

Mizuho Bank 2021 RMB Outlook

The return of RMB rally

June 2021

East Asia Treasury Department, Treasury Marketing Section

MIZUHO

The Mizuho Bank logo, featuring the word "MIZUHO" in a bold, white, sans-serif font, positioned above a white, curved line that resembles a stylized wave or a bridge.

Global – Deepening inflation concern

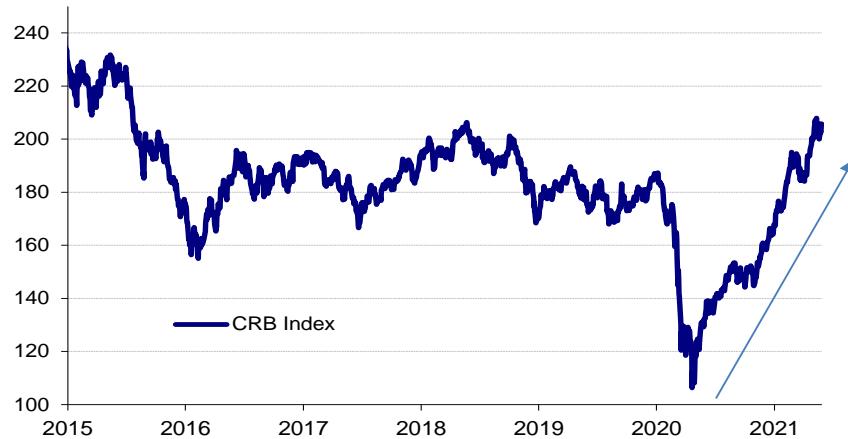
- The strong US policy support (~USD 6tn federal spending for FY 22) and global reopening fueled inflation pressure. While the disappointing US jobs report was partly due to the government subsidy distortion, US inflation data jumped
- The FOMC minutes for April revealed Fed’s hawkish shift. With mounting inflation risk, the Fed opened the door for the tapering discussion at the upcoming FOMC meetings
- Despite the resurgent virus infection in Asia, China managed to keep the epidemic spread under controls. The RMB extended its rally to below 6.4 handle for the first time in three years on strong capital inflow
- Cryptocurrencies swung vigorously as China and US tightened the regulations. Yet, the spillover to other risk assets was largely limited

Date	Key Events for 2021
Jun	10 (EZ) ECB meeting, 17 (US) FOMC meeting
Jul	23 (JP) Summer Olympics
Aug	26-28 (US) Jackson Hole Symposium
Sep	
Oct	22 (JP) General election
Nov	
Dec	
In the pipeline	Vaccination, global reopening in H2?

Global – Reflation is underway

- Inflation concern deepened following the jump in US CPI figures and surging commodity prices. Meanwhile, US equities continued to climb the wall of worry. Cryptocurrencies collapsed on China & US regulation tightening.

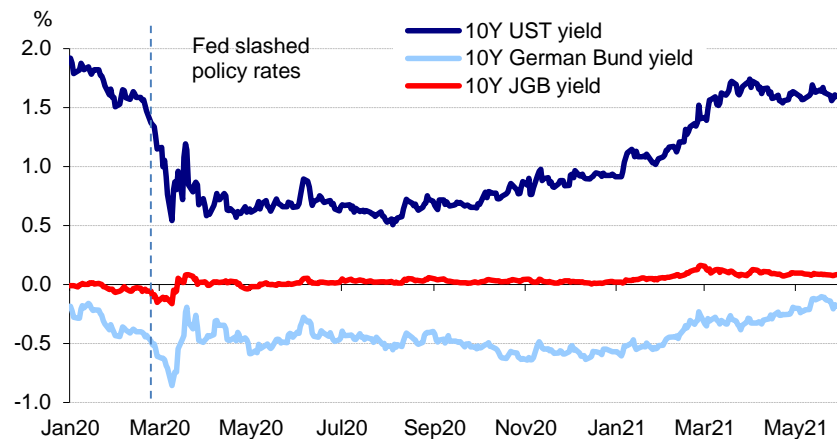
Commodity price entered into bullish cycle



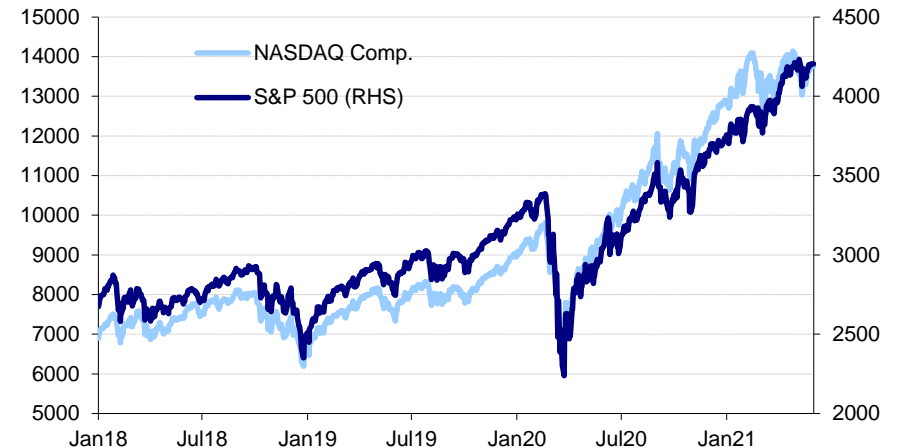
Cryptocurrency swung vigorously this year



Global yields back to pre-pandemic level



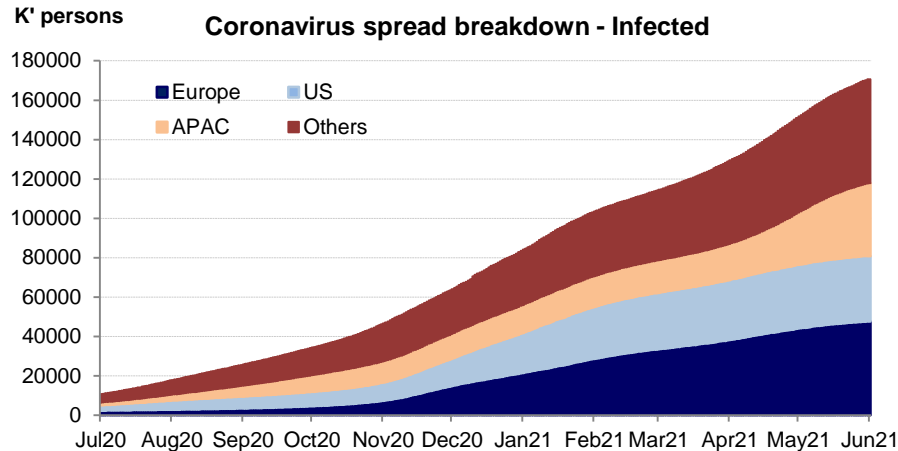
US equities climbing the wall of worry



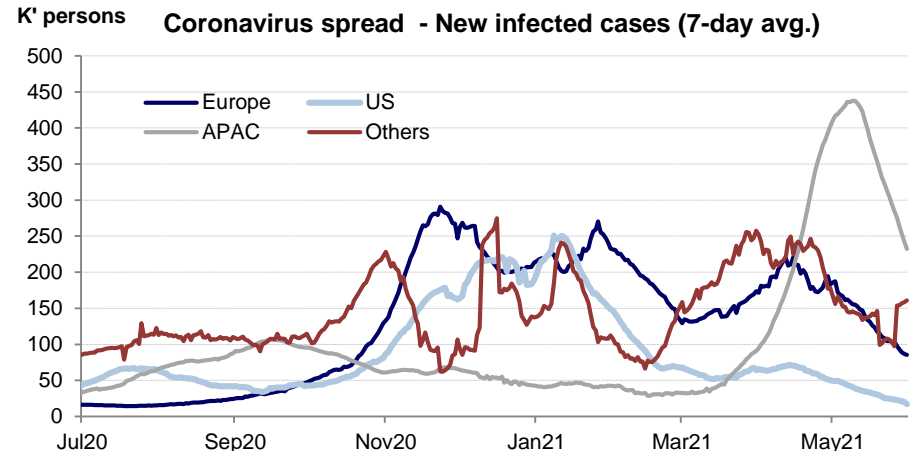
Virus – Reopening in Europe & US vs. resurgent infection in Asia

- Global infected cases surpassed 170mn, with death tolls topping 3.3mn. The vaccination roll-out curbed virus spread in Europe and US, while infected cases in Asia remained high. Global mfg. PMI climbed above 50 expansion mark

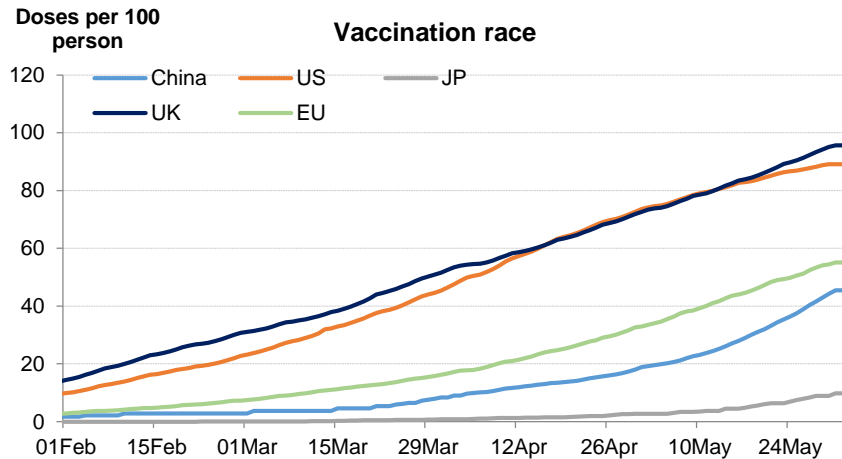
More 170mn infected globally



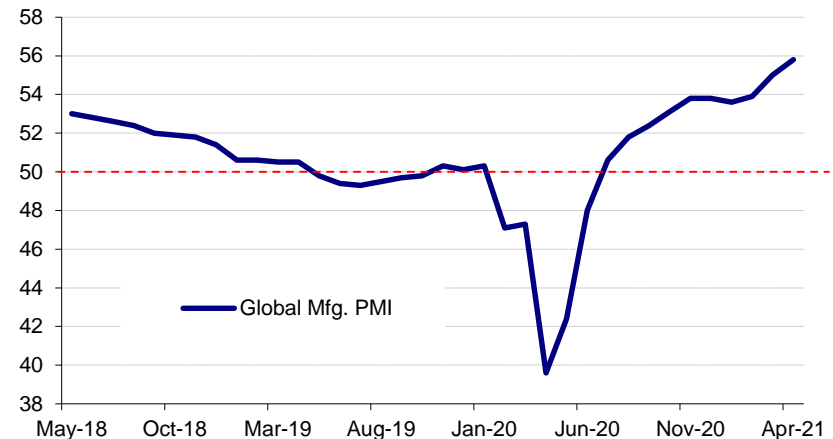
US & Europe spread slowed, Asia cases still high



