

FX Viewpoint Flash

Currencies
Global

RMB: Surprise rate cuts

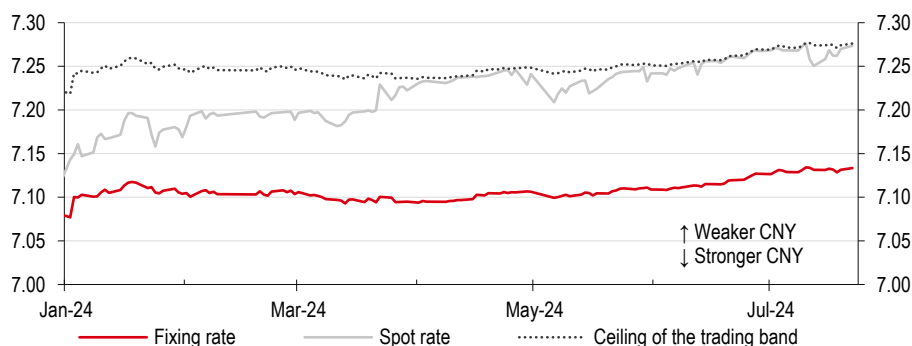
- ◆ The PBoC cut the 7-day reverse repo rate by 10bp to 1.7%; the 1-year and 5-year LPRs were also lowered by 10bp
- ◆ In our economists' view, while growth support will likely be led by the fiscal side, another 10bp cut this year is possible
- ◆ This earlier-than-expected rate cut will probably intensify the RMB's yield disadvantage; USD-RMB grinded higher

On 22 July, the People's Bank of China (PBoC) lowered the 7-day reverse repo rate (a key short-term policy rate) to 1.7% in its open market operations (OMO) from 1.8%. This was the first reduction in almost a year. **The market-oriented rates, the 1-year and 5-year loan prime rates (LPR), followed with 10bp cuts on the same day, bringing them to 3.35% and 3.85%, respectively.** The move was asynchronous from the earlier hold in the medium lending facility (MLF) rate on 15 July at 2.5%.

The rate cut came earlier than expected, as many market participants (including our economists) thought that the PBoC's rate cuts would come only after the Federal Reserve (Fed) starts its easing cycle. In our economists' view, **the surprise move is likely to signal a proactive stance for economic growth**, after the recent miss in 2Q GDP (which rose 4.7% from a year ago, below consensus expectations of 5% and 1Q growth rate of 5.3%) and June retail sales (which rose 2.0% from a year ago, below consensus expectations of 3.4% and May growth rate of 3.7%). Our economists expect one more 10bp cut this year, but still think **fiscal support will take the lead to support growth.**

For the RMB, this rate cut will probably intensify its yield disadvantage against the USD, in our view. **The USD-CNY fixing rate (i.e., central parity rate) has been grinding slowly higher from c7.10 in May to above 7.13 of late** (see the chart below). If the PBoC tweaks its FX policy or pivots towards more aggressive policy rate cuts, it will likely weigh on the RMB.

USD-CNY: Fixing rate vs spot rate



Source: Bloomberg, HSBC

It is also worth monitoring whether this monetary policy easing will be accompanied by some other measures (like more aggressive fiscal stimulus) that can revive market confidence and credit growth. If this happens alongside net capital inflows, some of the RMB depreciation pressure will be alleviated. **The upcoming Politburo meeting at the end of July may provide more clues.**

In a surprise move, the PBoC lowered its policy rate by 10bp on 22 July

Our economists expect one more 10bp cut this year

This will probably intensify the RMB's yield disadvantage against the USD...

...but any net capital inflows could help offset the downward pressure faced by the RMB

Disclosure appendix

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