

Mizuho Bank 2021 RMB Outlook

The resilience of RMB

July 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 – Fed’s hawkish surprise

- The Fed made a hawkish shift surprisingly at FOMC meeting. The tapering discussion has begun. With the projections of 2 rate hikes before 2023-end, market participants pushed forward the timing of Fed’s tapering and rate hike cycle
- US inflation data will remain on the spotlight in coming months. More upside surprises in CPI inflation could prompt the Fed to reveal its tapering plan as soon as in the Jackson Hole Symposium
- The virus spread remains unsettling. The latest virus variant may delay the global re-opening despite US & UK reaching the herd immunity
- PBoC took the policy actions to curb one-way RMB appreciation bias appropriately. The FX RRR hike prompted a RMB correction pre-emptively and the RMB’s knee-jerk decline to the USD rebound was at an orderly pace

Date	Key Events for 2021
Jul	23 (JP) Summer Olympics, 29 (US) FOMC meeting
Aug	26-28 (US) Jackson Hole Symposium
Sep	23 (US) FOMC meeting
Oct	22 (JP) General election
Nov	4 (US) FOMC meeting
Dec	16 (US) FOMC meeting
Others	Vaccinations vs. virus variants, border re-opening, ECB’s strategy review

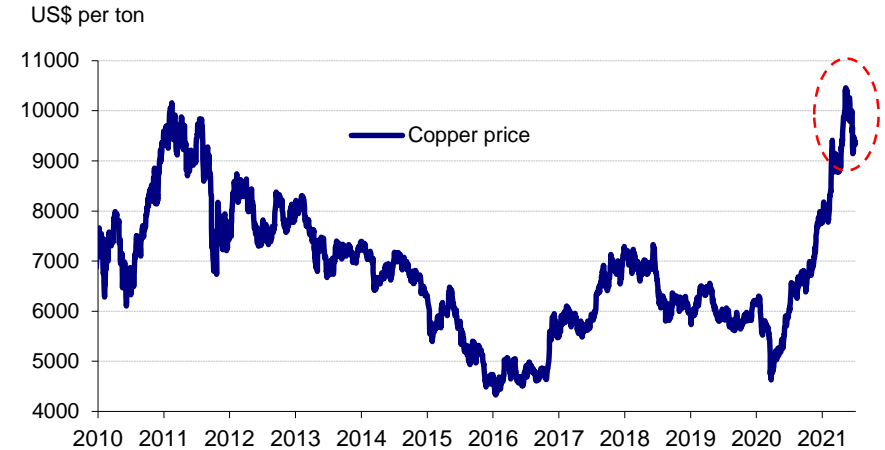
Global – Unwinding reflation trade

- The Fed delivered a hawkish surprise at the FOMC meeting and USD rebounded notably. The unwinding flow of reflation trade triggered UST yield curve flattening and commodities slid. Capital rotated back to tech sector

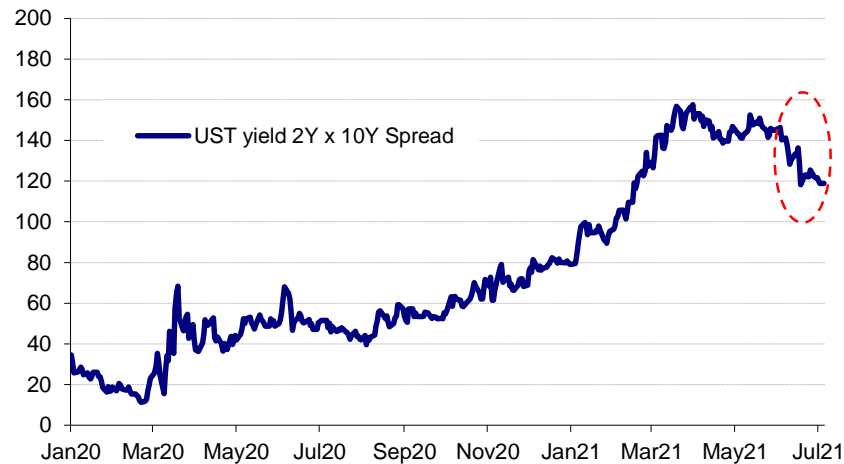
USD rebounded notably after Fed's hawkish shift



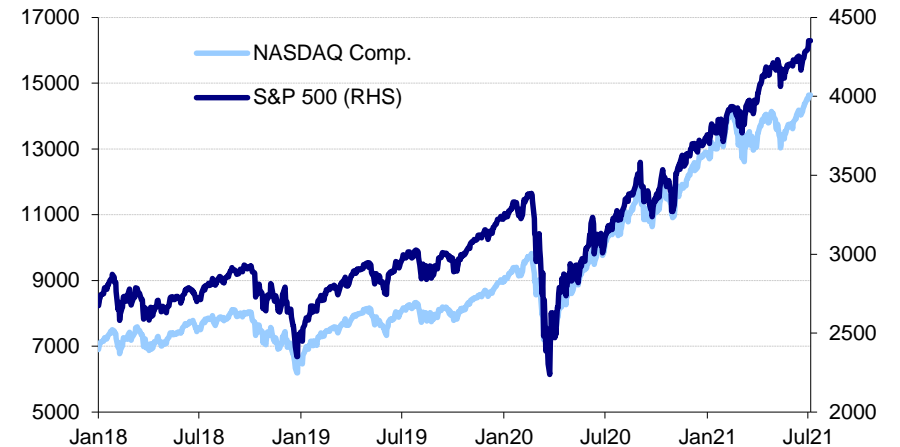
Copper price slid on reflation trade unwinding



UST yield curve flattening



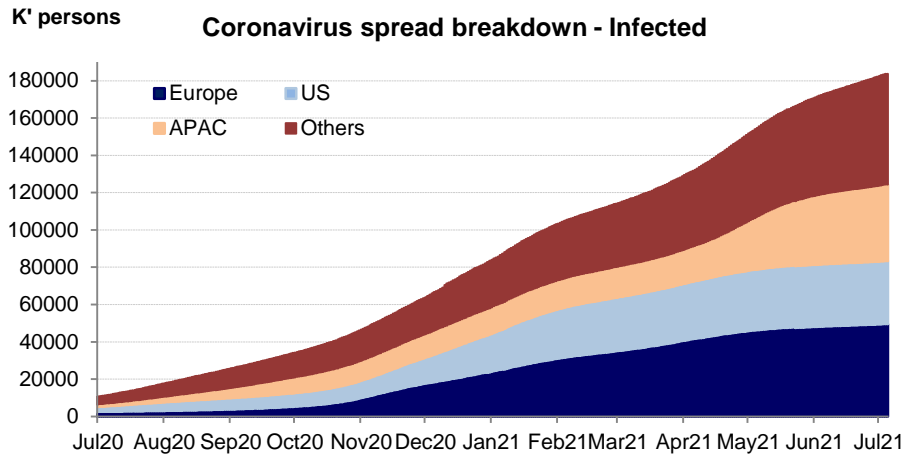
Capital rotated back to tech. NASDAQ jumped



