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ECONOMY

STABILITY OF YUAN SET TO REMAIN AS PBOC FOCUS

Central bank may delay monetary easing plans as economic weakness and lack of clarity on US rate moves put more pressure on the currency

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Renewed depreciation pressures facing the yuan and uncertainty over the exact timing of US interest rate cuts could delay the central bank's plans for more monetary easing, analysts say.

The yuan has been under stress since the US Federal Reserve held interest rates at its policy meeting last month. At least one reduction in US rates is widely anticipated for this year, and officials have suggested as many as three could be on the agenda.

The yuan has fallen an average of 0.53 per cent against the US dollar since the Fed meeting ended on March 20, despite strong fixing rates set by the People's Bank of China (PBOC).

Louise Loo, China economist at Oxford Economics, said the PBOC was still in a relatively "accommodative" mode when it came to yuan exchange rate management.

"The currency weakness is also, to a large degree, driven by dollar strength and still-weak domestic fundamentals, and a weak currency can provide a helpful economic boost – so we think they could still tolerate further weakening," Loo said.

Most analysts expect interest rate differentials between China and the US to remain significant until the Federal Reserve makes its first rate cut this year.

Money and credit growth slowed in February as the PBOC sought to manage the fallout from a property market downturn while countering deflationary pressures.

Xuan Changneng, a deputy governor at the PBOC, said at a press briefing on March 21 that there was still room to cut the amount of cash that lenders have to keep in reserve, and that the central bank had a "wealth" of monetary policy tools at its disposal.

The PBOC only made two "conservative" interest rate cuts in 2023, according to the US-based Institute of International Finance (IIF), a trade group for the financial services industry.

The PBOC has so far prioritised the stability of the yuan over easing. The nation's trade surplus – a point of contention with the US and Europe over perceived overcapacity – hit 4.6 per cent of gross domestic product (GDP) in 2023, the IIF said. Further depreciation of the yuan, it added, may trigger capital outflows and exacerbate trade imbalances.

"We think there is a chance for one more policy rate cut in 2024, especially if deflation stays entrenched and the Fed starts easing in the second half of this year," said the institute in a note on March 28, adding that much of the PBOC's monetary easing was achieved through quantity-based instruments, including credit policy tools.

To steady the yuan's exchange rate, last year the PBOC twice cut the amount of foreign exchange reserves that financial institutions would be required to hold, once in August and again in September.

However, Guan Tao, chief global economist for Bank of China International, said markets should not "misinterpret" the recent volatility of the yuan as a sign of depreciation.

"The trend of the yuan exchange rate cannot only depend on the decision of the Federal Reserve and the US dollar index, but also depends on the speed and quality of the potential growth rate of China's economy," said Guan, a former director of the State Administration of Foreign Exchange, in an editorial for media outlet Yicai on April 2.

Rory Green, head of Asia research at GlobalData TS Lombard, said while the PBOC was capable of taking steps to support growth and defend the yuan's exchange rate simultaneously, there was a limit on how long such contradictory policies would hold out.

"We think that despite PBOC intervention, the yuan will trend weaker, as US and China growth differentials persist and traders price in Trump trade war risks," Green said in a note on March 28.

The central bank says it has a wealth of policy tools available. Photo: AP