

China: slowing yuan appreciation

China's central bank has finally acted to deter further yuan appreciation. Will this work? Is this a backward move from exchange rate liberalisation?



Source: Shutterstock

Finally, the PBoC acts to deter yuan appreciation

After several rounds of talking down yuan appreciation, China's central bank has now taken some firmer action. The PBoC will [raise fx deposit reserves](#) from 5% to 7% effective from 15th June. This comes after the PBoC appreciated the USDCNY fixing this morning to 6.3681 from last Friday's 6.3858.

Will this work?

We believe that this increase in foreign deposit reserves will help to deter speculators and shield the yuan from further rapid appreciation unless those speculators believe that the yuan will appreciate by more than 2% points from now even after the PBoC has sent this strong signal. In short, this should be enough to slow the pace of the yuan's appreciation. But it may not stop it.

Is this a backward move on exchange rate liberalisation?

This sounds a bit like a retrograde step to the PBoC's ambitions on exchange rate liberalisation. But

it isn't really.

Looking at the fixing, which continued this morning to follow overnight developments of the dollar index, it looks as if the PBoC still wants to stick to the idea of exchange rate liberalisation.

But this is difficult to achieve if the PBoC doesn't like speculators occasionally taking charge of the direction and pace of the yuan FX market. A market consists of FX users and investors, including speculators.

We interpret the foreign deposit reserves as a tool to deter speculation, not yuan users (such as exporters and importers). And this type of administrative measure will continue to be used repeatedly when yuan moves look to be dominated too much by speculators.

We are maintaining our USDCNY forecast at 6.30 for the end of 2021.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com