

# Mizuho Bank 2021 RMB Outlook

## The return of RMB rally

May 2021

East Asia Treasury Department, Treasury Marketing Section

**MIZUHO**

The Mizuho Bank logo, featuring the word "MIZUHO" in a bold, white, sans-serif font with a thin white horizontal line underneath, set against a dark blue rectangular background.

## Global – USD & UST yields retracements

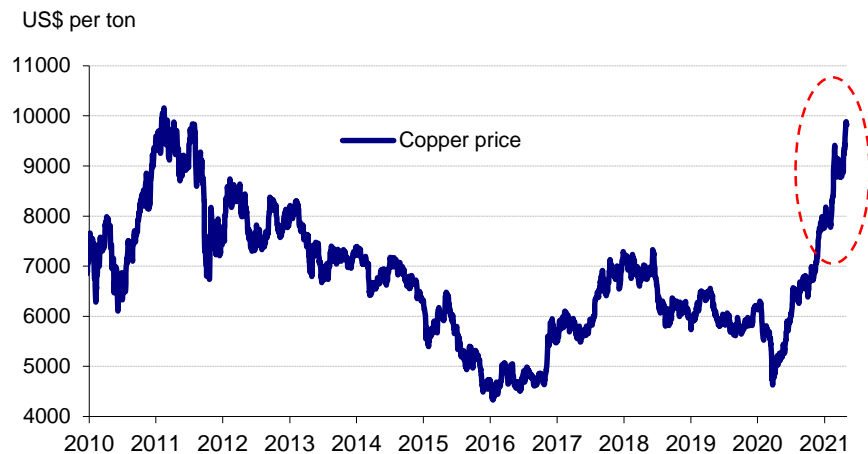
- USD and UST yields retreated as investors digested Biden's strong stimulus plan. His tax rate hike plan to raise capital gain tax to around 40% dealt a blow to risk assets but the sell-off was proved to be short-lived
- The Fed upgraded the US economic outlook but refrained from discussing its tapering plan. Inflationary pressure has been building up due to the transitory factors largely
- The global virus spread remains unsettling, with resurgent of India daily infections to above 300k, while the vaccinations progress helped contain virus spread in Europe and US

| Date            | Key Events for 2021                     |
|-----------------|---|
| May             | 6 (GB) Scottish parliamentary elections |
| Jun             |   |
| Jul             | 23 (JP) Summer Olympics                 |
| Aug             | 1 (HK) Equities stamp duty hike         |
| Sep             |   |
| Oct             | 22 (JP) General election                |
| Nov             |   |
| Dec             |   |
| In the pipeline | Vaccination, global reopening in H2?    |

# Global – Reflation trade still in play

- Global inflation picked up amid surging commodity prices. Cryptocurrency surged as a tool to hedge inflation and central bank easing risk. Global yields returned to pre-pandemic level. US equities pushed back to their record highs

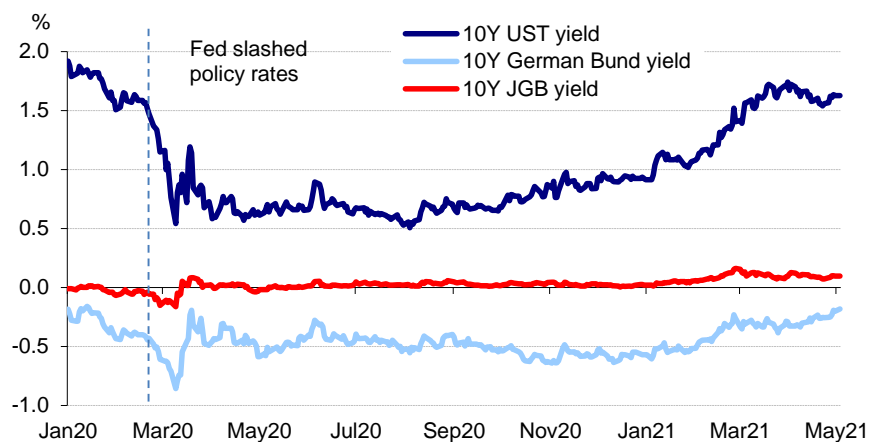
**Copper price hit its decade high of US\$10K per ton**



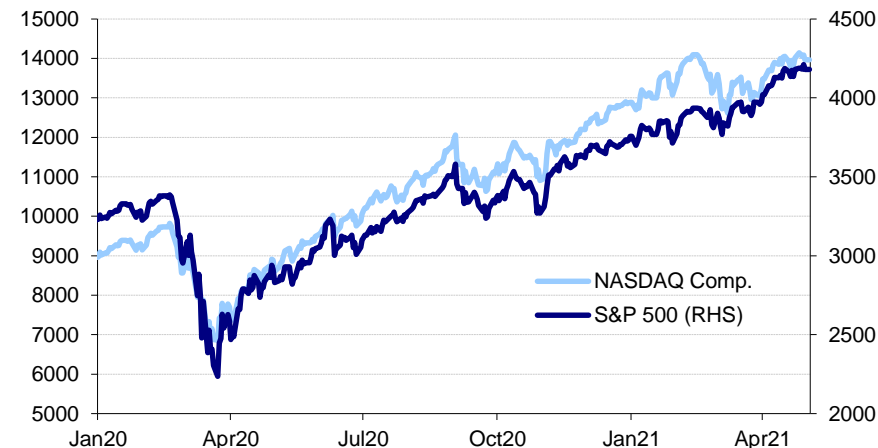
**Cryptocurrency frenzy**



**Global yields back to pre-pandemic level**



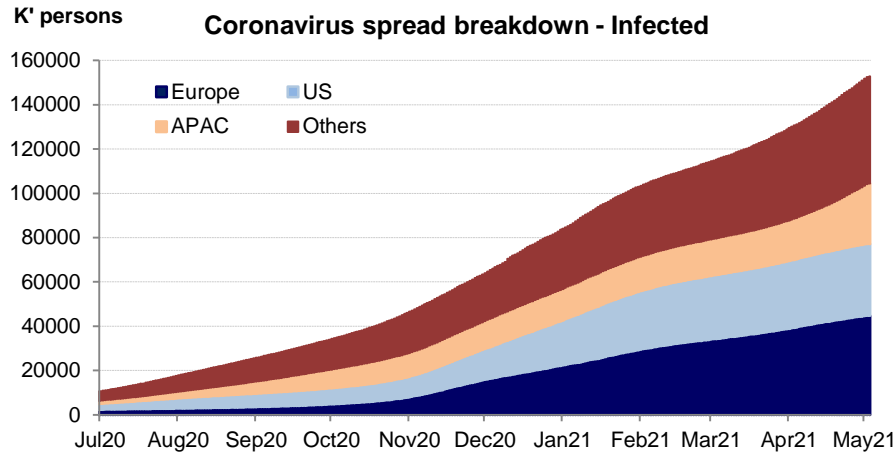
**US equities returned to record highs**



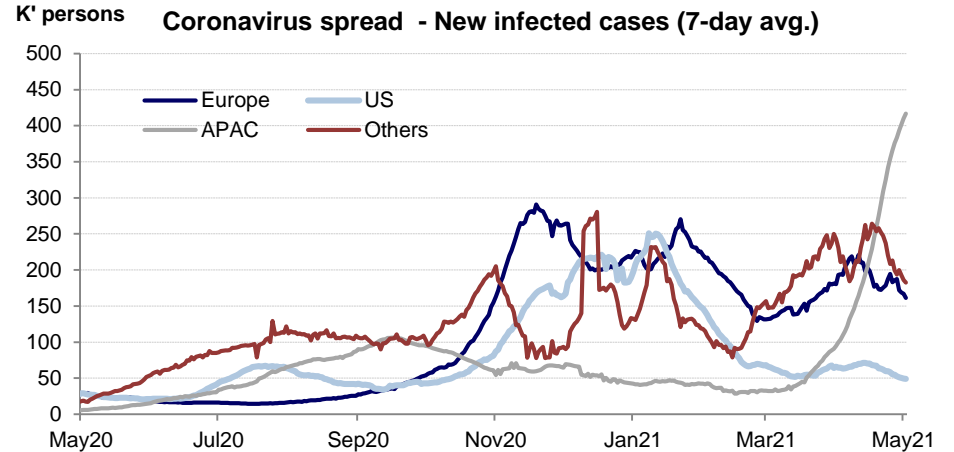
# Virus – Resurgent infection in India fuelled recovery uncertainties

- Global infected cases surpassed 150mn, with death tolls topping 3.2mn. The vaccination roll-out slowed virus spread in Europe and US, while India turned to be a new epicenter. Global mfg. PMI climbed above 50 expansion mark

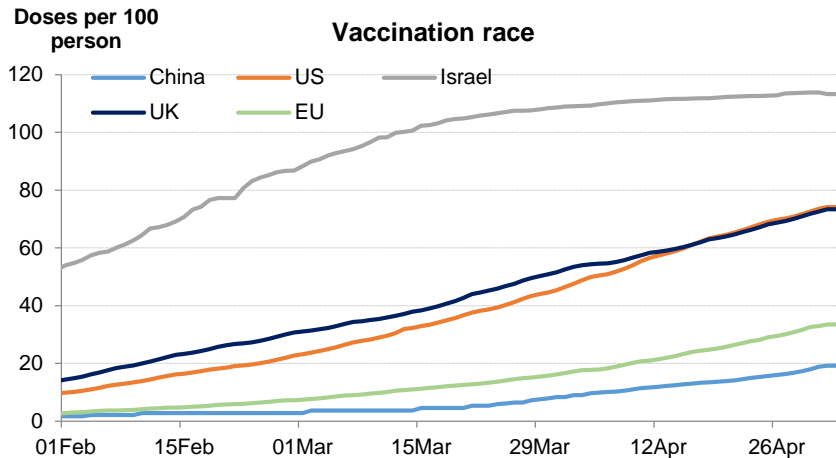
**Near 150mn infected globally**



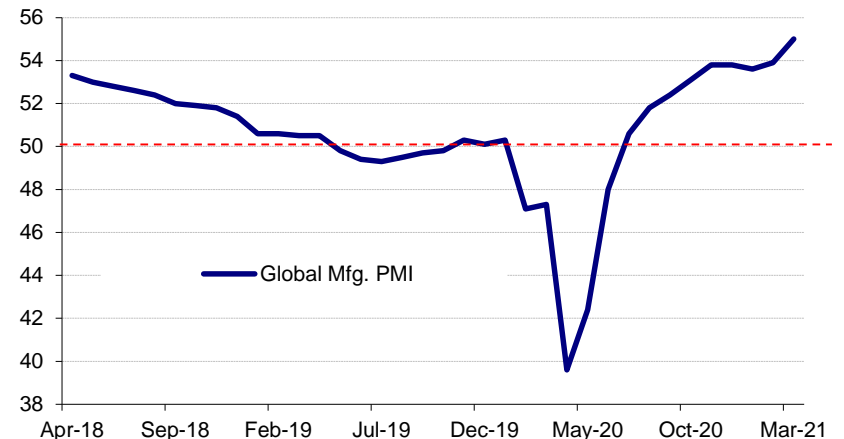
**US & Europe spread slowed, India as new epicenter**