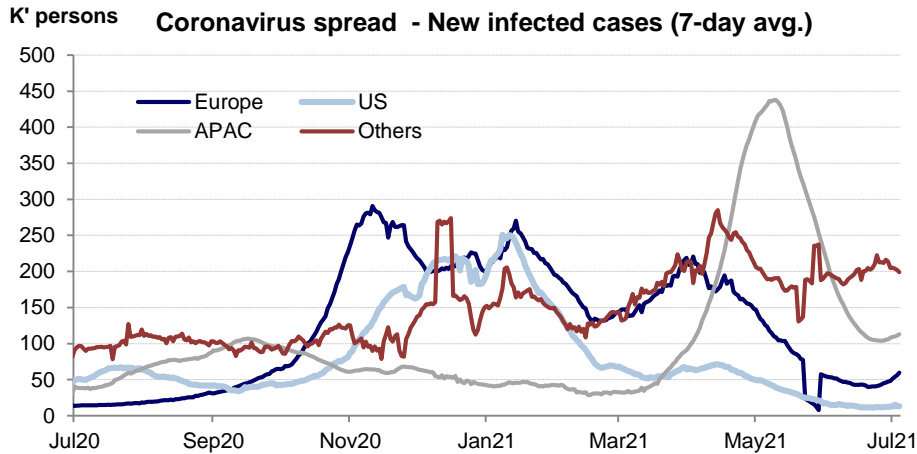
Virus – Setback in reopening on virus variants

- Global infected cases climbed to near 180mn, with death tolls topping 3.9mn. The more infectious Delta+ variant could threaten the re-opening plan in Europe. Global mfg. PMI climbed further above 50 expansion mark

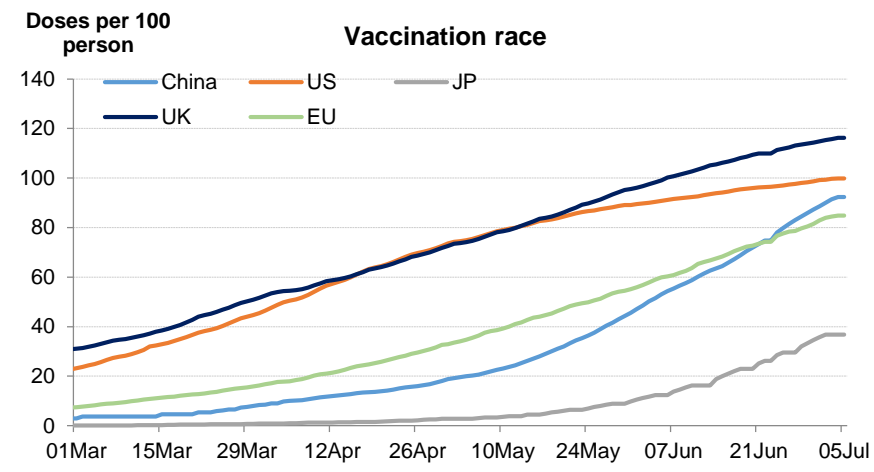
More 180mn infected globally



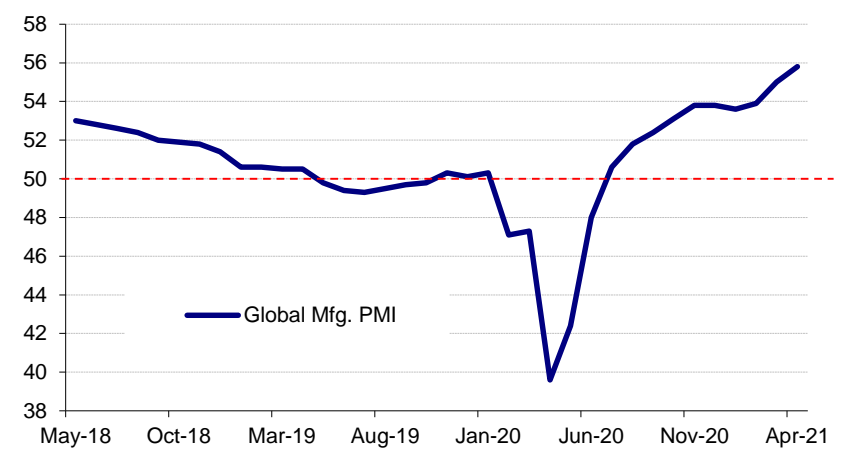
Unsettling virus spread with the variants



Resurgent virus spread in UK despite herd immunity



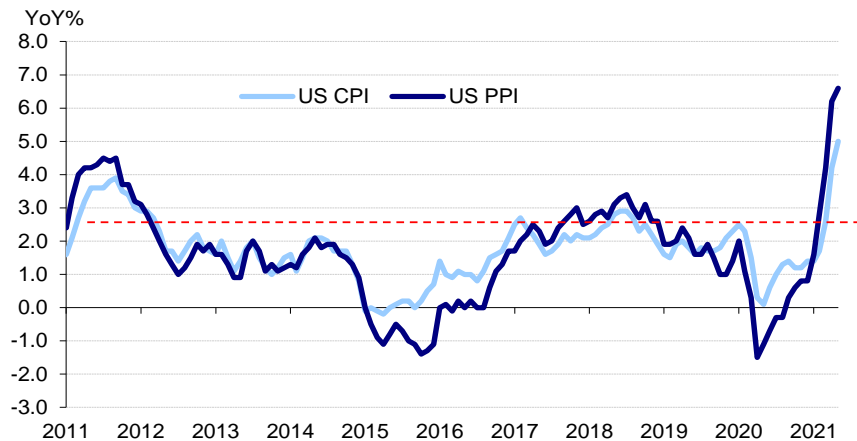
Global mfg. PMI: optimism on global reopening



