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Snap

Money flowing into China, thank you yuan

Chinese foreign exchange reserves rose slightly in February, with the value of non-dollar assets lower on the stronger dollar. We expect capital inflows to continue as more Chinese assets are included in equity and bond indices

Foreign reserves rise despite muted valuation effect

Chinese foreign exchange reserves rose to \$3.090 trillion in February from \$3.088 trillion a month ago.

We see the rise in foreign reserves as a result of two contrasting factors including a 0.31% appreciation of the yuan attracting capital inflows into the Chinese market, and contrary to this, the stronger dollar should push non-dollar asset values lower, limiting the rise.

More capital inflows expected

The stronger dollar effect seems to be fading, and so we expect the exchange rate valuation effect to turn positive in the coming months.

Also, the increase in the proportion of A-shares in the MSCI index and China onshore bonds in global bond indices will encourage capital to continue to flow into China. There will be even more inflows if the yuan keeps appreciating. Our USD/CNY and USD/CNH forecast are both 6.75 in 2019 - an appreciation of 1.89% over the year.

Given that the wording in the Government work report on the exchange rate mechanism is identical to that used in 2016, and since 2016, USD/CNY has followed the dollar index, it's possible USD/CNY will continue to track the dollar.

Overall, we expect capital inflows to increase, so keeping foreign reserves stable.

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