**EU playing a catch-up in vaccination race**



**Global mfg. PMI climbed further**

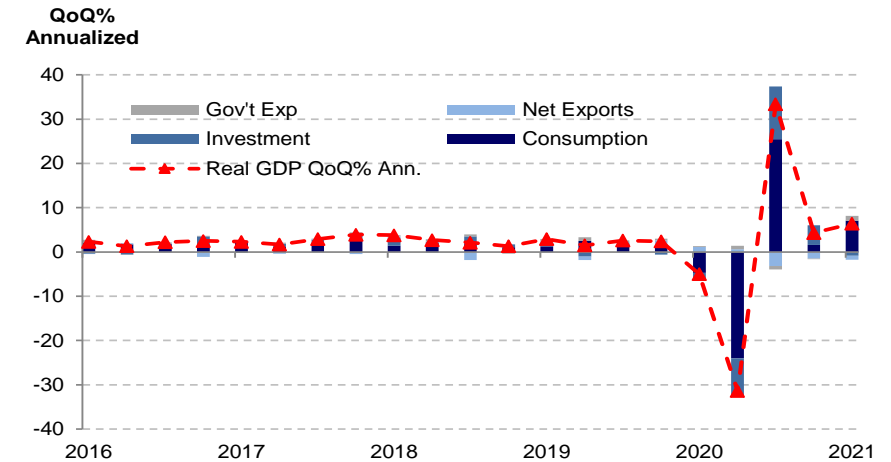


# US Economy – Strong policy support

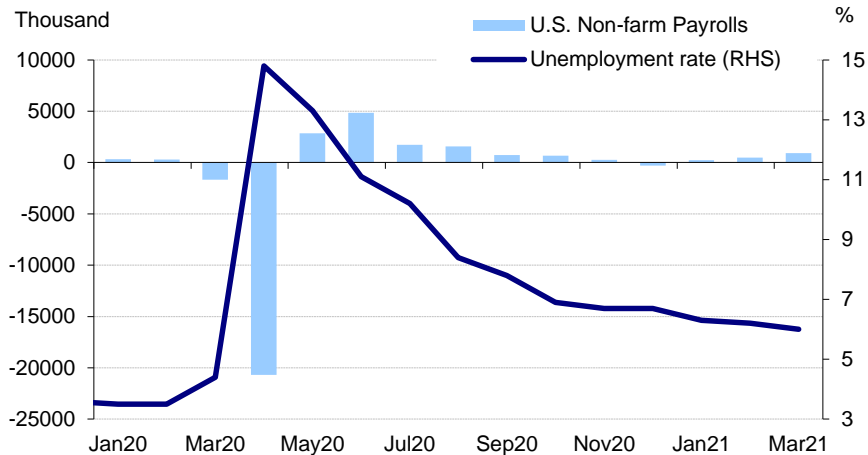
## Biden’s huge stimulus materializing to boost growth

- The vaccine rollout and Biden’s huge stimulus plan led to an upgrade on US growth outlook. Biden unveiled his USD 1.8tn American Families Plan to be financed by the tax hike for wealthiest groups in the US
- With the solid recovery in US labour market and the direct payment to US families in March, the strong Q1 consumption boosted Q1 GDP growth notably. Yet, the recovery remains uneven

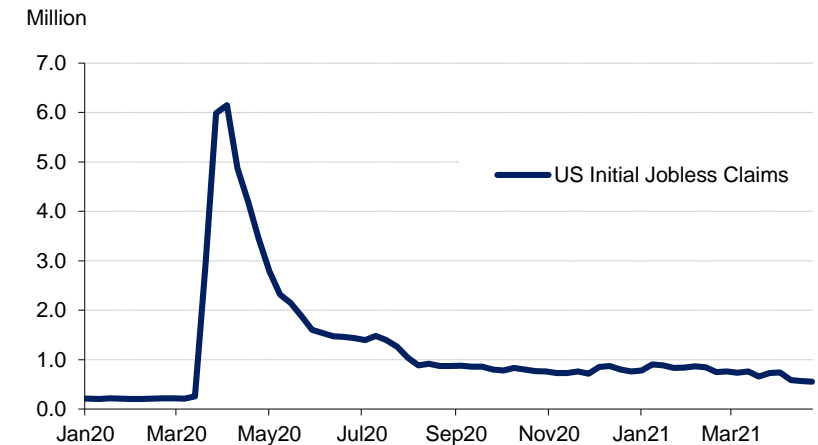
## Consumption boosted US Q1 growth



## Improvement in US jobs market regained momentum



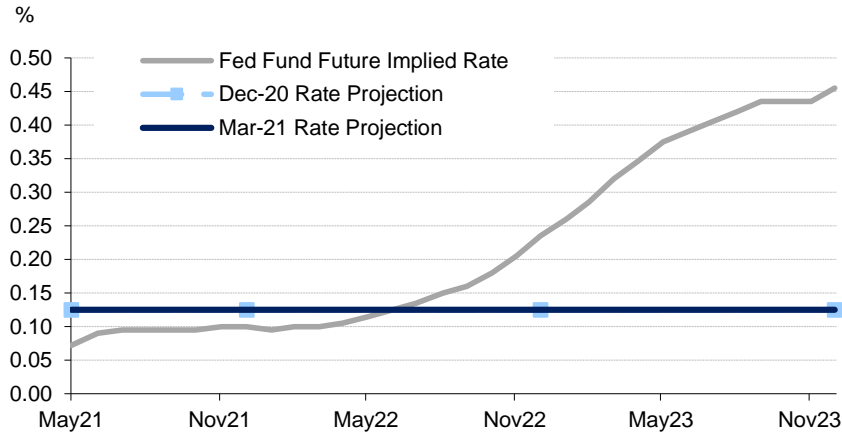
## Initial jobless claims fell further



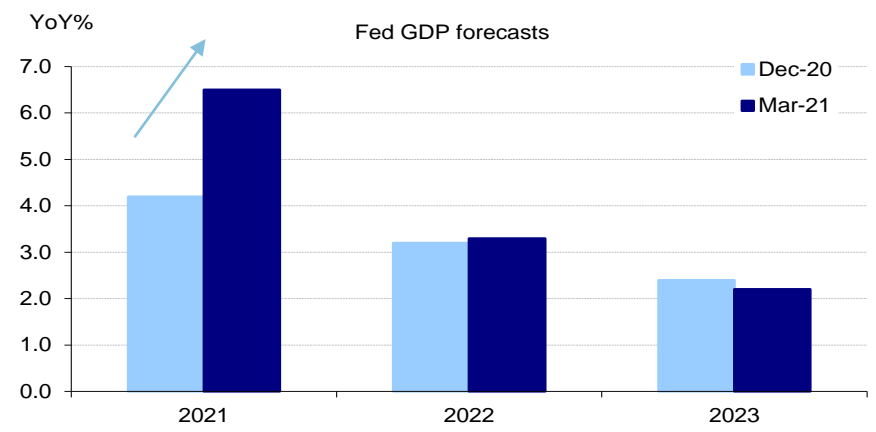
# Fed – Too early to discuss tapering

- The Fed upgraded the economic outlook at April meeting but chair Powell said it was too early to discuss the tapering plan given uneven recovery, and the central bank would act on actual data, not its forecasts

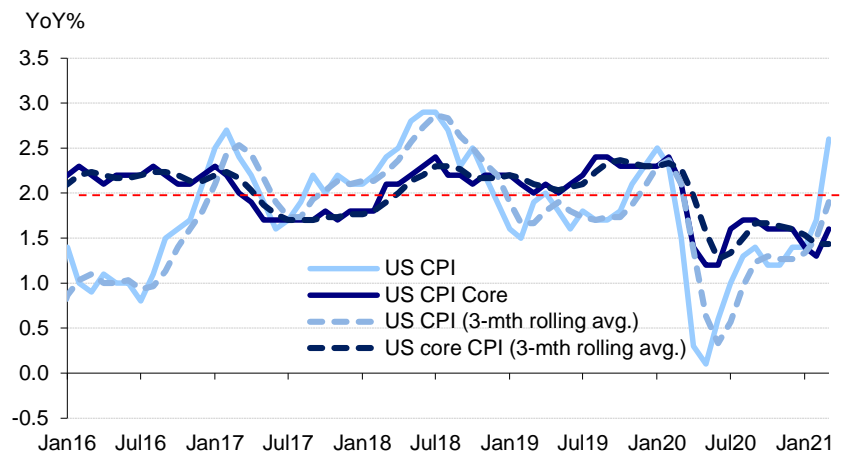
## Is the Fed behind the curve?



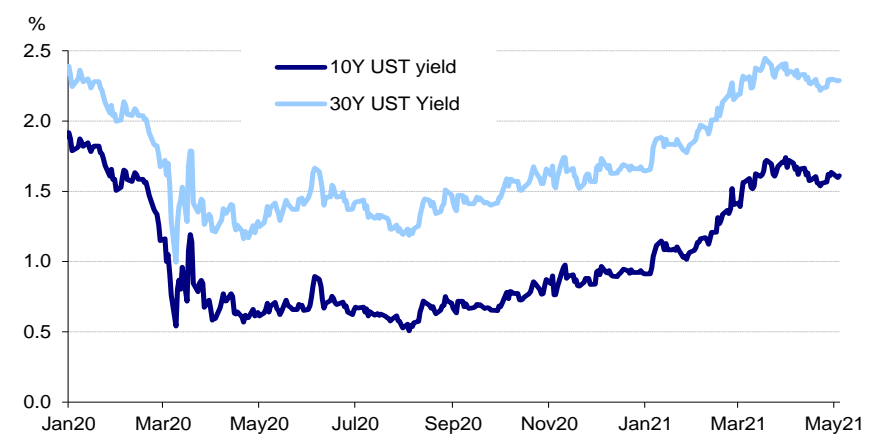
## Fed upgraded the 2021 growth outlook sharply



## Avg. inflation targeting: more tolerance on inflation



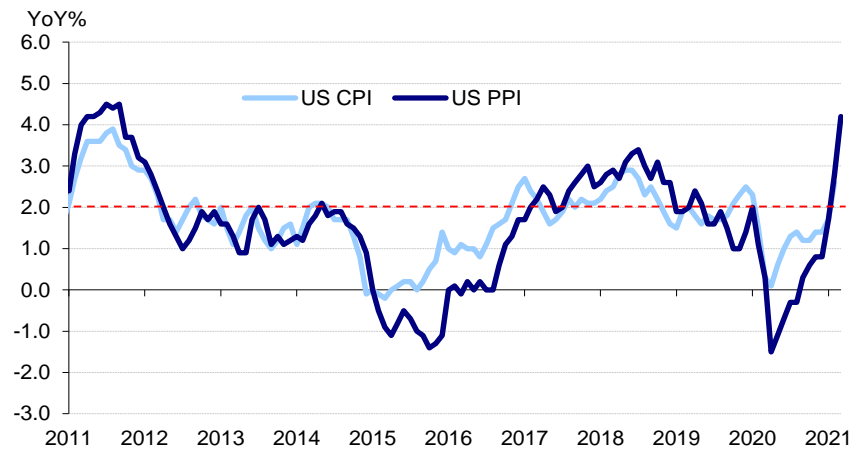
## Fed tolerates higher UST yields



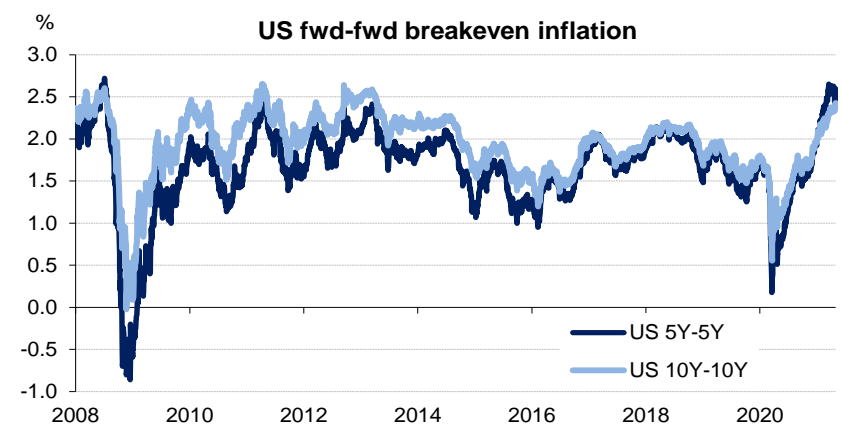
# USD (1) – Is US inflation transitory or persistent?