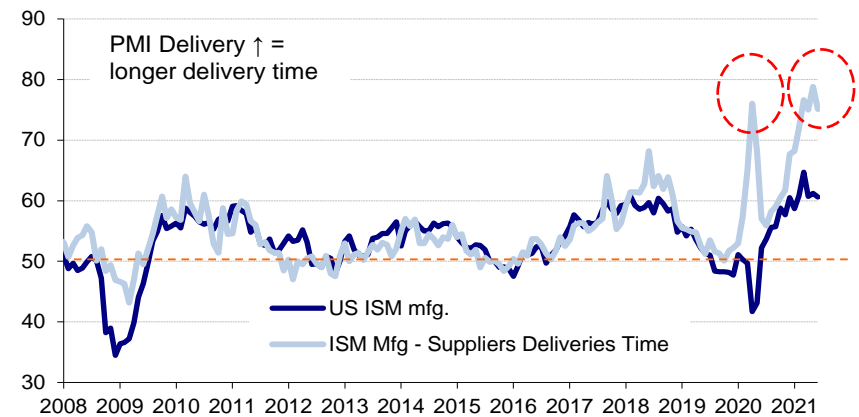
US Economy (1) – Inflation to be transitory or persistent?

- US inflation hit its 13-year high of 5%YoY alongside soaring PPI. 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. Inflation expectation eased after Fed's hawkish shift

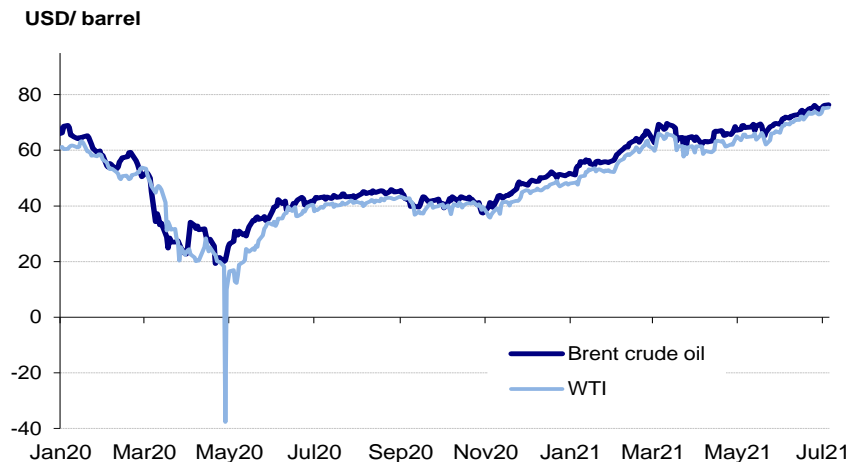
Soaring PPI pulling up CPI



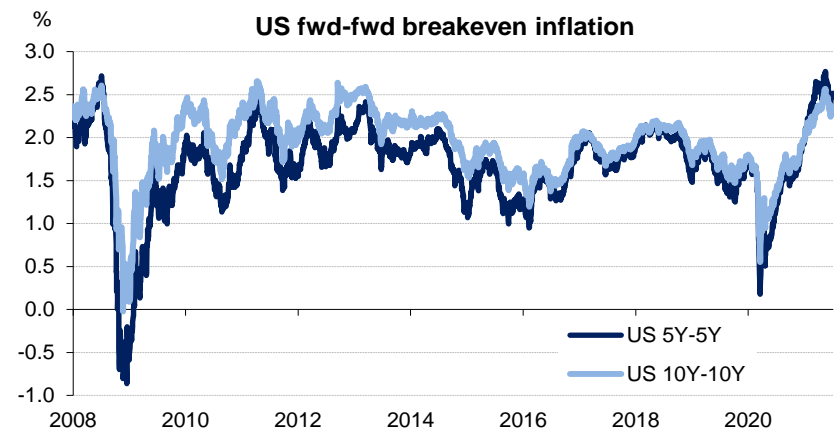
Longer delivery time reflected the bottle-neck



Surging energy prices fueled inflation



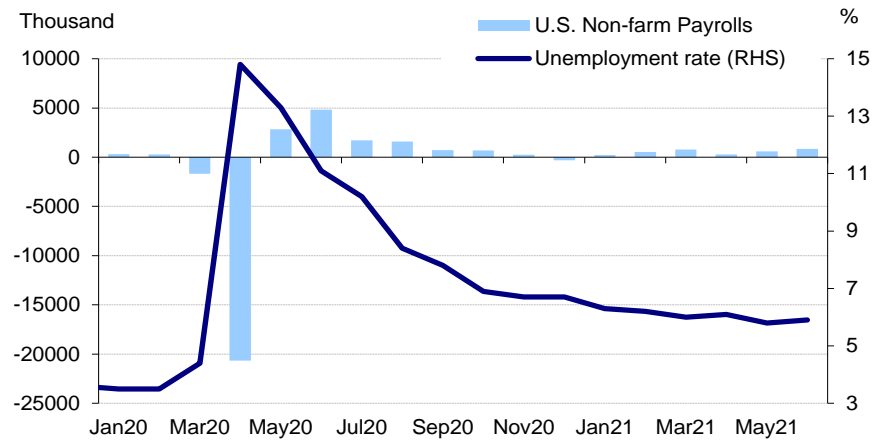
US inflation expectation eased as Fed turned hawkish



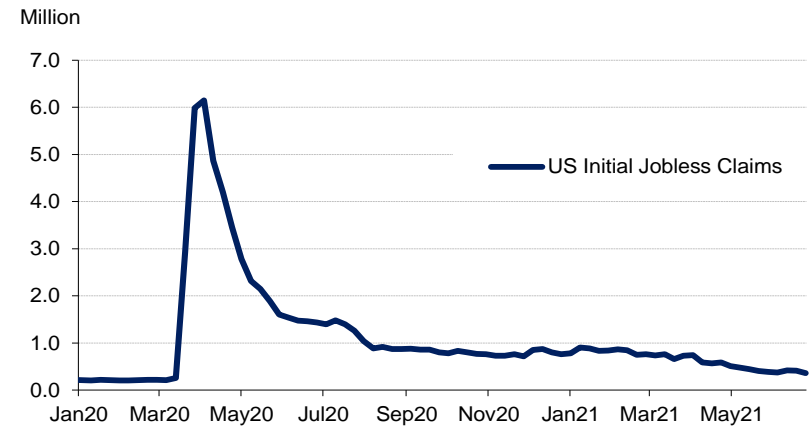
US Economy (2) – Labour market recovery

- US labour market recovery was underway but it will take time to recoup the employment loss since the pandemic outbreak. The government subsidy delayed the return of labour forces, and the labour shortage fueled salary growth

