

Signal to put a brake on RMB's rapid appreciation

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- The increase of “macro prudential coefficient” for domestic enterprise’s cross border lending quota will broaden the channel for capital outflows.
- The change of “currency adjustment factor” will encourage more RMB cash pooling to promote RMB’s cross border usage.
- The regulator has sent a clear signal that China is getting increasingly uncomfortable with the recent rapid pace of RMB appreciation.
- Nevertheless, the impact on RMB’s directional move is still limited.
- But it will narrow the gap between CNY and CNH as domestic enterprises have more incentive to purchase foreign currency in the offshore market given favourable CNH rate.
- Our view on bullish RMB outlook remains unchanged.

China’s central bank PBoC and currency regulator SAFE announced last night that it will increase the macro prudential coefficient for domestic enterprise’s cross border lending cap to 0.5 from 0.3. This will increase the quota for cross border lending and broaden the channel for capital outflows. According to the statement from the PBoC that the move will boost RMB’s cross border usage as well as promoting two-way capital flows.

In order to understand the policy implications of this new announcement, it is time for us to revisit two formulas associated with domestic enterprise’s cross border lending unveiled in 2016 under the <Circular Yin Fa 2016 No. 306> by SAFE.

1. Domestic enterprise’s cross border lending cap = the latest audited ownership equity * macro prudential coefficient.
2. Domestic enterprise’s cross border lending outstanding = sum of outbound loan + sum of outbound loan * currency adjustment factor.

Two changes as below:

1. Macro prudential coefficient has been increased to 0.5 from 0.3. In simple term, the maximum amount of loans a domestic enterprise in China can grant to its overseas operations can not be higher than 50% of its owner’s equity, which is up from previous 30%.
2. Currency adjustment factor for foreign currency loan will be increased to 0.5 from previously 0 while adjustment factor for RMB loan remains unchanged at 0. As the 50% cap applies to the aggregated amount of both RMB and foreign currency loans. Domestic companies can choose how they want to do cross border lending. However, under the new change, for the same amount of loan, RMB loan utilizes less quota as compared to foreign currency loan.

Implications

The latest move will help facilitate multinational companies' cash pooling business. We see two implications here.

First, the regulator has sent a clear signal that China is getting increasingly uncomfortable with the recent rapid pace of RMB appreciation against the US dollar by broadening the outflow channel. Nevertheless, given the number of domestic enterprises which are able to lend to overseas is limited, we think the impact on RMB's directional move is still limited.

Second, the tweak of currency adjustment factor may kill two birds with one stone. On one hand, it will boost RMB's cross border usage by granting RMB outbound loan lower utilization rate of the quota. On the other hand, it will also narrow the gap between CNY and CNH as domestic enterprise has more incentive to purchase the foreign currency in the offshore market given the favourable exchange rate of CNH in the offshore market and higher quota.

Overall, the latest announcement may put a brake on RMB's rapid move. Nevertheless, it did not change our bullish outlook on RMB given still favourable yield differential, China's first in first out economic recovery and China's gradual exit from monetary policy easing due to its increasing emphasize on stabilizing leverage ratio. As such, our view for the USDCNY to test 6.30 in 2021 remains unchanged.

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