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A Stronger CNY: What It Means for the Chinese Economy

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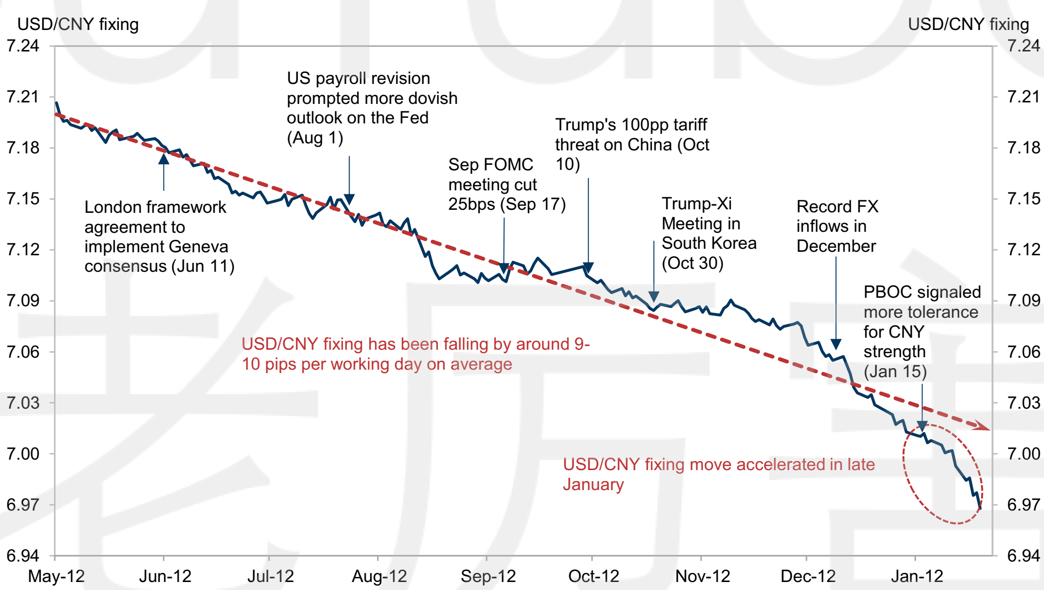
- USD/CNY broke below 7.0 in late December and continued to decline into early 2026, bringing the exchange rate back into focus. Improved sentiment on China's growth outlook, greater policy tolerance for CNY strength, and significant FX undervaluation have reinforced expectations for further CNY appreciation. Against this backdrop, clients increasingly ask whether a stronger CNY could weaken exports and/or deepen deflation pressures, given the importance of export growth and ongoing PPI deflation.
- We first examine how changes in USD/CNY translate into changes in CNY NEER (nominal effective exchange rate) and REER (real effective exchange rate), as the macro impact of exchange rate moves operates mainly through trade-weighted measures rather than USD/CNY, and both the nominal and real exchange rates matter (to price and growth, respectively). For NEER, we focus on the CFETS RMB index. Our analysis shows that the relationship between USD/CNY and the CFETS RMB index varies over time, depending on Dollar moves and the PBOC's FX management. Our FX strategy team's view on weakening broad USD, as well as other major currencies, implies a CNY NEER appreciation of 3% this year. Given lower CPI inflation in China (0.6% expected in 2026) than in the major trading partners (around 2%), a 3% NEER appreciation implies a smaller REER appreciation (around 1.5%).
- Building on our earlier work, we then update our estimates of how CNY appreciation affects trade volumes/prices, real GDP growth, and CPI/PPI inflation. We find that a 10% trade-weighted CNY appreciation in real terms would imply about a 4% decline in export volumes with a one-quarter lag, equivalent to a 70bp real GDP growth drag. On prices, a 10% trade-weighted CNY appreciation in nominal terms would lower CPI inflation by about 0.1pp and PPI inflation by around 1pp. Applied to our FX team's forecasts, the projected 3% NEER appreciation and a 1.5% REER appreciation expected this year would imply only a 10bp drag on real GDP growth in 2026, alongside a modest decline of around 5bp in CPI inflation and a 30bp decline in PPI inflation.
- Note that these estimates should be viewed as an upper bound, since it is estimated with historical data. The macro impact of currency strength is likely moderating over time. China's shift toward a higher-tech, higher value-added export basket has likely reduced exchange rate sensitivity, given these products are less substitutable. Besides, Chinese exporters are increasing their FX hedging

ratios with a rising RMB settlement share in cross-border trade, which should also limit exports' FX sensitivity. Overall, our analysis suggests that our baseline expectation of continued robust Chinese export growth is compatible with a gradually appreciating RMB.

