

Interview

The big picture

China's transformation from dragon to panda – a process that cannot be completely controlled by the government, but will open up opportunities.

/// Beijing must get used to the unpredictability of free capital markets. ///

Mr. Wöhrmann, we had planned to talk about the turnaround in U.S. rate policy. However, the Chinese central bank (PBoC) stole the Fed's thunder in August. It followed in the steps of the Swiss National Bank (SNB) and shocked the markets by taking a step back from currency intervention. Now, the yuan is no longer strictly pegged to the U.S. dollar. Supply and demand will influence the exchange rate to a greater extent. That has caused considerable market turmoil. Why have investors reacted so nervously?

In China's case, the currency-market reaction was still relatively moderate, not least due to the support measures taken by the PBoC. The yuan depreciated by about 5% versus the U.S. dollar within three days and then stabilized. However, due to its peg to the U.S. dollar it had previously appreciated against most other currencies and, in fact, the real effective exchange rate of the yuan has appreciated 50% versus the U.S. dollar since the financial crisis. Against this background, a yuan devaluation actually makes sense. But markets seemed to regard this step as an admission of the PBoC that China's economy is weak.

What will happen now to the yuan?

That remains to be seen. On the one hand, China wants to be adequately represented in international institutions in view of its economic strength. That is why it wants to comply with the recommendations of the International Monetary Fund (IMF)

in order to have the yuan included in its Special Drawing Rights (SDR) basket. Moreover, China is quite aware of the fact that, in the long run, it will need to accept that key variables such as interest rates, loan volumes and the exchange rate are determined by the market. In fact, a more relaxed exchange-rate regime is only one of several measures Beijing has taken in order to liberalize the capital markets. On the other hand, Beijing is still reluctant to totally give up control over these key variables. In all probability, the PBoC will peg the yuan to a broader currency basket while preserving some scope for action in the medium term. In the long run it will float the yuan and intervene only sporadically. From my vantage point, this is necessary and useful. A country of this size, which moreover has a share of almost one-sixth in total global trade, cannot peg its currency to that of another country. A more relaxed exchange-rate regime will enable quicker exchange-rate adjustments, which will help to counteract or even prevent large-scale market imbalances.

The devaluation accelerated the downtrend on global stock markets. Was it an accident that the PBoC took this step just at this point in time?

Of course, the devaluation has to be seen in the context of the economic environment as a whole. Investors thought it was another sign of China's growth slowdown. At the same time,

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