

Macro Brief – Why Beijing Will Not Deploy an Aggressive CNY Devaluation Strategy

In a Nutshell:

- Fervent bets that that Beijing will actively **weaken CNY in response to Trump tariffs** sorely *lacks nuance*, *misplaces context*, and *ignores lived experience*.
- Fact is, **Trump 1.0 tariffs required Beijing to support, not suppress, the CNY**. And **little has changed on that front**.
- Above all, **CNY depreciation pressures** (from tariffs) **accentuating wider China macro woes** amid intensifying geo-political stress (including trade antagonism) is a **greater threat than any imagined relief sought from a weaker CNY**.
- To be sure, **CNY depreciation risks** are heightened. But this is **from market pressures amid geo-economic stress** and *not a policy response to tariff threats*.

Lopsided, if not Misguided: Reports that Beijing could resort to CNY depreciation in response to, or to mitigate tariffs is a lopsided argument given *benefits don't outweigh the associated costs*. At best, it **overstates the case and latitude for CNY depreciation**. *At worst, it is grossly misguided*.

Balance of Risks Favours CNY Stability: In the grander scheme of things, the **desirability of a broadly stable and supported CNY*** *overwhelms narrow and potentially high-cost CNY depreciation*.

Destabilizing Capital Outflows a Prominent Threat: Specifically, the **threat of an adverse, self-reinforcing loop of depreciation and potentially destabilizing capital outflows**. This remains a **prominent threat** as Beijing struggles to simultaneously reinstate onshore confidence and confronts geo-political threats.

Trade Benefit of Weaker CNY Limited: What's more, the **trade advantages from a cheap(er) renminbi** as China scales the value chain are **far less compelling**.

Tariff Cushion: **Admittedly**, a **cheaper CNY** that (all else equal) allows for lower USD pricing of exports could **initially cushion against the adverse demand impact of tariffs**.

Involves Greater Macro Risks: But it inevitably entails **greater macro risks**. For one, it is **ultimately repressive for Chinese industries** (and inevitably, the economy). More dangerously, such **overt (FX) mercantilism will court, and ironically justify, further US trade backlash**.

Neither Convincing ...: Point being, **CNY depreciation is simply not convincing** as a credible mitigation for trade conflict threats risks insofar that it **risks further inflaming trade animosity** and **impedes China's more strategic pursuit of technological leadership**.

... Nor Controlled: Moreover, **acute geo-political stress** that threaten to **intensify capital/financial outflow risks** that simultaneously feed into, and off, **CNY pressures** suggest that **CNY depreciation as a tool lacks requisite** (but critical) **control to avert the dangers of spiralling macro instability**.

Trump 1.0 Tariffs Required CNY Support: In fact, **CNY depreciation during Trump 1.0 tariffs was in spite, not because, of Beijing's emphatic attempts to shore up the CNY**. So, cheapening the CNY in response to tariffs is **not the lived experience**. Nor is it likely to be a new reality.