USD/CNY broke below 7.0 in late December and continued to decline towards 6.90 in January, putting the exchange rate back in focus. With sentiment toward China's growth improving, most clients now expect a stronger CNY against the USD in 2026. Greater policy tolerance for CNY strength, solid export performance, and significant FX undervaluation all point to further downside in USD/CNY (Exhibit 1). Reflecting these factors, our FX strategists have revised 12-month USD/CNY forecast to 6.70, from 6.85 previously, implying around 4% appreciation against the USD. This raises a key question: with exports remaining critical to China's growth outlook and PPI still in deflation, could further CNY appreciation weaken export momentum and add to disinflationary pressures? In this note, we first examine how changes in USD/CNY translate into changes in CNY NEER (nominal effective exchange rate) and REER (real effective exchange rate), as the macro impact of exchange rate moves operates mainly through trade-weighted measures rather than USD/CNY, and both the nominal and real exchange rates matter (to price and growth, respectively). We then build on our earlier work to update estimates of how CNY appreciation affects trade volumes and prices, and the implications for real GDP growth and CPI/PPI inflation.

Exhibit 1: USD/CNY fixing accelerated its descent in late January, consistent with greater policy tolerance for currency strength



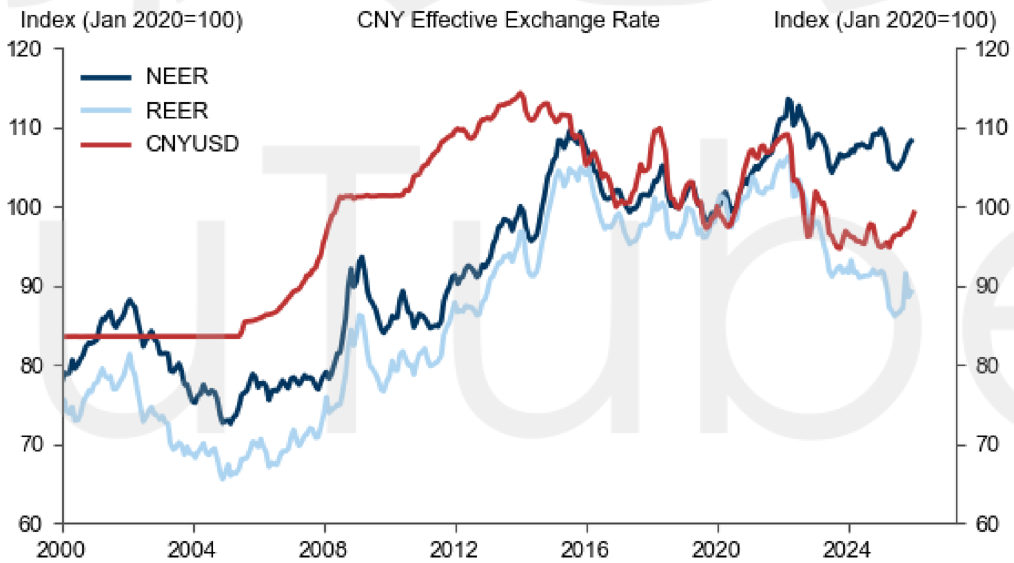
Source: Data compiled by Goldman Sachs Global Investment Research

Mapping USD/CNY moves into NEER and REER

USD/CNY outlook is typically the focal point of FX discussions, as it matters more for capital flows and much of the PBOC's FX policy toolkit operates through it. However, trade-weighted measures, such as NEER and REER, are more relevant for assessing the macro impact of currency strength. REER adjusts for relative inflation across trading partners and is therefore more relevant for export competitiveness and volume growth, while NEER captures nominal currency movements and is more closely linked to import prices and inflation.[1] A stronger CNY in NEER tends to raise export prices and lower import prices, while a stronger CNY in REER generally discourages export volume growth and boosts import volumes.

