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Renmimbi - a managed currency

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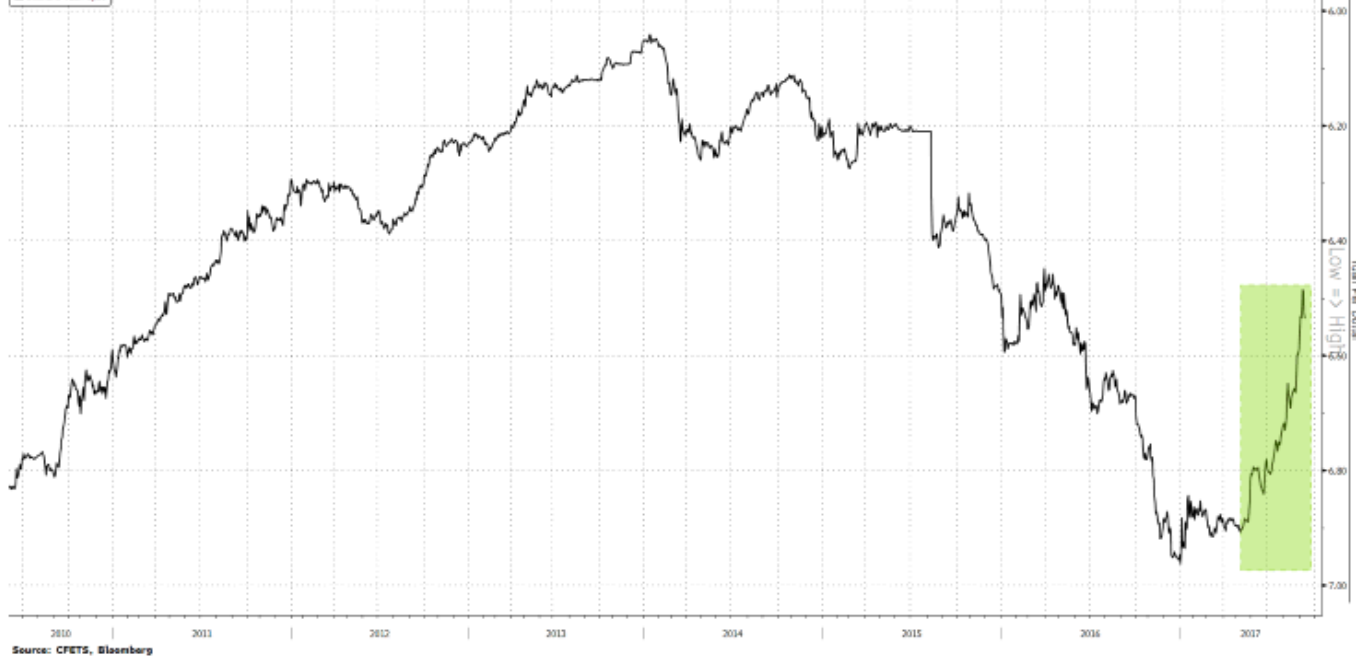
Jenny Teng is senior fund manager in the equity team of Erste AM. Born in China she is employed since 2008 at ERSTE-SPARINVEST and responsible for the Asian equity markets.

Long enough we have heard about the depreciation of Chinese currency Renmimbi (RMB), but this year RMB has showed rather unusual movements.

With an appreciation of 7%, the Chinese currency reached its strongest level versus US dollar since sixteen months in the first week of September. This is indeed a remarkable movement after the currency's continuously depreciation from 2014 to 2016.

Development of Renmimbi vs. US-Dollar (01/2010-09/2017)

