FX FOCUS

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Chinese yuan

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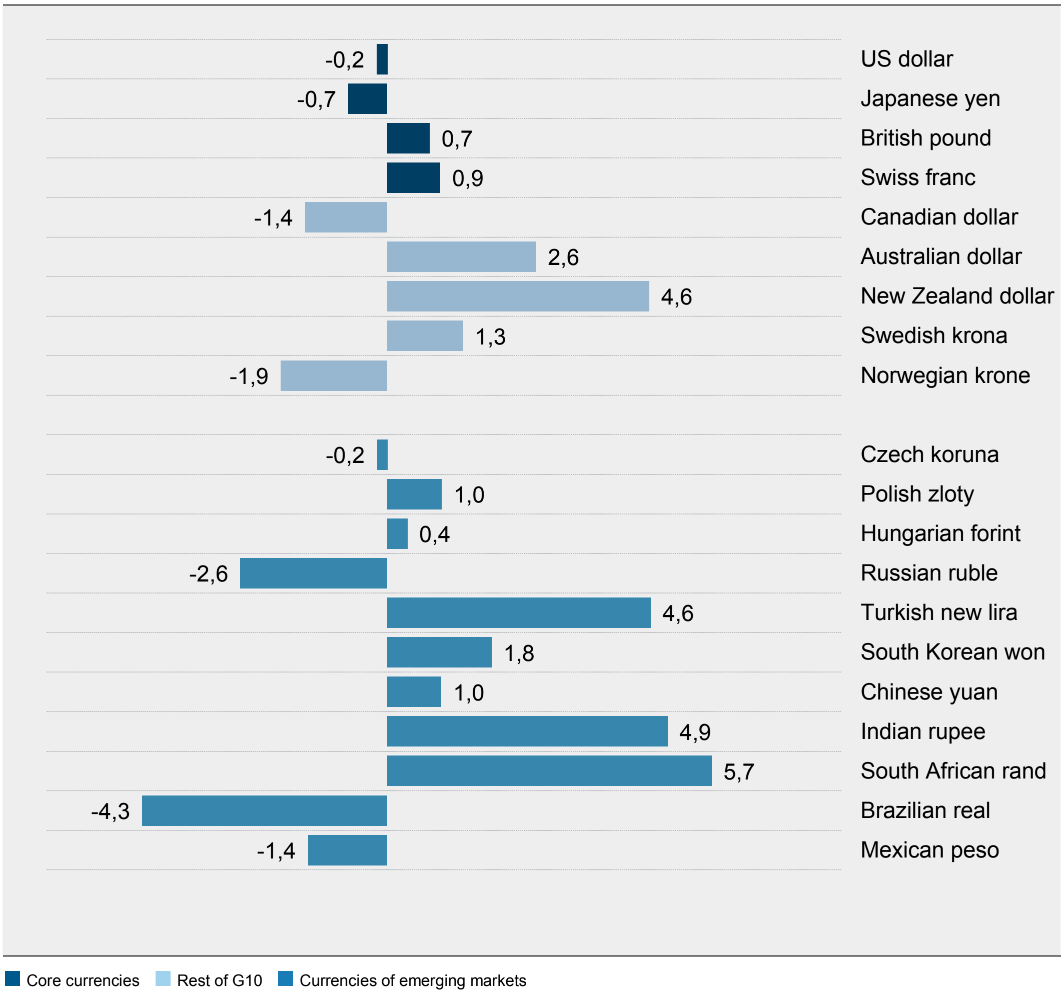
- The Chinese yuan declined significantly against the US dollar this year. The trade conflict is affecting the yuan exchange rates, although a targeted devaluation strategy is not discernible. Developments in the economy and monetary policy justify a weaker yuan. In 2019, however, some of these factors should turn around. In the wake of a general weakening of the US dollar, the yuan should gain slightly. However, China's currency will probably depreciate against the euro.
- The euro-dollar rate traded hardly unchanged. Australia’s and New Zealand’s currencies appreciated. The majority of emerging market currencies recovered. The South African rand and the Turkish lira appreciated significantly, while the Brazilian real lost ground.
- Helaba Currency Forecasts

Performance on a month-over-month basis

% vs. euro compared to the previous month (from 10/30 to 11/28/18)