US & UK approaching herd immunity



Global mfg. PMI: optimism on global reopening

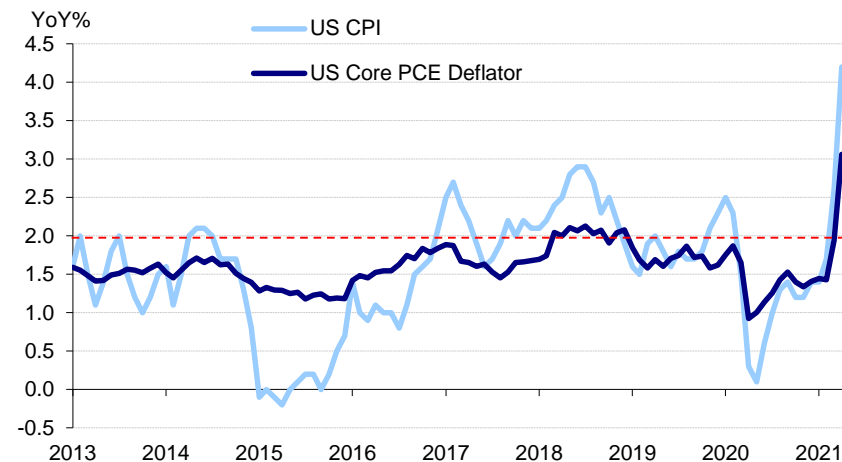


US Economy – Soaring inflation

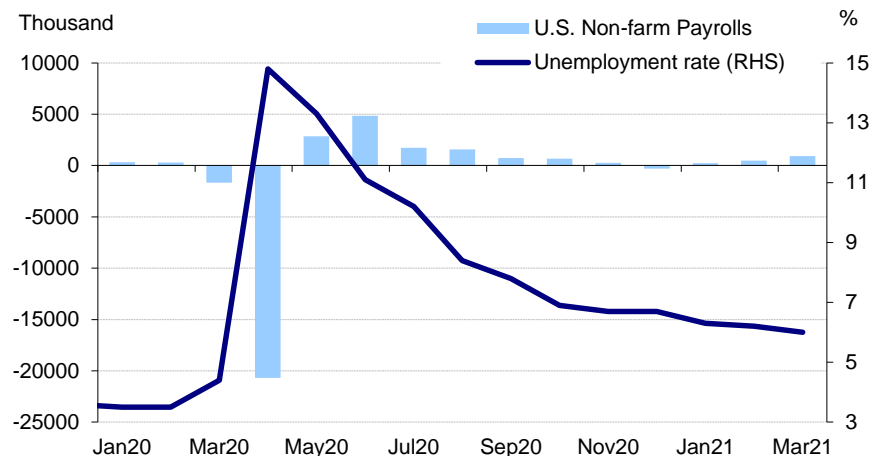
Labour market mixed, inflation pressure mounted

- US job reports for April surprised to the downside. Yet, the generous government subsidy scheme might discourage the return of employment. Moreover, the soaring job vacancies and falling initial jobless claims pointed to labour market recovery
- The surging US CPI figure highlighted the imminent and heightening inflation risk. PCE core deflator, Fed's preferred inflation gauge, also overshoot Fed's inflation target of 2% notably

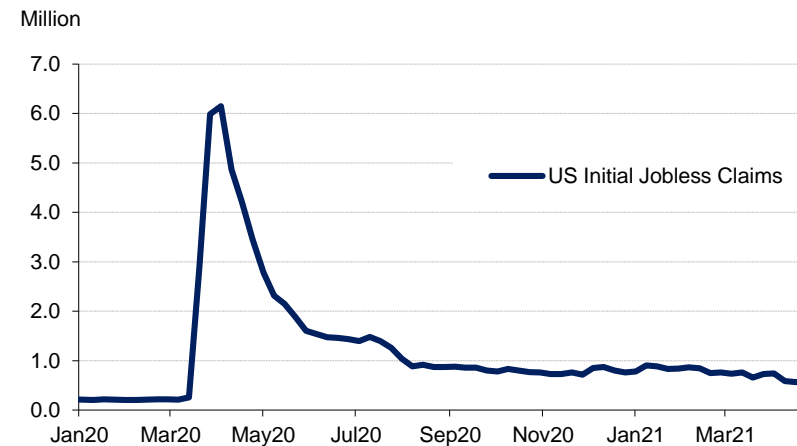
CPI inflation overshoot Fed's target of 2%



Disappointing US jobs report caused jitters...



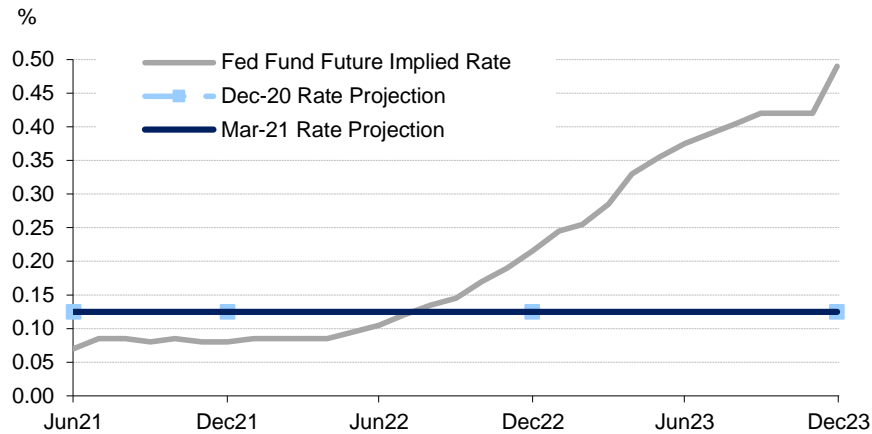
...but initial jobless claims continued to fall



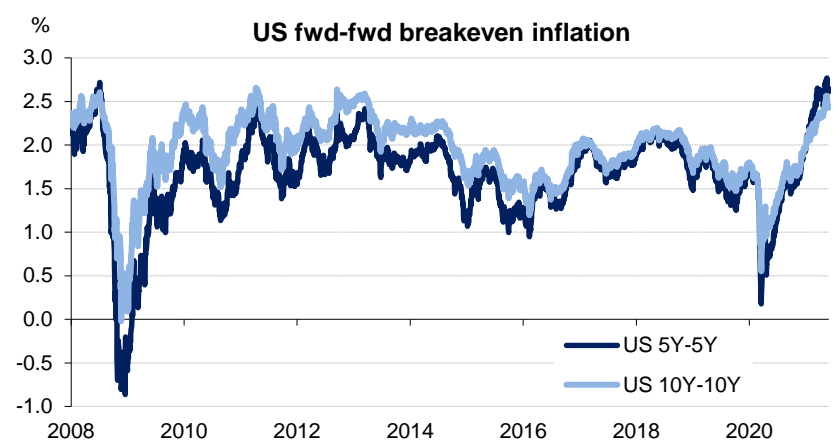
Fed – Changing its tone for tapering discussion

- The Fed opened the door for the tapering discussion at the upcoming FOMC meetings after digesting the US data shocks. The rate projection in FOMC meeting in June and Jackson Hole Symposium will be closely monitored. The Fed's reverse repo surged to record highs, reflecting flooding USD liquidity in the money market

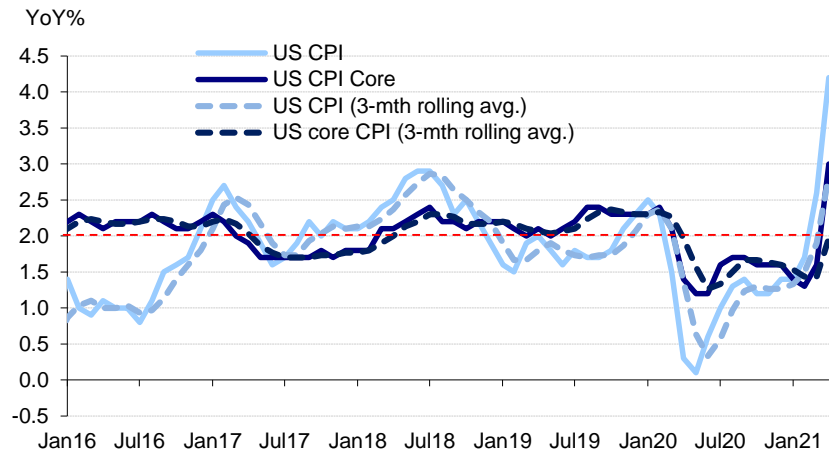
Is the Fed behind the curve?



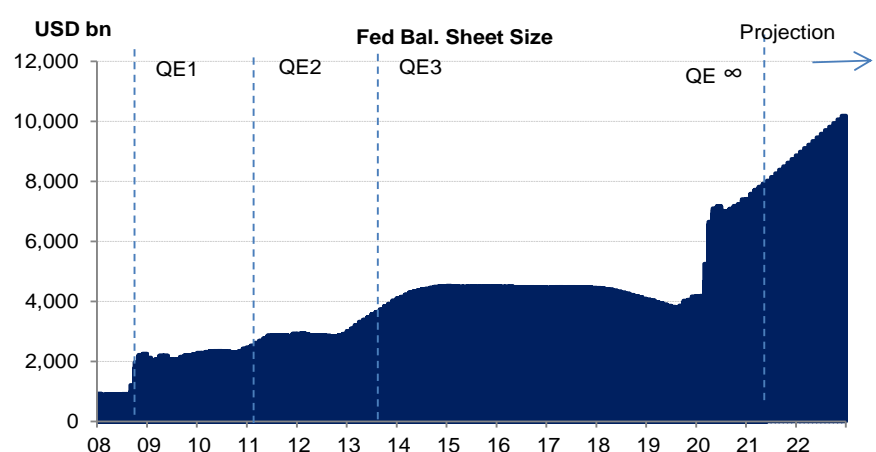
US inflation expectation running higher



Avg. inflation targeting: more tolerance on inflation



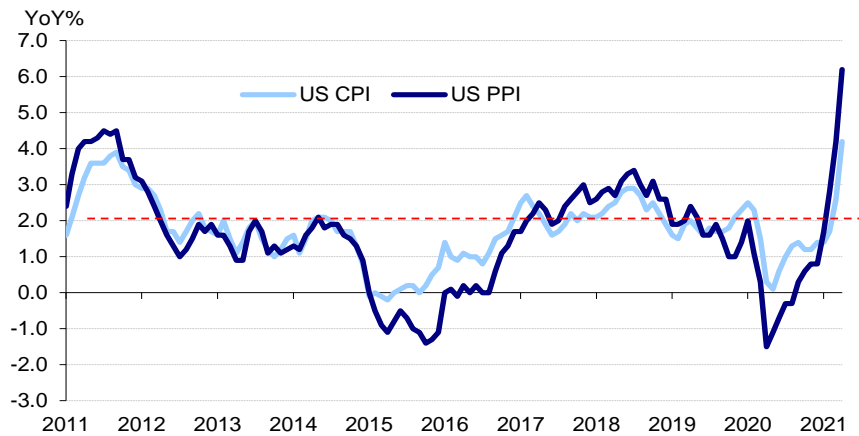
Tapering to come sooner rather than later?



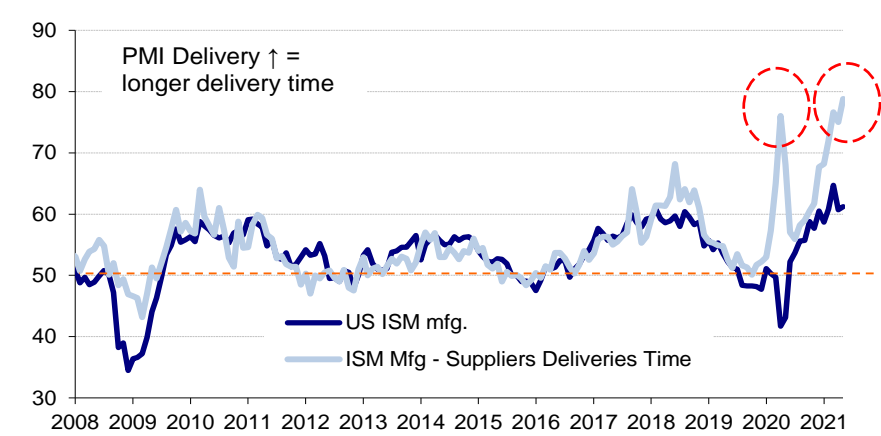
USD (1) – Is US inflation transitory or persistent?