Understanding how USD/CNY moves map into NEER and REER is therefore key to interpreting the impact of USD/CNY moves. Empirically, USD/CNY, NEER and REER can diverge meaningfully over time, reflecting FX management and underlying economic forces (Exhibit 2). For NEER, we focus on the CFETS RMB index, which is widely regarded as a benchmark for FX policy, and serves as a reference for CFETS basket-based trading strategies.

Exhibit 2: CNY has weakened in REER terms despite NEER appreciation, reflecting low CPI inflation and deflationary pressures in China



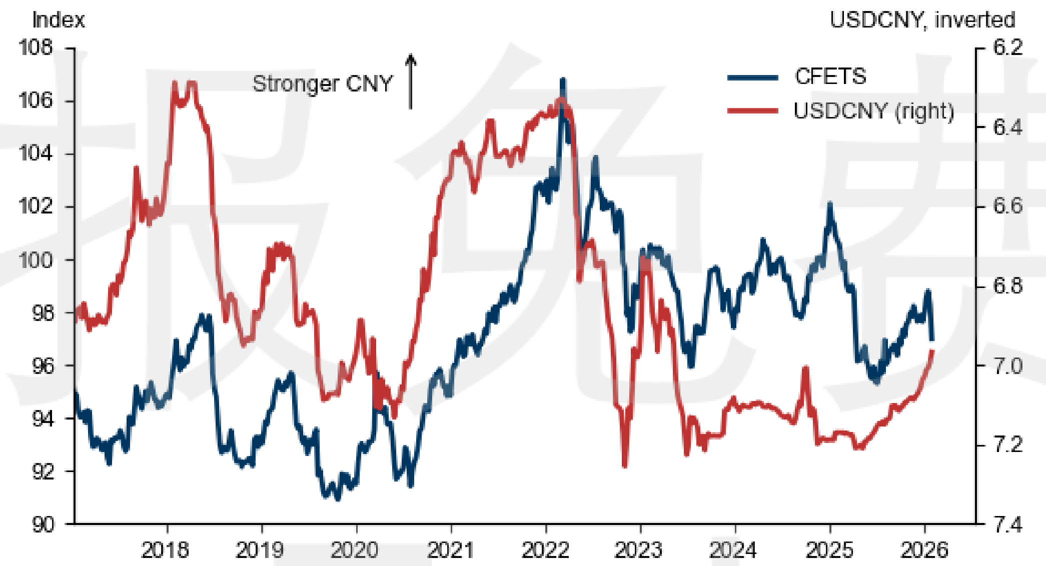
Source: Haver Analytics

CNY/USD and the CFETS RMB index generally move in the same direction, but fluctuations in the CFETS index are typically much smaller (Exhibit 3). Historically, for every 10% move in CNY/USD spot, the CFETS RMB index changes by 4%, assuming the Dollar is broadly stable against other currencies in the basket.[2] Applying this relationship, our projected 3.8% appreciation against the USD would imply around a 1.5% appreciation on a CFETS basket basis. However, the relationship varies significantly from time to time and depends on Dollar moves and the PBOC's FX management (see Box for more details). Our FX strategy team's forecasts of the major crosses imply a 3% appreciation in CNY NEER this year. Given lower CPI inflation in China (0.6% expected in 2026) than in the major trading partners (around 2%), a 3% NEER appreciation implies a smaller REER appreciation (around 1.5%).

1 We use the BIS CPI-deflated REER index and the BIS NEER index. For a detailed discussion of the choice of trade-weighted exchange rates and their relationship with growth and inflation, see our earlier work, Asia in Focus: China: Revisiting the Effect of RMB Depreciation on Growth and Inflation.

2 The changes in the CFETS RMB index can be mechanically decomposed into movements in CNY/USD and changes in the USD against the CFETS basket.

