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Alicia Garcia Herrero, (852) 3900-8680, alicia.garciaherrero@ap.natixis.com
Iris Pang, (852) 3900-8682, iris.pang@ap.natixis.com
Gary Ng, (852) 3915-1242, gary.ng-ext@ap.natixis.com

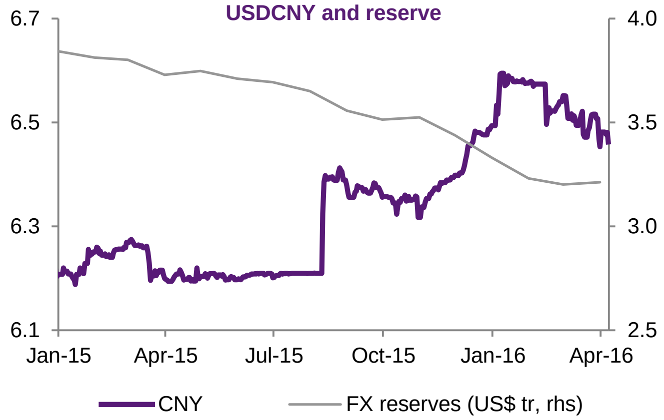
China: Could foreign central banks give PBoC a hand in falling reserves?

The PBoC announced that foreign central banks can invest in the interbank bond and fx market in China without any limit. This does not only apply to investments, but also the repatriation of funds[1] in RMB or converted into foreign currencies.

In order for foreign central banks to invest in yuan assets, their economies should have debts denominated in RMB, which is very tiny in the rest of the world. Hong Kong is the largest offshore RMB centre, and it only has RMB 297.6 billion RMB loan outstanding in November 2015.

If a foreign central would like to enter the China interbank market then it should have forecasted an appreciating RMB and a higher interest rate in China. The latter could be correct depends on the country's own interest rate and other sovereign bond rates. But as we forecast a depreciating CNY to 6.90 by the end of 2016, we do not think that this policy will trigger a massive capital inflow into China in 2016. If the FED raises interest rate in June, CNY would depreciate against the dollar, which could trigger another wave of capital outflow from China.

Chart 1
USDCNY and reserve



Source: Bloomberg, Natixis

In the long run, foreign central banks holding CNY interbank assets would boost the corporate confidence in CNY assets, as well as China's interbank bond market and interbank fx market. Together with the recent policy of opening up the interbank bond market to foreign investors by removing the interbank bond market investment quota, we expect there will be more capital inflow into China in the long term.

[1] Details of the policy: http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3048164/index.html

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