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Offshore Renminbi Weekly Report

East Asia Treasury Department

22-Mar-24

＜Forex＞ The CNY breakout above 7.2 sparked RMB sell-off

＜Interest Rates＞Chinese banks left LPRs unchanged

＜Equity＞Shanghai Composite defended 3,000 level

Weekly Price Change	Week Open	Week High	Week Low	Week Close	Weekly change (※)
USD/CNH	7.2045	7.2688	7.2019	7.2651	+625
USD/CNY	7.1979	7.2287	7.1946	7.2284	+342
CNY PBoC Fixing	7.0943	7.1004	7.0942	7.1004	+30
Shanghai Composite Index	3,057.21	3,090.05	3,027.76	3,048.03	-37

※pips in USD/CNY,USD/CNH

Weekly Price Change	HK Close	Weekly Change		HK Close	Weekly Change
CNH Forward (1yr)	-1,745	+107	CNH HIBOR (3mth)	3.04%	+0.30 ppt
CNH Currency Swap (3yr)	3.04%	0.30 ppt	CNH Implied yield (1Y	2.51%	+1.11 ppt

【Weekly review and forecasts】

Late in the week of busy central banks' meetings, the PBoC suddenly allowed the CNY spot trading to surpass the 7.20 handle, sending the CNH spot to 4-month low of 7.269. Despite the steady CNY fixing around 7.1, the sudden removal of CNY spot cap at 7.2 raised concerns about PBoC's potential FX policy tweaks later this year. In our view, the PBoC may be testing the waters for RMB depreciation, while keeping RMB depreciation magnitude under control by allowing the CNY spot to surpass 7.2 but maintaining a steady CNY fixing at 7.1 level, which aims to protect the topside of USD/CNY spot at 7.24 based on the 2% trading band rule. The clearer roadmap of major central banks' (excluding the BoJ) to begin their easing cycle in the summer, alongside stabilizing China data for first two months,. may be the reasons behind the PBoC's FX policy tweak.

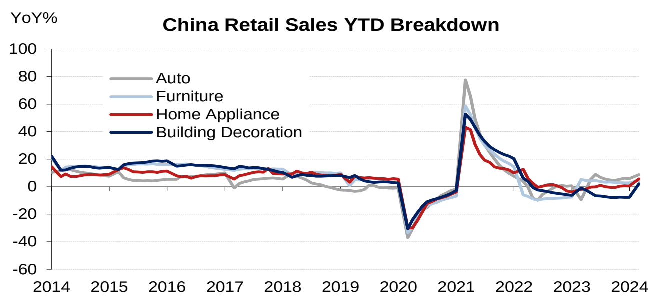
As expected, Chinese banks kept the 1Y and 5Y LPRs unchanged at 3.45% and 3.95%, respectively. Following a deep 25bps cut in the 5Y LPR in February, there is limited incentive for Chinese banks to lower LPRs, given the narrow net interest rate margins (NIMs) and status quo of MLF yield and saving rates this year. In addition, PBoC Deputy Governor Xuan Changneng's comment that China still has room to lower the RRR for banks just reassured its preference for RRR cuts over immediate rate cuts. We reckon that the RRR cut is favoured as it will help facilitate the issuances of ultra-long special China Government Bond (CGB). Separately, the PBoC scaled down its reverse repo operations, net draining CNY 17bn of liquidity over the week.

The PBoC's CNY fixing policy is in the spotlight now. The CNY breakout above 7.2 level has increased the risk of its FX policy change. However, we reckon that the PBoC will guide the RMB depreciation only at a gradual pace, as a sharp one-off RMB depreciation would be detrimental to China growth recovery and financial market stability. We do not expect a policy move similar to 2015.8.11 CNY fixing reform. Meanwhile, PBoC officials might engage in communication with market participants if the RMB depreciation ran too fast. Next week, the CNY fixing on Monday will be closely monitored to assess PBoC's latest FX policy signal, while the PBoC may intend to set the USD/CNY fixing moderately weaker to guide the CNY spot to a new trading range.

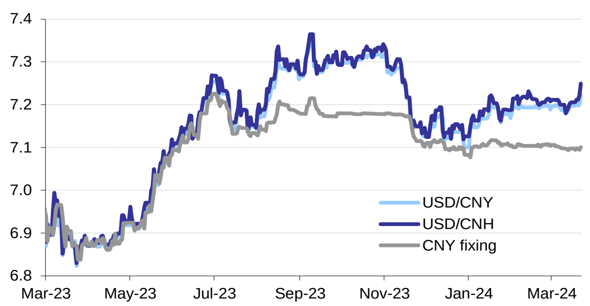
【Data & Policy Updates】

The China hard data for first two months showed some improvements, painting a less bearish picture of China growth outlook. China retail sales for first two months climbed by 5.5%YoY (vs. +5.6%YoY expected). The negative impact from the property downturn on housing related consumption was fading. Looking at the breakdown, home appliance and building decoration items jumped by 5.7%YoY and 2.1%YoY, respectively. Automobile sales also see a significant rise of 8.7%YoY. The catering revenue moderated to +12.5%YoY from prior +30%YoY, due to the higher base effect after the reopening. In addition, industrial production came in higher than expected at 7.0%YoY (vs. +5.2%YoY expected), thanks to the pick-up in high tech manufacturing. While the property sector remains a weak spot, fixed assets investments growth beat consensus at +7.0%YoY (vs. +5.2%YoY expected). The breakdown showed that the acceleration in infrastructure and manufacturing investment helped counter downside pressure from the property sector.

＜China retail sales stabilized＞



＜USD/CNY, USD/CNH vs. USD/CNY fixing＞



(Sources: Bloomberg, Mizuho HK)