- US inflation risk is subjected to upside given soaring PPI, rising salary growth and mounting inflation expectation. With strong stimulus, US output gap is set to turn positive and persistent inflation will pressure the Fed to discuss tapering sooner this year

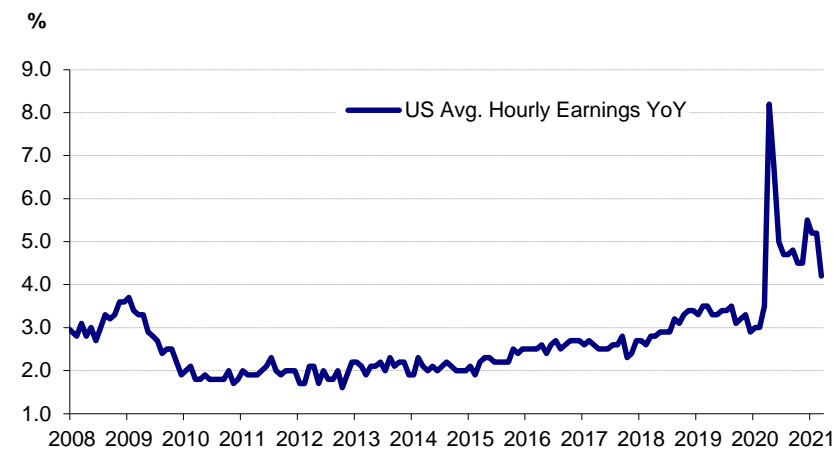
**Soaring PPI could pull up CPI**



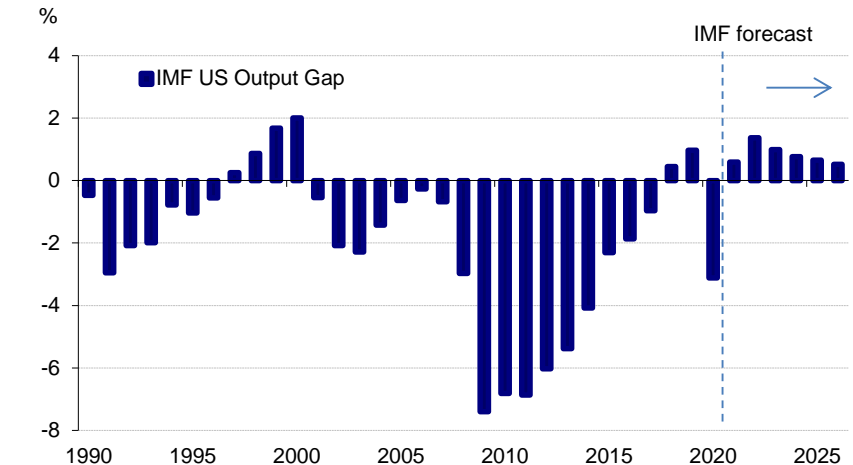
**US inflation expectation hit decade high**



**Upward pressure in salary growth**



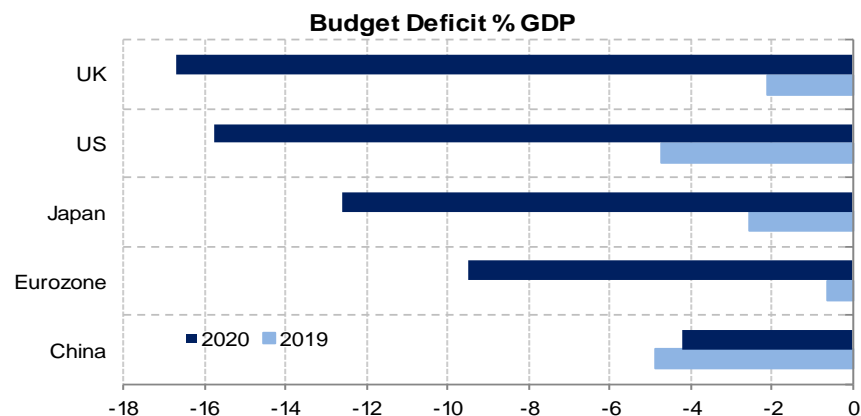
**IMF expect US output gap to turn positive**



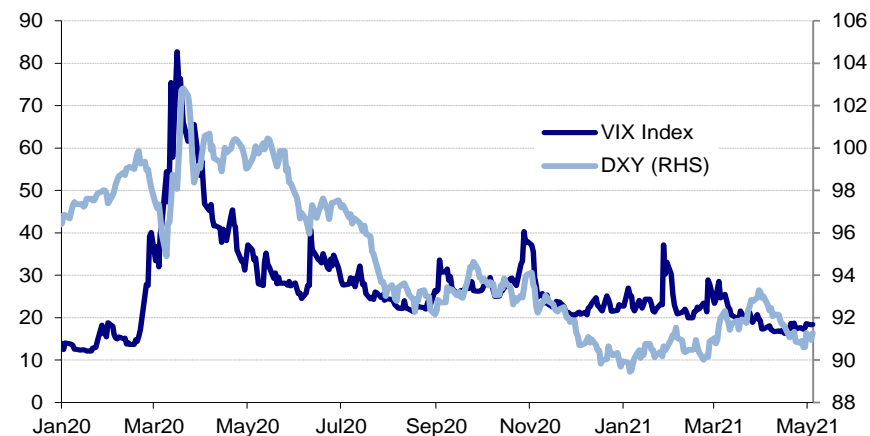
## USD (2) – Safe-haven status undergoing change

- USD yield advantage has been recovering while the Fed may have to discuss the tapering plan sooner given the US stimulus boost, posing a change to the USD's safe-haven status. US fiscal deficit worsened, while investors kept speculative USD short position

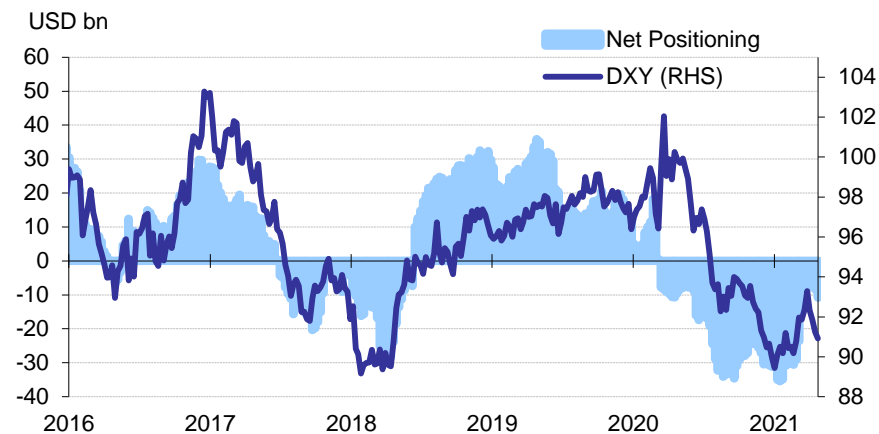
### US not only one facing with worsening budget deficit



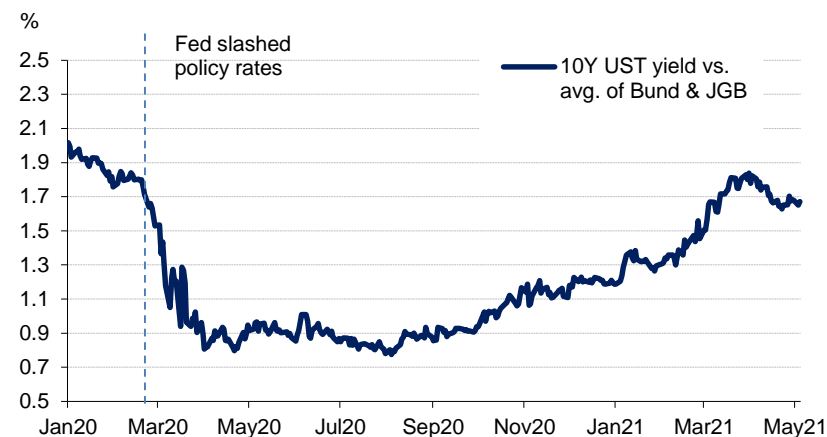
### USD's safe-haven status undergoing change



### Speculative USD short positioning remains



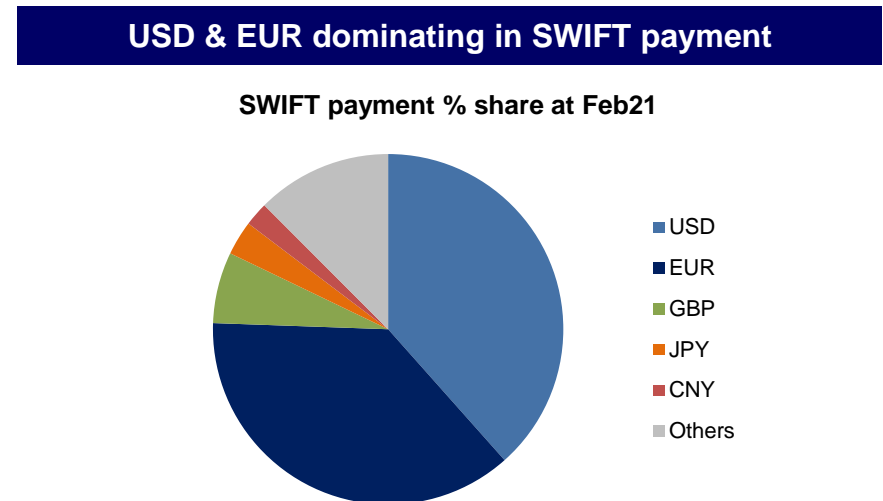
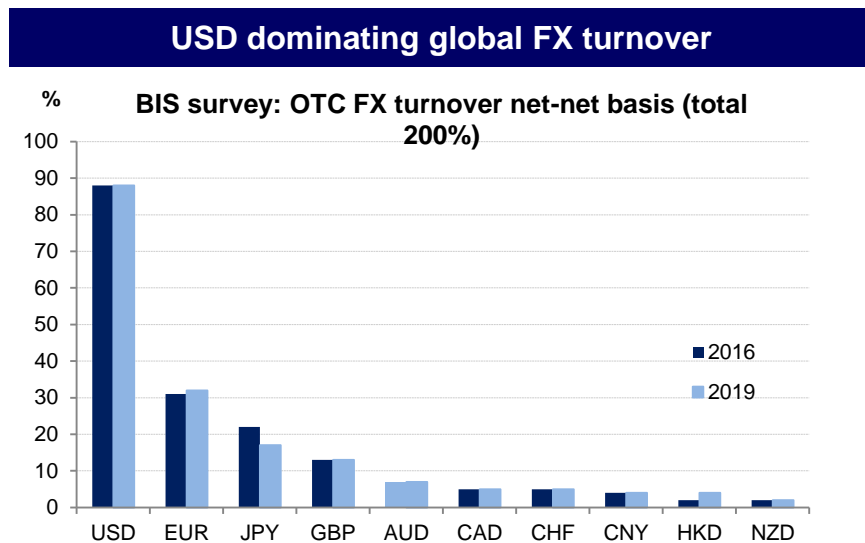
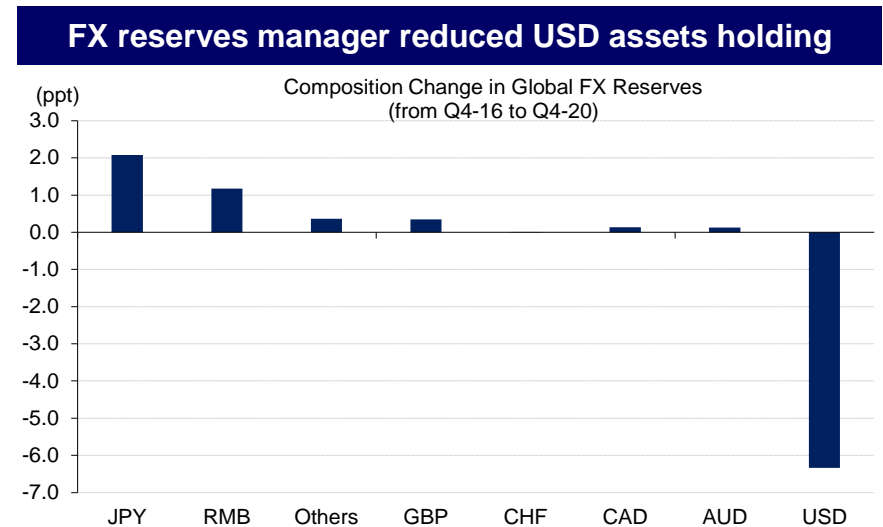
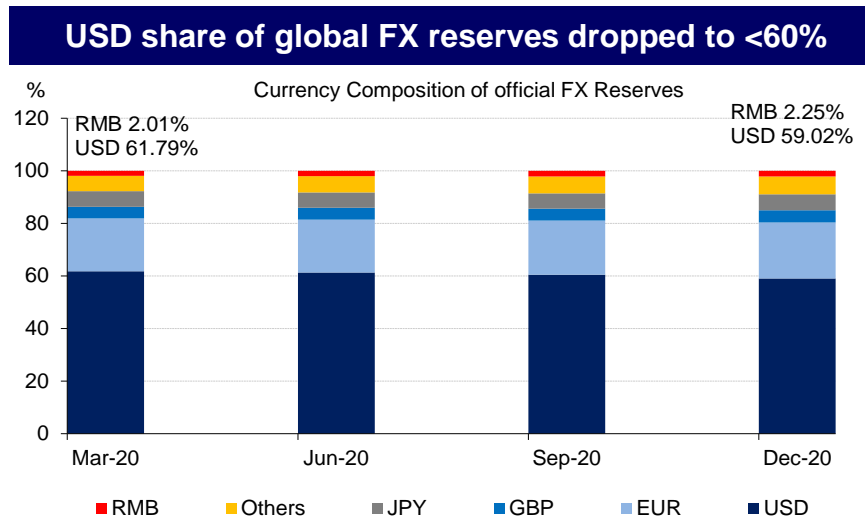
### USD regaining its yield advantage





