# CNY: PBOC relinquishes some control

China is changing the way it manages the Renminbi and we think the move is line with PBoC's journey towards liberalising its FX regime


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The Renminbi (CNY) has weakened today on news that the People's Bank of China (PBOC) has told commercial bank counter-parties that it is removing the counter-cyclical factor (CCF) from its daily CNY fixing mechanism. The CCF was an arcane measure introduced last May by the PBOC to exert more influence over the Renminbi – after USD/CNY neared 7.00 and threatened to exacerbate portfolio outflows from China.

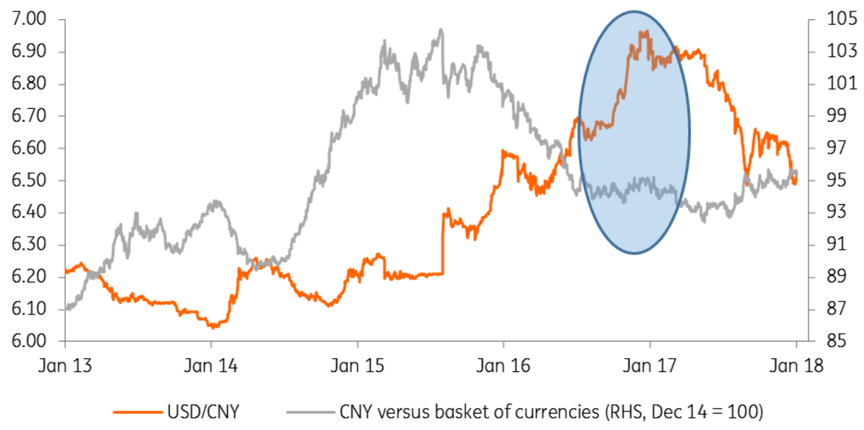
## Why now?

At the time (May 2017) we felt the introduction of the measure was to limit the chances of USD/CNY breaking above 7.00 – triggering further portfolio outflows and likely to send China's FX reserves below the psychological US$3 trn level.

In a way, the PBOC was unlucky in choosing to liberalise its FX regime at the start of 2016, choosing to keep the Renminbi stable against a basket of currencies rather than the dollar. The PBOC was caught out by the dollar strength from 2016 onwards as the ECB extended QE, and the dollar broadly rallied.

## USD/CNY versus CNY basket

PBOC had struggled with USD/CNY near 7.00 in late 2016 and early 2017




Source: Bloomberg

Indeed the CCF was introduced to try and break the 'herd behaviour' of dollar strength, leading to higher USD/CNY fixings, fuelling expectations of further USD/CNY strength.

Yet the broad dollar trend turned in 2017, and the PBOC will be far less concerned now about CNY weakness. In fact, one could argue that today's move could have been triggered by a desire to prevent excessive CNY strength. Incidentally, the Korean Won weakened yesterday when a government official warned it would take action to avoid one-sided moves in the Won.

## What's the outlook for the Renminbi?

The initial market reaction has seen USD/CNY move higher on the view that the PBOC is down-scaling its support operation for the CNY. We prefer to view the move as one in keeping with the PBOC's journey towards liberalising the FX regime – after a retrograde step last May.

A more flexible (and presumably more volatile) Renminbi should, therefore, be more susceptible to the external FX environment. Given that we look for the DXY dollar index to depreciate around 7% this year, we believe the USD/CNY bear trend will remain in place.

As ING's Economist for Greater China, Iris Pang, notes, we expect PBOC to tolerate modest appreciation pressure in the Renminbi this year and USD/CNY to end 2018 at 6.30.

Read why we expect 3% appreciation of CNY against the USD

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