Sources: Bloomberg, Helaba Research

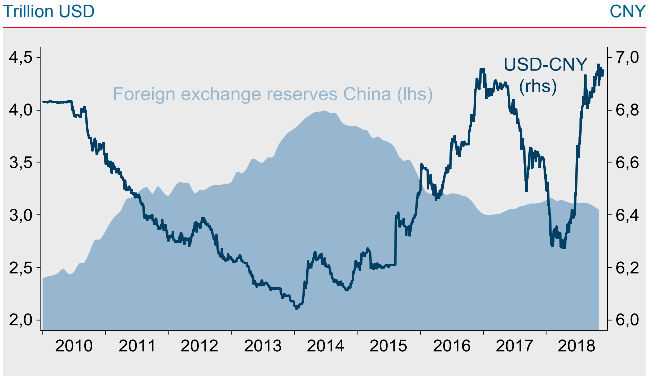
CNY: stability

China's currency is under observation – above all because of the escalating trade conflict with the US. Are the Chinese countering punitive US tariffs with a currency devaluation? The exchange rate swings are noteworthy – the yuan lost 6% against the US dollar so far this year, but they pale in comparison to other emerging market currencies. The euro-yuan exchange rate is virtually unchanged from the end of last year.

Manipulation or market forces?

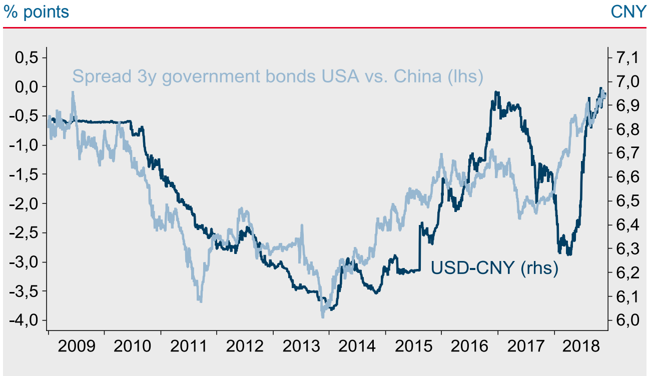
Although the Chinese state influences the yuan exchange rates, it does not control them completely. Due to the lack of convertibility – exchangeability is limited – and the immense foreign exchange reserves of around USD 3 trillion, China finds it easier to exert influence. Nevertheless, the government cannot completely prevent the underlying market movements. If Beijing were to deliberately devalue its currency through intervention, its currency reserves would have to grow visibly. In fact, they have shrunk by nearly USD 90 billion in the current year. To be sure, the decline can also be partly explained by valuation effects. Assuming that the data is not manipulated and that China is not operating clandestinely, the weakness of the yuan is more in line with market forces, even if government intervention certainly reduces the fluctuations.

Slight decline in currency reserves



Sources: Macrobond, Helaba Research

China's interest rate advantage all but gone



Sources: Macrobond, Helaba Research

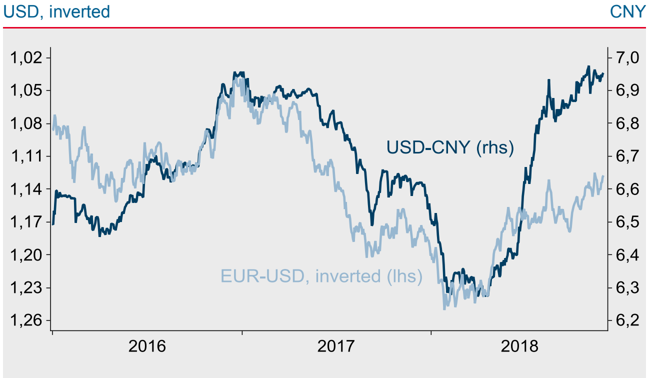
Monetary policy a burden in 2018

Growth rates of over 6 % and a key interest rate of 4.35 % with moderate inflation make China's currency appear attractive at first glance. Upon closer examination, however, the situation is less unambiguous. The economy is losing momentum, albeit from a high growth level. The lending rate does not have a major influence in China. Overall, monetary policy has become more expansionary. Thus, capital market interest rates have fallen since the beginning of 2018, and the yield on three-year government bonds is about 90 basis points lower. In the US, on the other hand, the central bank is raising its key interest rate quarterly. China's yield advantage on three-year government bonds has nearly disappeared. This explains at least in part the rise in the dollar-yuan exchange rate.

