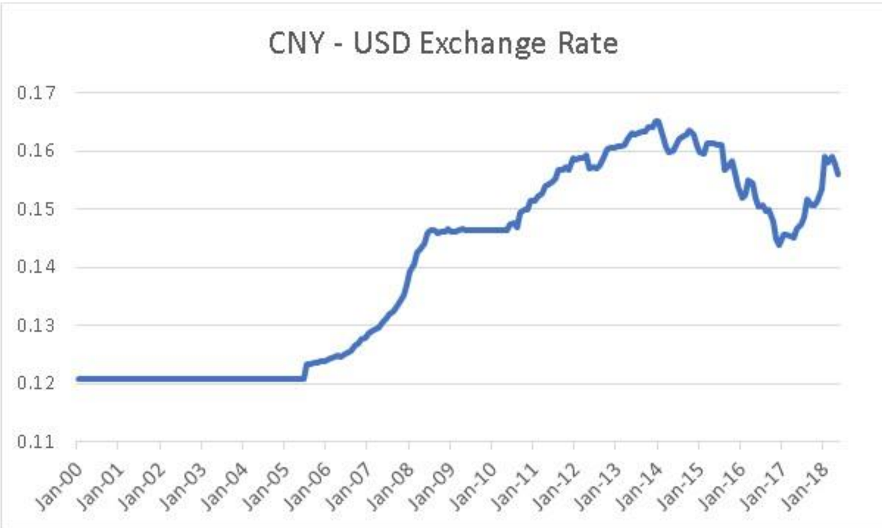
THE CHANGING NATURE OF THE CHINESE RENMINBI

Russell Clark's
Market Views

"Recently the CNY has begun to weaken again, and markets are reacting as if the 2018 devaluation is a replay of the 2015 devaluation. However, the economic environment in China now and in 2015 is vastly different."

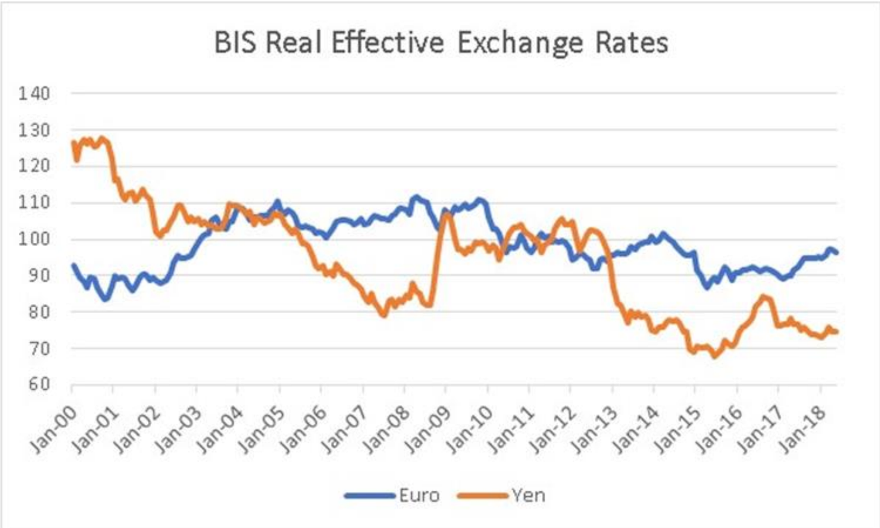
Most investors look at the Renminbi (CNY) in terms of its dollar exchange rate. When looked in these terms, CNY was fixed at a very cheap exchange rate for many years, before it de-pegged from the dollar and began to appreciate from 2005 to 2014, before depreciating again. We show the inverted exchange rate below, so as the Renminbi appreciates in value, it rises in the graph.



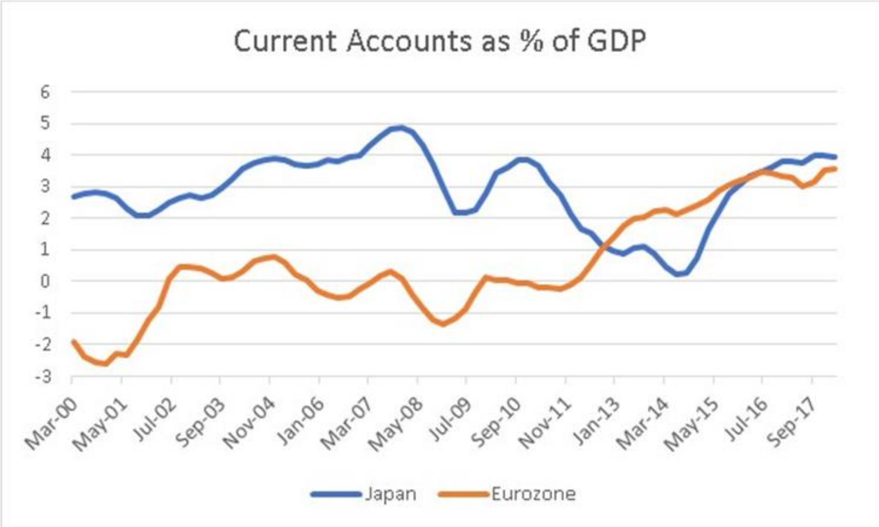
This graph would imply that the Renminbi has been becoming a steadily more expensive currency over time. However, China trades with many countries other than the US. A better measure is to look at the trade weighted effective exchange rate. The Bank for International Settlements ('BIS') provides a real effective trade weighted exchange rate, and this shows the appreciation in CNY only occurred from 2011 onwards, when the CNY moved above levels first seen in 2001.

