CEAC Commentary

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Xi's Struggle on A Rapid Fall of Renminbi

By TAMURA Hideo

The Chinese authority makes every effort to prevent a sharp devaluation of renminbi. The People's Bank of China curbs money supply and raises interest rates, but the rise of American interest rates diminishes the effect of these measures. If China were to leave the renminbi devalued, Trump's America would definitely blame it, while a tight monetary policy would lead to a drop of real estate price. If it happens, that may have a ripple effect throughout the world, but a continual Chinese bubble is more dangerous. Let me mention the transition of Chinese interest rates and renminbi exchange rates to the US dollar. The renminbi turned into a downtrend since August 2015, and it has stopped falling since the beginning of this year. Nevertheless, the renminbi managed to avoid tumbling into a precipitous free fall, simply because the Chinese financial authority raised interest rates by all means, but still, they have not mitigated the downward pressure.

There are no "patriots" in China. People above the middle income group who have financial assets and companies that have business connections with Communist Party leaders, whether state-run or private, move their assets abroad by any means, including underground channels, once the renminbi exchange rate shows a downturn trend. According to the IIF (Institute of International Finance) whose headquarters is in Washington DC, the amount of net fund outflow from China reached 725 billion dollars in 2016. Such a sharp rise of capital outflow is expected to slow down this year, but the IIF sees that the basic trends will not change. Above all, though the Chinese authority strict capital regulations, they cannot stop a huge amount of capital exodus. This is because Communist Party leaders help illegal outflow by their colleagues and relatives, though they are supposed to enforce regulations. There are no remaining options other than manipulation of renminbi exchange rates and a hike in interest rates. They set the standard value of renminbi arbitrarily, and limit daily fluctuation range within 2% above or below that value, but they cannot manipulate the rate that is starkly different from market reality. In that case, the market will lose confidence in their standard value, which leads to aggressive sell out of the renminbi in huge quantities.

An interest rate hike in the United State would destabilize the renminbi. If American interest rates were to rise, people would sell the renminbi and buy the US dollar, thus, China would raise interest rates higher than that of the United States. That would ultimately lead to a bust of the renminbi asset bubble. The real estate market would accommodate a huge amount of funds surplus at this stage, but property trade in Shanghai has already peaked out, and the bubble is shifting to the inland area, though it is hardly imaginable the demands for properties in this region is so high. The market price would plunge, once the prospect of real estate market price ceased to rise faster than the interest rate of borrowed funds. If it were to happen, bad loans at the bank would expand rapidly, and money supply into the real economy would fall short of the demand. China would fall into something like the collapse of Japanese bubble in the 1990s.

This problem has been mentioned frequently up to now, but thanks to intransparent market under the Communist Party rule, China manages to avoid a financial crisis. There is no clear standard of bad loans and debts, and therefore, it is easy for businesses and financial institutions to hide or shift bad loans to another account, which is called "stock shuffling". If it were revealed, banks would not be able to raise funds and deposits, and fall into bankruptcy. That would destabilize the global financial market, but shatter Xi Jinping's expansionist ambitions that could be achieved through imposing worthless renminbi on Asian neighbors.

(This is an English translation of the article written by TAMURA Hideo, Journalist, which originally appeared on the e-forum "Hyakka-Somei (Hundred Ducks in Full Voice)" of CEAC on July 11, 2017.)