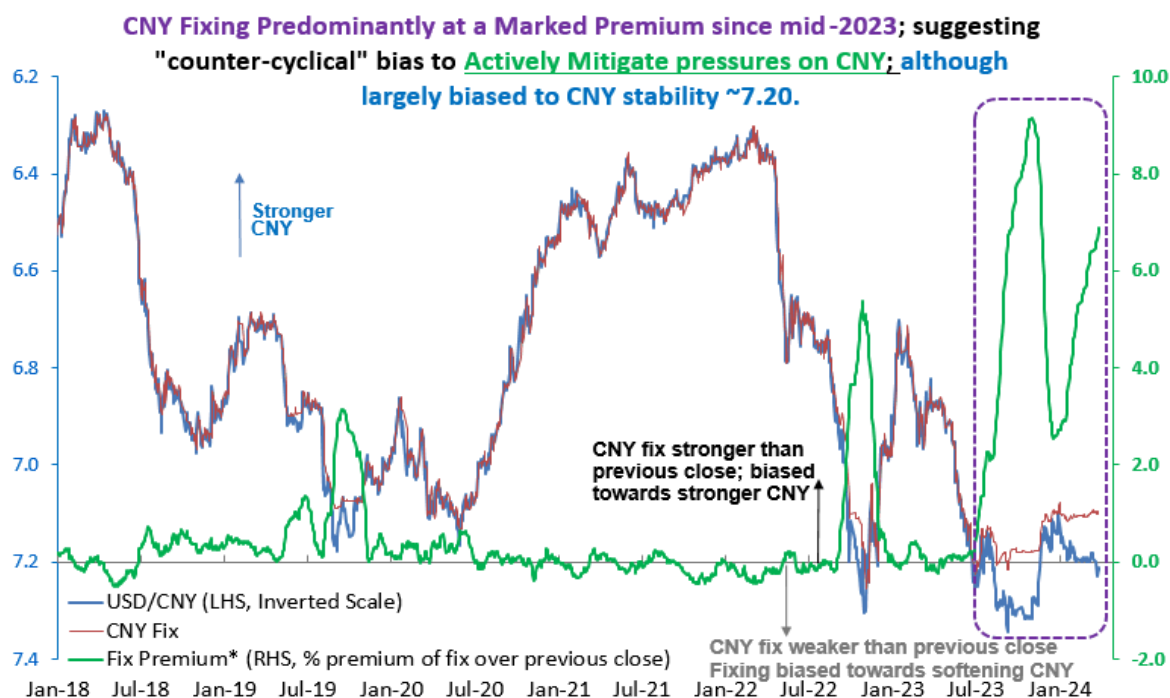


No Panacea & Problematic 'PBoC Put'



Sources: Bloomberg, Mizuho Bank

1. Not a Panacea

- The **relief** is that last week's CNY (and CNH) wobbles proved fleeting. The worry is that it effectively **required PBoC intervention**.
- And insofar as the former does not supplant the latter, **opportunistic CNY buy-back should not be mistaken for a vindication of CNY risks**
- Point being, that CNY support was restored as a result of the PBoC's FX activism in the "fixing" is **not an unequivocally good sign**.
- In fact, the PBoC's **ability to backstop CNY is categorically not a panacea**.
- Worse, it may *merely conceal an unresolved underlying problem*.
- Specifically, that **observable policy confidence in the PBoC's ability to backstop, is not analogous to stand-alone confidence about CNY**.
- In other words, the **ostensible need for PBoC crutch** is a scathing statement of a **conspicuous absence of stand-alone CNY confidence**.
- And that this is *despite China's strong Current Account surplus* position, which is accretive for FX reserve building, is *a particular bug bear*.
- Especially insofar that **persistent CNY pressures reveal capital outflow risks amid a conspiracy of broader geo-economic and structural stress factors**.
- What's more, **PBoC support comes at a cost**.

In particular, *imposing policy constraints* that **render** options to exercise a **so-called "PBoC put" problematic**.

2. Problematic 'PBoC Put'

- **At the heart of this problematic 'PBoC Put'** is **unrelenting policy dilemma** *between stimulating the economy and FX(broader financial) stability*.
- To that end, any **policy calculus** aimed at stimulus **must inevitably factor in inadvertent destabilizing effects in FX and wider asset markets**.
- Especially given the inextricable and circular reinforcement between FX pressures and asset sell-off ultimately resulting in capital outflows.
- To be sure, **memories of 2015-16 "China crisis"** mean that the **PBoC will more likely than not err on the side of caution/stability**.
- **Regardless**, arguably more **accentuated vulnerabilities now demand even more delicate policy balance** *as the trade-offs have sharpened dramatically*.
- Right off the bat, this materially **restrains policy options to a far greater degree than is widely appreciated or conventionally expected**.
- For one, despite deflation providing conventional grounds for cuts, **headline rate cuts remain a tricky proposition in reality**. *At least until a more emphatic global rate cut cycle is underway*, providing requisite cover for CNY stability
- Instead, the PBoC may have to resort to a **suite of targeted and calibrated easing** for the time-being. These include, but are not limited to, *RRR cuts supplemented by credit quota-type of tools* to encourage bank lending.
- But even then, **worries of abrupt asset quality deterioration** in certain sectors (e.g. real estate, subordinated local government vehicles), compounded by shadow banking woes, **threaten to inadvertently stymie stimulus efforts**.
- Mainly as bank credit, despite strong growth, being unevenly distributed, and/or entailing problematic risk transfer at pain of future contagion.
- The upshot is that given the binding constraints and inherent risks the **idea of a "PBoC Put" is more problematic than it is a panacea**.
- In turn this means that **firing up economic tailwinds without invoking financial stability risks** will as a minimum **require sharp policy compromises and deep fiscal back-up**.

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