

RMB: More predictable or unpredictable?

Friday, January 08, 2016

Highlights:

- The PBoC surprised the market again with today's daily fixing. After today's fixing, we think PBoC has been more predictable rather than unpredictable even though we started this week with fear of unknown.
- The CFETS statement yesterday gives us the qualitative guidance on China's RMB policy stance.
- While this morning's fixing gives us the quantitative guidance on how market can view RMB policy from basket currency perspective.
- Based on today's fixing of 6.5636, our model shows that RMB index is at 99.96, around 100 level. This signals that 100 is likely to be the near term defend for RMB index.
- RMB has already given up all the gains against the basket currency since end of 2014. We think it is now a better time for us to gauge the boundary of PBoC's RMB policy.
- Looking ahead, our forecast of USDCNY for 2016 (assuming no one time devaluation) will be broken into two parts including the forecast of RMB index, which reflects underlying macro and balance of payment fundamentals, and its implied USDCNY based on the Euro and JPY's projections.

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The PBoC set the daily USDCNY fixing at 6.5636 this morning, significantly lower than yesterday's 4:30pm closing of 6.5939, reversing the upside surprise for the past few days. The widening gap between fixing and closing prices has raised the question whether the PBoC has been more unpredictable. In fact, we beg to differ; and we think the PBoC has become more predictable after yesterday's CFETS statement and today's daily CNY fixing.

We started this week with the fear of unknown (Please refer to our latest report<Fear of Unknown>), which accelerated the RMB depreciation against the dollar in both onshore and offshore market. We think a better communication either via statement or market action is important to guide market expectations and keep the panic in check.

In our latest report, we mentioned "Frankly speaking, we are still not quite sure where the PBoC boundary is at the current stage. The fear of unknown has become the largest risk for RMB in the near term." Nevertheless, we believe we have better understanding now after reading CFETS statement as well as this morning's fixing action.

Highlights from CFETS statement

Let's start from the CFETS statement first. There are four key highlights from the CFETS statement. First, there is not necessary for China to stimulate export through a competitive devaluation of the RMB. Second, RMB exchange rate will reflect the dynamics of supply and demand. However, positions from pro-cyclical and leveraged speculative forces are not the market demand and supply China will follow. Third, the PBoC is capable of maintaining the RMB exchange rate basically stable at an adaptive and equilibrium level against those speculators. Fourth, RMB exchange rate regime will continue to be based on market supply and demand and with reference to a basket of currencies.

The CFETS statement gives us the qualitative guidance on China's RMB policy stance. And the key takeaway is that China has no intention to devalue the currency to support the export and the current RMB exchange rate regime will refer to a basket of currencies in addition to supply and demand.

Watch out for RMB index

If CFETS statement gives us the qualitative refreshment on China's RMB policy stance, this morning's fixing gives us the quantitative guidance on how market can view RMB policy from basket currency perspective. Since August, we have shifted our attention to RMB's basket currency value. The release of the weights of RMB index by CFETS in December kept us on the same page as PBoC when looking at RMB's basket value. The RMB index has fallen at a faster pace since December. As of yesterday, the RMB index slipped to 100.53 from 102.93 on 30 Nov. Should the USDCNY fixing are being set a level close to yesterday's closing of 6.5939, the RMB index is projected to fall significantly to around 99.50. Interesting to note, based on today's fixing of 6.5636, our model shows that RMB index is at 99.96, around 100 level. This signals that 100 is likely to be near term defence for the RMB index. To recall, China's fixing mechanism depends on three parameters including previous day's closing, overnight dollar movement and supply demand matrix. The RMB index can be used as the reference to track overnight dollar movement in addition to dollar index.

Having said that, the decline of RMB index to 99.96 today shows that RMB has already given up all the gains against the basket currency since end of 2014. We think now is a better time for us to gauge the boundary of PBoC's RMB policy. We believe China is likely to keep RMB's basket currency value stable at a reasonable level. As such, 98-102 is a reasonable range for RMB index this year, in our view.

Looking ahead, our forecast of USDCNY for 2016 (assuming no one time devaluation) will be broken into two parts including the forecast of RMB index, which reflects underlying macro and balance of payment fundamentals and its implied USDCNY based on the Euro and JPY's projections (as EUR, USD and JPY accounted for almost 70% basket assuming HKD is still pegged to USD).

Below are four scenario analyses from perspective of basket currency.

Scenarios	EURUSD	USDJPY	RMB Index	USDCNY
1	1.00	125	98	6.90
2	1.05	120	99	6.70
3	1.10	115	100	6.54
4	1.15	110	101	6.36

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