- US inflation risk is subjected to upside given soaring PPI, rising salary growth and mounting inflation expectation. While the longer delivery time reflected the bottleneck issue due to demand-supply imbalance, the salary upward pressure could lift inflation in the medium term

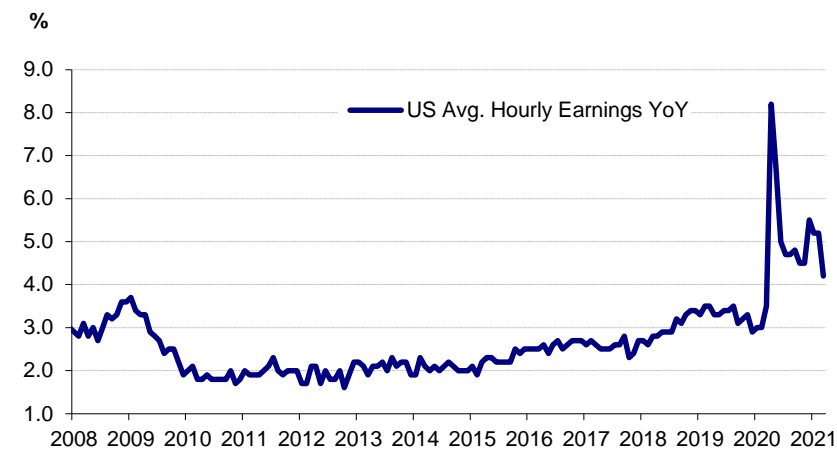
Soaring PPI pulling up CPI



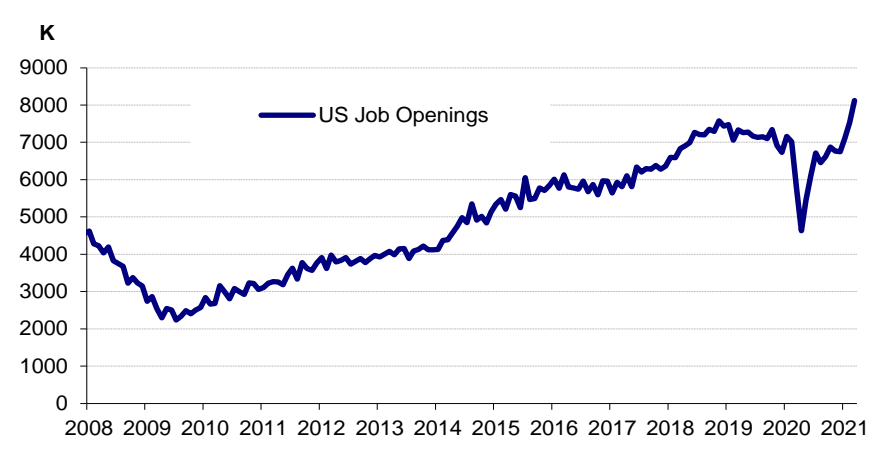
Longer delivery time reflected the bottle-neck



Upward pressure in salary growth



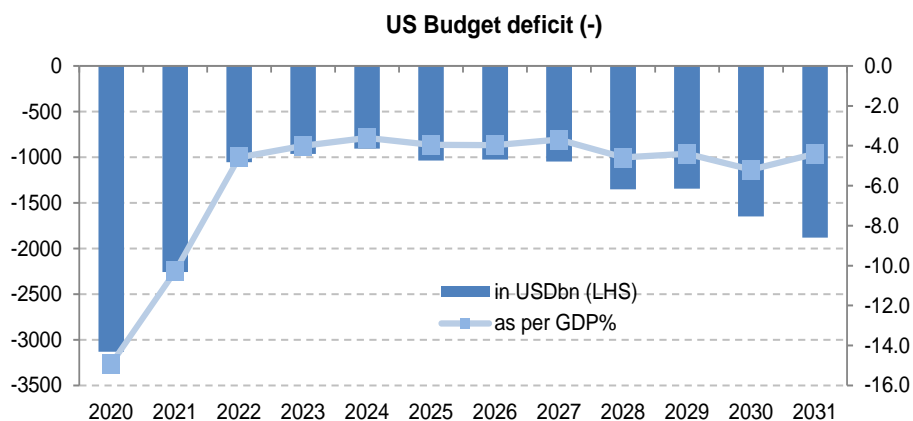
US job openings surged despite employment miss



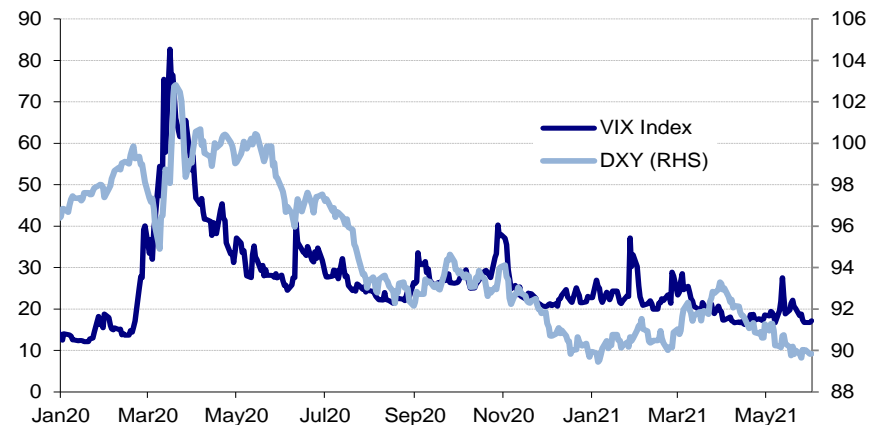
USD (2) – Safe-haven status undergoing change

- USD yield advantage recovered most of the ground lost. When the Fed began its tapering discussion, another round of surging UST yields could lift the USD again. This would lead to decoupling of USD-VIX relationship and a change of USD's safe haven status. US fiscal deficit worsened. Investors added speculative USD short position again

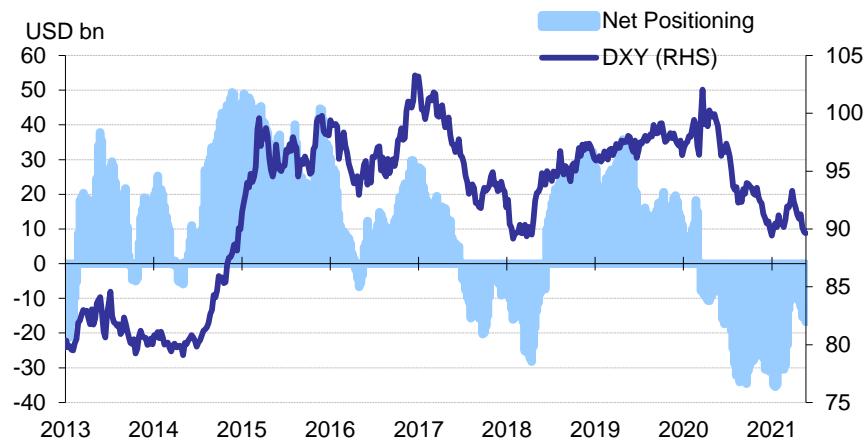
US budget deficit deepened after pandemic



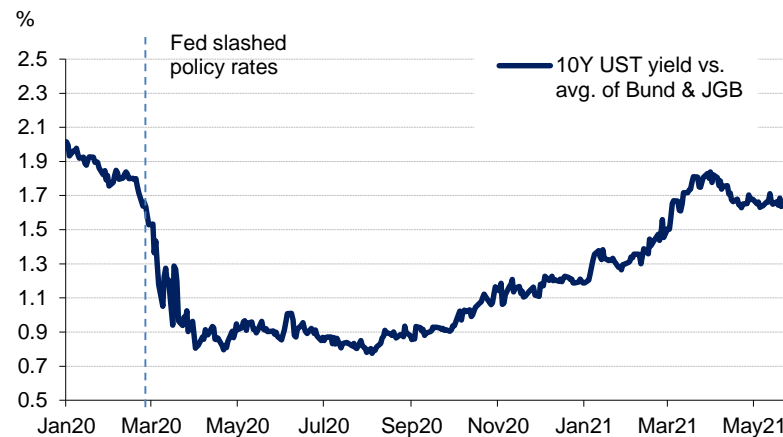
USD's safe-haven status undergoing change



Speculative USD short positioning picked up again



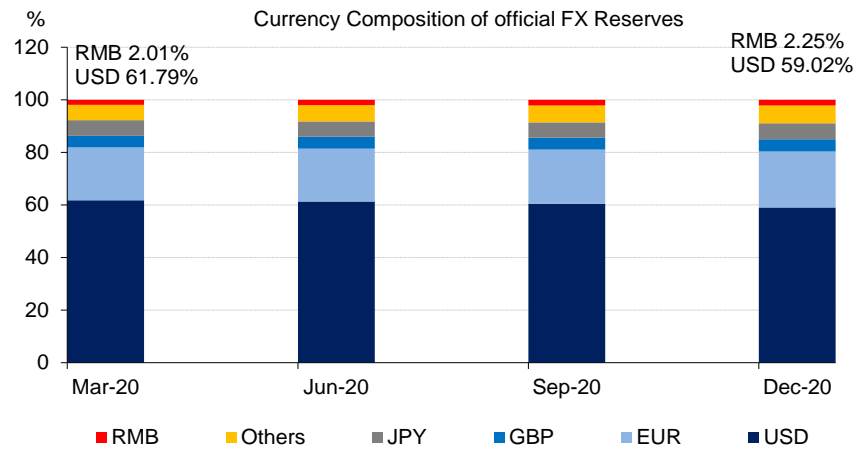
USD regained its yield advantage



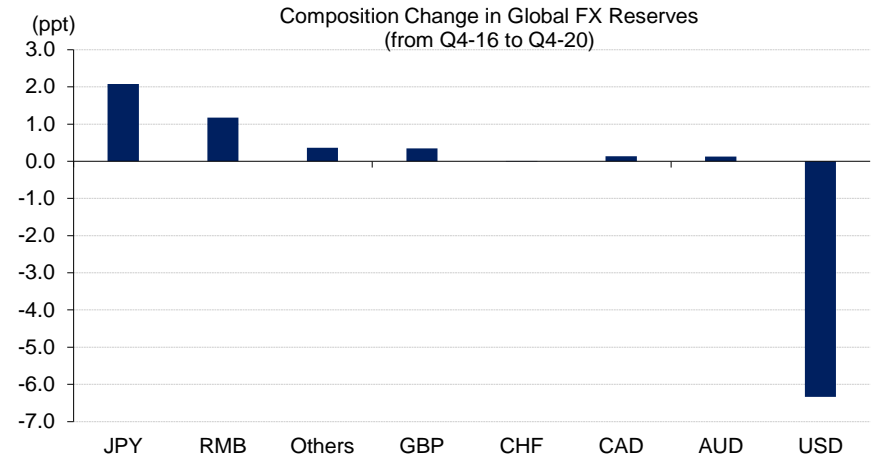
USD (3) – Central banks trimmed USD exposure in FX reserves in Q4-20

