Economic Analysis

The delay of Fed's liftoff will buy more time for China

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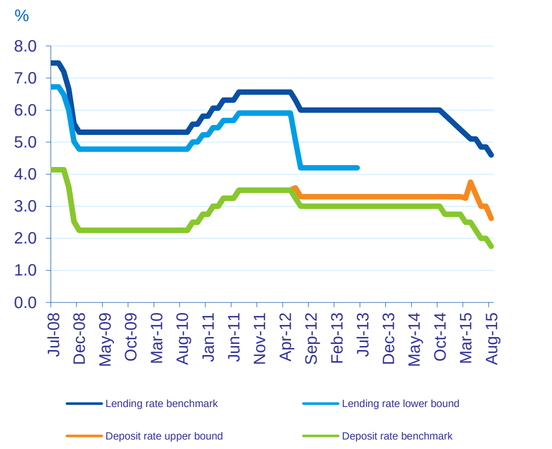
The September's FOMC decided to hold on rate hike, showing the Fed's true dovish colour. The FOMC reemphasize the need to see "some further improvement in the labor market" and "the inflation will move back to its 2 percent target over the medium term." Another reason of the delay is that the latest spillover from China's market turmoil, as the statement also noted that "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." The Fed's decision to delay the first rate hike has shifted our expectations to December of this year. We believe that the Fed's delay of liftoff is generally positive for China, giving the world second largest economy more time to repair its financial system, stabilize the RMB exchange rate and step up easing efforts to support growth. All in all, we expect the RMB exchange rate to remain stable throughout the rest of the year. Our end-of-year forecast of CNYUSD is slightly adjusted to 6.40-6.45 from 6.50 previously, reflecting the benign impact of the Fed's liftoff.

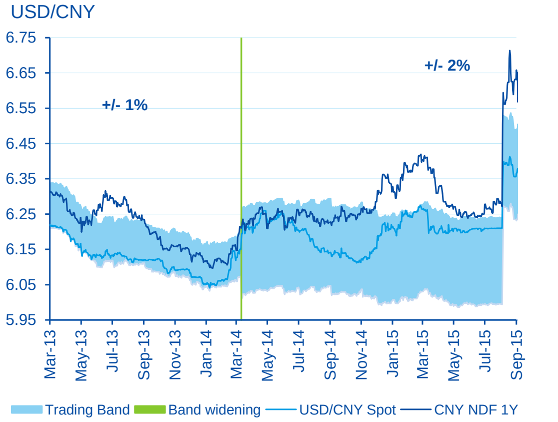
- **The Fed's delayed rate hike will enable China to cut interest rate before December.** The recent stock market crash and the unexpected RMB depreciation in August have added more headwinds to China's growth, which prompt the authorities to beef up easing efforts in support of growth. Previously, we expected that the Fed's prospective interest rate hike in September would constrain the PBoC from further trimming interest rate as it is to narrow the interest rate differential between two countries and therefore could aggravate capital outflows. Now the delay of the Fed's liftoff has indeed provided a time window for China's authorities to use the price tool to spur demand. The authorities are likely to implement another 25 bps cut in interest rates between now and December, along with three times of RRR cuts as we projected previously. (Figure 1)
- **The delay can help China to stabilize the RMB exchange rate.** The unexpected RMB devaluation and accompanied reform of fixing rate mechanism have great knock-on effects on the financial markets around the world, which in return reinforced investors' pessimism for the RMB exchange rate and China's economic outlook. (Figure 2) Through market intervention, China authorities have temporarily stabilized the RMB exchange rate. The delay of the Fed's liftoff will give additional time for Chinese authorities to anchor investors' expectations and regain their confidence in China's long-term outlook during a relatively tranquil period of global financial markets. At the same time, China can enhance their lobbying their efforts to increase the chance of the RMB being included in the IMF's special drawing rights (SDR). We believe this must be on President Xi's agenda for his imminent visit to the US from September 22nd to 25th.

Figure 1
Based on the delayed interest rate hike, we forecast PBoC will adopt another interest rate cut



Source: CEIC and BBVA Research

Figure 2
The delayed rate hike helps RMB to further stabilize after its sharp depreciation in August



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