China: Foreign reserves show no outflow panic

Foreign exchange reserves dropped by $34 billion in October, the largest drop in 2018 so far, though still small compared to 2015. This means there was no capital outflow panic even as the yuan approached 7.0 against the dollar. We expect USD/CNY and USD/CNH to cross the 7-handle anytime between now and the end of 2018, moving slowly to 7.30 by the end of 2019

Source: Shutterstock

No panic

China foreign exchange reserves fell to $3.053 trillion from $3.087 trillion in October. Though the drop was the largest on a monthly basis in 2018, it was still small compared to monthly drops in 2015 (in excess of $100 billion in a month).

This implies that there is no capital outflow panic in China even as USD/CNY approached 7.0, and depreciated 1.56% in the month. The yuan's weakest closing level against the dollar was 6.9757 on 31 October.

The USD/CNY 7.0 handle is not to be feared

The data confirms our view that the USD/CNY 7.0 handle is a mere round number, not a psychological barrier, as the currency pair has approached this level a number of times.

We expect that USD/CNY and USD/CNH will cross 7.0 anytime between now and the end of 2018. And the chances of such would be high if the sideline meeting of President Xi and President Trump at the G20 shows no progress in delaying the proposed increase in tariffs on $200 billion of Chinese goods from 10% to 25% on the first day of 2019.

The yuan will depreciate slowly after crossing 7.0

After crossing 7.0, the currency pair could pull back slightly but the yuan would then continue to depreciate further.

We expect USD/CNY and USD/CNH to reach 7.3 by the end of 2019.

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