

Global Commodities

Strategy: China CNY change to weigh on prices

Equities

Global

Mining & Metals

The People's Bank of China unexpectedly devalues the CNY

The People's Bank of China unexpectedly cut its daily fixing range for the CNY by 1.9% today as part of changes designed to make the CNY fix more reflective of market forces. UBS' China Macro team, led by Tao Wang, explain the move and our revised CNY forecasts in [China's Move on CNY](#).

What next? CNY to weaken, just a question of how much & how fast

How the People's Bank of China manages the CNY fix in coming days will reveal much about the attitude of the government towards CNY depreciation in the face of weakening economic growth, anaemic exports and persistent producer price deflation. Ahead of the announcement, CNY was trading at 6.21 to the US dollar; at time of writing, the currency had eased ~2% to 6.33. UBS now expects CNY/USD to ease a further ~3% to 6.5 by end 2015e and to 6.6 by end 2016e.

What's the impact for commodities? Bearish USD prices by degrees

A weaker CNY increases the price of Chinese commodity imports and decreases the price of Chinese commodity exports. Importers will try to substitute toward domestic supply where China's supply is large eg: met & thermal coal; except where they cannot due to high import dependency eg: iron ore, crude oil, nickel and copper (metal and conc). Exporters will try to lift supply to world markets reflecting enhanced competitiveness eg: aluminium, steel & coal. Lower Chinese commodity import demand and higher Chinese commodity export supply would pressure US dollar commodity prices lower, all else constant.

Weaker CNY to drive incremental, not step change, price impacts

A ~5% depreciation of the CNY relative to the US dollar over 4-6 months is not a major step change, particularly in light of the myriad factors that drive commodity prices in the near and medium term. Rather it represents another incremental factor likely to weigh on US dollar denominated prices over time. Further managed depreciation beyond UBS' views would, however, have larger consequences on commodity prices.

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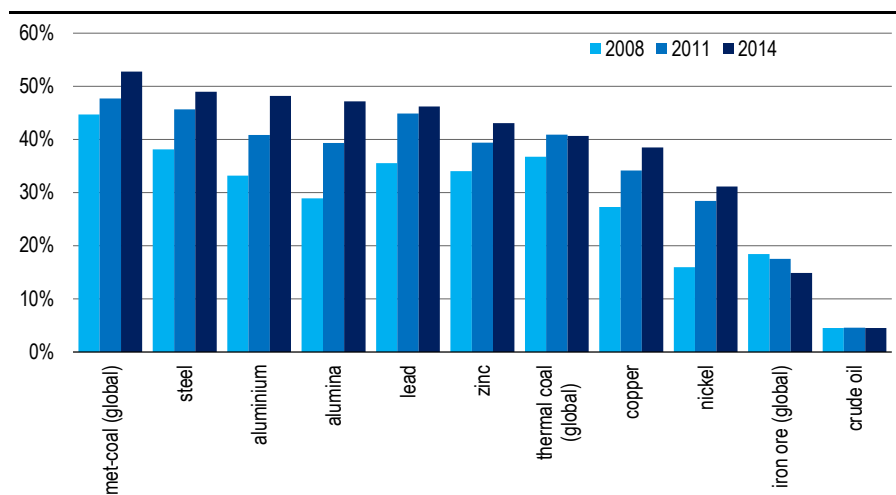
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Figure 1: China's domestic commodity output as % share of world output



Source: WoodMac, AME, TEX Report, UNCTAD, WSA, IAI, BP, company filings, UBS Research.

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