

Why sharp yuan appreciation or depreciation is unlikely in 2019

Since the central government described the Chinese yuan as a 'stable' currency, we have seen some structural changes in the movements of USD/CNY. This is why we're revising our forecasts of USD/CNY and USD/CNH



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The 'two sessions' structurally changed yuan movements

After the 'two sessions' in March, the USD/CNY and USD/CNH have traded in narrow ranges as yuan stability is one of the big focuses of the Chinese government. And now, it is beginning to look clearer that yuan stability means the central bank manages the yuan movements in a narrow range.

Onshore yuan depreciated 0.2% against the dollar in March, and so far has dropped 0.3% in April (until 29/4/2019). These narrow range bounds are very different from the movements observed in the first two months of 2019 when the yuan appreciated 2.45% against the dollar.

We are forecasting USD/CNY to touch 6.75 by the end of 2Q19 and 6.80 by the end of 3Q19, which is equivalent to 1.89% and 1.16% year to date appreciation

It's important to note that not only has the range narrowed, but the direction has also changed from yuan appreciation to yuan depreciation.

We believe the change in direction, albeit small in substance, is a way for China to show that its yuan policy is independent from the influence of other countries. We think this is a snub to the Trump administration who said that the yuan cannot depreciate if there is a US-China trade deal.

Where is the yuan headed after a trade deal is finalised?

Even though we have few clues about when a trade deal between the US and China will be signed, we need to think about the path of the yuan when it eventually is. We think the narrow range bound may not change even after there is a deal.

China will probably want market stability at the beginning of the trade deal, and not add more uncertainty when both sides begin with the implementation. Moreover, we don't think the execution of the trade deal will be smooth, also noting that the US is pressurising its allies to refrain from using China's 5G equipment.

We don't think a sharp yuan appreciation or depreciation is likely for the political environment in 2019

We're ruling out a sharp yuan appreciation because we believe that will be interpreted as appeasing the US, which is probably politically incorrect from Beijing's point of view and we think a substantial yuan depreciation would only be possible if China wants to pick a fight with the US, at the cost of increasing market concern about capital flight from the country and this seems highly unlikely.

So, neither a sharp yuan appreciation nor depreciation is likely for the political environment in 2019.

Revising USD/CNY and USD/CNH forecasts

At the time of writing this article, USD/CNY spot was near 6.73 and has depreciated from 6.71 since the end of 1Q19.

We are forecasting USD/CNY to touch 6.75 by the end of 2Q19 and 6.80 by the end of 3Q19, which is equivalent to 1.89% and 1.16% year to date appreciation, respectively. Our previous forecasts for 2Q and 3Q were 6.85.

We maintain our 4Q19 forecast at 6.75, which suggests the yuan is going to appreciate by 2.62% in 2019.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com