

Sujet: La devise chinoise flottera un peu plus face au dollar US / China's currency to lessen its tracking of US dollar

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CHINA ECONOMICS UPDATE

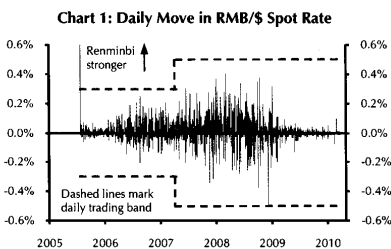
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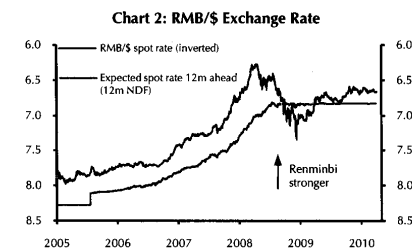
Wider renminbi band would be largely symbolic

- Chinese policymakers are reportedly close to agreement on the next step in exchange rate reform: a widening of the renminbi's trading band with the dollar. This would be a sensible move, but its immediate impact would be largely symbolic.
- Speculation is mounting that the first step in resumption of exchange rate reform is imminent. According to a report in the latest edition of *Caijing*, key policymakers are moving closer to consensus on the way forward for currency policy. Most important, they are considering widening the band within which the renminbi is allowed to trade against the dollar, possibly as early as April. The band is currently set at 0.5% on either side of the reference exchange rate published each day by the People's Bank.
- A move in the next couple of weeks would be seen as a concession ahead of the release of the US Treasury's currency report. There is a precedent: China last widened the dollar trading band, from +/- 0.3%, in May 2007 at a time of similar tension on the eve of high-level economic talks with the US. However, such a gesture might not be needed to avoid China being singled out as a "currency manipulator" in the report. (See our latest *China Watch*, "China set for a well-timed trade deficit", 30th March.) (Furthermore, it is worth noting that the date of the currency report's publication has not been confirmed. The report is formally supposed to be issued every six months, and the last edition came out on 15th October. But the schedule has slipped in the past.)
- Regardless of the timing, the proposal makes a great deal of sense. A wider trading band against the dollar is needed if the renminbi is to start tracking a basket of currencies rather than simply the dollar. A crawling peg against a basket would give policymakers more control over the effective exchange rate and would be consistent with the current official description of the exchange rate as managed "with reference to a basket". (See our *China Economics Focus*, "Where next for the renminbi?", 8th March.) **But while a move to targeting a basket would be sensible, it would also have the politically-unpalatable consequence of causing the renminbi at times to weaken against the US dollar.** Hence such a shift is likely to happen slowly.
- In that case, band widening would be largely symbolic. As Chart 1 shows, the renminbi has touched the edge of its trading band with the dollar on only one occasion since 2005. The greater flexibility afforded by widening the band in 2007 has only been used a handful of times. **Clearly, the current band has not been a limiting factor in the renminbi's pace of gains.** Indeed, one motivation for widening the band would probably be to deter speculative inflows by allowing bigger moves in both directions.
- Overall, it seems plausible that the renminbi's trading band against the dollar will be widened as appreciation in the spot rate resumes. This would lay the groundwork for medium-term reform, and would also help divert attention from what is likely to be a slow pace of movement once appreciation against the dollar does restart. The *Caijing* report notwithstanding, we still think that shift is most likely from June when policymakers will have a clearer view of the strength of the recovery. Our forecast remains for the renminbi to reach 6.60/\$ at end-2010 from 6.83/\$ today. This is a slightly faster pace of appreciation than that priced into the non-deliverable forwards market (nine-month NDFs are at 6.70), but is still a very slow pace of movement. (See Chart 2.) We expect faster gains to 6.20/\$ at end-2011.

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