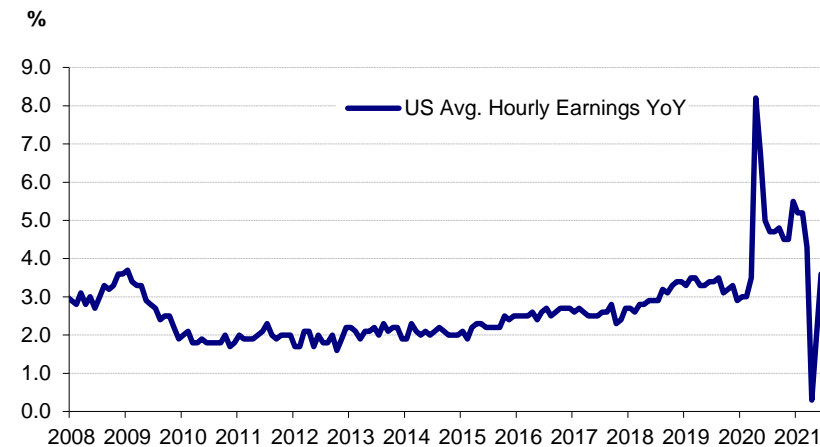
US labour market recovery at a gradual pace



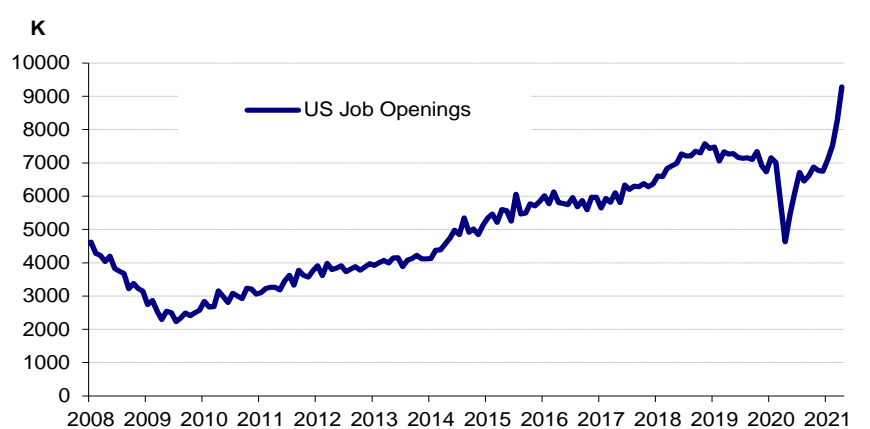
Jobless claims continued to fall



Upward pressure in salary growth



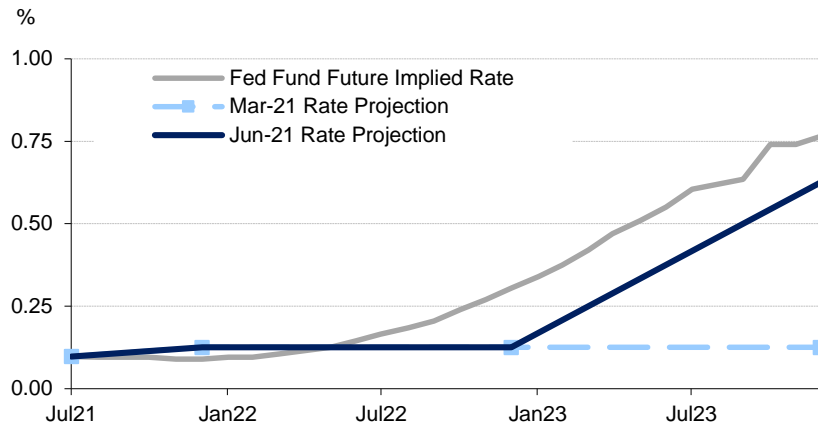
US job openings surged at the reopening



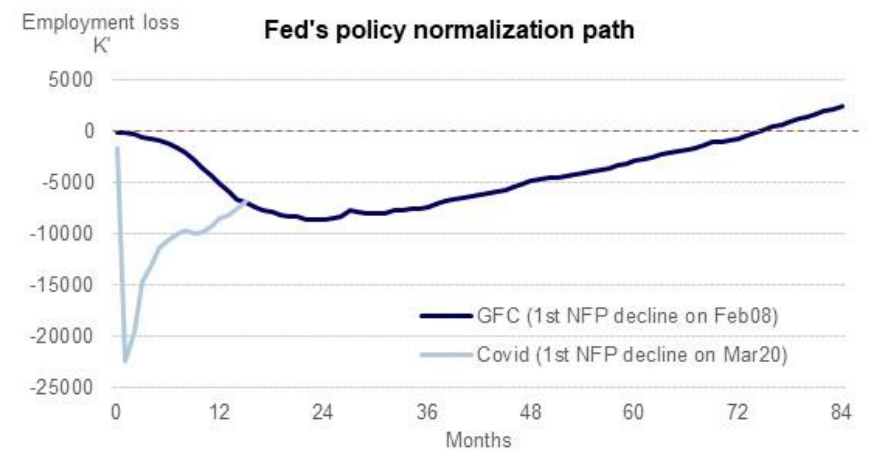
Fed – Hawkish shift

- The Fed delivered a hawkish shift surprisingly, projecting 2 rate hike by 2023-end. To drain excessive USD liquidity, the Fed also raised the Interest rate on Excess Reserves (IOER) by 5bps to 0.15%. Powell said they were talking about tapering at the meeting