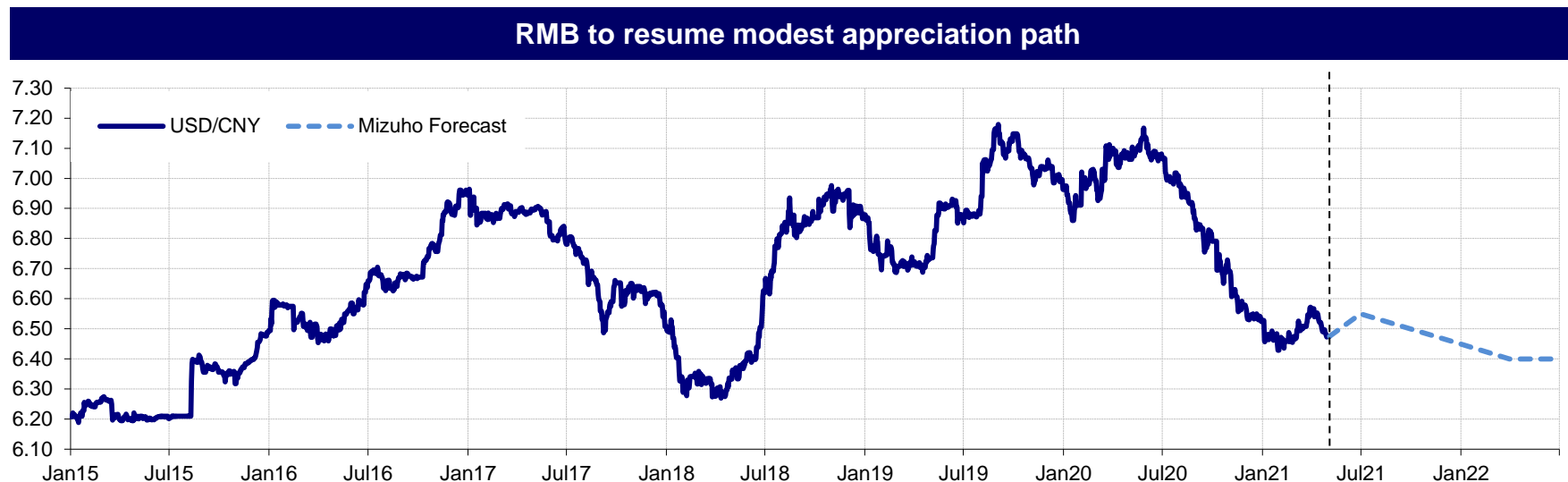
# USD (3) – Central banks trimmed USD exposure in FX reserves in Q4-20

- Despite USD's dominance in global FX reserves, USD share dropped to its 25-year low of 59% amid the prevailing bearish USD sentiment. The significant share of USD FX turnover and SWIFT payment highlighted its FX importance



## RMB (1) – The return of RMB rally

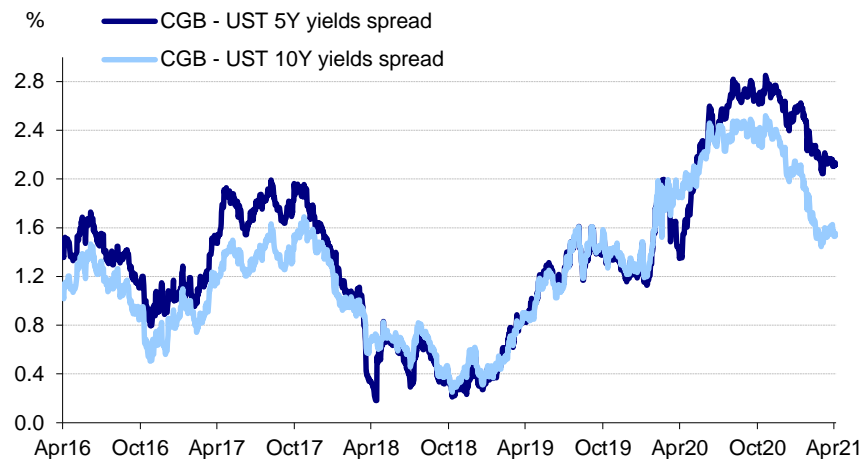
- The RMB pared back its year-to-date loss from the tapering tantrum, and we expect the RMB modest appreciation path to resume amid the robust recovery given the successful epidemic controls
  - **PBoC-Fed monetary divergence:** The Fed pledged to keep its easing measures despite the brighter US growth outlook. With the unsettling Chinese bond market, the PBoC refrained from starting the rate hike cycle. Both China and US will lead global recovery and their monetary divergence will be narrowing
  - **Vaccinations progress:** The fast vaccination rollout in the US slowed the virus spread and boosted US growth outlook. While the vaccination will undermine China growth exceptionalism, the upgrade in global outlook will support China export sector and counter the downside risk towards 6% annual growth
  - **China-US tensions:** Biden kept the hardline stance against China, and the return of China-US tensions, especially on the financial sanctions front, could moderate capital inflow to RMB assets. The broader tensions between China and Western countries pointed to higher risks of multilateral sanctions



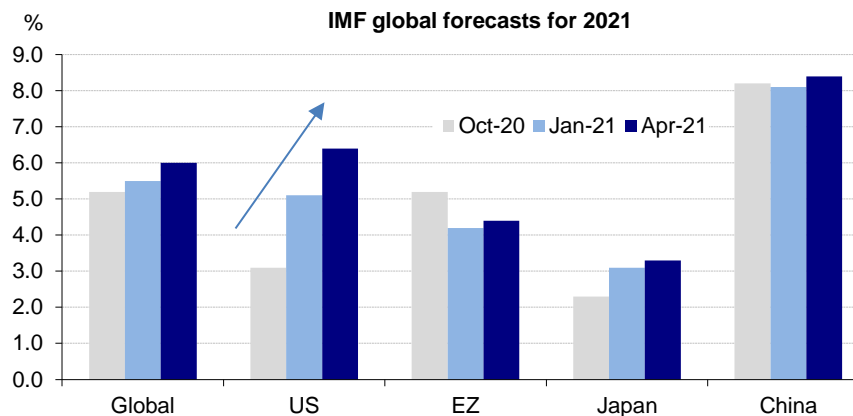
## RMB (2) – Asset allocation capital inflow

- The narrowing CGB-UST yield spread and undermining China growth exceptionalism pointed to less appealing RMB investment. A-share inflow stalled, while bond inflow climbed robustly amid global bond indices inclusion

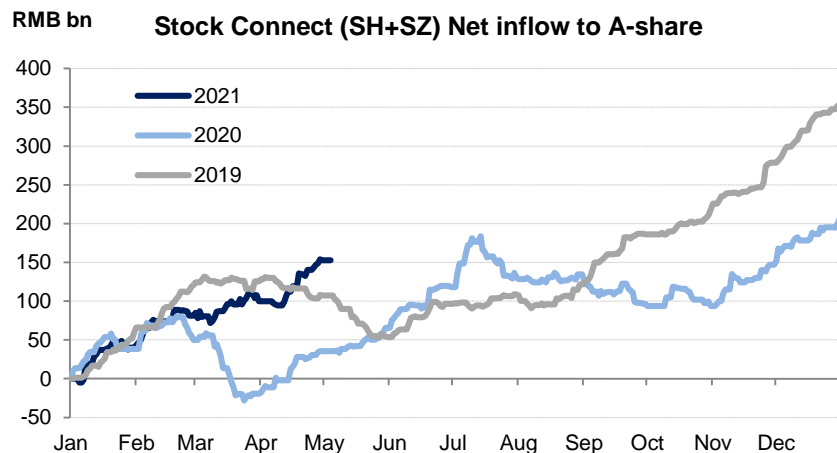
### CGB-UST yield spread narrowed



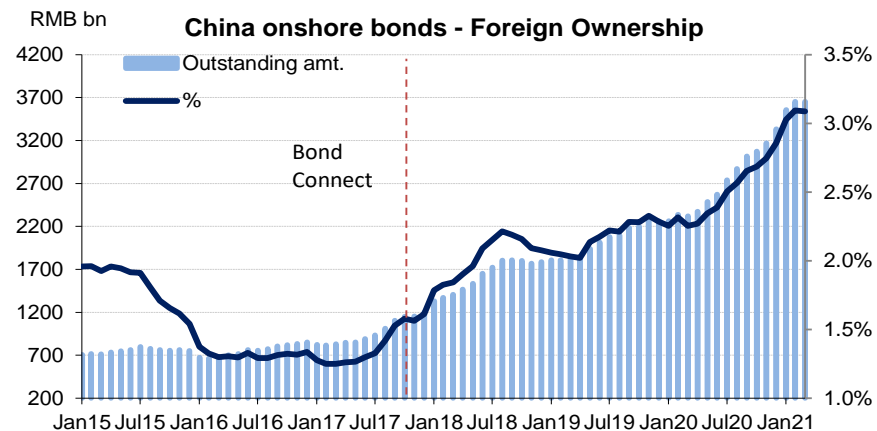
### US growth upgrade dampened China exceptionalism