From 2005 to 2007, even as the CNY appreciated against USD, it was falling against other currencies. This was most helpful in allowing the Chinese current account surplus to reach 10% of GDP in 2007, as China gained more and more market share. As the Renminbi has continued to appreciate the current account surplus has normalised a far more reasonable 1% of GDP.

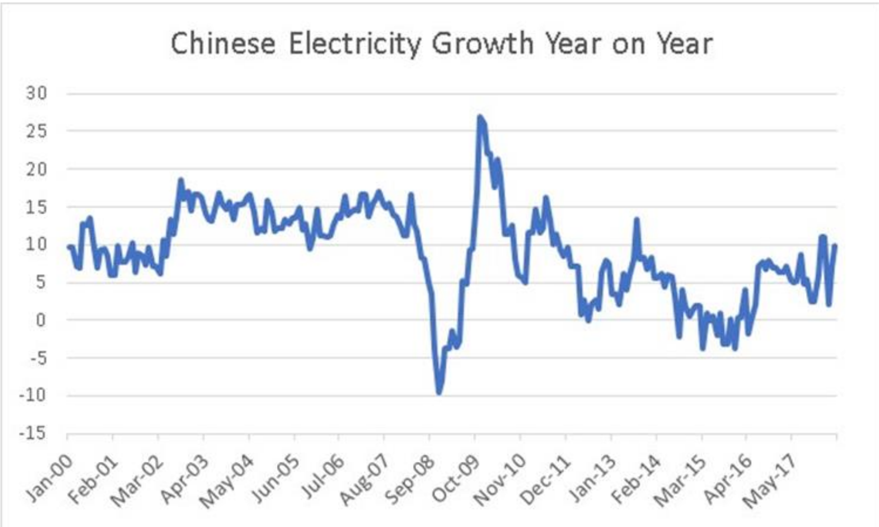
One of the reasons that the trade weighted CNY only appreciated from 2012 was that was when we began to see two other large economies, Europe and Japan, engage in quantitative easing ('QE') policies to devalue their currencies, with the Yen being particularly weak.



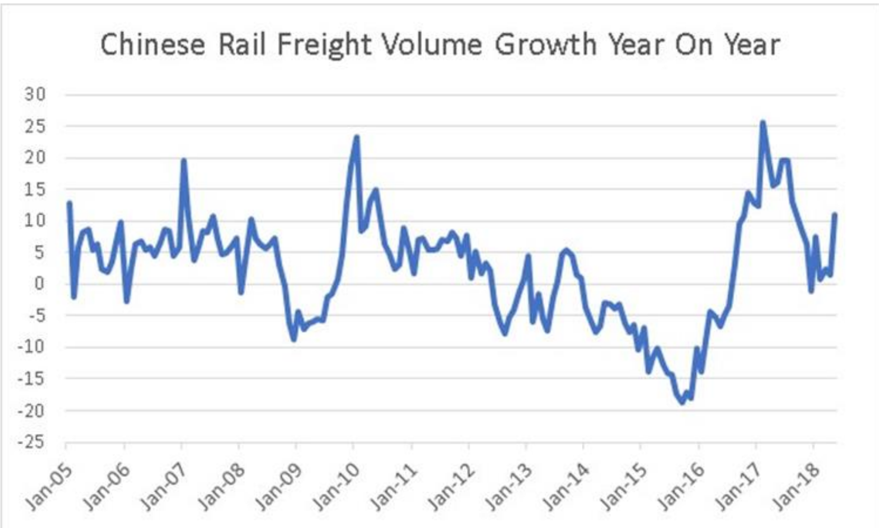
The devaluation of the Euro and Yen has led to both the Eurozone and Japan having close to record current account surpluses, of around 4% of GDP.



Recently the CNY has begun to weaken again, and markets are reacting as if the 2018 devaluation is a replay of the 2015 devaluation. However, the economic environment in China now and in 2015 are vastly different. In 2015, Chinese electricity consumption growth was collapsing, while currently it is running at it's strongest level since 2010.



Chinese rail freight volume is growing at levels associated with robust growth.



The far more likely explanation for weakness of CNY is that Euro and Yen have also weakened lately, and the People's Bank of China is seeking to maintain the CNY at a similar level. It seems to me that the CNY-JPY exchange rate is being managed so that Yen does not weaken against the CNY any further.

If the CNY is moving to maintain a level with JPY, the CNY devaluation is not necessarily bearish for Chinese growth, however it does have negative connotations for Japanese exporters to China, who have become reliant on a weak Yen and a strong Renminbi to grow profits.

INFORMATION

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