

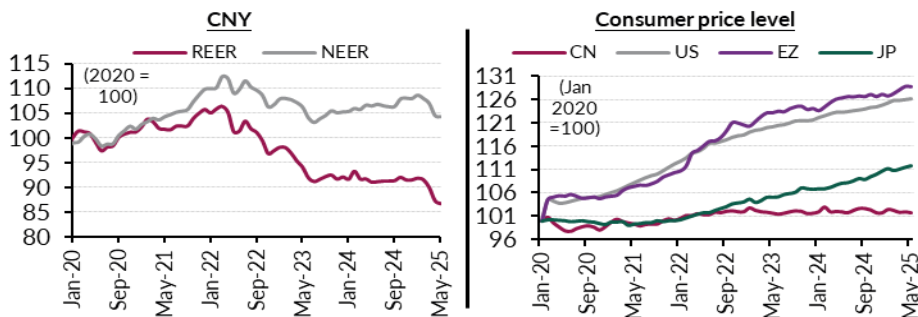
## Will the weakness in the CNY persist?

Even as the CNY's 3% nominal rise against the USD grabs market attention, its real-effective-exchange-rate (REER) is down a steep 4% over the same period. While the near-term driver is a weaker USD, the CNY REER's 18% drop in three years is mainly due to a widening inflation gap vs. other major economies: China's prices have lagged US/EU/JP by 15-20%. Whereas headlines track nominal exchange rates, especially against the USD, the REER affects (and is driven by) economic competitiveness. CNY REER's divergence from CA balances is mostly due to capital outflows hurting its BoP, but this perpetuates continued distortion of global trade balances and China's manufacturing domination.

June 30, 2025

China Currency

**Exhibit 1 - CNY's real levels have fallen sharply as inflation is now much lower**



Source: BIS; CEIC; Axis Bank Research

### Low inflation has pushed China's real-effective-exchange-rate to 13-year lows

Even as commentators have focused on the CNY's 3% nominal appreciation against the USD in the last three months (Fig 2), its real-effective-exchange-rate (REER) is down a steep ~4% (Fig 3). This is mainly due to the USD's depreciation against other currencies, but the record low inflation in China is contributing. The gap in inflation vs. major economies is the main driver of the 18% fall in REER from its peak in Mar-2022. Since Jan-2022, consumer price indices of US, EU and JP have risen 11%/15%/10% respectively more than China's (Fig 4, 5).

### NEER for sentiment, REER for the economic undercurrents and impact

Currency markets and newspapers focus on nominal exchange rates, and that too mostly the level against the USD. As the USD embarks on its multi-year downward adjustment ([link](#): a potential 25%-plus fall in the REER over 3-5 years), and inflation trends diverge from prior patterns, such measures can be misleading. On the other hand, the REER drives economic competitiveness, as it adjusts for effects of inflation on local costs: relative producer prices have fallen even more than CPI (Fig 6), and wage growth has slowed sharply too (Fig 7).

### REER diverging from current account trends: continued global distortions

REER generally reflects current account (CA)/balance-of-payment (BoP) trends. During the policy-driven ~27% nominal appreciation against the USD from 2005 to 2014, the REER rose 45%. The REER has diverged from China's current account balances (Fig 8, 9) since 2021 due to the surge in capital outflows hurting its BoP ([link](#); Fig 10, 11). Capital flows are not on the list of measures used by US policymakers to fish out currency manipulators ([link](#)), though CA balances and bilateral trade deficits are. The CNY REER weakness is likely to exacerbate global imbalances, in our view, raising the risk of stronger policy disruptions. That said, most Asian REERs are mostly at the bottom-end of the 2020-25 range (Fig 12).

