EXPERT INVESTOR
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China's currency a rising concern in 2017

By Imogene Wong (https://expertinvestoreurope.com/author/imogene-wong/), 5 Jan 17

RMB depreciation is posing a risk for both equity and fixed income investment.

Over the last three years, the onshore Chinese yuan has weakened 2.4% in 2014, 4.2% in 2015 and 7.2% in 2016 against the US dollar. The accelerating pace of depreciation is a concern, investors believe.

Further pressure on China's currency will come from interest rate hikes in the US, said Pranay Gupta, head of multi-asset strategies at Fullerton Fund Management.

"The potential of a Fed rate hike can be a game changer, because there would be substantial pressure on the RMB to depreciate. We believe it is China's implicit policy to depreciate the RMB progressively at a rate of 4-5% every year – an abrupt shock could push this figure to 6-8%," he said.

Equity risk

Manulife Asset Management Greater China equities senior portfolio manager Kai Kong Chay said the yuan remains the biggest risk for the China stock market in 2017.

"So far, equity investors in China have not been rattled by the slightly quicker pace of RMB depreciation against the US dollar – which moved largely in line with the euro and yen, rather than with the Mexican peso or other emerging market currencies.

"However, the RMB has been softening in anticipation of the likely fallout from the Trump administration's likely policy direction. We continue to believe that the biggest overall risk for China equities is the weakening RMB, which could prompt speculators to short the stock market."

It will also impact the fixed income market, according to Endre Pedersen, Asia ex-Japan fixed income CIO also from Manulife AM. "The RMB is expected to stay weak versus the dollar and the trade-weighted basket of currencies. The People's Bank of China is also expected to keep a firm hand on monetary policy, suggesting the key battleground will be over capital flows.

"Due to the impact of this capital in regional fixed income demand, particularly the purchase of dollar fixed income bond assets, it is a key source of demand that needs to be watched in 2017."

Stricter capital controls

China's currency weakness has been an incentive for onshore investors to move money out of the country. "Any capital outflow will have a significant impact on Asia and the world," said Fullerton's Gupta.

To curb capital outflows from China, more rules have been imposed at both the individual and corporate level. They include extra scrutiny of citizens who want to convert the currency into foreign money (capped at the equivalent of $50,000), limiting the cash withdrawal for China Unionpay cardholders and limiting corporate overseas direct investments.

"More capital control measures are expected to be adopted, including reducing the individual $50,000 exchange quota, among others, to prevent potential new waves of capital outflow against the general backdrop of a tightening property market," said Amundi Asset Management Management's chief economist for Asia ex-Japan Mo Ji.

However, Mo believes the RMB will instead become a stable currency this year, "a phenomenon that is still underestimated by the market", she said.

"With US dollar gaining much strength by appreciating 3.1% after Trump's election, the Chinese yuan weathered the shock nicely by only depreciating 1.4%, i.e. a much smaller degree of depreciation versus dollar appreciation, implying the relative hidden strength in the yuan," Mo explained.