- 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

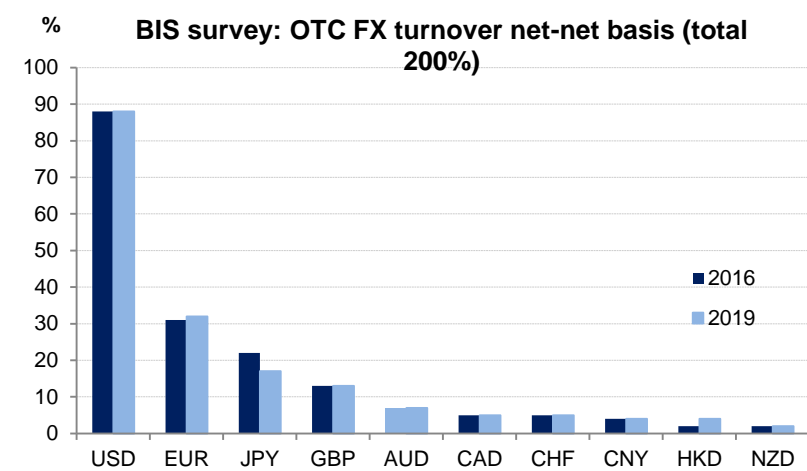
USD share of global FX reserves dropped to <60%



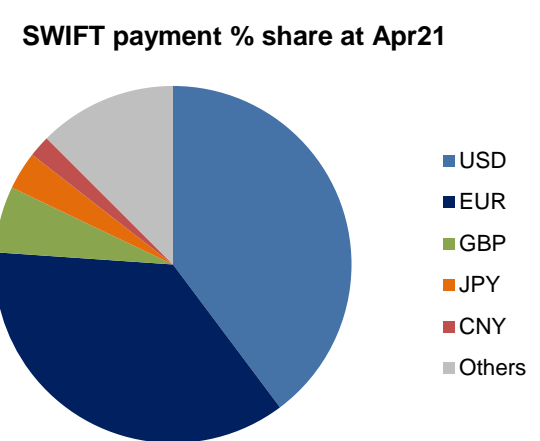
FX reserves manager reduced USD assets holding



USD dominating global FX turnover

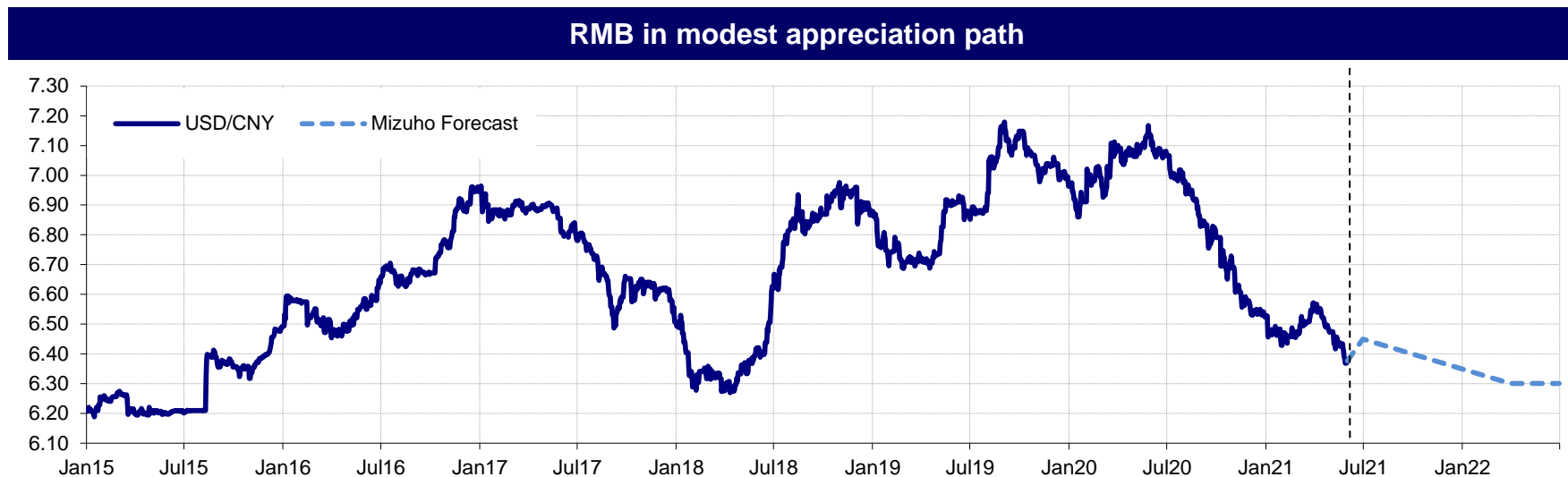


USD & EUR dominating in SWIFT payment



RMB (1) – The return of RMB rally

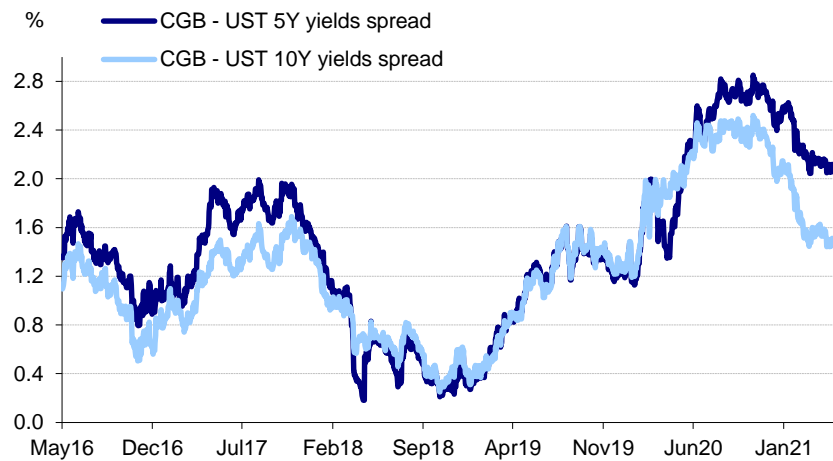
- The RMB strengthened to below 6.4 handle for the first time in 3 years on resurgent capital inflow to China A-share market. In response, the PBoC stepped up its action to curb the RMB gains by raising the FX Required Reserve Ratio (RRR) to 7% from 5%
 - **PBoC-Fed monetary divergence:** While both China and US will likely lead global recovery, the Fed and PBoC are reluctant to begin its stimulus withdrawal shortly.
 - **PBoC's FX policy:** The PBoC tolerated higher two-way FX volatility, but eventually took action to curb the one-way RMB gains when the RMB basket index soared to its 5 year-high. The central bank also warned on the bullish RMB speculations. The FX RRR hike may mark the beginning of PBoC's policy combination to contain RMB gains
 - **China-US tensions:** US Trade Representative Katherine Tai held a first call under Biden's presidency with Chinese Vice Premier Liu He. The less tense trade talk bodes well for trade negotiation on tariffs arrangement in the future



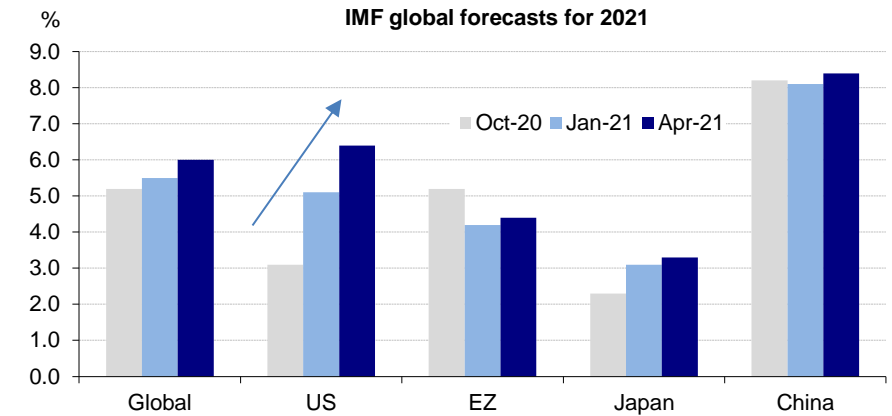
RMB (2) – Asset allocation capital inflow

- The steadier CGB-UST yield spread supported the ongoing capital inflow to China bond market amid global bond indices inclusion. Foreign investors poured money into A-share markets again given flooding USD liquidity

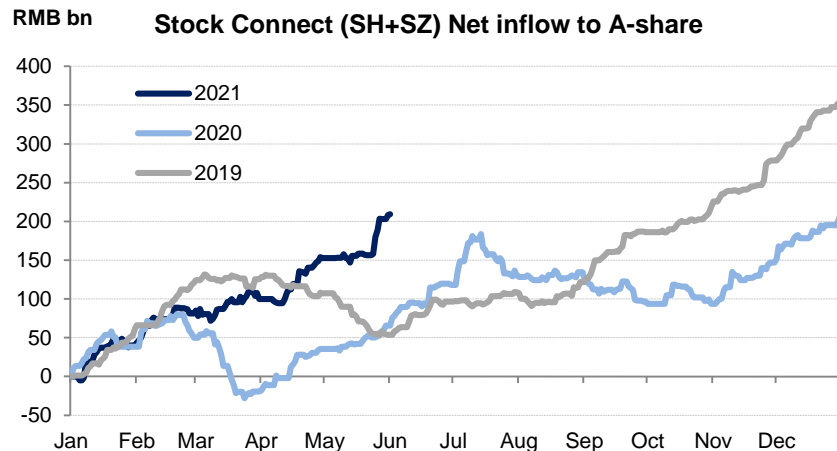
CGB-UST yield spread steadier after narrowing



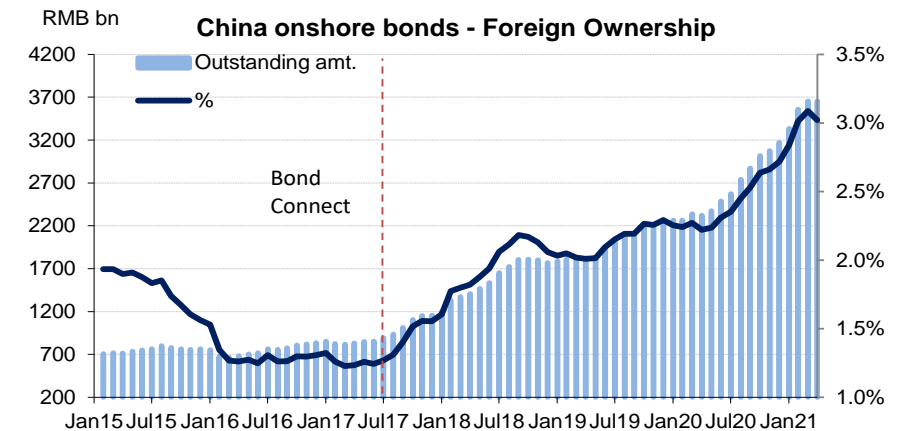
US growth upgrade dampened China exceptionalism