### Stock Connect flow to A-share market

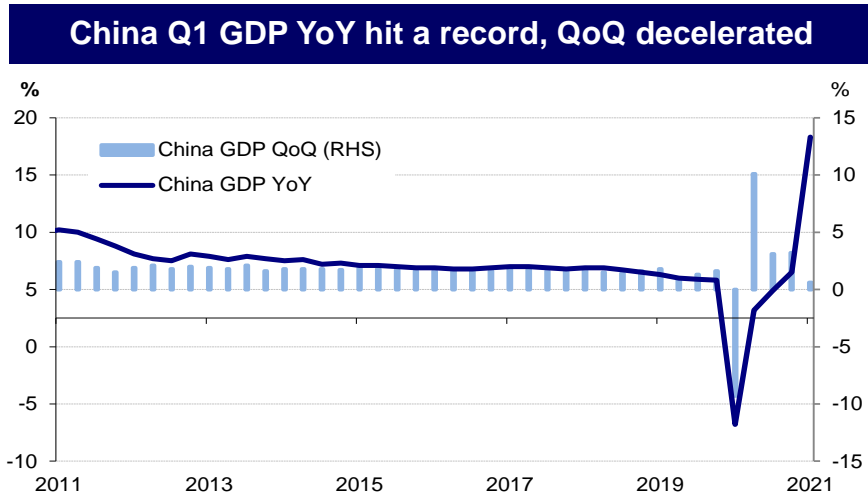


### Foreign share in onshore bond climbed robustly



# China economy (1) – Data surged on based effect

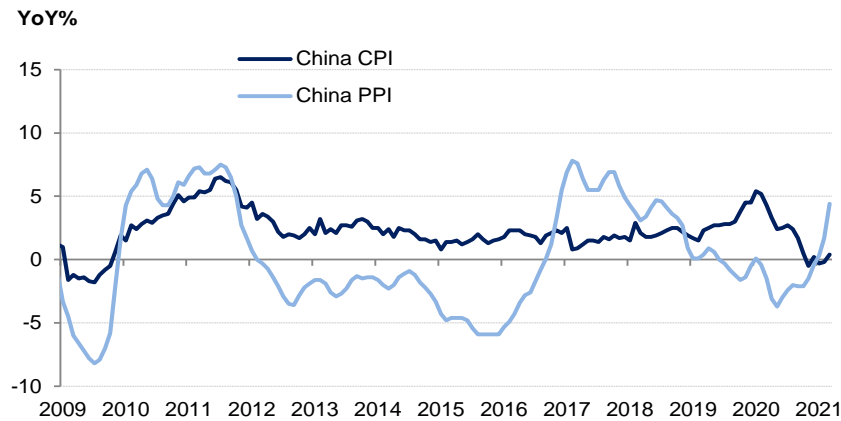
- China Q1 GDP growth soared by a record of +18.3%YoY due to the strong base effect. China industrial production and retail sales for March also surged and the recovery looked more even. Online sales maintained high growth



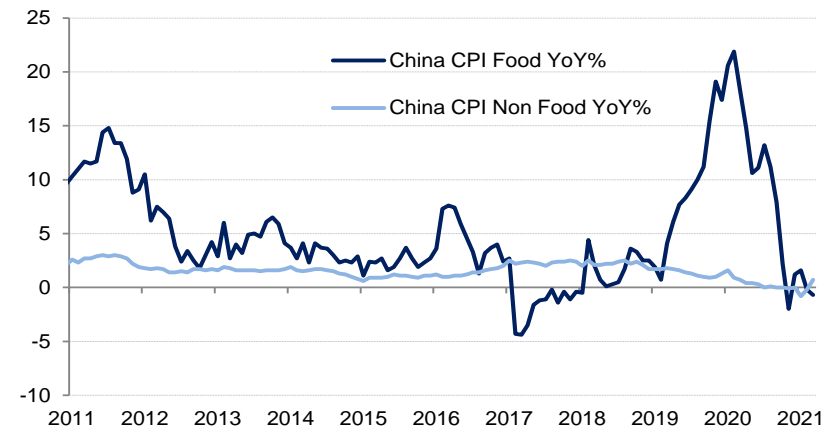
# China economy (2) – Data surged on based effect

- China CPI halted its back-to-back deflation while soaring PPI fueled global reflation concern. FAI also shot up on base-effect and strong real estate investment. China PMIs dipped but stayed above 50 expansion mark

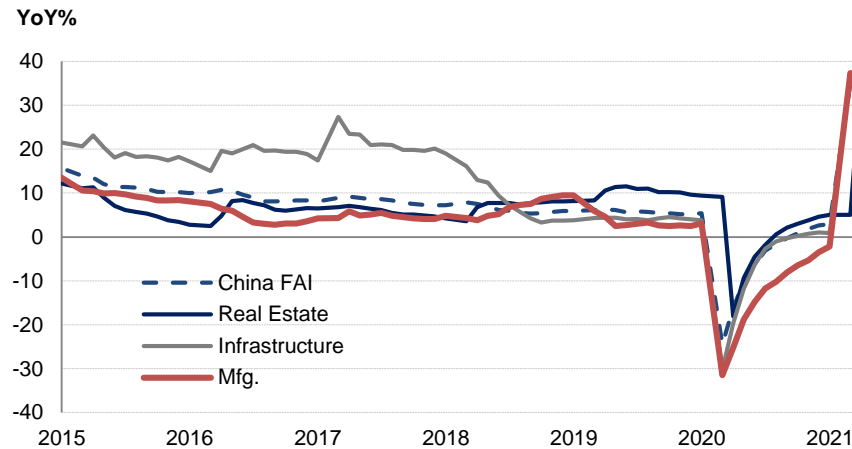
**China CPI subdued, PPI jumped**



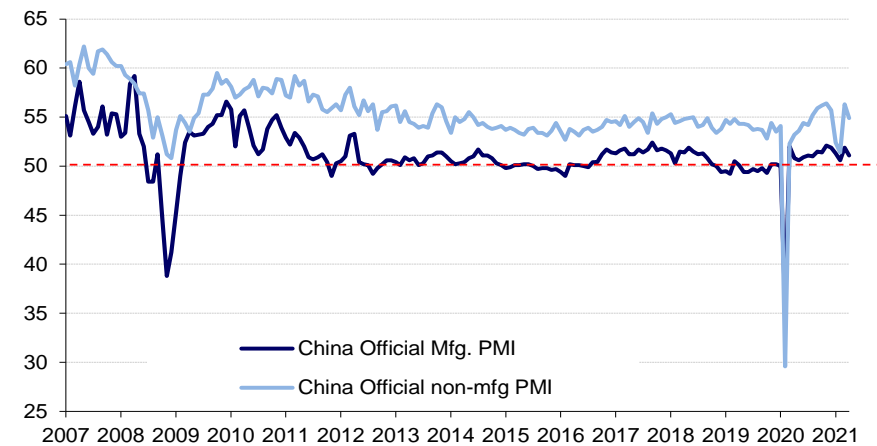
**Non-food CPI drifted lower**



**FAI recovery lagging behind**



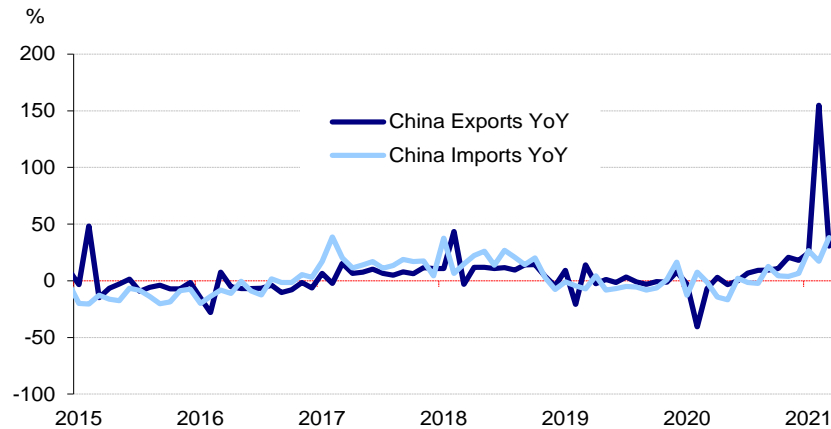
**China PMIs dipped but remained above 50**



# China economy (3) – Pent-up demand boosted exports

- China exports surged on the base effect and the pent-up demand for global reopening, with still robust demand for medical products. The narrowing tourism deficit under border controls in C/A narrowed offered fundamental supports to RMB

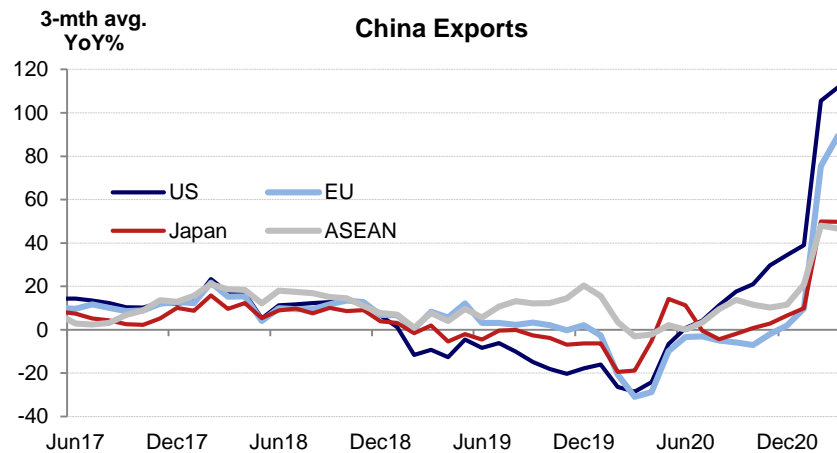
**Strong China exports in Q1**



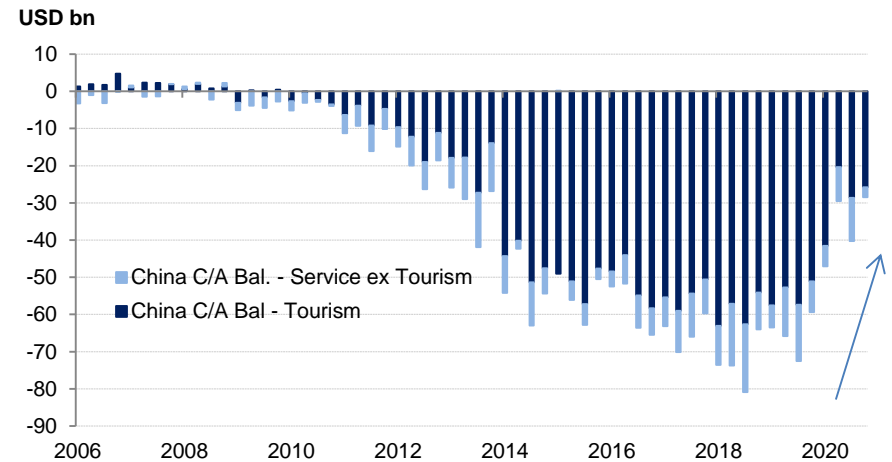
**Medical exports con't to jump as virus unsettles**



