

We're revising our yuan forecast again and expect far more volatility

China's unexpected retaliation last week and the hasty US reaction means we can expect China to use tools other than tariffs for future retaliation. The yuan is likely to be one of these, but the central bank probably wouldn't want one-way depreciation lest it triggers capital outflows. Therefore, we revise our USD/CNY forecast.. again



Dollars surrounded by Chinese yuan

It's all kicking off again

Last Friday, China surprised markets by imposing new tariffs on more US goods imported into China. The retaliation in terms of the amount is small (simply because China exports more goods to the US than it imports), so in principle this shouldn't have much of an impact on the US. It could ignore this - after all it was retaliation.

The unexpected announcement hit a nerve

Another [perspective on the entire situation](#) is the flurry of tweets that came almost immediately

from President Trump displaying his anger. The Chinese tariffs seem to have hit a nerve.

The wobbly stock market

This marginal increase in tariffs might not be a substantial issue for China as the initial tariffs should have already been enough of a hindrance for Chinese businesses exporting to the US.

But with the surprise increase in tariffs, the Chinese action pretty much had the desired impact on the stock market.

Over to China

The ball is now firmly in China's court. We think imposing more tariffs isn't the most effective way to create more hurdles for a Trump Administration that will soon begin to campaign in earnest for the 2020 presidential elections. Instead, China could probably cause more disruption if it keeps catching US stock markets - as well as potential Trump voters - off guard.

There are two possibilities open to China:

1. **Unreliable entity list:** Inclusion of any US companies in the list means those companies cannot tap into the Chinese market. This is a very powerful tool that has the potential to lead to increased volatility as well as periods of sudden yuan weakness.
2. **Firm stance on trade talks:** Talks without progress are more likely to provoke additional tariffs from the US. Even though this is to be expected, it is likely to weaken the yuan significantly. USD/CNY could cross 7.18 (the recent high) to near 7.20. This alone, without any retaliation from China, has the potential to create further market disruption.

Revising yuan forecasts

Arguing that both measures will end up with a weaker yuan, we revise our USD/CNY forecasts.

We also think the central bank won't want the market to believe that the yuan can only depreciate against the dollar. So we expect that - in between these "unexpected" events - the yuan will strengthen against the dollar from time to time.

If we draw a monthly chart of USD/CNY, we should see increased USD/CNY volatility, even we only see a linear weakening yuan trend at every quarter-end.

Our range forecast of USD/CNY for the rest of 2019 is 7.05 - 7.50. Volatility should be high given that China's objective is to use the yuan as a surprise tool for the market. The spikes in USD/CNY may not be reflected in the quarter-end point forecasts. Our previous forecasts were 7.10, 7.00 and 6.90 for the end of 2019, 2020 and 2021, respectively.

Revised yuan forecasts as of 27/8/2019

	1M	3Q19	4Q19	4Q20	4Q21
USD/CNY	7.18	7.18	7.20	7.30	7.20