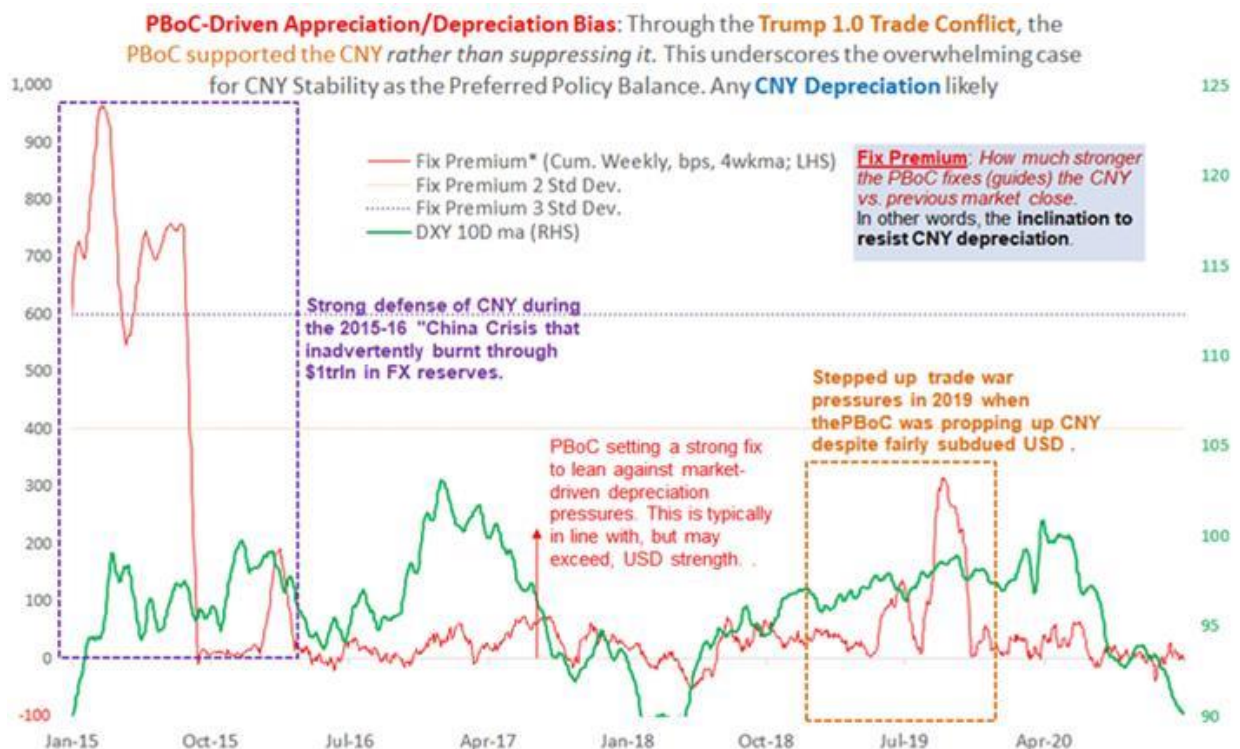
As Macro Stability Trumps Tariff: Fact is, **sharp CNY depreciation threatens to impose far more debilitating macro pain** from destabilizing outflows. Whereas *China's unmatched industrial scale, expertise and ecosystem allows it to weather tariffs without unduly exposing itself to destabilizing FX risks.*

Admittedly, Path of Least Resistance (& Optimal Stability): **To be sure, CNY depreciation is likely to be a glaring outcome** of trade/geo-political stress. But not by Beijing's design (or even desire). Instead, the PBoC will merely be judicious in the sharp trade off between CNY defense and FX reserve depletion so that it does **not engage in futile, and wasteful resistance**. Counterintuitively, **accommodating some CNY depreciation** is healthy pressure relief that **helps deflect adverse spiral of depreciation and capital outflows**. So, CNY depreciation may be conceded, not encouraged; with a view of **optimal stability between CNY backstop and wealth (FX reserve) preservation**. More so, **as Beijing commits looser monetary policy stance**.

CNY Relief Overstated, If Not Illusory: But all said, any **imagined benefit of cheap CNY to counteract Trump 2.0 tariffs** is not just **overstated**, but **arguably illusory**. And ultimately, it may prove to be **strategically self-defeating**. Especially given the geo-economic cross-roads, where China will need to be more acquisitive (be it talent, technology, know-how or resources) to ensure industry leadership.

Beijing Can't Afford Cheap (CNY): All said, **a cheap CNY** to counteract tariffs will **inadvertently and ironically prove too costly** for overall macro-stability. Critically, *Beijing especially can't afford a cheap CNY* that not only threatens to potentially destabilize macro/financial conditions amid current uncertainty/doubts, but over time, impedes Beijing's broader technological ambitions.

* More so in trade-weighted terms, but not at the exclusion of relative USD/CNY stability (once the broader and sweeping USD trend is accounted for).



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