In addition to interest rate differentials, foreigners and Chinese nationals are probably also withdrawing capital from China because of the bleaker growth prospects. Even if not directly, the trade conflict does effect the currency market indirectly. China's export economy is suffering from punitive US tariffs; the economy as a whole is likely to grow by "only" 6.0 % in 2019. As a result, Chinese monetary policy will tend to become more expansionary. However, the yuan exchange rates are by no means dependent solely on developments in China. The US economy will also lose momentum. The Federal Reserve will suspend its cycle of interest rate hikes in the course of 2019. Interest rate differentials will therefore hardly continue to develop to the detriment of the yuan.

China's exchange rate policy is formally oriented not only towards the US dollar, but towards a basket of currencies. In the past, therefore, significant movements in the euro-dollar exchange rate were also reflected in the dollar-yuan exchange rate, as China was striving for a stable external value. A higher euro-dollar exchange rate was accompanied by a falling dollar-yuan exchange rate. Since the euro-dollar exchange rate should rise again in 2019 in view of the looming end of the US interest rate hikes and other political burdens, the yuan should at least not weaken much more against the US dollar.

Euro appreciation should help yuan against the dollar



Sources: Macrobond, Helaba Research

Export with smaller significance

Sources: Macrobond, Helaba Research

Targeted devaluation strategy unlikely

The fundamental environment therefore argues against a marked yuan weakness in 2019. It is also questionable whether China wants to use the currency as a weapon in the trade conflict. The government could lose control over the devaluation of the yuan if it leads to strong private capital outflows. Chinese companies with dollar debts would then be very vulnerable. Moreover, exports are no longer as important as growth driver as they were ten or twenty years ago. The exchange rate has therefore become less important for China as an instrument for stimulating the economy. In any case, Beijing hardly wants to fuel the conflict with Washington any further. A deliberate devaluation strategy is therefore unlikely.

The environment will hardly change in the short term. The dollar-yuan exchange rate should remain close to the 7.0 mark. China's policy is likely to prevent a rise beyond that, especially as speculative investors would increase their bets against the yuan in the event of a breakthrough. If the US dollar generally weakens in the course of 2019, China's currency will probably also benefit slightly from this. The dollar-yuan exchange rate should fall to 6.8 by the end of 2019. By contrast, the yuan will probably weaken against the euro. The euro-yuan exchange rate will probably climb from just under 7.9 to over 8.3 in 2019.

Helaba Currency Forecasts

	Performance year to date	1 month	current*	Forecast horizon at end ... Q4/2018	Q1/2019	Q2/2019	Q3/2019
vs. Euro	(vs. Euro, %)						
US dollar	5,6	-0,2	1,14	1,15	1,15	1,20	1,20
Japanese yen	4,7	-0,7	129	129	125	128	128
British pound	0,2	0,7	0,89	0,85	0,85	0,85	0,80
Swiss franc	3,6	0,9	1,13	1,15	1,15	1,15	1,20
Canadian dollar	0,0	-1,4	1,51	1,48	1,48	1,52	1,52
Australian dollar	-1,2	2,6	1,56	1,60	1,55	1,60	1,58
Swedish krona	-4,3	1,3	10,27	10,20	9,90	9,80	9,60
Norwegian krone	1,2	-1,9	9,73	9,40	9,30	9,10	8,90
Chinese yuan	-0,5	1,0	7,84	7,99	8,05	8,28	8,28
vs. US-Dollar	(vs. USD, %)						
Japanese yen	-0,9	-0,5	114	112	109	107	107
Swiss franc	-2,0	1,1	0,99	1,00	1,00	0,96	1,00
Canadian dollar	-5,3	-1,2	1,33	1,29	1,29	1,27	1,27
Swedish krona	-9,5	1,5	9,04	8,87	8,61	8,17	8,00
Norwegian krone	-4,1	-1,7	8,56	8,17	8,09	7,58	7,42
Chinese yuan	-6,4	0,2	6,95	6,95	7,00	6,90	6,90
US-Dollar vs. ...	(vs. USD, %)						
British pound	-5,1	0,9	1,28	1,35	1,35	1,41	1,50
Australian dollar	-6,4	2,8	0,73	0,72	0,74	0,75	0,76

*28.11.2018

Sources: Bloomberg, Helaba Research ■