

## INSIGHT: How Low Could Yuan Fall to Restore China Export Growth?

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(Bloomberg Intelligence) -- Analysis by Bloomberg Intelligence Economics suggests a drop in the yuan to 7.70 to the U.S. dollar could return export growth to 10% year on year by end-2016 and add 0.7 percentage point to GDP growth. A slide to that level could also result in capital outflows of around

\$670 billion, though that appears manageable given the People's Bank of China's large foreign exchange reserves.

### Export Growth and Real Effective Exchange Rate

(Chart available in ECWB)

The main benefit to China's economy from a weaker yuan comes through the export channel. Looking at the historical relationship between exports and the real effective exchange rate, taking export growth back to 10% year on year at the end of 2016 would require a 13% drop in the REER, all else being equal. That would imply a drop in the yuan to 7.70 to the dollar, below the most pessimistic forecast from the street.

### Exports as a Share of GDP

(Chart available in ECWB)

A return to life for exports, which have been contracting for the last five months, would represent a significant boost to China's growth. Average export growth of 5% in 2016 would raise GDP by 0.7%, according to BI Economics' calculations. That's relative to a baseline scenario of zero export growth, and assumes the domestic value-added share of exports is two thirds.

With China's growth sputtering, policy makers may reason that a period of turbulence is a price worth paying for stronger overseas sales.

### Yuan and Cross-Border Capital Flows

(Chart available in ECWB)

The main cost to China's economy from yuan depreciation is capital outflows. Based on the past relationship between cross-border capital flows and the exchange rate, BI Economics estimates that a drop in the yuan to 7.70 to the dollar could trigger \$670 billion in capital outflows. That calculation is subject to uncertainty given lack of good data on portfolio flows. However, given China's FX reserves are currently above

\$3.4 trillion, that suggests the problem could be manageable.

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