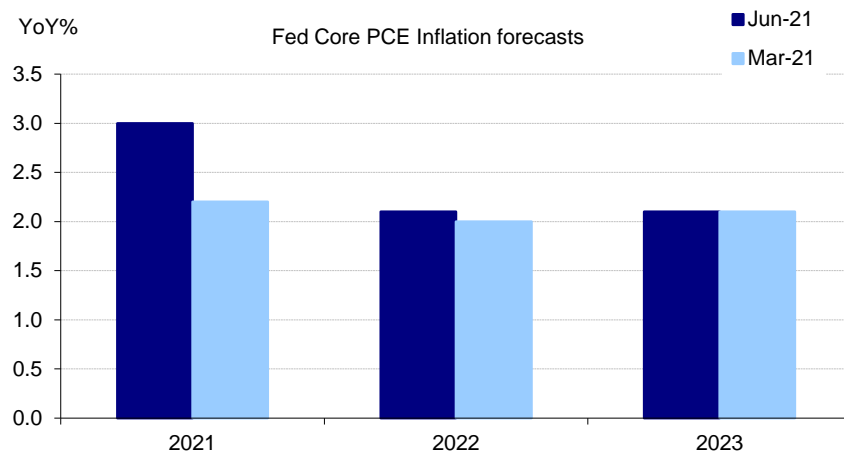
Fed projected 2 rate hike, catching up mkt pricing



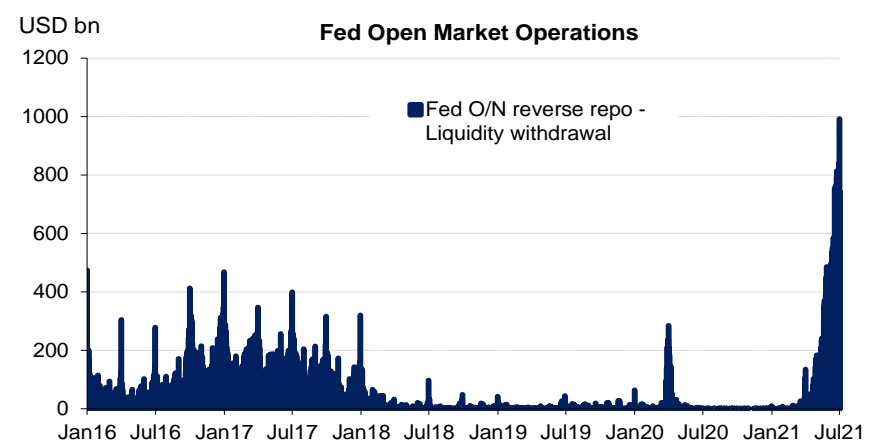
Fed's path to tapering on labour mkt recovery



Upgrade on core PCI, but inflation to stay transitory



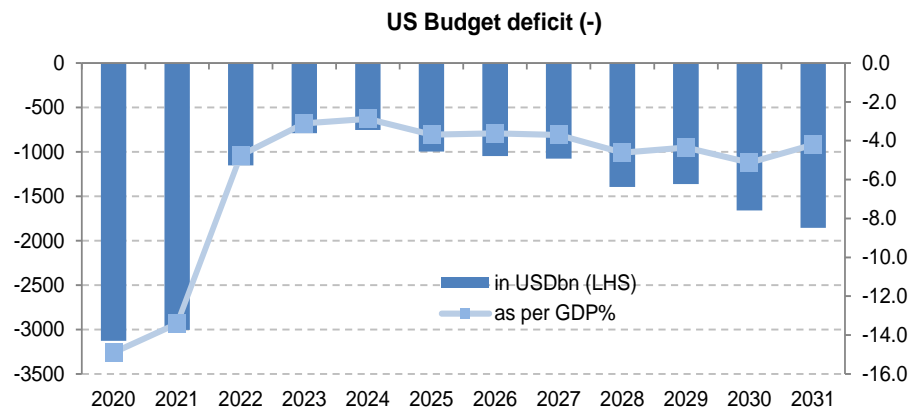
Fed's liquidity trap? Reverse Repo at record highs



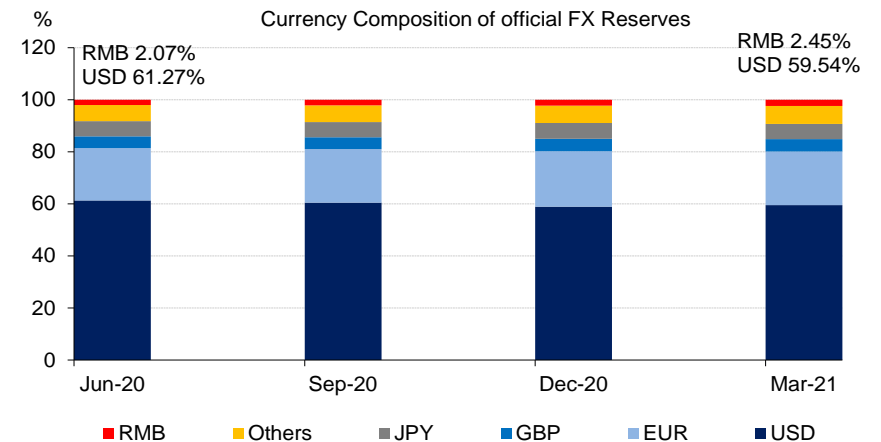
USD – Bottoming out

- As Fed began its tapering discussion lately, the repricing of Fed's tapering risk and the return of UST yields advantage could boost the USD. Encouragingly global central banks' USD sell-off paused while the deepening US budget deficit could keep the USD rally in check

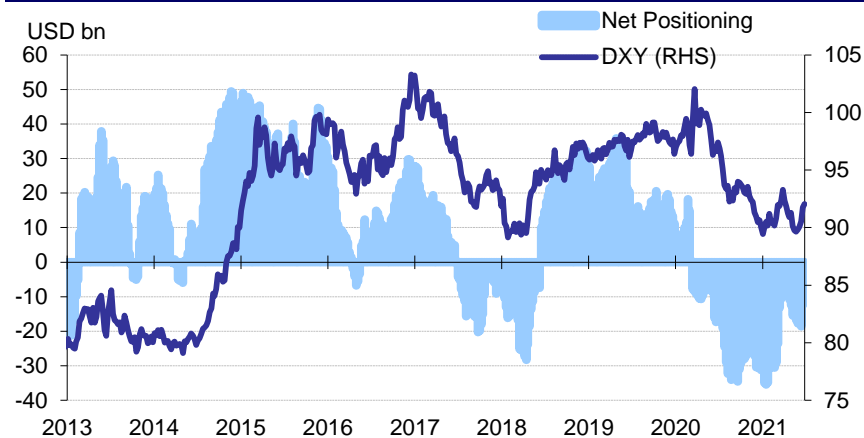
US budget deficit deepened after pandemic



