People's Bank of China curbs yuan enthusiasm

The plan to remove fx forward reserve requirements could slow the pace of CNY appreciation

On Friday, People's Bank of China announced banks would no longer have to place reserves for clients' forward FX trading it had imposed on financial institutions in October 2015.

At the time, the CNY had been under heavy pressure following the August 2015 fixing adjustment, seen by the market as a prelude to a larger devaluation. Since then strong CNY fixes and broad dollar weakness have helped and USD/CNY has been trending lower and last week traded under 6.50.

The short term impact of this is that there are now fewer restrictions on banks' dollar purchases. One interpretation is that the pace of CNY appreciation has taken the PBoC, as well as the market by surprise. We believe CNY appreciation will continue, but at a slower pace from now on.

For the longer term impact, this is indeed a liberalisation of the forex market for RMB. This will also reduce costs for exporters' forex hedging, which may be a preparation for further liberalisation of the CNY daily fixing mechanism.

The move to withdraw the reserve requirement suggests PBOC now feels comfortable with supply-demand trends in the CNY market – and potentially ushering in a less one-way market in USD/CNY. That said, with the USD trend staying neutral/soft and scope for portfolio inflows to resume into China, our team have revised USD/CNY end 17 and end 18 forecasts to 6.40 and 6.20

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