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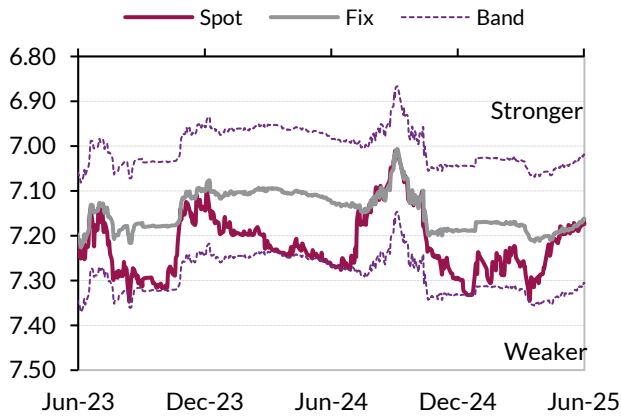
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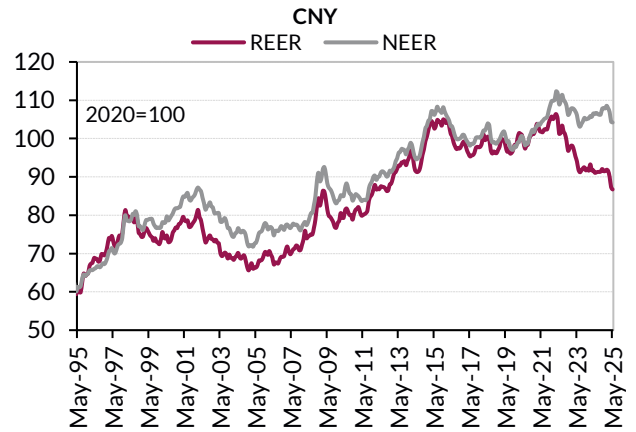
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**Exhibit 2 - The fix is being moved up to encourage CNY appreciation against the dollar**