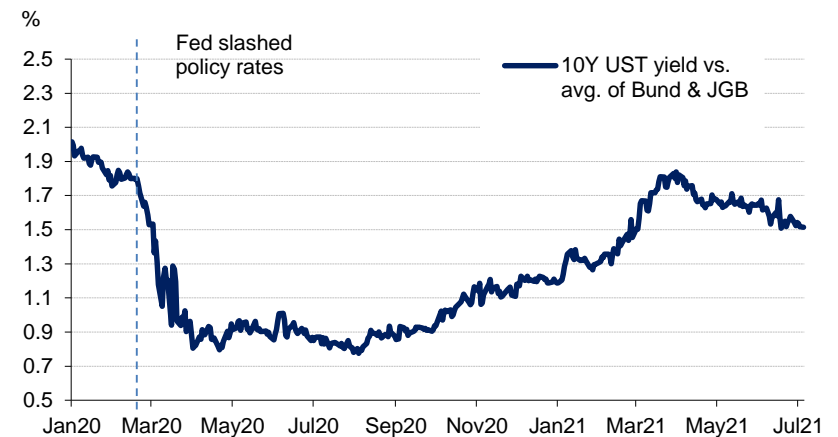
Central banks' USD sell-off paused



Speculative USD short positioning narrowed

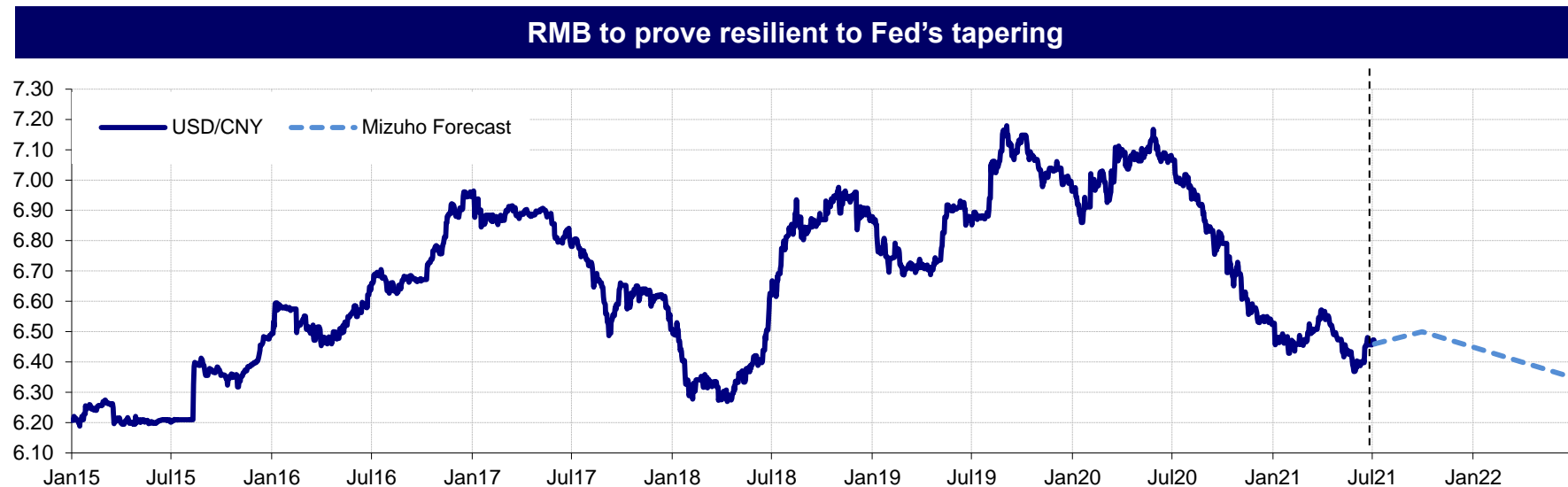


USD regained its yield advantage



RMB (1) – Resilient to Fed's tapering

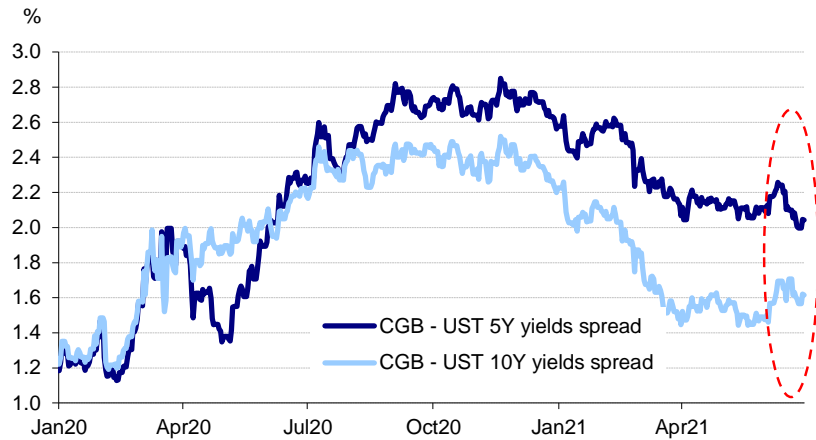
- The PBoC raised the FX Required Reserve Ratio (RRR) to 7% to curb one-way RMB expectation. The USD rebound after Fed's hawkish shift put the EM Asian currencies under pressure and RMB sentiment turned more neutral
 - **PBoC-Fed monetary divergence:** The Fed turned hawkish and the second round of tapering tantrum could put EM Asian currencies under pressure. However, the PBoC's steady monetary policy after the pandemic outbreak and lingering capital inflow should help defend the RMB from external shocks in H2-21
 - **PBoC's FX policy:** The PBoC took action to curb one-way RMB gains when the RMB basket index soared to its 5 year-high. As bullish RMB sentiment cooled down, the PBoC would stay aside in the near term
 - **China-US tensions:** US top officials in trade and finance in Biden's administration kicked off the conversation with China counter parts. Yet, room for improvement in China-US relationship remains limited



