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AMP CAPITAL

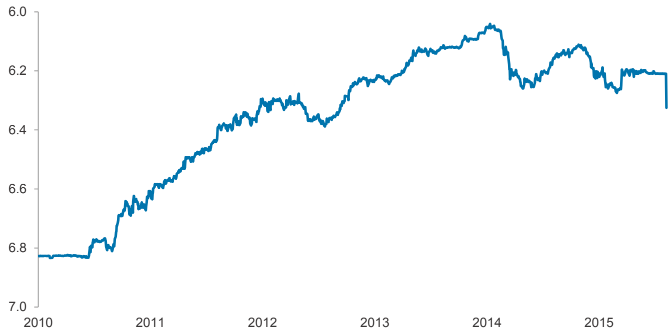
# SOME PERSPECTIVE ON CHINA'S CURRENCY DEVALUATION

AUGUST 2015

China surprised the markets by devaluing their currency by 1.9% against the US dollar overnight. This brief note provides some perspective on the devaluation. In our view the move is not particularly negative for New Zealand or other China export markets. Furthermore, the devaluation does not flag China's entrance into a currency war.

The markets reacted negatively to the surprise 1.9% Chinese currency devaluation overnight. US equities were down 1%, closer to 2% lower in Europe, the New Zealand dollar declined more than a percent, while global bond yields rallied 0.1%.

### CHINESE YUAN (PER ONE US DOLLAR)

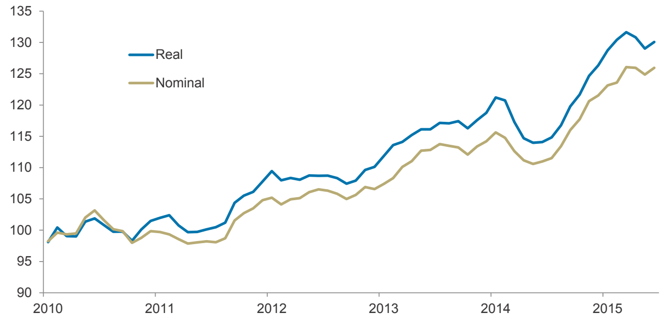



Source: Bloomberg

On the back of the recent domestic share market correction and surprisingly weak manufacturing (Caixin PMI) data this was further fuel to the fire for China bears.

China's trade weighted exchange rate has been on a steady upwards path in recent times, rising about 25% over the last five years and 13% in the last year alone (more in real terms). So in this context the devaluation is a relatively minor one.

### CHINA EFFECTIVE EXCHANGE RATE




Source: BIS, AMP Capital

The devaluation has been presented by the authorities as a one-time move and a more market-determined approach to setting the Chinese yuan, as the daily fix now refers to the closing rate of the interbank foreign exchange market.

In our view the devaluation is not particularly negative for New Zealand or other China export markets.

Large declines in commodities prices means China is already facing very cheap import good prices compared to a year ago in US dollar terms, which most commodities are priced in. After the 1.9% currency revaluation lower, import prices will still be very cheap for Chinese importers.

**EVEN FOR NON-COMMODITY EXPORTERS TO CHINA, SUCH AS JAPAN AND GERMANY, NEAR 20% DECLINES IN THE EURO AND YEN OVER THE LAST YEAR MEANS THEIR EXPORT GOODS ARE STILL VERY COMPETITIVELY PRICED.**

Furthermore, we think the devaluation overnight does not flag China's entrance into a currency war. The authorities have indicated it is a one-time move, and it could strengthen the case for the yuan's inclusion in the International Monetary Fund's reserve currency basket (SDR) later this year.

It also provides some succour to the export sector which has been struggling of late. The property market has been getting lower interest rates and an easing of borrowing restrictions. The banking sector has been given easier reserve ratios and capital requirements, while the industrial sector is getting an increase in infrastructure spending. It now looks like everyone is getting a bit of help as the economy adjusts to a slower growth path.

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## CONTACT US

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