

Weird Movements in RMB and Capital Account Liberalization in China.

On Oct 30, the PBOC announced that it would study a trial scheme for QDII2 at the Shanghai Free Trade Zone, in a step towards capital account convertibility. The reaction of CNY and CNH was puzzling. CNY strengthened from 6.357 to 6.3175 with CNH in tow.

One would have expected CNY to weaken if the capital account was more open on account of increased capital flight. I can only theorize that the move to open the capital account is another measure towards satisfying SDR inclusion criteria and that the PBOC then moved to support CNY to signal to domestic investors that although the door was open, they should not be too keen to use it.

The Nov 2 CNY fixing has more or less confirmed this view. Despite the sharpest rise in the daily fixing, the CNY has weakened back to 6.337 this afternoon.

These moves are disconcerting as they illustrate that while China moves towards a market driven economy and financial system, the government is still intervening and will likely keep intervening in markets in unpredictable ways.

This is not to single out China as an unpredictable market manipulator among the world's governments. Western democracies have had more practice interfering with market mechanisms than China who is relatively new at this game. China used to rule by decree. It is freeing up important bits of its markets and economy to market forces and will have to learn new skills to influence pricing under euphemistically free markets.