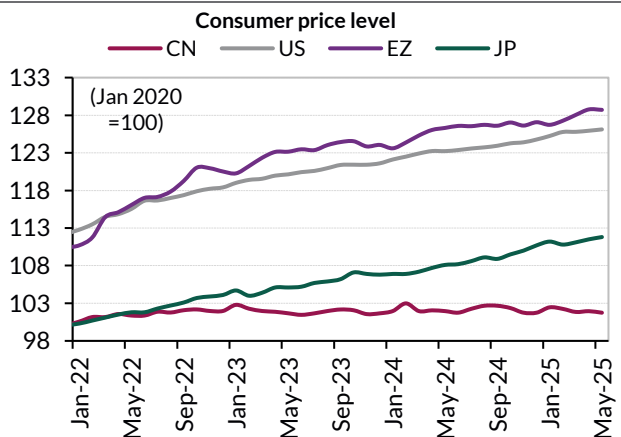
Source: Refinitiv; Axis Bank Research

**Exhibit 3 - CNY REER is at 2012 level, down 18% from its peak in Mar 2022 (NEER down 7% from peak)**



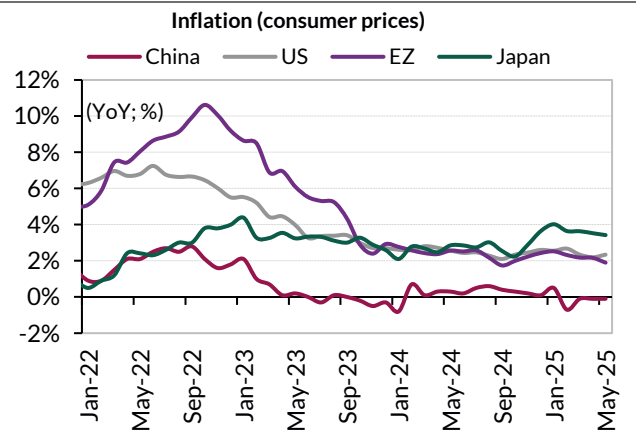
Source: CEIC; Axis Bank Research

**Exhibit 4 - Consumer prices differential between CN and other major economies has widened by 10-15%**



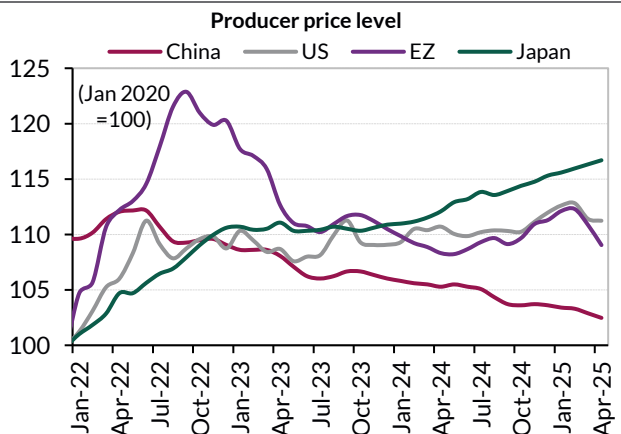
Source: CEIC; Axis Bank Research; PCE for US and HICP for EZ

**Exhibit 5 - China's CPI inflation stuck near 0%; for US, EZ and JP, inflation down from peak but still above 2%**



Source: CEIC; Axis Bank Research

**Exhibit 6 - Producer prices in China are 7% below 2022 levels vs. 9-16% growth in US, Eurozone and Japan**

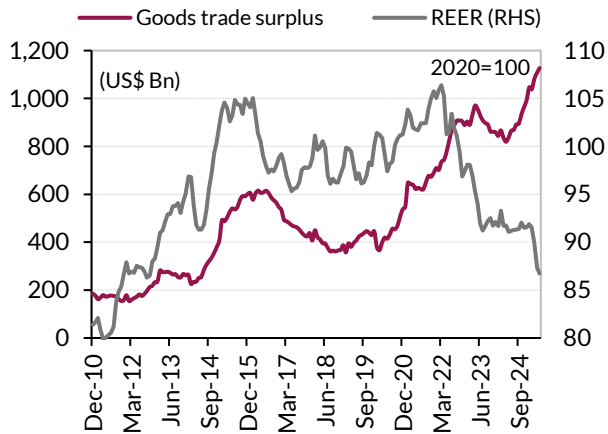


Source: CEIC; Axis Bank Research

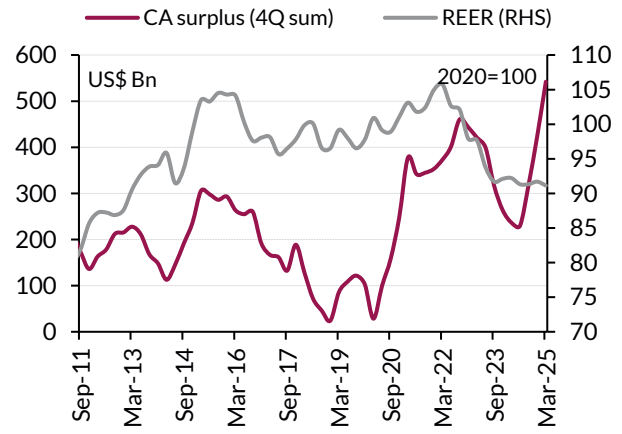
**Exhibit 7 - Wage growth in China has slowed down to 4% YoY from over 10% in 2021**