Stock Connect flow to A-share market spiked



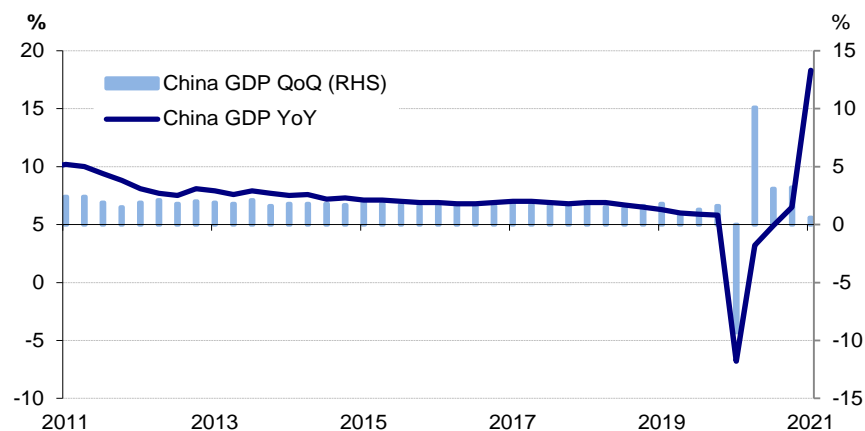
Foreign share in onshore bond climbed robustly



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 but the QoQ growth decelerated. China industrial production for April remained high but supply-chain redirection after the global reopening could disrupt growth. Mild consumption growth highlighted uneven recovery. Online sales maintained high growth

China Q1 GDP YoY hit a record, QoQ decelerated



Consumption recovery lagging behind



IP surged as China was in lockdown last year



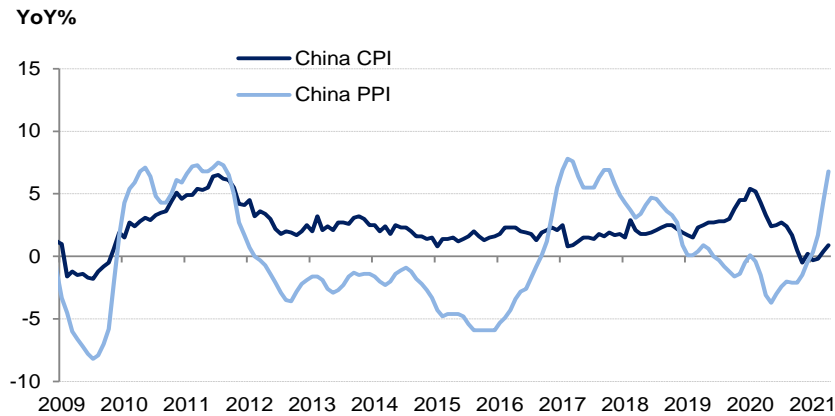
Online sales maintained high growth



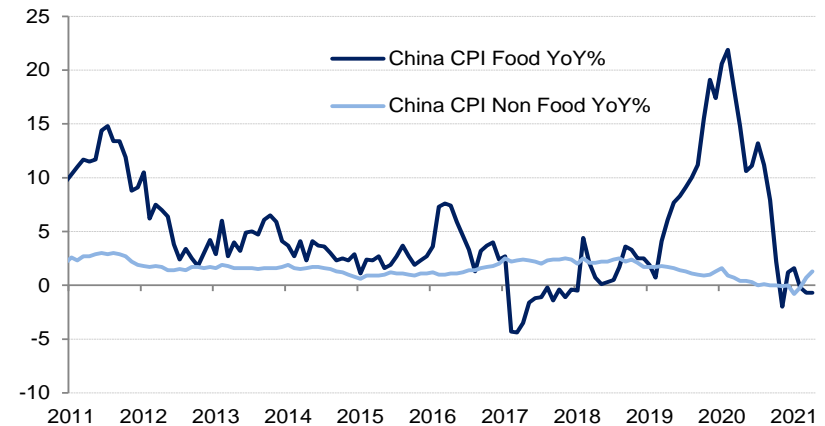
China economy (2) – Data surged on based effect

- China CPI picked up but inflation remained benign. Soaring PPI fueled global reflation concern. The lower local gov't bond issuance dragged on infrastructure FAI. China PMIs stayed above 50 expansion mark. Non-mfg. PMI was elevated amid reopening

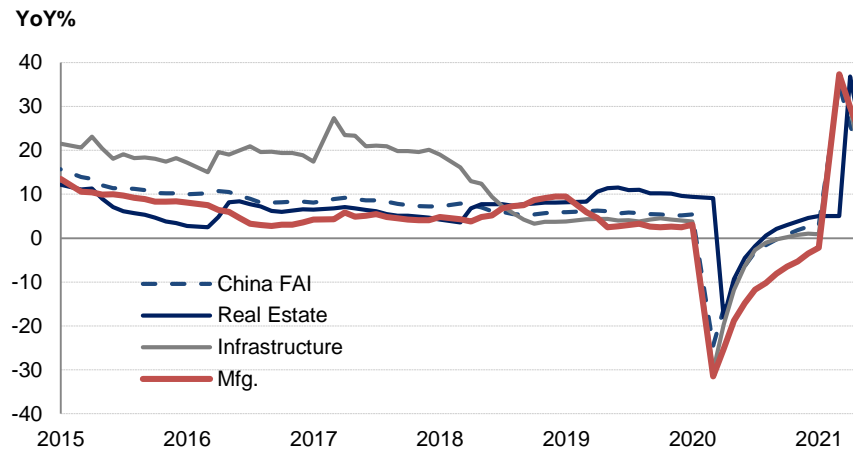
China CPI subdued, PPI jumped



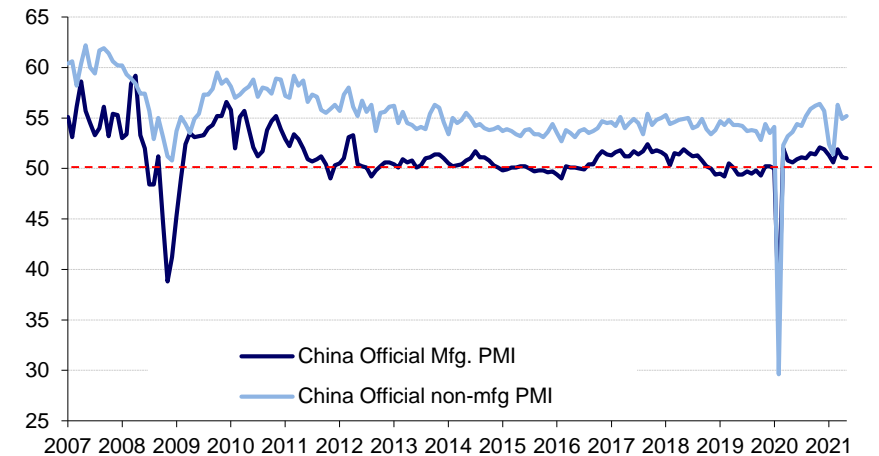
Non-food CPI picking up



FAI recovery lagging behind



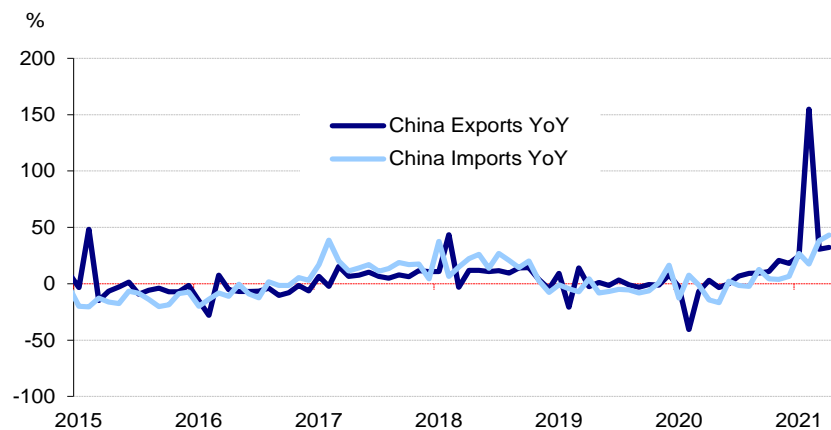
China PMIs stayed above 50



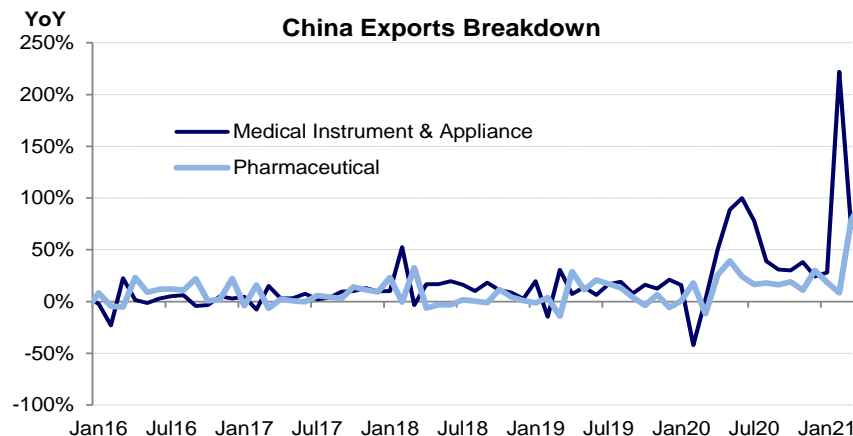
China economy (3) – Pent-up demand boosted exports

- China exports maintained high-speed growth 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

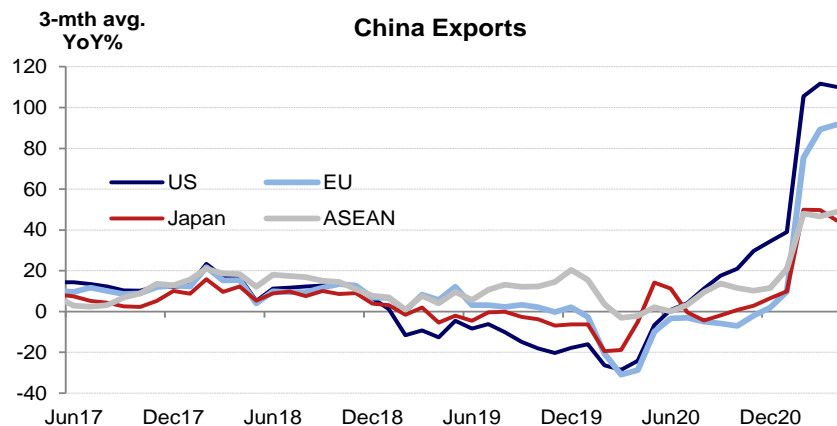
Strong China exports in Q1



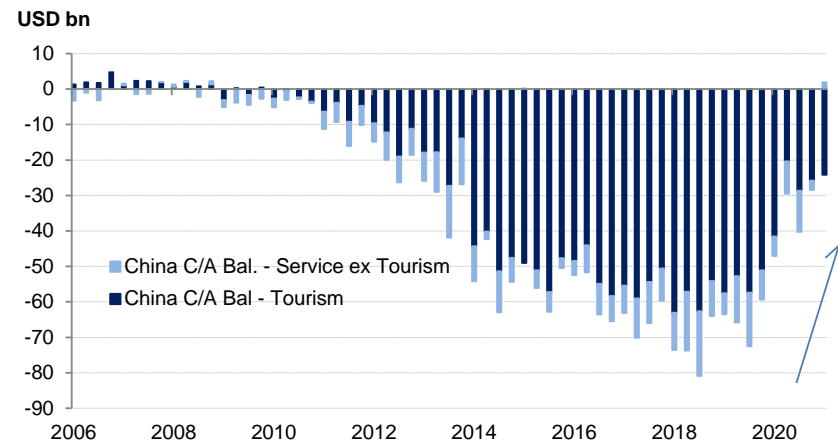
Medical exports con't to jump as virus unsettles