Through the Valley
The yuan has been rapidly reversing its longer-term trend



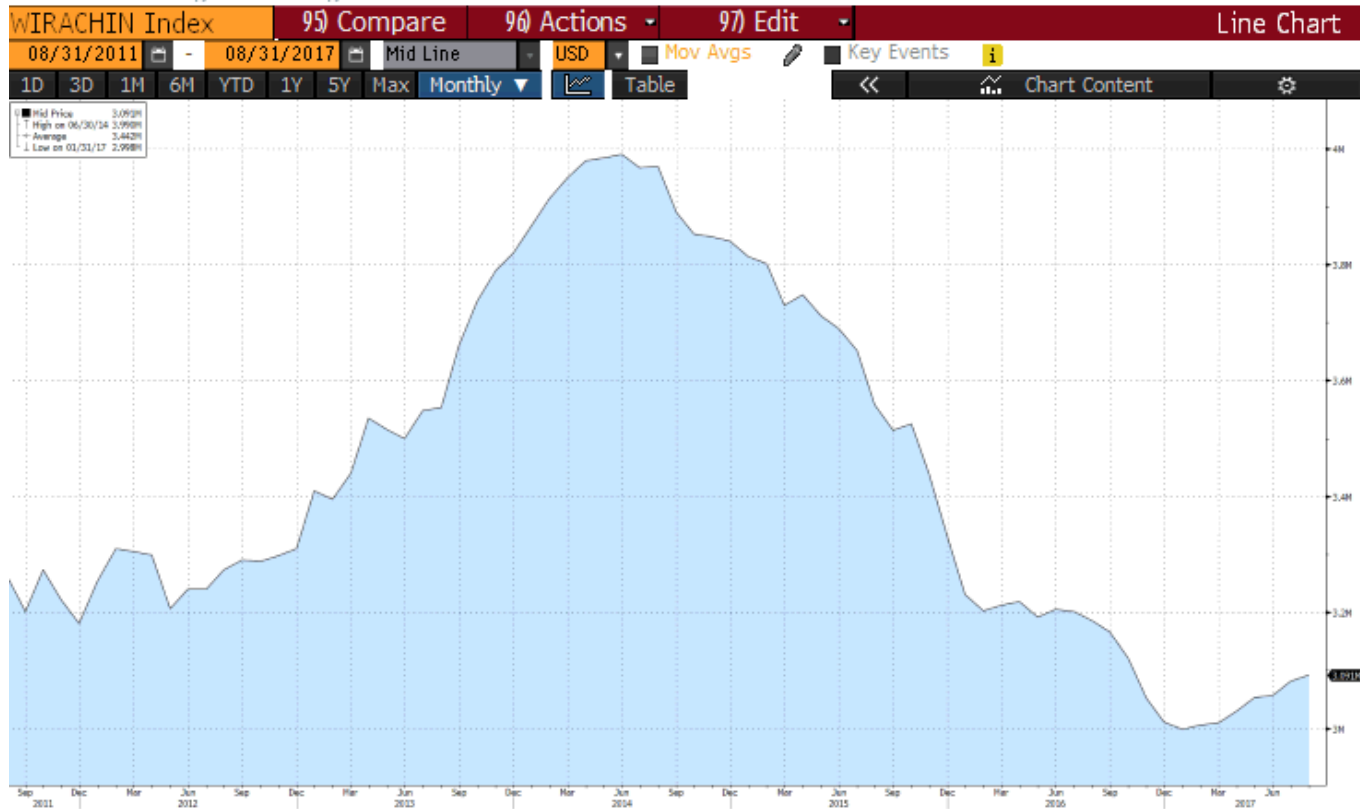
Source: Bloomberg; Data as of 2.10.2017

What are the drivers of the rally?

Besides a general US-Dollar (USD) weakening and a better outlook of the Chinese economy it is highly speculated that the sharp appreciation is the consequence of the Chinese government's intervention. Starting in late 2016 the Chinese authorities took steps to support RMB versus USD. Due to this FX policy shift, companies and residents in China are facing increasing restrictions on converting RMB into foreign currencies.

It is also reported that the Chinese government asked state-owned enterprises (SOEs) to convert their foreign currencies into RMB. In May 2017 the People's Bank of China (PBOC) adjusted the formula for calculating its daily RMB reference rate. A "counter-cyclical adjustment factor" has been added, giving the central bank more direct control over the value of the currency. These actions to a large extent caused the rally of RMB this year and helped China's FX reserve rising for seven consecutive months from February to August.

China Foreign Exchange Reserves (in Million USD)



Source: Bloomberg

Why does China want to strengthen RMB at this point?

One of the most important reasons is to ease capital outflows, which was a major cause of downward pressure on RMB. According to estimates from Bloomberg Intelligence, more than \$1.2 trillion fled out of China from August 2015 to December 2016. Foreign companies transferred cash out of the country. Chinese companies repaid dollar debt, increased overseas mergers and acquisitions. Also Chinese households changed RMB to foreign currencies for overseas investment, adding to more capital outflows. China spent its foreign-exchange reserve to defend RMB, causing a decrease of its FX reserves from USD 4 trillion in June 2014 to around \$3 trillion in January 2017. A slump in currency and FX reserves caused concerns. China's policy makers therefore took steps to reverse the trend.

Another important reason is to maintain the relationship with the United States. The sharp appreciation of RMB began in May, shortly after the Summit between US President Trump and Chinese President Xi in April. Bear in mind that President Trump stopped accusing China of currency manipulation after his meeting with Xi, the timing of these events might not be a coincidence.

The efforts to strengthen RMB are also seen as part of a response to Moody's downgrade of China's sovereign credit rating in May, the first downgrade since 1989. China needs stronger RMB to boost investors' confidence and attract more foreign investment.

Is RMB appreciation sustainable?

What happens to RMB next will depend on USD direction and China's FX policy. There are several important political events happening in the coming months: the 19th Communist Party Congress in October, President Trump's visit to China in November. RMB may stay relatively strong versus USD till then. However, China does not want RMB to strengthen so much, that it weighs on the country's exports. As evidence China's central bank took actions on 8 September to slow down the appreciation. The PBOC removed the reserve requirements for financial institutions to buy FX. This will reduce the cost of buying FX and pare the RMB's strength indirectly in the short-term.

With the opening up of China's financial markets, RMB will become in long term a more market-driven currency. In short term, neither sharp depreciation nor sharp appreciation will be tolerated by the Chinese government. At present RMB remains to be a managed currency, a strictly managed one.

Please note:

Prognoses are not a reliable indicator for future developments.

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