Exhibit 3: CNY/USD and CFETS RMB index generally move in the same direction

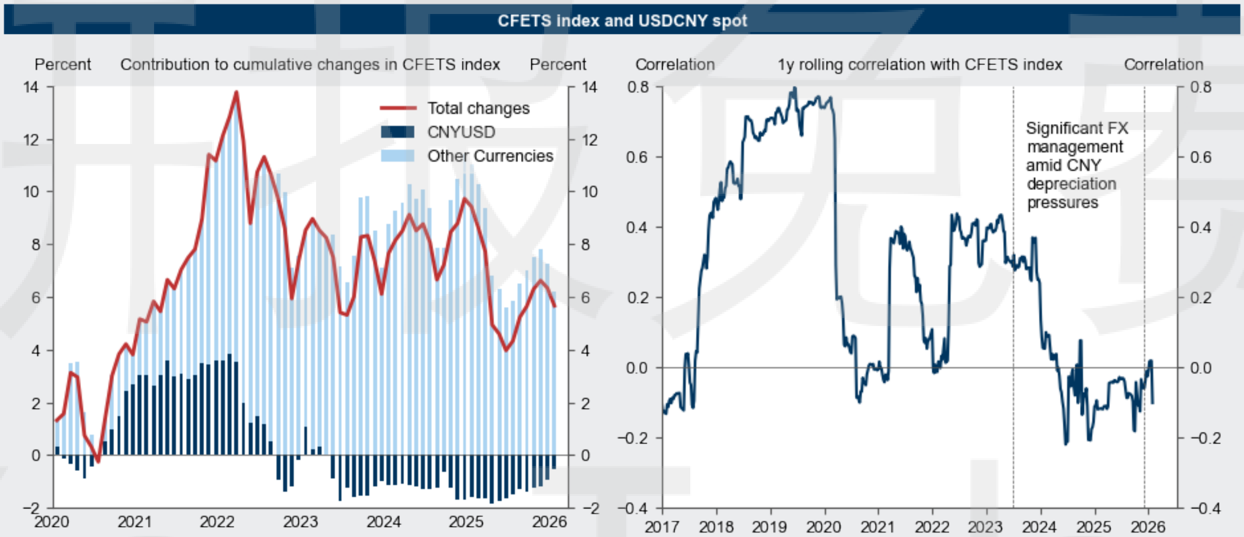


Source: Wind, Goldman Sachs Global Investment Research

How FX management shapes the relationship between USD/CNY and the CFETS RMB index

The relationship between CNY/USD and the CFETS basket has weakened since 2020. Movements in the CNY/USD spot explain a small share of the changes in the CFETS RMB index, and the two have even moved in opposite direction in some episodes (Exhibit 4). We find that PBOC's FX management — which is proxied by the counter-cyclical factor in the USD/CNY fixing in our analysis — is likely a key reason behind this change. When USD strengthens, policymakers want to limit the extent of CNY depreciation against the USD. Therefore, the CNY can weaken against the USD while strengthen against other currencies, resulting in a stable or even appreciating CFETS RMB index. Conversely, when USD weakens, policymakers also wants to control the extent of CNY appreciation against the USD. As a result, CNY may appreciate against the USD by less than other currencies and the CFETS RMB index weakens (see an example here). In 2026, if the USD experiences "shallow depreciation" as our FX strategy team expects, and if the PBOC shows greater tolerance for RMB appreciation as recent policy communications suggest, we are more likely to see CNY appreciate against the USD with the CFETS RMB index strengthening in tandem. In the event of a sharp USD deprecation, the PBOC is likely to step in to reduce USD/CNY volatility, the RMB may still appreciate against the USD, but the CFETS RMB index could remain stable or even weaken.

Exhibit 4: CNY/USD moves only account for a small portion of changes in CFETS RMB index, with correlation turning negative over the past two years



