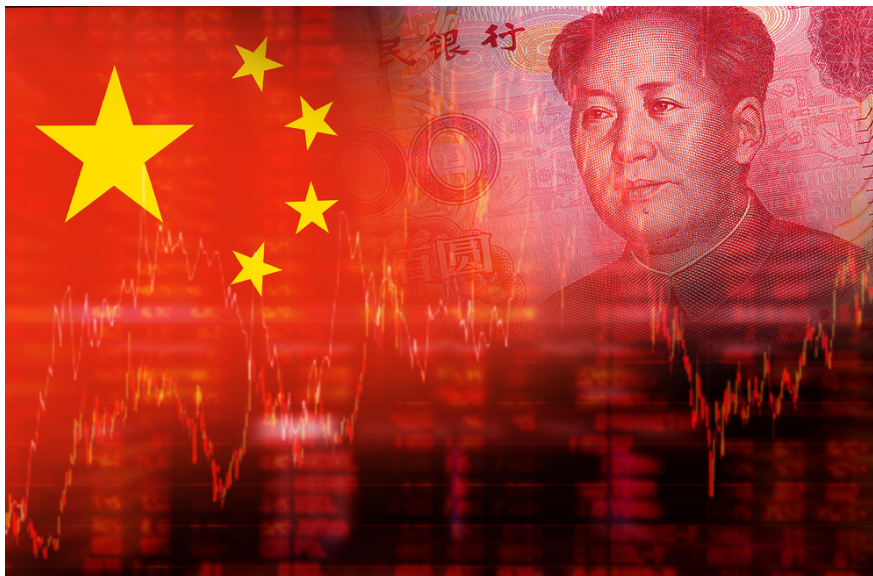


Snap | 3 August 2018

China blinks at a 7.00 handle for the yuan

The People's Bank of China (PBOC) has announced a re-introduction of reserve requirements on FX forwards trading – a move clearly aimed at taking pressure off the renminbi as USD/CNY closed in on 7.00. This looks only a temporary reprieve for the renminbi; prior PBoC attempts to stem CNY weakness haven't been all that successful in reversing a trend

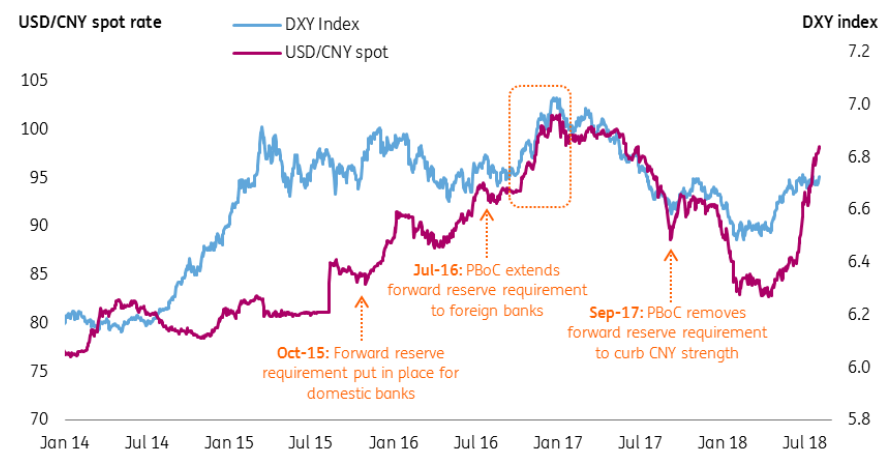


Reserve requirements back in play

Since 2015 the PBOC has used reserve requirements on FX forward transactions as a tool to control 'macro-financial risks'. The measure puts a 20% required reserve ratio for financial institutions when conducting onshore CNY forwards business on behalf of customers. The move makes it effectively costlier for the market to fund short CNY positions through the forwards market.

This measure was first used for domestic financial institutions in October 2015 and then broadened to include foreign institutions in July 2016 when USD/CNY was pushing above 6.70. These reserve requirements were scrapped when USD/CNY was dipping below 6.50 in September 2017 amidst broad dollar weakness.

Prior PBoC attempts to stem CNY weakness haven't been all that successful



Source: ING, Bloomberg

Why now?

It seems pretty clear that these measures have been introduced to trigger a squeeze in short CNY positions and keep USD/CNY away from 7.00. This reserve requirement is a relatively soft measure and avoids the bigger stick of FX intervention or rate hikes at a time policymakers are delicately deleveraging the economy.

We also think Chinese policymakers had a bad experience when USD/CNY was last trading near 7.00 in late 2016. Investors struggled to digest the message at the time that the renminbi was stable versus the basket and that the move to 7.00 was all about the dollar. That message will be so much harder to deliver today given the 6% decline in the renminbi against its trading basket since late June and the uncertainty over whether this is a market-led decline or the PBOC is using the renminbi as a weapon in the current trade war.

Temporary reprieve

USD/CNH has sold off 1% on today's (Friday) news, but we doubt investors will be encouraged to return to Renminbi exposure anytime soon. US Commerce Secretary Wilbur Ross has made the US trade position clear by outlining that Washington wants to create a situation where it's more painful for China to continue current practices than it is for China to reform.

An increase in the proposed tariff rate to 25% on the next \$200bn worth of Chinese imports looks likely over coming weeks. And combined with firm US rates and what look like continued dollar strength over coming months, it looks as though the PBOC will be forced to use more of its currency toolkit to prevent USD/CNY going through 7.00.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.