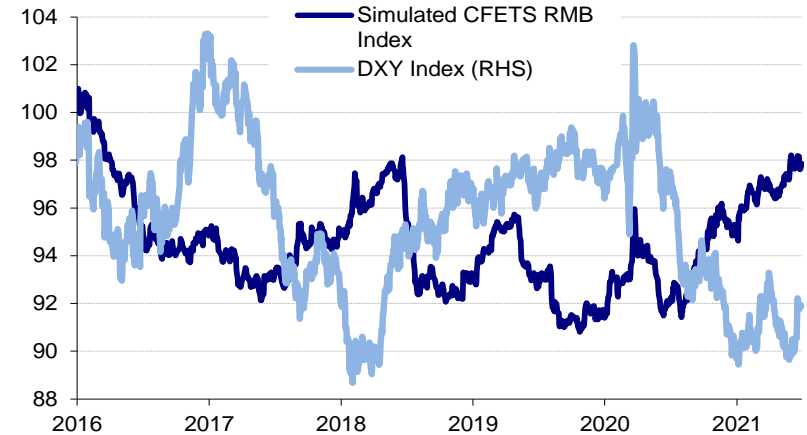
RMB (2) – Asset allocation capital inflow

- The USD rebound was negative to RMB, but RMB basket index stayed elevated on linger capital inflow. Long-term CGB-UST yield spread held up after Fed's hawkish shift

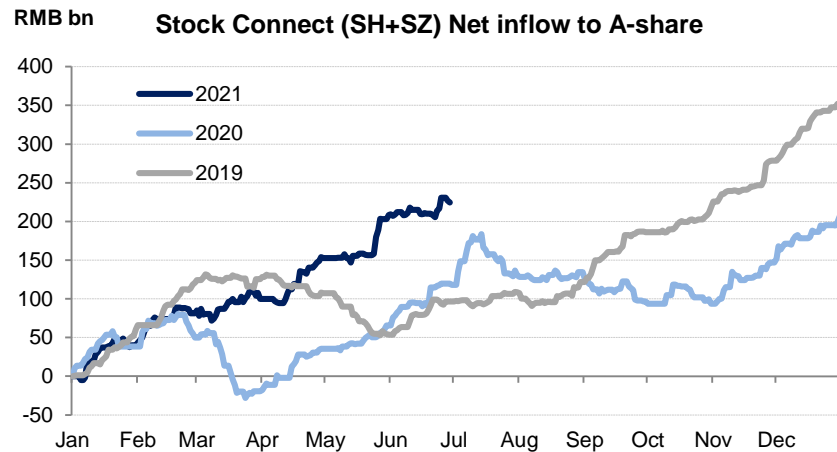
CGB-UST yield spread stabilized in back-end



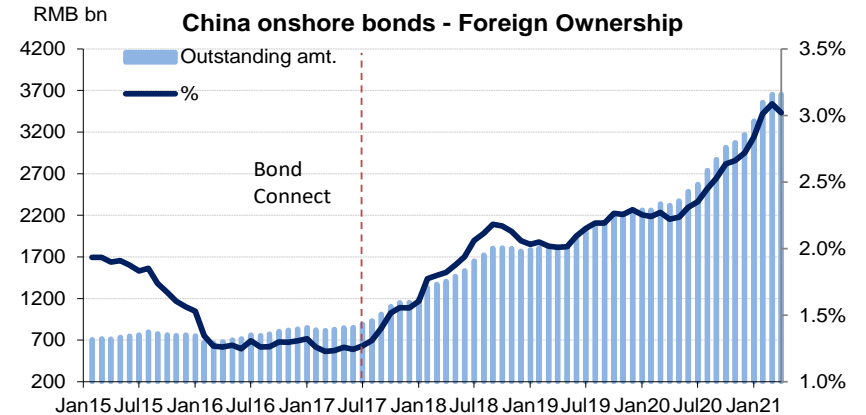
RMB Index elevated after USD rebound



Stock Connect flow to A-share market spiked



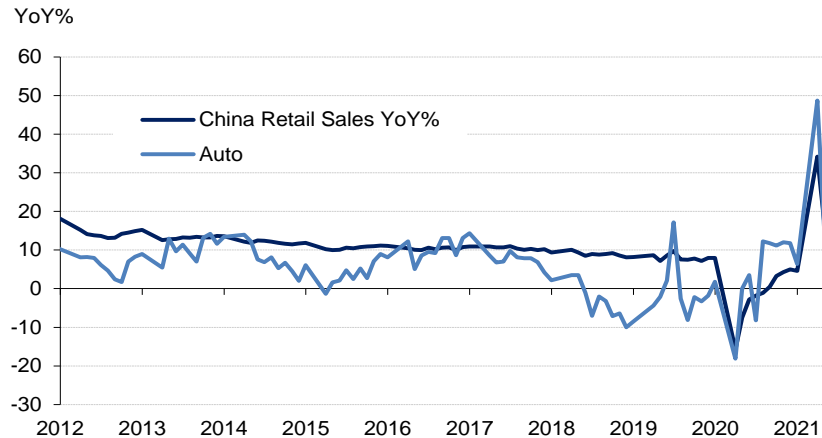
Foreign share in onshore bond climbed robustly



China economy (1) – Growth momentum slowing

- China growth momentum was moderating with fading base effect. Growth remained uneven with softer consumption, while rising production costs were dragging on industrial production. The slow local government bond issuances pace also restricted the fixed assets investment expansion

