

Hong Kong / Brussels, 14 March 2017

RMB depreciation, capital flow measures and new monetary stance: What are the implications for Chinese corporates?

The potential depreciation of the renminbi (RMB), along with the implementation of capital flow measures, are longstanding concerns for China. The country's recently announced monetary policy stance of being "prudent and neutral" (which was reiterated during the National People's Congress) is now an additional focus of attention.

Going forwards, the People's Bank of China (PBoC) will probably adopt a wait-and-see approach when reacting to the real interest rate differentials between the US and China, particularly as the Fed's monetary policy will be subject to more details from US President Donald Trump's administration regarding tax policy, trade policy and infrastructure investment.

Notwithstanding the impact from the US, the PBoC is expected to gradually tighten its monetary policy, by shifting the expected interest rate corridor up by 20 to 30 basis points in 2017, mainly to contain financial risks and asset bubbles. This would mean **higher borrowing costs for Chinese corporates** and possibly the kick-start of long-expected corporate deleveraging. This would imply higher credit risks for Chinese corporates, especially for those with weak financials.

With the prudent monetary policy and capital flow measures implemented by the Chinese authorities, the RMB is likely to continue its depreciation at a slightly slower pace, of 3% to 5% by the end of 2017. Capital outflows from China will therefore probably persist.

The PBoC's stronger emphasis on the RMB indices probably indicates higher tolerance on the volatility of the RMB/USD exchange rate, which therefore moderates the positive impact of the RMB's depreciation on boosting China's export volumes. At the same time, **import costs are expected to gradually increase**. This is likely to weigh on the Chinese corporates that rely heavily on imported products for production.

In summary, most Chinese corporates are expected to have a challenging year ahead, with higher borrowing costs (amid the upward shift of the interest rate corridor) and keener market competition (with the opening up of more industries to foreign companies). Some companies may face higher import costs, due to the RMB's depreciation. All of these factors are likely to weigh on the profitability of Chinese corporates, although a recovery in external demand (if not interrupted by trade protectionism) could provide a buffer.



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