Source: Haver Analytics, Goldman Sachs Global Investment Research

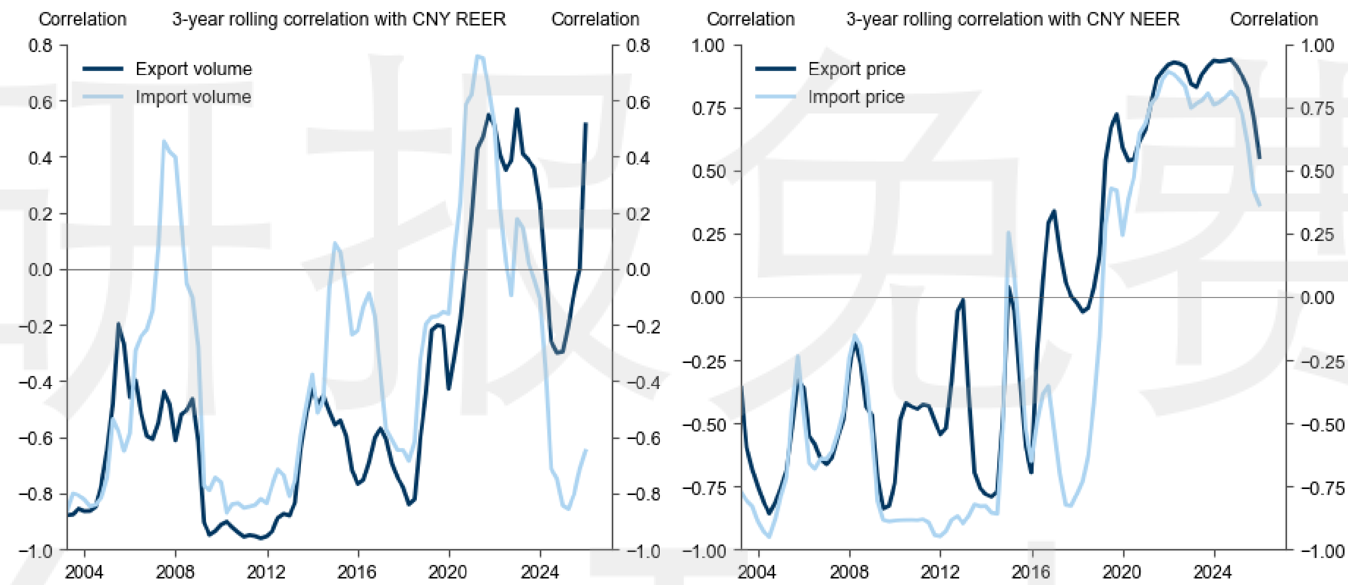
CNY appreciation poses limited downside to China's growth and inflation

Consistent with our previous note, we focus on trade-weighted exchange rates rather than USD/CNY when assessing macro impacts of currency strength. Our estimates of exchange rate effects on trade volumes and prices are based on OLS regressions and a VAR model using NEER and trade data. Sub-sample analysis suggests that export volume elasticity to exchange rate has declined over time, while exchange rate pass-through to export prices has increased, likely reflecting China's shift toward a higher-tech, higher value-added export basket. Such products are less substitutable, resulting in lower demand elasticity and greater scope for exporters to raise prices gradually. As a result, we find that the adjustment in export volumes has tended to be even slower and more gradual in recent years.

Import volumes and prices move closely with exports, reflecting China's role in global supply chains. Around 75% of China's imports are intermediate goods, much of which would feed into export-oriented manufacturing. As a result, exchange rate driven weakness in export volume growth can also dampen import volume growth. In addition, common factors such as global supply chain disruptions can push export price and import price in the same direction. Taken together, these may even reverse the correlation between trade volumes/prices and exchange rates (Exhibit 5).[3] To disentangle these effects, we use a VAR model to examine the joint dynamics of the exchange rate, trade volumes and prices. Our results suggest that a 10% NEER appreciation is associated with a 2.4pp increase in import volumes and roughly a 3pp decline in import prices, with a 2-4 quarter lag.

[3] In theory, a stronger CNY should boost export volume and price, but weigh on import volume and price.

Exhibit 5: Rolling correlation show unstable links between exchange rates and trade volumes/prices



NEER and REER are lagged by one quarter.

