



The RMB depreciation series 2: CNY forecast revision

Summary: This round of rapid RMB depreciation has apparently come to an end (Figure 1). We now project USD/CNY to be around 6.5 (6.3 before) by end-2015 and 6.9 (6.5 before) by end-2016. We maintain our view that there will be one more interest rate cut this year (in Q3), but believe more RRR cuts will be seen down the road—one in each of the coming quarters of 2015 and 2016, including Q3.

Strong messages from the PBoC suggest that rapid depreciation of the RMB (4.6% over the past week) has come to an end in the short term. In a press conference on Thursday, the PBoC made it clear that they believed this round of “correction” for the RMB had almost completed. Jun Ma, Chief Economist of the PBoC, also indicated on Wednesday that the PBoC had the capacity to intervene and keep the RMB at a reasonable level.

Looking forward, we revise our forecasts of USD/CNY to 6.5 by end-2015 (previously 6.3) and 6.9 by end-2016 (previously 6.5), with high volatilities expected in both directions. Meanwhile, we do not think such moderate depreciation against USD alone will generate visible impact on exports or overall growth.

This week’s developments have a couple of implications on interest-rate prospects. On the one hand, the depreciation will put additional pressure on CPI inflation, which is already on the rise. On the other hand, with part of the RMB depreciation risk materialized, and to the extent that it alleviated the depreciation expectation, it should reduce the need for the PBoC to keep the rate to prevent capital outflows. On balance, we maintain our view that there will be one more interest rate cut this year, in Q3.

We revised our RRR outlook though: we now expect more RRR cuts down the road by the PBoC, one in each of the coming quarters of 2015 and 2016, including Q3. There are several reasons for this revision. First, the continued decline in PBoC’s foreign currency reserves since mid-2014, which perhaps saw some acceleration in the past week, has been squeezing liquidity. Second, the ongoing central-local government debt swap will require a large amount of additional liquidity. Our rough estimate suggests that the central government may need to issue 3 trillion RMB worth of bonds for this purpose in each of the next five years. Finally, from a historical perspective, the RRR is still at a high level and has ample room to be cut (Figure 2).

We maintain our growth (7.0 in Q3 and 7.2 in Q4) and CPI (1.8 in Q3 and 2.2 in Q4) forecasts for the year.