External demand up after vaccine breakthrough



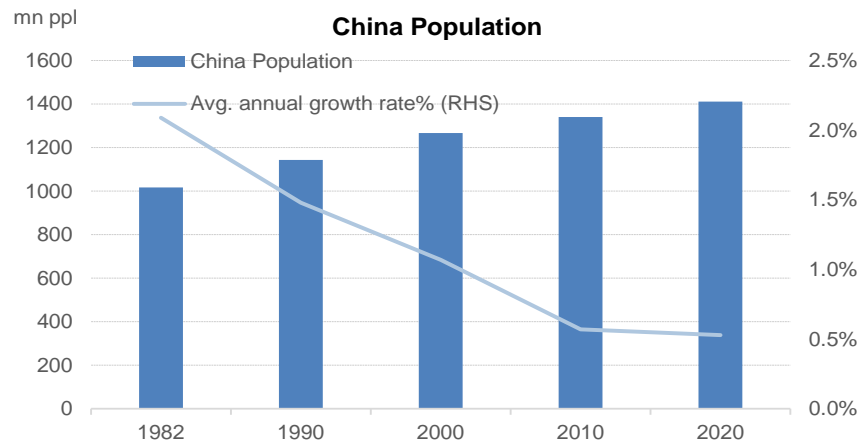
China C/A of service & tourism deficit narrowed



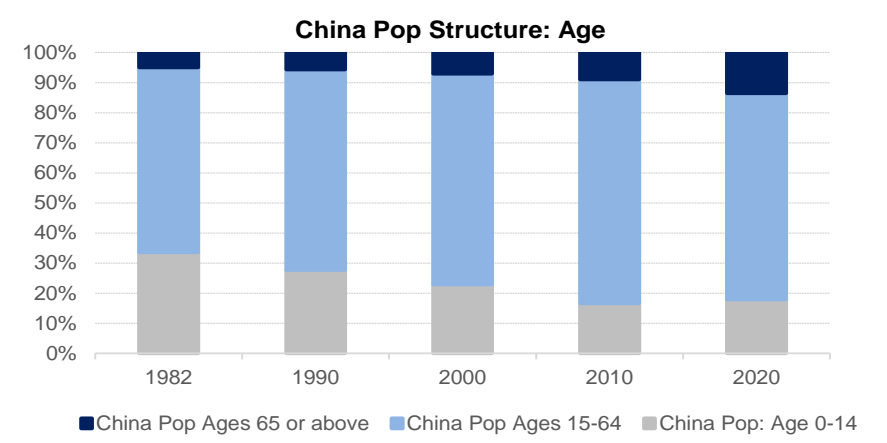
China census – Population structure problems to hinder its growth

- The 7th China census revealed China population for 2020 rose to 14.43bn but the annual avg. growth rate dropped to +0.53%. The aging population and gender imbalance could hinder growth prospect. The urbanization could be running its course after climbing to above 60%. The Politburo meeting decided a shift towards 3-child policy

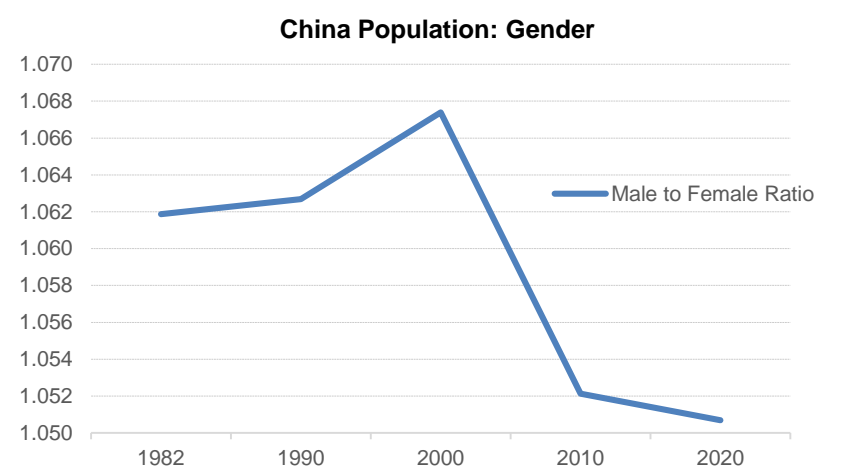
Slowing population growth



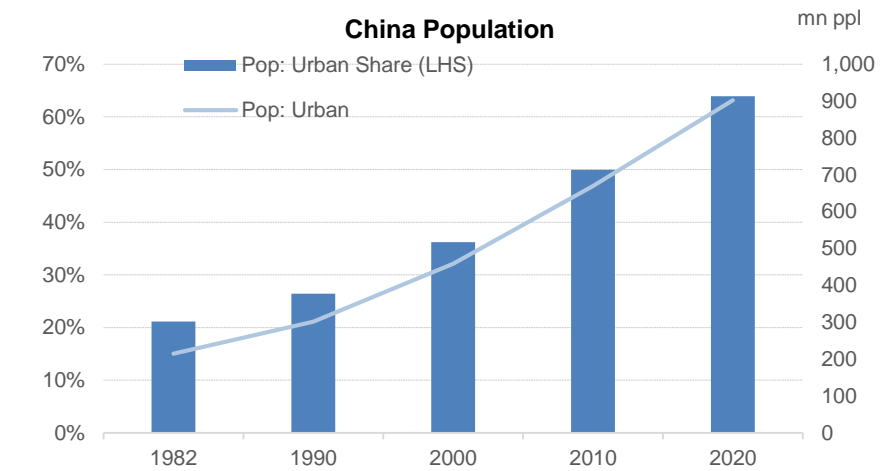
China: aging population



Gender imbalance more or less the same



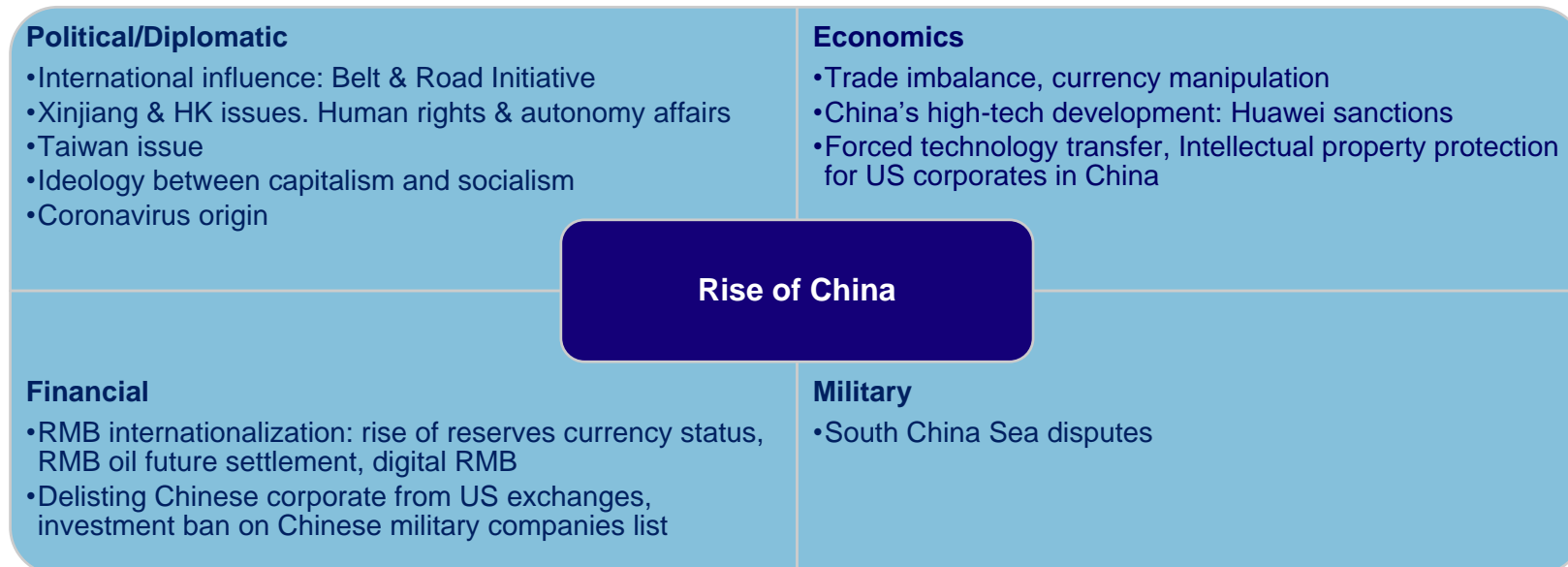
Urbanization to run its course?



China-US Tensions – Conflicts beyond trade imbalance

Biden retains 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.** Biden's administration upholds the phase one deal and retains Trump's sanctions and hardline policy against China, with the shift of focus to human rights from trade imbalance
- 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. Biden rejoined the World Health Organization (WHO) and the Paris Climate Agreement. If Biden managed to repair the relationship allies, the coordinated sanctions against China, if any, would prove to be more threatening



Phase one deal – To continue under Biden’s presidency

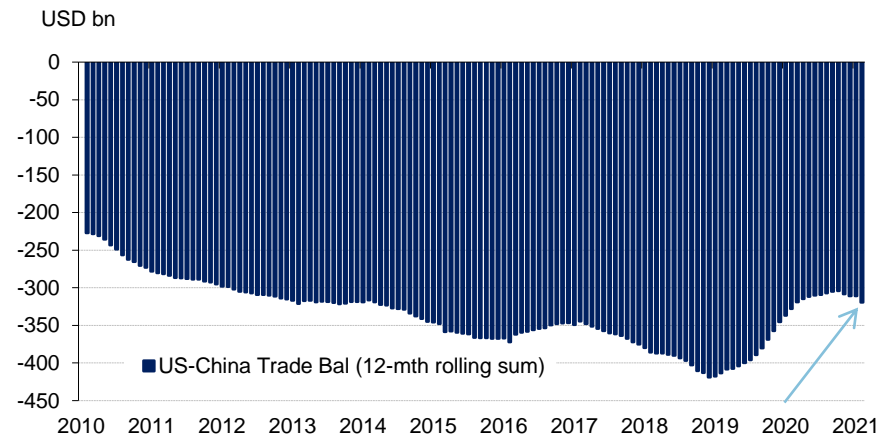
US Trade Representative held the first call with Chinese Vice Premier Liu He

- 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
- US TR Katherine Tai held a first call under Biden’s presidency with Chinese Vice Premier Liu He. Both sides recognized the importance of bilateral trade, exchanged views and agreed keeping communication. The constructive atmosphere bodes well on trade talks later this year

