

## Economic Analysis

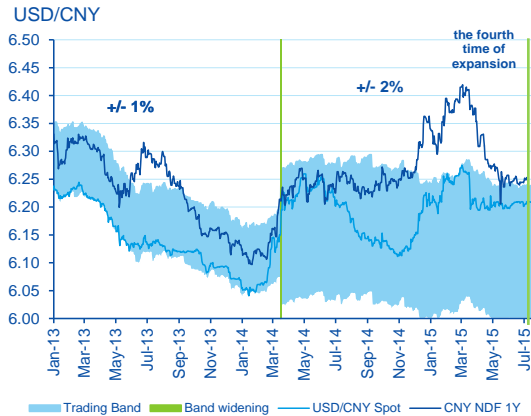
## The State Council expanded the RMB floating band to stimulate exports and growth

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Today, the State Council of China promulgated a series of new policies to stimulate exports and support growth, in response of the recent economic headwinds and stock market crash. The most important one is to expand the RMB floating band, after three expansions since the 2005 exchange rate reform, which will further promote financial liberalization and RMB internationalization. (Figure 1) Other policies include further facilitating the cross-border RMB settlements, promoting more financial products to help enterprises avoid the exchange rate risks, expanding the export credit insurance, etc. We expect that these new export stimulation policies will help to stabilize China's exports in face of weak domestic and external demand. Looking ahead, we envisage that more easing measures will be ahead to avoid economic hard-landing in the rest of 2015.

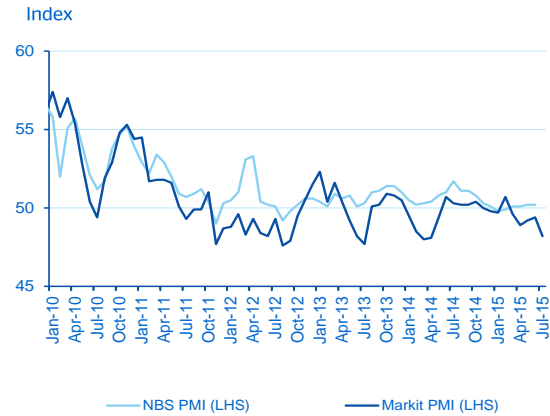
- **The sluggish domestic and external demand, together with the recent stock market crash, promoted the State Council to issue new export policies.** Today, the Caixin China PMI was announced, which dipped to 48.2 from 49.4 of the previous month, also below the market consensus 49.7. (Figure 2) This indicates that the economic slow-down continues in the first month of Q3. Moreover, the recent stock market crash may have spill-over effect to the real economy, further downward adjusted the market investors' expectation of Chinese economy. Except for the continuing sluggish domestic demand, the heightened external uncertainty, centring on the "Grexit", also prompted the State Council to issue new policies to stimulate exports. As EU is the largest trade partner of China, the Greece's possibility of exiting EU may add more risks to China's exports to EU, ultimately affecting China's growth momentum.
- **Expanding RMB floating band indicates another significant move of financial liberalization.** Since the China's exchange rate reform in 2005, the authorities have expanded three times of exchange rate band to 2% of the current floating range. Although the exact time and the extent of expansion have not announced yet, the market expected it will be in 2H 2015 and to expand to 3%. Irrefutably, the fourth time of expanding the RMB floating band will further promote financial liberalization and RMB internationalization. Thus, it will increase the chance that RMB to be included in the IMF's Special Drawing Rights (SDR) as financial liberalization is one of the most important concerns of IMF, the final result of which will be announced this November.
- **Looking forward, more easing policies are expected to stimulate growth in the rest of 2015.** On the front of monetary policy, we envisage that the PBoC will implement an additional interest rate cut of 25 bps in Q3, which is likely to be accompanied by a 50-bps universal reduction in the RRR. The PBoC will also increase the usage of unconventional targeted tools to ensure liquidity adequacy in the banking system in a bid to lower financing costs for firms, such as QE-like measures. On the fiscal front, as we anticipated, the authorities started to relax some tightening measures on local governments and to expand fiscal deficit, in order to avoid fiscal consolidation at the local government level.

Figure 1  
**The State Council promulgated to further expand RMB floating band to stimulate exports**



Source: CEIC and BBVA Research

Figure 2  
**... responding to weak domestic and external demand**



Source: CEIC and BBVA Research

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