**External demand up after vaccine breakthrough**



**China C/A of service & tourism deficit narrowed**



# China-US Tensions – Conflicts beyond trade imbalance

## Biden retained Trump's hardline stance against China

- **Thucydides trap:** *When one great power threatens to displace another, war is almost always the result. USD dominance and US supremacy are threatened by the rise of China*
- **China-US tensions spreading over different areas.** While the trade conflicts was in the background, the rise of China in financial influence and high-tech development prompted Trump to impose sanctions. Biden's administration will uphold the phase one deal and the existing tariffs before renegotiation in the future
- Fundamentally China and US share different ideologies. Hong Kong has become the battlefield of China-US rivalry. The miscalculations in South China Sea disputes and Taiwan issues could fuel geopolitical risks. The Xinjiang issue broadened tensions between China and Western countries
- Biden's presidency signaled the return of multilateralism. Yet, the first high-level diplomatic meeting which opened with tensions and ended up without statement reflected no improvement under Biden's presidency

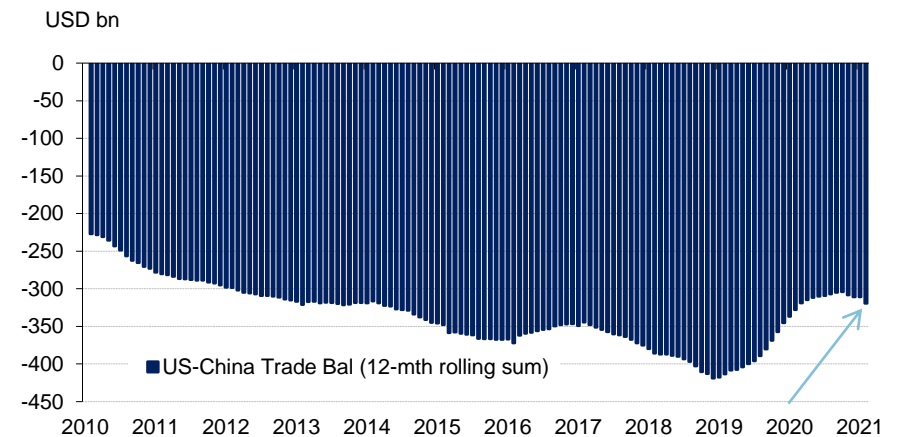


# Phase one deal – To continue under Biden’s presidency

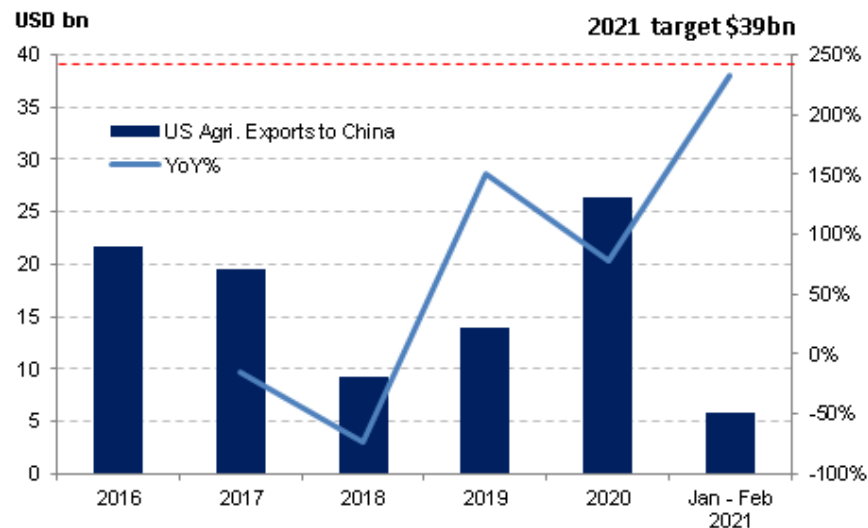
## New TR to keep the tariffs & phase one deal

- China pledged to buy more US products in mfg. (e.g. aircrafts), agri., energy products and services in upcoming 2 years in phase one deal. Yet, the actual China purchases were falling short of the targets
- The US Trade Representative said China has fallen short on its commitments to protect American intellectual property in the phase one deal. Any updates on the renegotiations of phase one deal will be watched

## US trade deficit to China narrowing



## China purchase target for 21 more challenging



## China’s shopping list

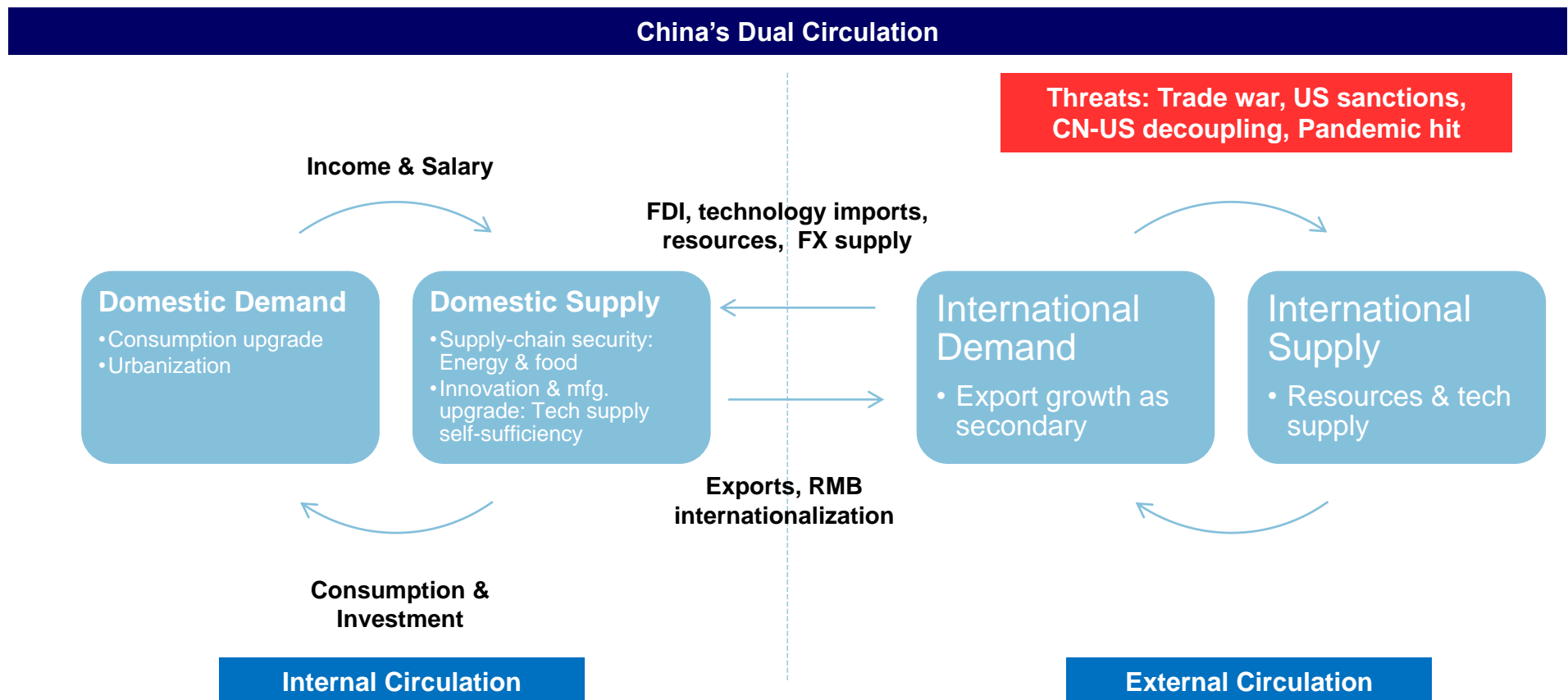
| (in USD bn)        | Additional US exports to China on top of 2017 baseline |              |              |
|--------------------|--|--------------|--------------|
|                    | Year 1   | Year2        | 2-Year Total |
| Manufactured goods | 32.9   | 44.8         | 77.7         |
| Agriculture        | 12.5   | 19.5         | 32           |
| Energy             | 18.5   | 33.9         | 52.4         |
| Services           | 12.8   | 25.1         | 37.9         |
| <b>Total</b>       | <b>76.7</b>  | <b>123.3</b> | <b>210</b>   |



# China Policy (1) – Dual circulation

## Dual circulation as the blueprint for 14<sup>th</sup> Five Year Plan

- Chinese Communist Party held the Fifth Plenum Session and unveiled details on 14<sup>th</sup> Five Year Plan and 2035 Vision. The key takeaways are the emphasis on quality of growth and technology self-reliance. Innovation and environmental protections are on the agenda. President Xi also revealed the target of doubling 2020 GDP in 2035, implying 4.7% annual growth target in the coming decade
- **Dual circulation 3 themes:** Expanding domestic consumption, cut reliance on exports, enhance supply-chain security

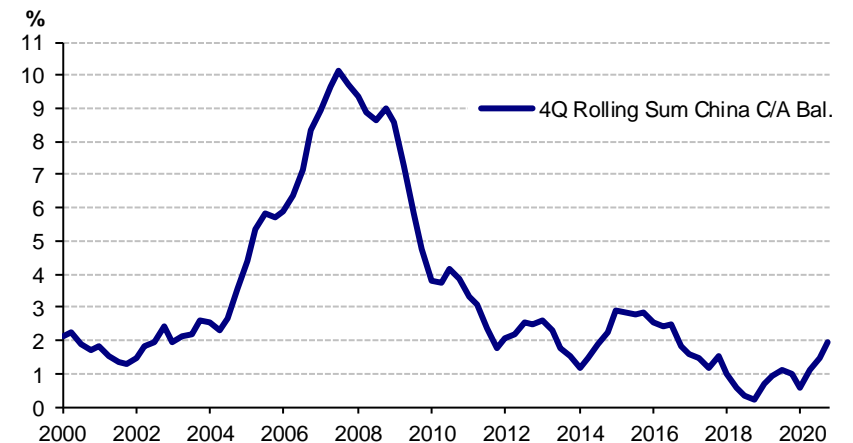


# China Policy (2) – Dual circulation

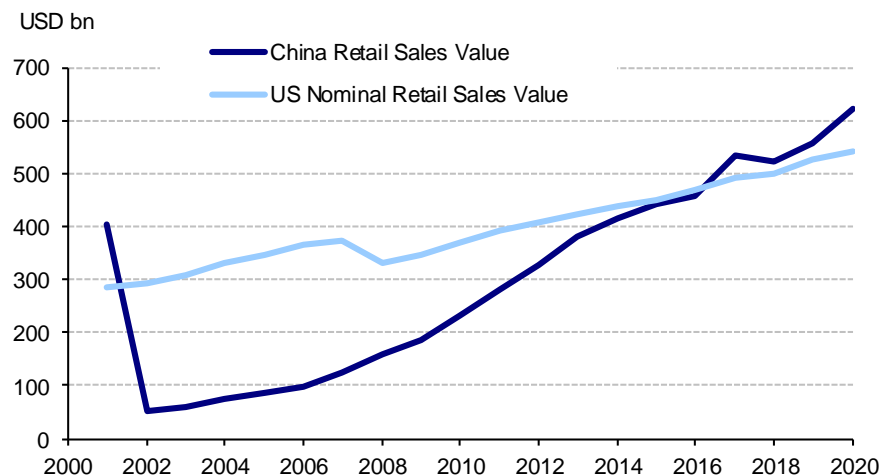
## Less motivated to use weak RMB to stimulate growth

- The dual circulation strategy aims to cushion impact from external shock but not to cut its connection to the world economy. Instead, the China economy will be more integrated into the global market
- **FX implications:** External growth will become secondary given the China-US trade war and the heightening China-US decoupling risk. China is less motivated to use RMB depreciation to stimulate the economy

