

PBOC's Policy Change Regarding Foreign Currency Risk Reserve

People's bank of China (PBOC) promulgated the "Circular on the policy of PBOC regarding foreign currency risk reserve" (Yinfa [2017] No.207, hereinafter, "the Circular") on September 8, 2017.

1. Contents of the Circular

- ① Transactions subject to the foreign currency risk reserve
 - (1) Forward yuan selling contracts for clients by onshore financial institutions
 - (2) Cover transactions with regard to (1) by offshore financial institutions in onshore interbank foreign exchange market.
 - (3) Transactions in yuan buying and selling agency bank business same as (1).
- ② The foreign currency risk reserve ratio is set at 0% from September 11, 2017, which had been set at 20%.

2. Comment

- PBOC promulgated the "Circular on the Macro Control of Foreign Currency Forward Contract Buying Foreign Currency and Selling Yuan" (Yinfa[2015] No.273) on August 31, 2015, and had imposed foreign currency risk reserve requirement on financial institutions.
- The intention of this circular is generally seen to restrain yuan depreciation expectations, which had depreciated sharply in onshore and offshore market since the reform of yuan exchange rate formation mechanism by PBOC on August 8, 2015.
- Based on this premise, we consider PBOC could cut foreign currency risk reserve ratio to 0% because of yuan strong appreciation against USD in 2017, especially since May in the background of USD depreciation and the change in yuan exchange rate formation mechanism by PBOC, i.e. incorporation of a counter-cyclical factor.
- The Circular enables our customers to deal foreign currency forward transaction, selling yuan and buying foreign currency, with more reasonable price. In addition, it could be the sign that foreign exchange policy has gradually moved from tightening to easing.

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