Whether the 20% reserves would be enough to slow down yuan depreciation speed?

We believe the effect could be short-lived as the trade war escalation would mean a stronger dollar, which is a safe-haven currency. Then the next step would be that the PBoC would impose a "counter-cyclical factor" in the daily yuan fixing formula. The "factor" is like a blackbox to the market, so the fixing would be "determined" by the PBoC. We expect the PBoC would either fix steadily or even drive the fixing to appreciate slightly from the previous day if the yuan depreciates against the dollar quickly during the intraday.

2 What would China do to react to US tariffs on more Chinese goods?

Though the timing of US tariffs on \$200 billion of goods is still uncertain, we expect that tariffs on \$300 billion of imports from China are still possible. China would retaliate by increasing the tariff rates to 25% on all \$60 billion imports from the US, as well as implement qualitative measures, which could limit US companies' operation activities and/or limit US companies' M&A activities.

We keep our USDCNY forecast by year end at 7.0