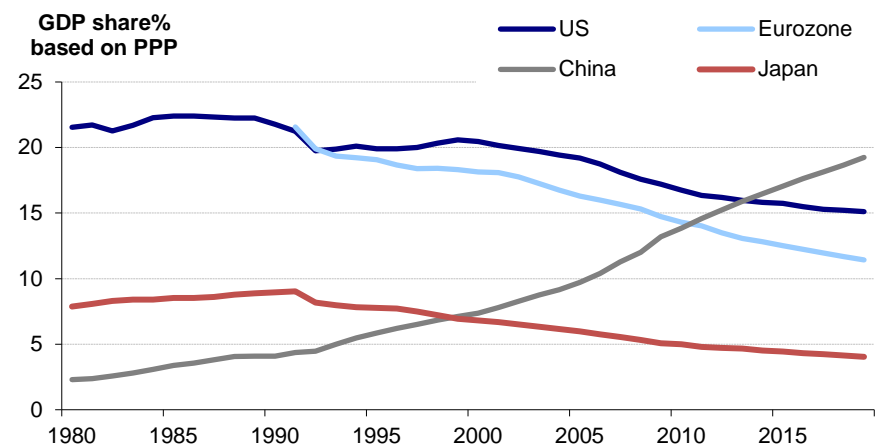
China C/A surplus shrank since 2007



China retail sales outstanding surpassed US



China's GDP share on PPP outsizing G3



# PBoC Policy (1) – Slowing RMB appreciation pace

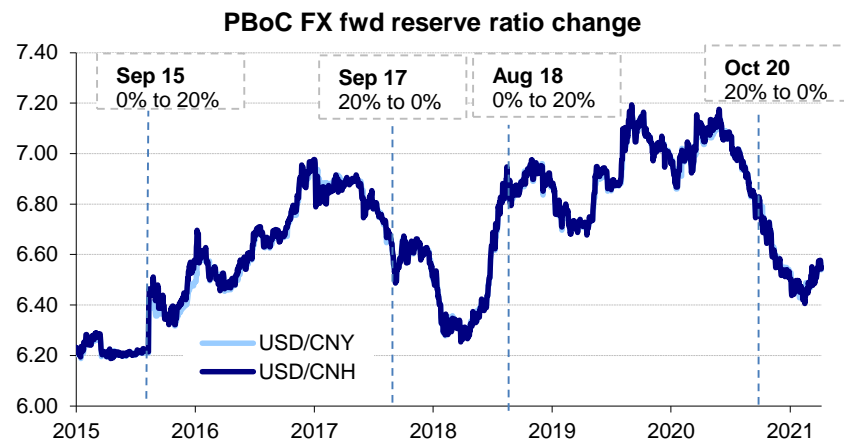
## FX forward risk reserves ratio cut and neutralizing CCF

- PBoC lowered FX forward risk reserves ratio to 0% from 20% and faded out the counter cyclical factor (CCF) adjustment in the CNY fixing to curb RMB appreciation bias
- Under the dual circulation plan and onshore financial market open-up, PBoC should have more tolerance on the RMB appreciation but too fast RMB appreciation could hurt recovery
- China still reserves ample tools to curb RMB rally, such as expanding the Qualified Domestic Institutional Investors (QDII) quota to relax outward investment channel. The regulators could modify the FX forward risk and CCF to curb RMB appreciation bias and tame capital inflow

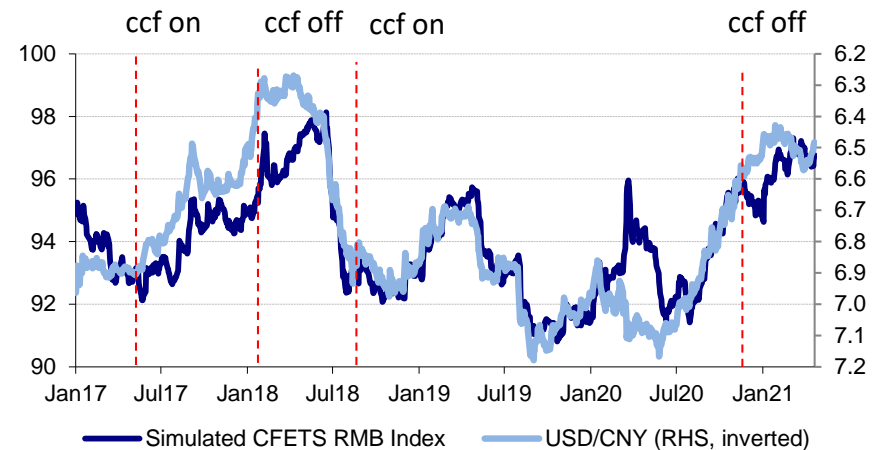
## China expanded QDII quota



## PBoC lowered FX risk reserves



## CCF faded out

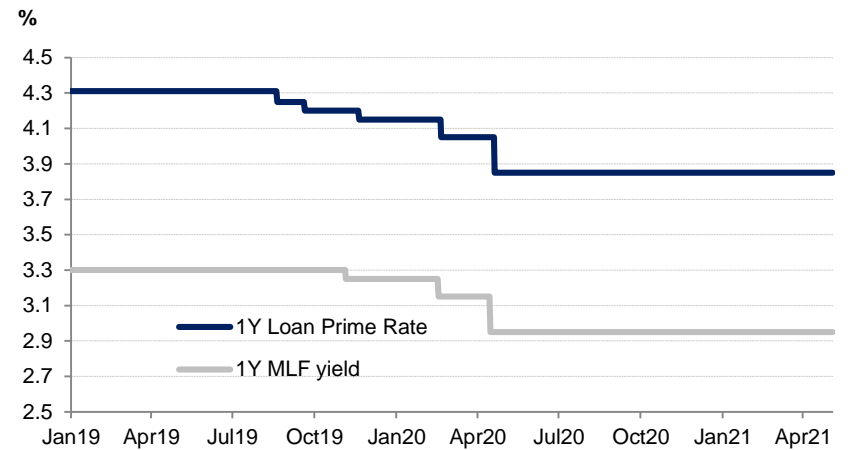


# PBoC Policy (2) – No policy U-turn

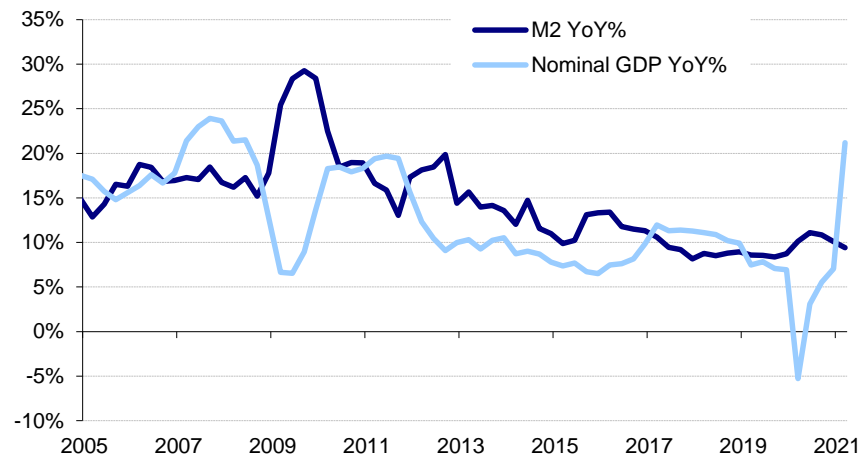
## Rates to stay unchanged, while keep liquidity ample

- PBoC noted to keep the policy continuity, stability and sustainability, and pledged to align money supply & social financing in line with nominal GDP growth and stabilize the macro leverage ratio, with no policy U-turn
- In order to keep liquidity condition reasonably ample, the PBoC rolled over the MLF while its open market operations (OMOs) were not that active in recent weeks
- With uneven recovery and unsettling Chinese bond market, the PBoC is unlikely resume its tightening cycle. Impact from the Huarong issue should prove to be short-lived given the PBoC's help