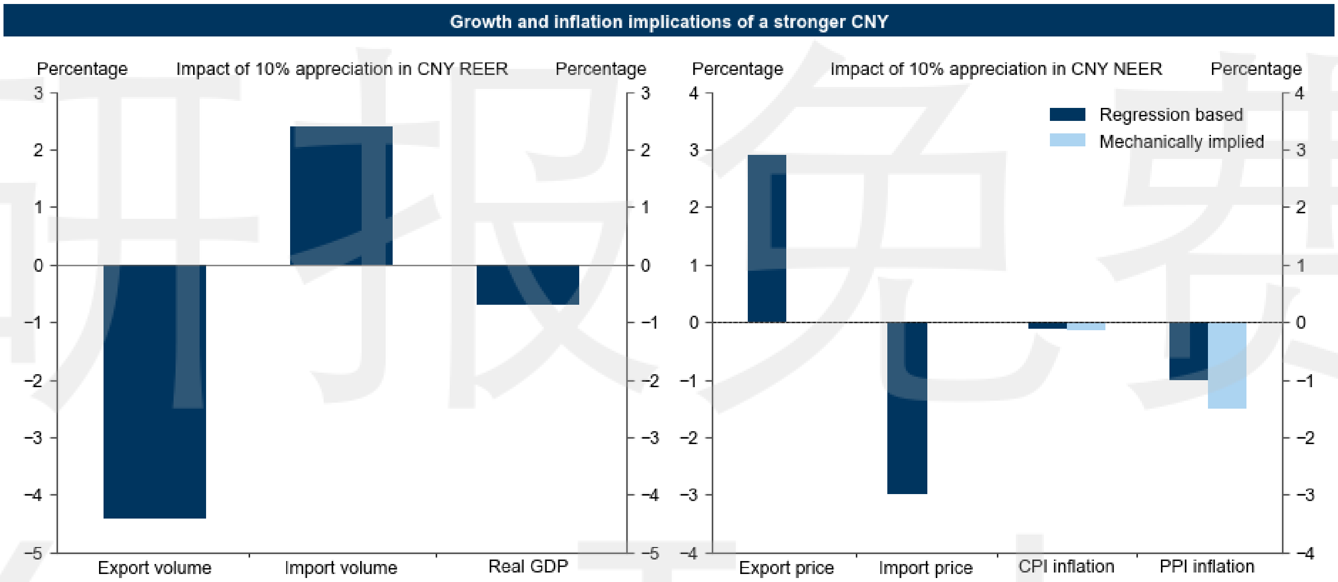
Source: Haver Analytics, Goldman Sachs Global Investment Research

We then assess the implications for CPI and PPI inflation through the import price pass-through channel. Goods are 60% of Chinese CPI baskets, and around 8% of consumer goods are imported. Therefore, approximately 5% of China's CPI basket is imported goods. On this basis, a 10% CNY NEER appreciation would lower CPI inflation by 0.15pp. As a cross-check, we also estimate the relationship between CPI inflation and the exchange rate directly using OLS regressions and obtain similar results.[4] For PPI inflation, our previous work suggests a 1% increase in import prices raises PPI inflation by around 0.5%. Applying this relationship, a 10% CNY NEER appreciation would lead to a 1.5pp decline in PPI inflation. However, direct OLS regressions point to a somewhat smaller impact (a 1pp decline in PPI inflation).

Exhibit 6 summarizes the estimated macro impact of a 10% CNY appreciation on a trade-weighted basis. On activity, a 10% REER appreciation is associated with a 4.4pp decline in export volumes with a one-quarter lag, implying roughly a 70bp drag on real GDP growth. On prices, a stronger CNY is disinflationary: a 10% NEER appreciation lowers CPI inflation by 0.1pp and PPI inflation by about 1pp, with the larger response in PPI reflecting its greater exposure to imported goods, especially commodities. Applied to our current FX forecasts, which imply a 3% NEER appreciation and a 1.5% REER appreciation this year, these estimates translate into a roughly 10bp drag on real GDP growth in 2026, alongside a modest decline of around 5bp in CPI inflation and about a 30pp decline in PPI inflation.

[4] We find that the exchange rate matters for non-food goods prices, but not for food or services prices.

Exhibit 6: Estimated macro impact of a 10% CNY NEER appreciation



Estimates are based on quarterly data from 2006-2025. On the RHS chart, "regression-based" estimates rely on econometric relationships between macro variables and the exchange rate, while "mechanically implied" estimates are derived from accounting relationships (e.g., import shares in household consumption).

Source: Goldman Sachs Global Investment Research

Note that these estimates should be viewed as an upper bound, since it is estimated with historical data. The macro impact of currency strength is likely moderating over time. China's shift toward a higher-tech, higher value-added export basket has likely reduced exchange rate sensitivity, given these products are less substitutable. Besides, Chinese exporters are increasing their FX hedging ratios with a rising RMB settlement share in cross-border trade, which should also limit exports' FX sensitivity. Overall, our analysis suggests that our baseline expectation of continued robust Chinese export growth is compatible with a gradually appreciating RMB.

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