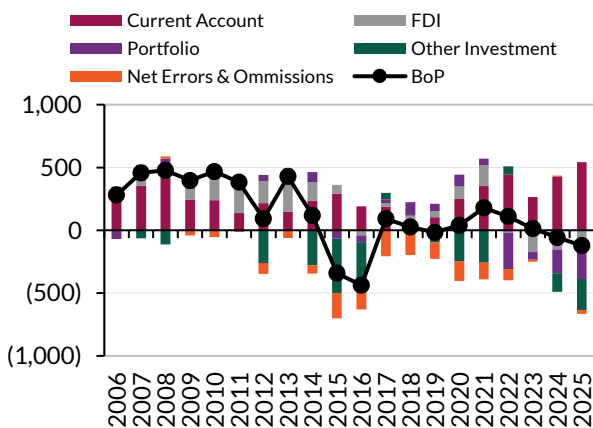
Source: CEIC; Axis Bank Research

**Exhibit 8 - The relation between China's goods trade surplus and REER broke after 2022**


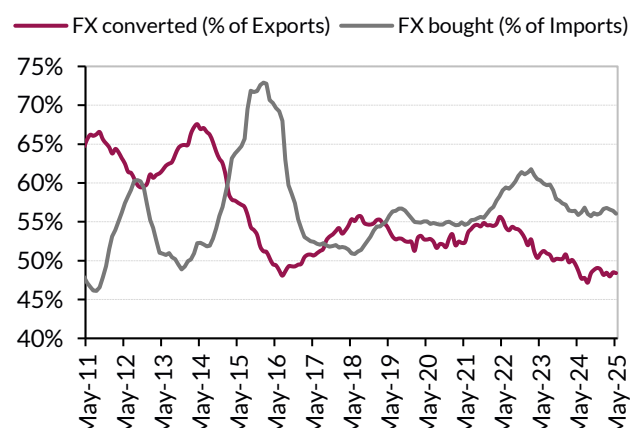
Source: CEIC; Axis Bank Research

**Exhibit 9 - REER stuck at low levels despite CA surplus bouncing back since H22024**


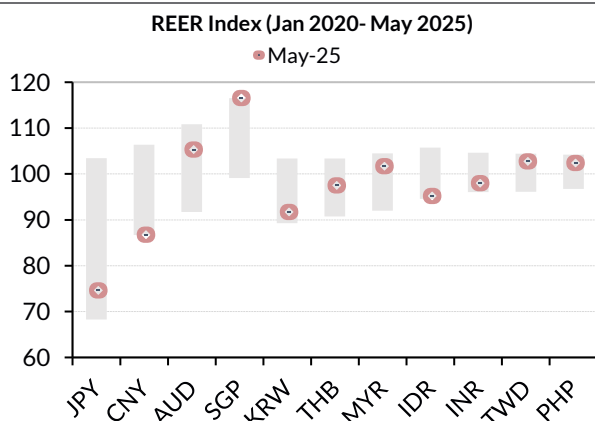
Source: CEIC; Axis Bank Research

**Exhibit 10 - The pressure on BoP is worsening since 2021, mainly due to capital outflows**


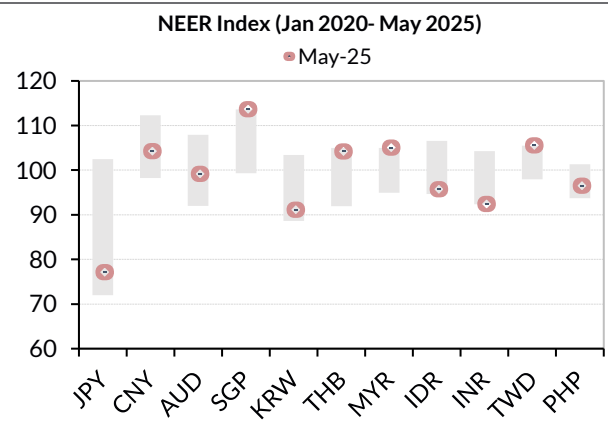
Source: CEIC; Axis Bank Research; 2025 is Mar 4Q rolling sum

**Exhibit 11 - Exporters are retaining more earnings in FX; importer demand for FX elevated, but down from peak**


Source: CEIC; Axis Bank Research

**Exhibit 12 - JPY, CNY, KRW, IDR and INR near the bottom of the 2020-25 range of REER**


Source: BIS; Axis Bank Research

**Exhibit 13 - NEER for CNY, AUD, THB, PHP not aligned with moves in REER between 2020-25**


Source: BIS; Axis Bank Research

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