China purchase target for 21 more challenging



US trade deficit to China steadier



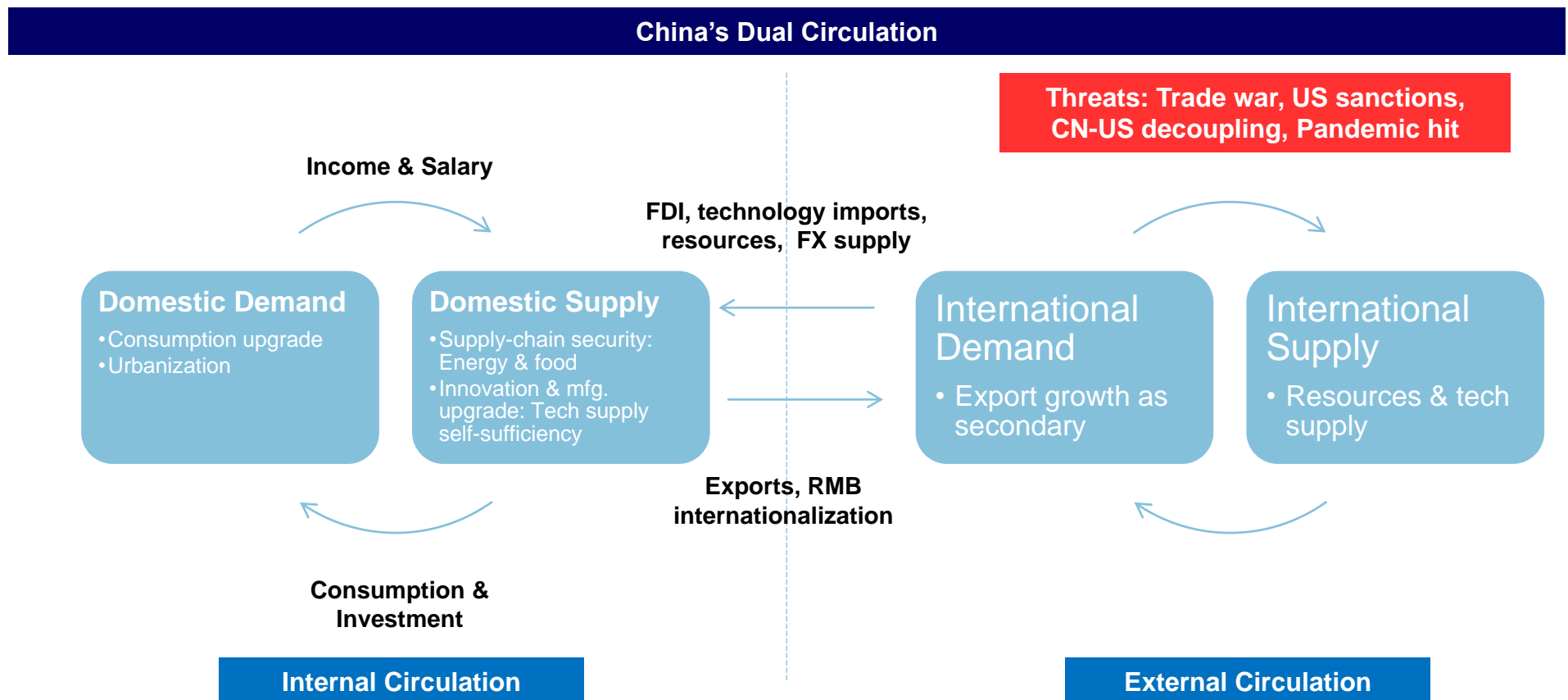
China’s shopping list

(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
Total	76.7	123.3	210

China Policy (1) – Dual circulation

Dual circulation as the blueprint for 14th Five Year Plan

- Chinese Communist Party held the Fifth Plenum Session and unveiled details on 14th 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

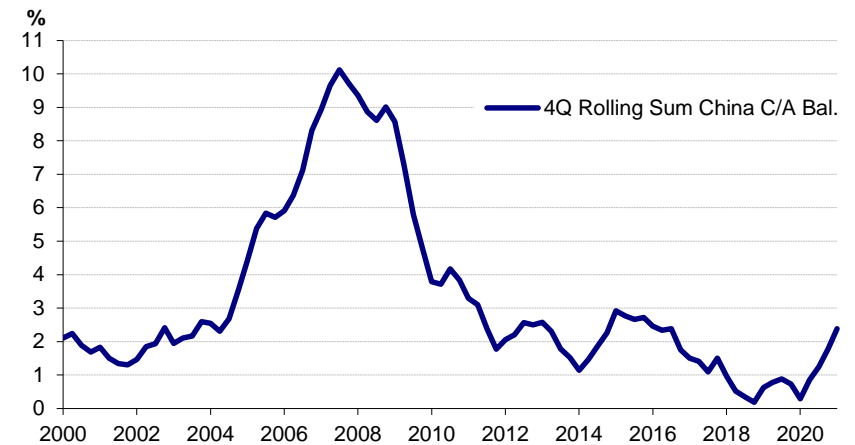


China Policy (2) – Dual circulation

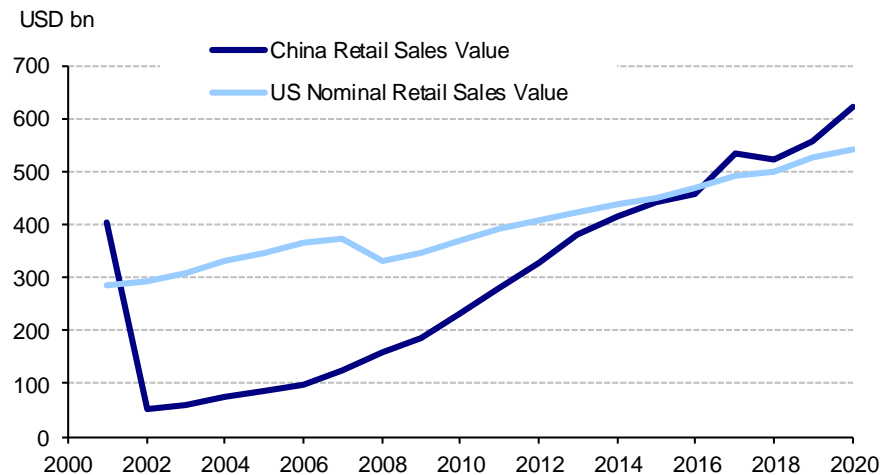
Less motivated to use weak RMB to stimulate growth

- 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

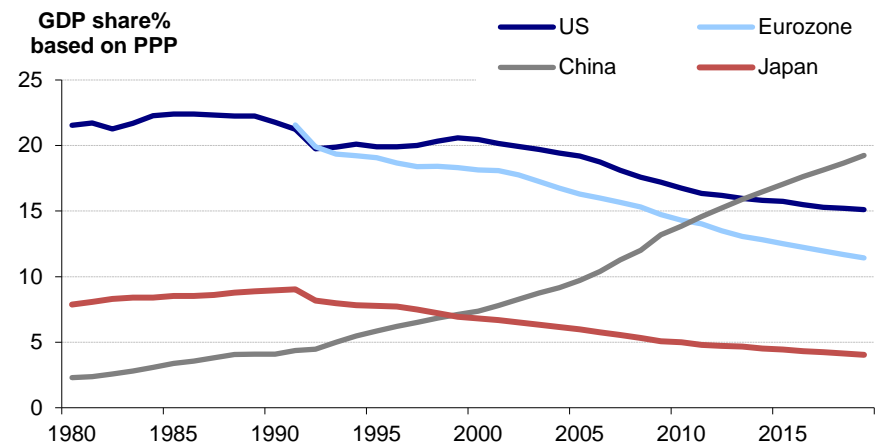
China C/A surplus shrank since 2007



China retail sales outstanding surpassed US



China's GDP share on PPP outsizing G3



PBoC Policy (1) – Curb RMB gains

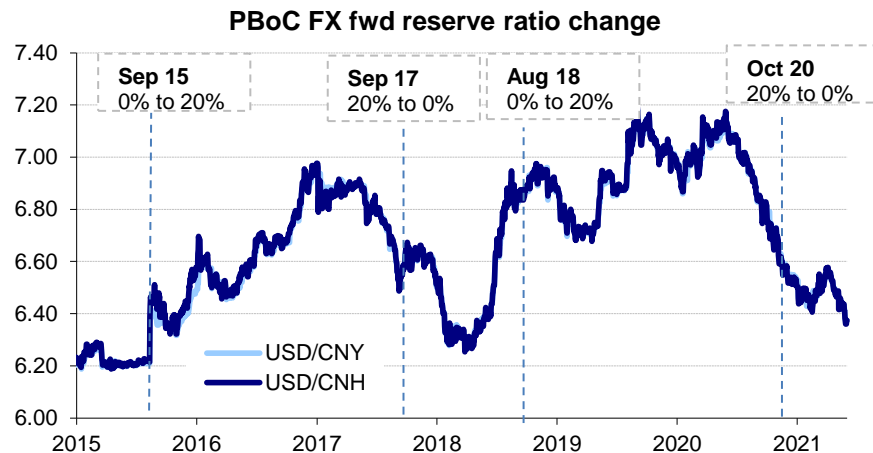
PBoC raised FX RRR for the 1st time since 2007

- The PBoC took action to curb the RMB gains by raising FX Required Reserve Ratio (RRR) to 7% from 5% to be effective on 15 June. The FX RRR hike is estimated to drain USD 20bn liquidity
- The triggers to PBoC's action are resurfacing expectation for one-way RMB appreciation and surging RMB basket index to its 5-year high
- The FX RRR hike signaled more forthcoming policy combinations, with the potential activation of counter cyclical factor adjustment in CNY fixing and expansion of QDII quota to encourage outbound investment flow

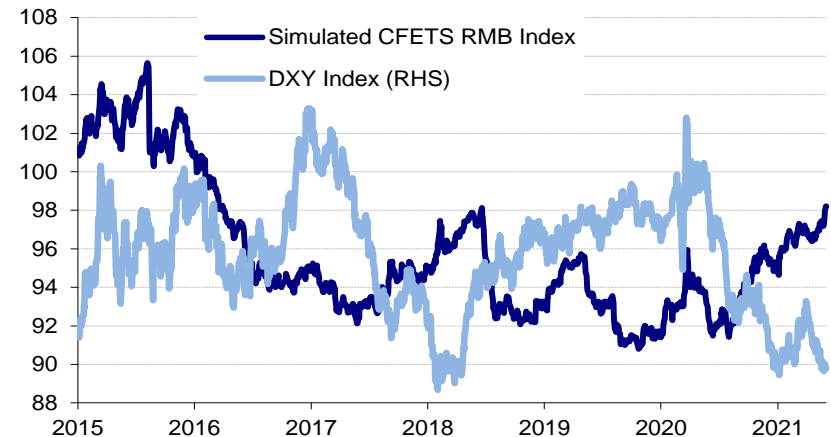
China expanded QDII quota



PBoC lowered FX risk reserves



Simulated CFETS RMB baskets climbed to 5 yr high

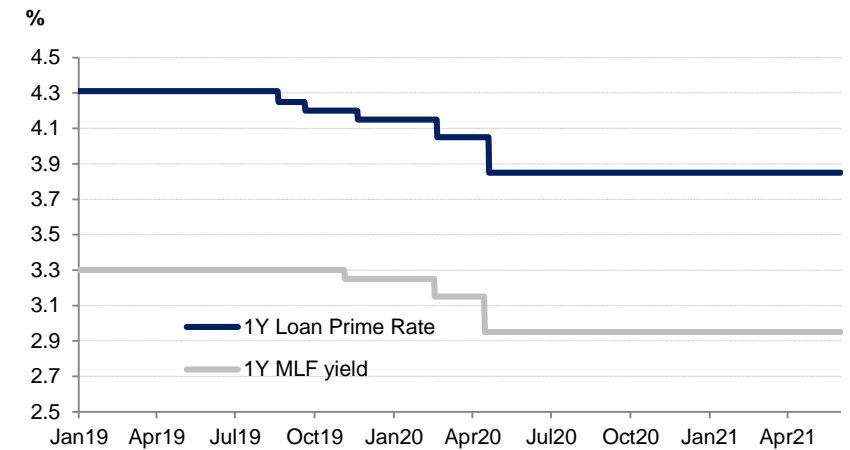


PBoC Policy (2) – No policy U-turn

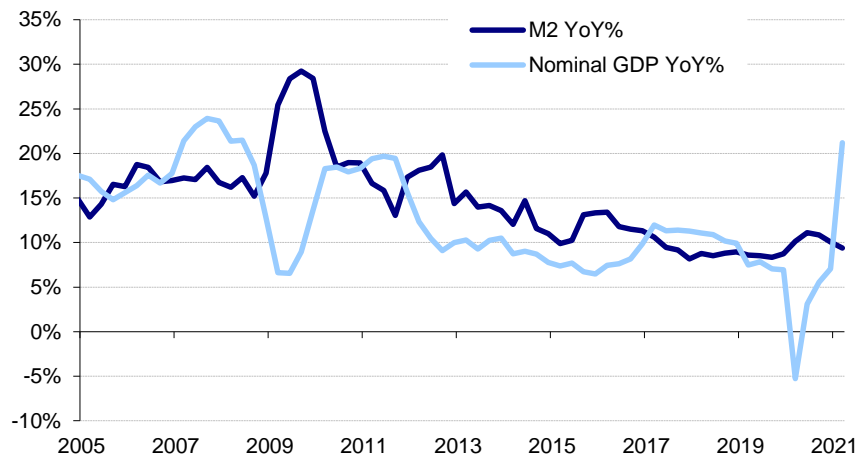
Rates to stay unchanged, while keep liquidity ample