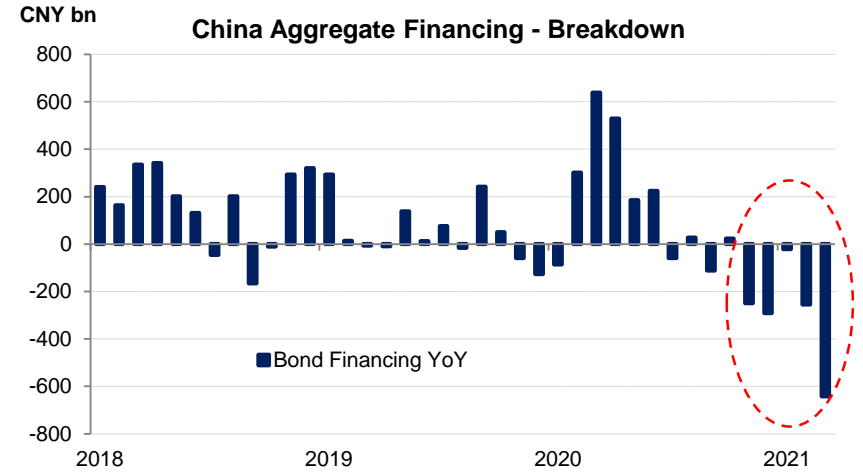
## Rate cut cycle paused since April



## China Q1 nominal GDP growth spiked



## Bond financing shrinking since the SOEs default

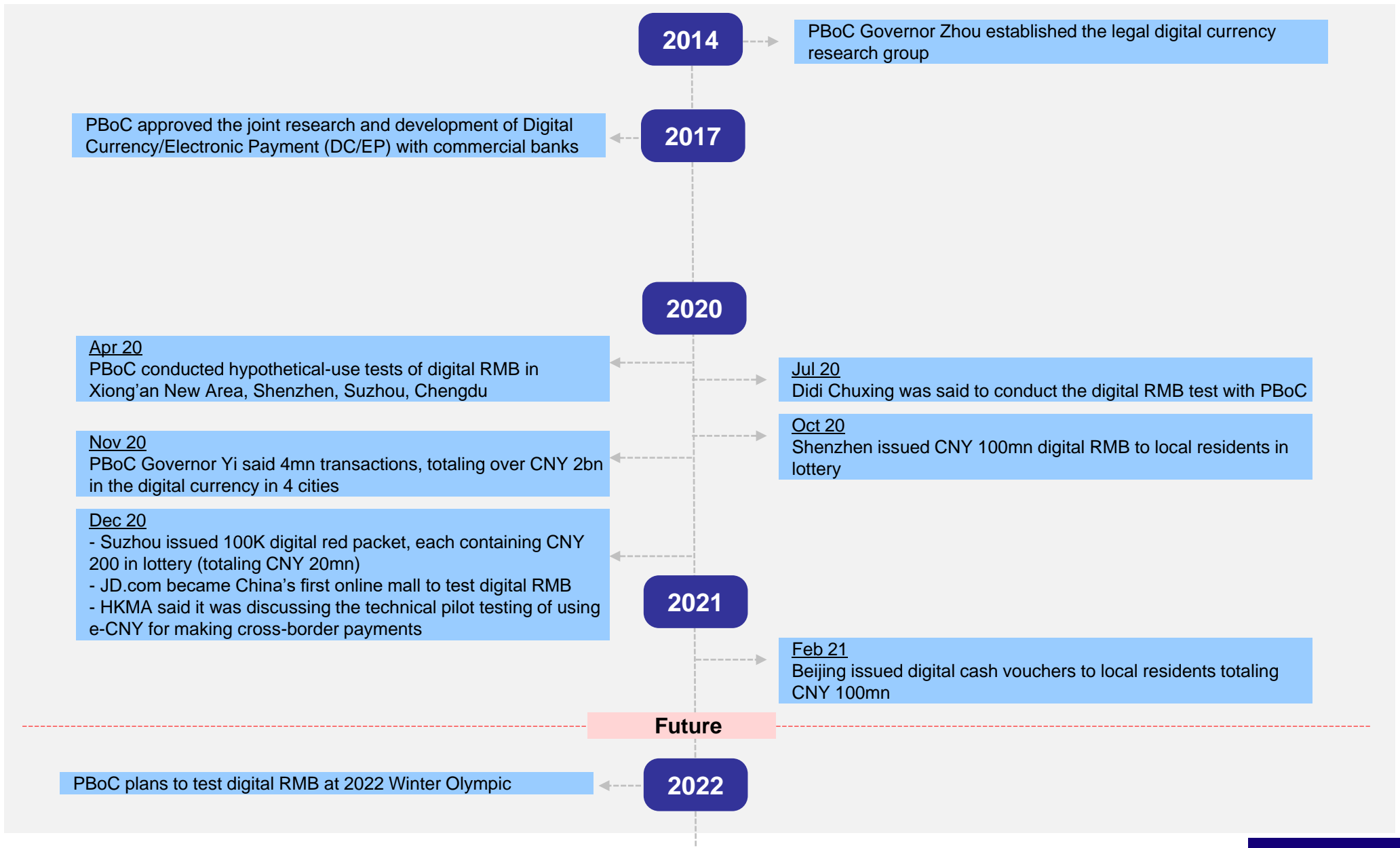


# China's Digital RMB – e-CNY

- The PBoC initiated the study of Digital Currency/Electronic Payment in 2014 and the e-CNY has been in trial in several cities before the official launch (Shenzhen, Suzhou, Xiong'an, Chengdu + 2022 Winter Olympics)
- The e-CNY is the electronic form of RMB, which is counted as the M0, and this central bank digital currency (CBDC) is not a crypto-currency with decentralized settlement. The PBoC applies a two-tier system, distributing the e-CNY to second-tier providers including state-owned banks and online payment providers, such as Ailipay and WeChat pay
- Chinese officials stressed the e-CNY is for the domestic retail use at initial stage while we reckon that the e-CNY will play a role to drive RMB internationalization when the cross-order settlement is available
- In comparison to the online payment platforms, the e-CNY settlement is available without the internet and bank accounts
- PBoC ruled out the complete anonymity of the e-CNY in order to monitor crimes such as money laundering, illegal financing and tax evasion
- **FX Implication:** At this stage the e-CNY will serve as the digital format of currency in circulation and its immediate impact on the CNY will be largely muted. In the future when the e-CNY is available for the cross-border settlement (given its nature of partially traceable), it will help accelerate China capital account open-up and RMB internationalization by containing outflow risk via underground channels. The rise of RMB as an international currency will be bullish to the RMB exchange rate



# The development of e-CNY: Timeline



## The role of e-CNY – Features Comparison

- PBoC mentioned that the digital RMB is a substitute of legal tender of M0 back up by the central bank. Applied a two-tier system, the PBoC is expected to issue the e-CNY to commercial banks in return of 100% required reserves without interest bearing
- Being a M0, the e-CNY preserves the function of money including medium of exchange, unit of account and store of value. The e-CNY is regarded as a more efficient version of cash. Different from cryptocurrency, the e-CNY is an unit of account with government backstop and high price volatility is not involved
- The PBoC said the digital RMB will co-exist with Alipay and WeChat (these are actually claims of bank deposit), and provides the backup to the dominating online payment platforms when the internet and bank accounts are not available. The PBoC's assess to the e-CNY circulation information will help formulate its monetary policy and enhance the stability of electronic payment system operated by private companies

**Comparisons between currencies/payment methods**

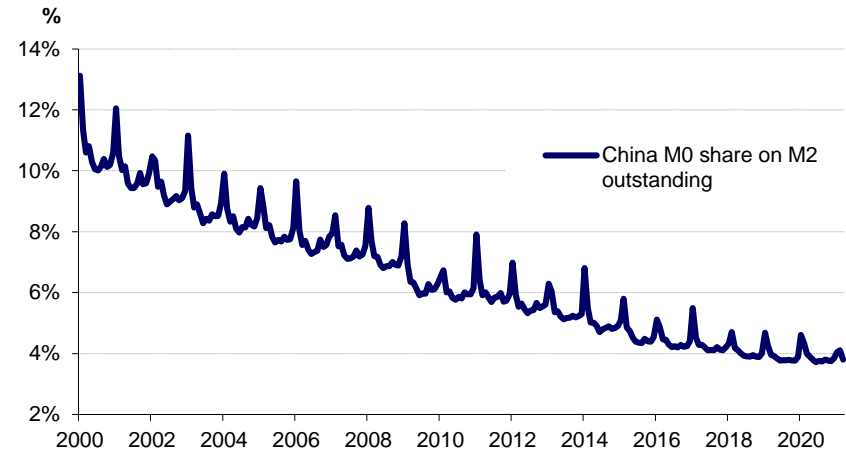
| Payment method  | e-CNY                  | Alipay/WeChat    | Cash       | Cryptocurrency |
|-----------------|------------------------|------------------|------------|----------------|
| Anonymity       | Limited                | No               | Yes        | Yes            |
| Offline payment | Yes                    | No               | Yes        | No             |
| Issuer          | Government             | Private          | Government | Private        |
| Efficiency      | High                   | High             | Low        | Low            |
| Volatility      | Low                    | Low              | Low        | High           |
| Technology      | Centralized/Blockchain | QR Code, network | N/A        | Blockchain     |

# e-CNY - FX implications

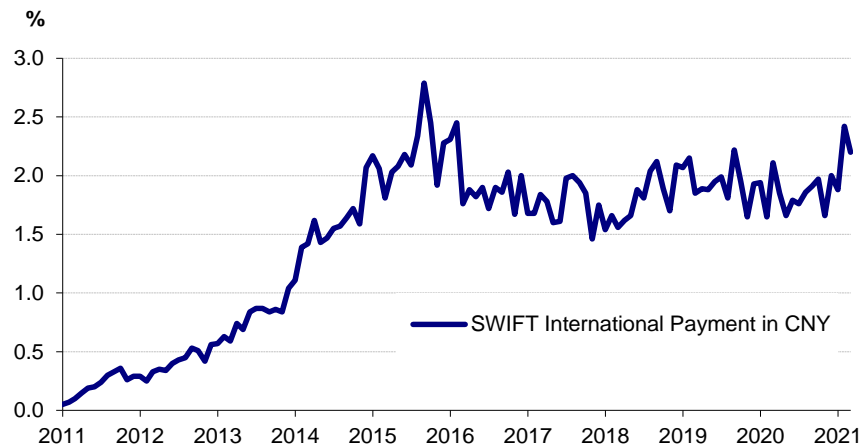
## Limited in the near-term, positive in the medium term

- The PBoC stressed that the e-CNY will serve the M0 substitute for domestic retail use. The e-CNY will enhance the payment efficiency compared to cash but is unlikely to drive the RMB exchange rate at the launch
- In the future when the e-CNY is available for the cross-border settlement (given its nature of partially traceable), it will help accelerate China capital account open-up and RMB internationalization. So far, the RMB share in global payment and FX reserves remains low compared to major currencies. The rise of RMB as an international currency will help break the USD dominance and is bullish for the RMB

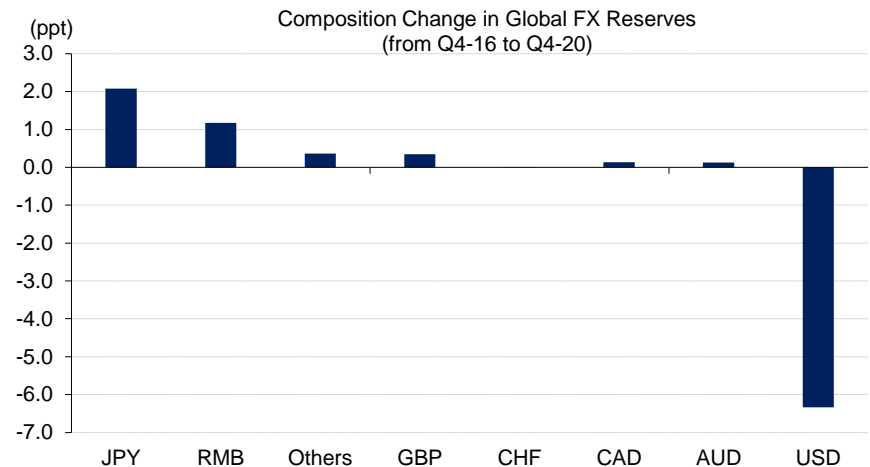
### China moving towards cashless society



### CNY global payment share moving sideways



### RMB reserves share rose on USD share decline





# Mizuho FX Forecasts

|                | 2021                        |                       |                       |                       | 2022                  |                       |
|----------------|-----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                | Jan - Apr                   | May - Jun             | Jul - Sep             | Oct - Dec             | Jan - Mar             | Apr - Jun             |
| <b>USD/JPY</b> | 102.60 ~ 110.85<br>(108.85) | 106 ~ 112<br>(109)    | 107 ~ 113<br>(110)    | 107 ~ 114<br>(112)    | 108 ~ 115<br>(113)    | 108 ~ 116<br>(114)    |
| <b>EUR/USD</b> | 1.1704 ~ 1.2349<br>(1.2125) | 1.17 ~ 1.21<br>(1.19) | 1.16 ~ 1.21<br>(1.18) | 1.15 ~ 1.21<br>(1.17) | 1.15 ~ 1.21<br>(1.18) | 1.14 ~ 1.20<br>(1.18) |
| <b>EUR/JPY</b> | 125.10 ~ 132.35<br>(132.00) | 128 ~ 134<br>(130)    | 129 ~ 135<br>(130)    | 130 ~ 136<br>(131)    | 131 ~ 138<br>(133)    | 132 ~ 139<br>(135)    |

|                | 2021                        |                          |                          |                          | 2022                     |                          |
|----------------|-----------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
|                | Jan - Apr                   | May - Jun                | Jul - Sep                | Oct - Dec                | Jan - Mar                | Apr - Jun                |
| <b>USD/CNY</b> | 6.4236 ~ 6.5793<br>(6.4863) | 6.40 ~ 6.70<br>(6.55)    | 6.35 ~ 6.65<br>(6.50)    | 6.30 ~ 6.60<br>(6.45)    | 6.25 ~ 6.55<br>(6.40)    | 6.25 ~ 6.55<br>(6.40)    |
| <b>EUR/CNY</b> | 7.6801 ~ 8.0559<br>(7.8382) | 7.49 ~ 8.11<br>(7.79)    | 7.37 ~ 8.05<br>(7.67)    | 7.25 ~ 7.99<br>(7.55)    | 7.19 ~ 7.93<br>(7.55)    | 7.13 ~ 7.86<br>(7.55)    |
| <b>CNY/JPY</b> | 15.731 ~ 16.919<br>(16.808) | 15.82 ~ 17.50<br>(16.64) | 16.09 ~ 17.80<br>(16.92) | 16.21 ~ 18.10<br>(17.36) | 16.49 ~ 18.40<br>(17.66) | 16.49 ~ 18.56<br>(17.81) |

Notes:

1. Prepared by East Asia Treasury Department, Shanghai Treasury and Tokyo headquarter
2. Actual quotes updated at 30 Apr from Bloomberg
3. In the forecast columns, the exchange rates in parentheses are quarter-end forecasts.

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