

China's tech war with the US has made us revise our yuan forecast

The persistence of the technology war is hurting long term Chinese growth and the yuan's strength. Although we're revising our yuan forecast, it isn't much stronger from the current spot



In this photo illustration, a TikTok logo is seen displayed on a smartphone with the Chinese and American flag in the background

Source: Shutterstock

New challenges to economic growth

The Chinese economy is recovering. GDP grew by 3.2% year-on-year in 2Q20 but there are new challenges ahead.

- The first-in-first-out from Covid-19 has been China's advantage compared to other economies. There have been some small clusters recently, but the government has acted swiftly to impose very tight social distancing measures, limiting the impact on the economy.
- There has been widespread flooding affecting agriculture as well as infrastructure construction. The typhoon season has also arrived, bringing more uncertainty to the flood damage.

These two challenges hurt short-term economic growth, and the government has offered help to offset some of the damage, so we are not too worried that these will hit GDP growth significantly

in 2H20.

The longer-term challenge to the economy is the US becoming increasingly aggressive towards Chinese tech companies. US companies are banned from doing business with more Chinese companies and there were renewed threats on Huawei in May. Recently, the US administration has forced TikTok, whose parent company is a Chinese corporate, to be sold to US companies or stop operating in the US.

This hurts China's long term growth in technology exports.

The yuan strengthens but only slightly

This technology war has put yuan strength at risk.

Even though China has fought against Covid-19 quite successfully, the yuan depreciated against the dollar to 7.1680 per dollar in May, which was the peak in 2020, as a result of the renewed threats to Chinese telecommunications group Huawei.

But in June, economic indicators improved and since then the Chinese economy has started to recover. From its peak, USD/CNY at 7.1680 to 6.9809 on 3 August, the yuan has appreciated by 2.61%.

If we measure the yuan's performance from the beginning of 2020, then it is still 0.25% weaker against the USD. This is in contrast with the dollar index's 2.95% depreciation over the same period. Some of the yuan appreciation that should have reflected in the USD/CNY exchange rate has been offset by the technology war.

We expect the technology war to persist for the rest of the year, which will continue to affect the yuan's performance.

We have revised our USD/CNY forecast to 6.97 from the previous 7.05 by the end of 2020.

We expect a stronger yuan from the previous forecast but the strength of the yuan from now to the end of 2020 is likely to be hit by negative news from the tech war.