

REGIONAL IMPACT AND IMPLICATIONS OF RENMINBI DEVALUATION

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Executive Summary

1. The renminbi (RMB) faces significant downward pressures in the near term due to weak growth momentum and capital outflow pressures arising from a gradually liberalised capital account, normalisation of US interest rate as well as the dollar debt pay down by Chinese corporates.
2. Further RMB depreciation has significant repercussions for the region. At a broad macro level, economies that rely more on China's domestic demand and are competitors with China are likely to be hit by further declines in the RMB.
3. In the event of a depreciating RMB, Taiwan, Japan and South Korea are more likely to face competition from the Mainland in the machinery segment of electrical components and devices (e.g. semiconductors or integrated circuits) since their export structures are relatively similar in these items. Thailand's export basket is similar to that of China in computers and peripherals like hard disk drives.
4. Indonesia is likely to compete with China in labour-intensive tradeables while the Philippines, with an increasing diversified export mix, is expected to compete with China in product categories such as chemicals, intermediate machinery parts and plastics.
5. China's improved export competitiveness due to a depreciating yuan implies that East Asian economies generally benefit from exporting semi-finished goods to China for assembly and subsequent re-exporting of finished products to other countries.
6. RMB depreciation is expected to drive up the cost of servicing foreign debt held by Chinese corporates and adversely affect corporate profits and domestic investment. It would also affect China's imports of raw materials and commodities from Asia, alongside reduced demand for regional commodities from China's growth slowdown.

7. A depreciating RMB could affect economies that are financial hubs for the mainland corporate sector's offshore funding. For instance, loan growth could falter due to an unwinding of HK banks' lending to mainland Chinese entities. HK banks' asset quality in cross-border lending could be affected as the repayment capacity of mainland borrowers in US\$ or HK\$ weakens with a depreciating yuan.
8. If RMB depreciation pressures intensify, the demand for investment products, insurance and bonds denominated in offshore yuan is likely to weaken. The growth of offshore RMB business can temporarily slow, potentially affecting the dim sum (offshore RMB-denominated) bond issuance and thus hurting the revenue streams for financial institutions in HK.
9. A depreciating yuan could slow China's outbound tourism growth, delivering a major hit to tourism sectors in the region, particularly HK, Thailand, Singapore and Malaysia.