- 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) was in auto-pilot mode
- With uneven recovery, unsettling Chinese bond market and benign inflation pressure, the PBoC is unlikely resume its tightening cycle in the near term

No change in policy rates for 13 months



China Q1 nominal GDP growth spiked



Bond financing shrinking since the SOEs default

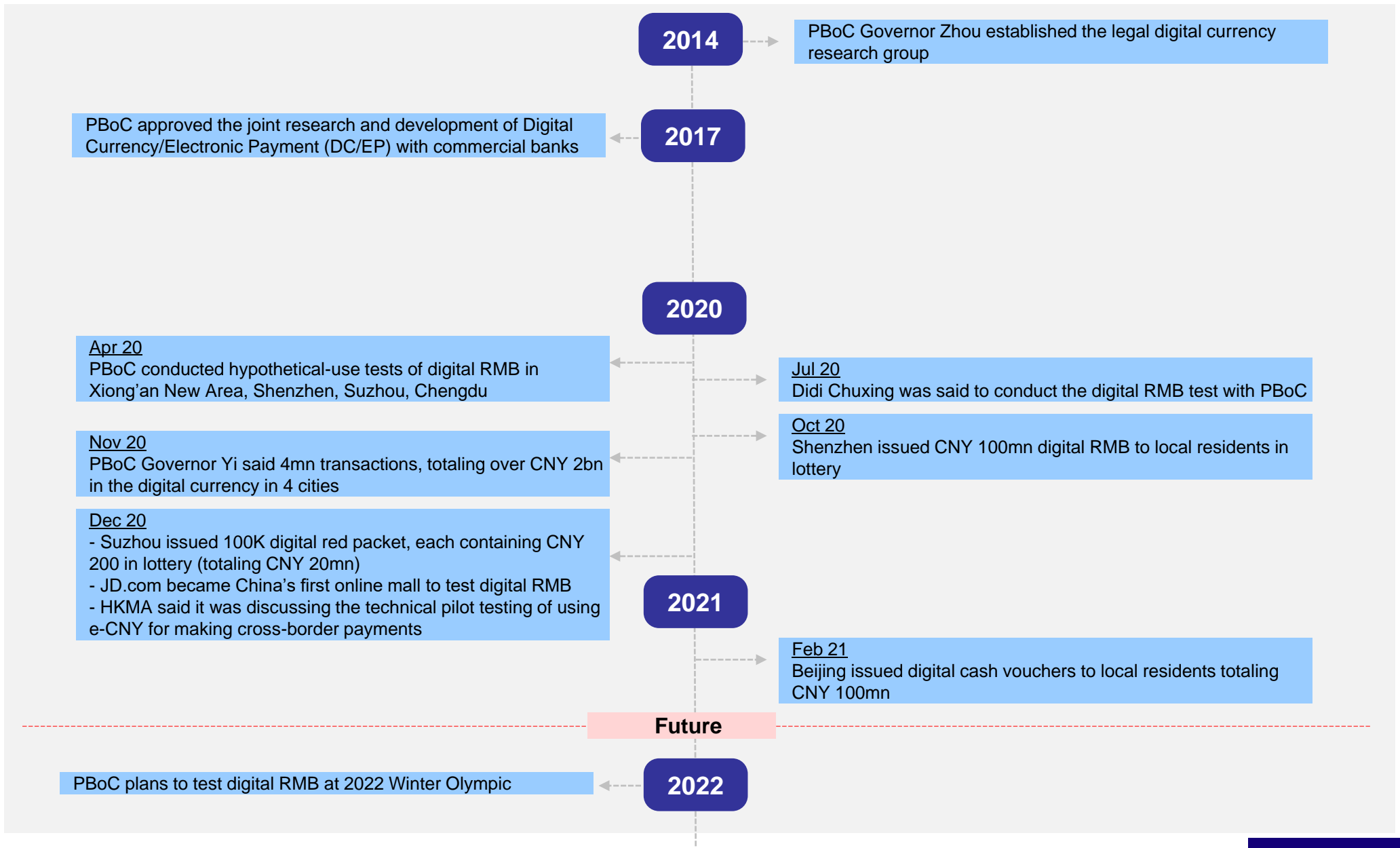


China's Digital RMB – e-CNY

- 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

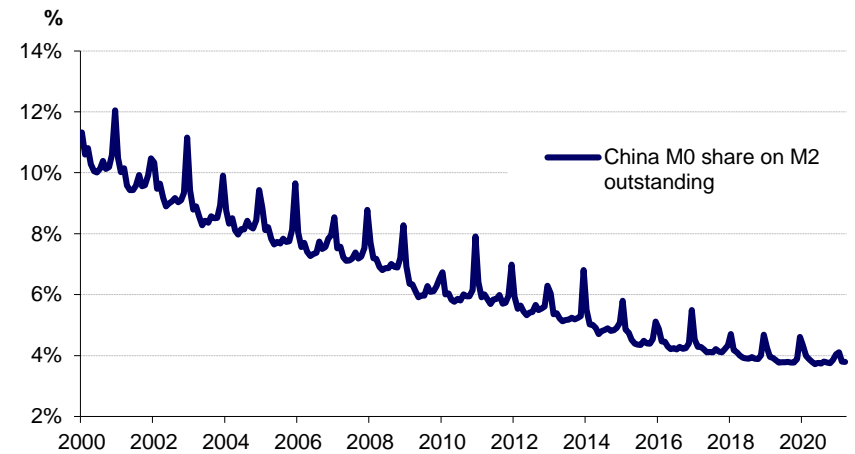
Payment method	e-CNY	Alipay/WeChat	Cash	Cryptocurrency
Anonymity	Limited	No	Yes	Yes
Offline payment	Yes	No	Yes	No
Issuer	Government	Private	Government	Private
Efficiency	High	High	Low	Low
Volatility	Low	Low	Low	High
Technology	Centralized/Blockchain	QR Code, network	N/A	Blockchain

e-CNY - FX implications

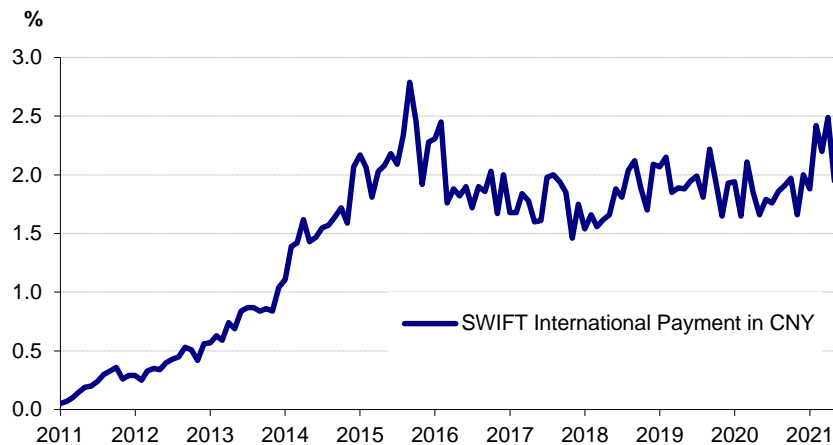
Limited in the near-term, positive in the medium term

- 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

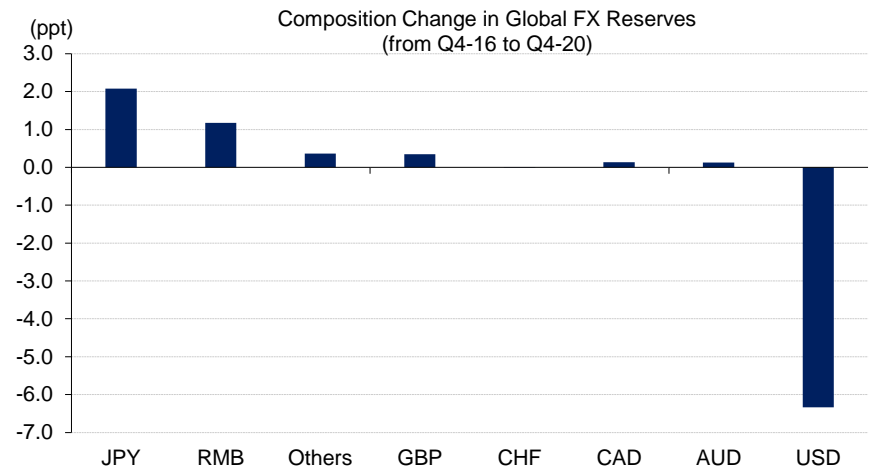
China moving towards cashless society



CNY global payment share moving sideways



RMB reserves share rose on USD share decline



Mizuho FX Forecasts

	2021				2022	
	Jan - May	Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun
USD/JPY	102.60 ~ 110.85 (109.78)	108 ~ 112 (110)	109 ~ 114 (112)	110 ~ 115 (113)	109 ~ 115 (114)	110 ~ 116 (115)
EUR/USD	1.1704 ~ 1.2349 (1.2190)	1.20 ~ 1.23 (1.21)	1.18 ~ 1.23 (1.19)	1.17 ~ 1.22 (1.19)	1.16 ~ 1.21 (1.18)	1.15 ~ 1.20 (1.17)
EUR/JPY	125.10 ~ 134.04 (133.83)	131 ~ 136 (133)	132 ~ 138 (133)	132 ~ 138 (134)	133 ~ 140 (135)	134 ~ 141 (135)

	2021				2022	
	Jan - May	Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun
USD/CNY	6.3570 ~ 6.5793 (6.3701)	6.30 ~ 6.55 (6.45)	6.25 ~ 6.55 (6.40)	6.20 ~ 6.50 (6.35)	6.15 ~ 6.45 (6.30)	6.15 ~ 6.45 (6.30)
EUR/CNY	7.6801 ~ 8.0559 (7.7878)	7.56 ~ 8.06 (7.80)	7.38 ~ 8.06 (7.62)	7.25 ~ 7.93 (7.56)	7.13 ~ 7.80 (7.43)	7.07 ~ 7.74 (7.37)
CNY/JPY	15.731 ~ 17.286 (17.188)	16.49 ~ 17.78 (17.05)	16.64 ~ 18.24 (17.50)	16.92 ~ 18.55 (17.80)	16.90 ~ 18.70 (18.10)	17.05 ~ 18.86 (18.25)

Notes:

1. Prepared by East Asia Treasury Department, Shanghai Treasury and Tokyo headquarter
2. Actual quotes updated at 31 May from Bloomberg
3. In the forecast columns, the exchange rates in parentheses are quarter-end forecasts.

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