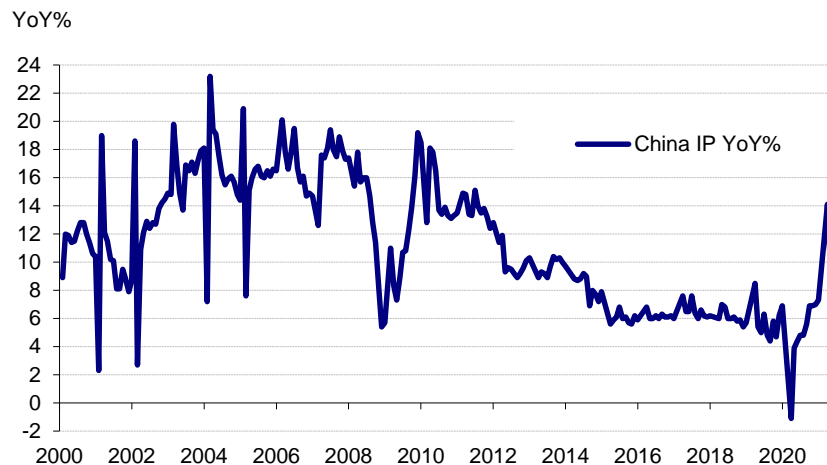
Consumption recovery lagging behind



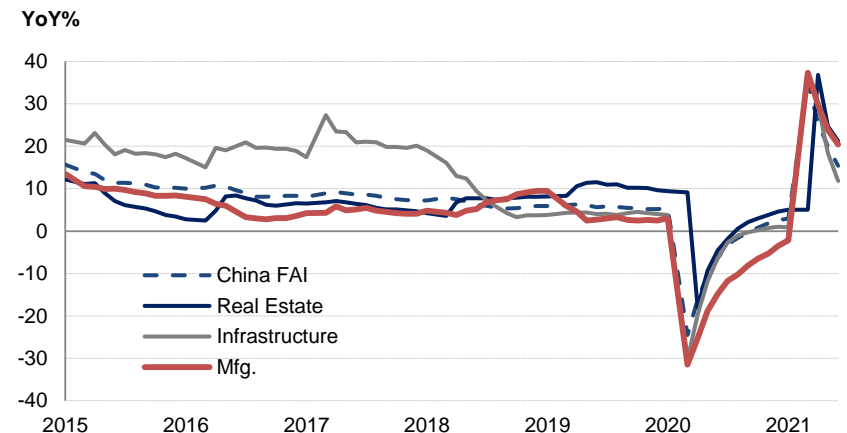
Online sales maintained high growth



Rising production costs dragged on IP



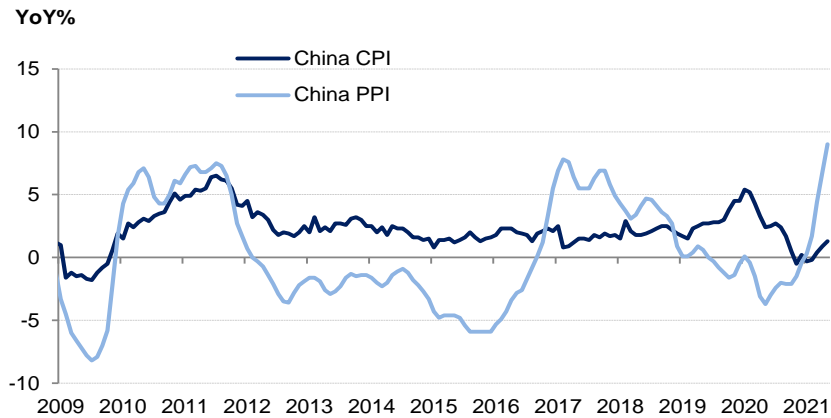
Soft FAI expansion on slow local govies issuance



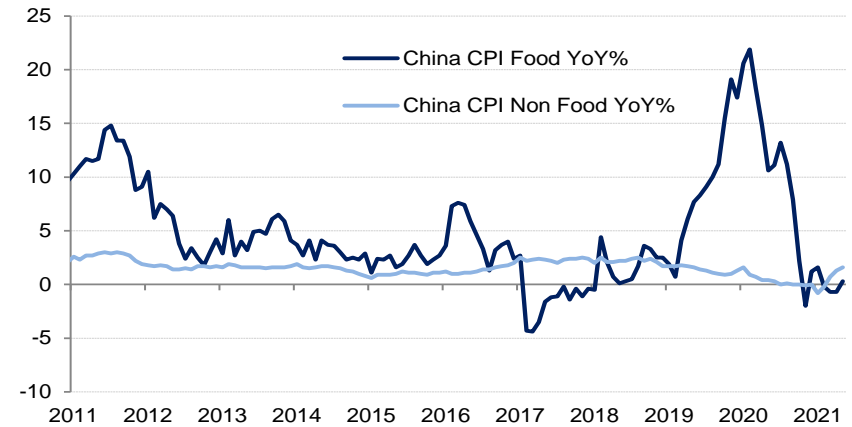
China economy (2) – Benign inflationary pressure

- China CPI pressure was anchored by falling pork prices, while PPI continued to soar. China PMIs stayed above 50 expansion mark. Non-mfg. PMI was elevated amid reopening

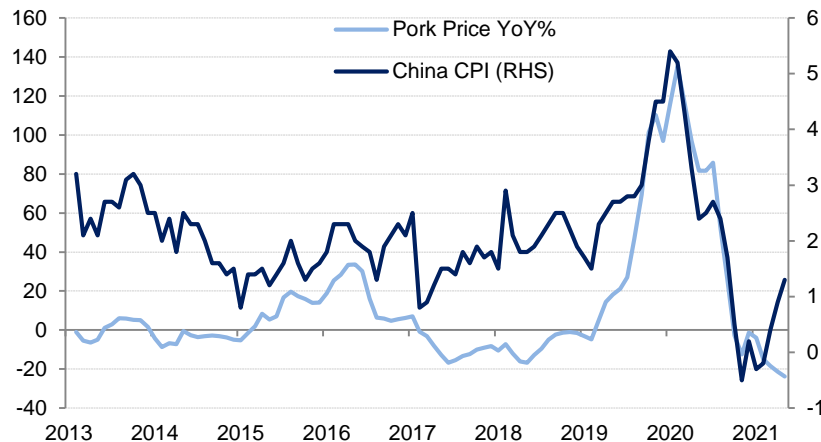
China CPI stayed benign, PPI jumped



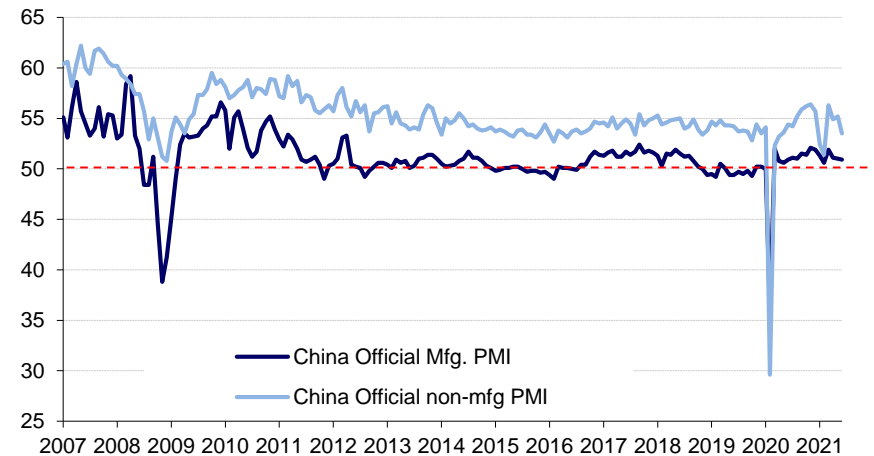
Non-food CPI picking up



Falling pork prices anchored CPI inflation



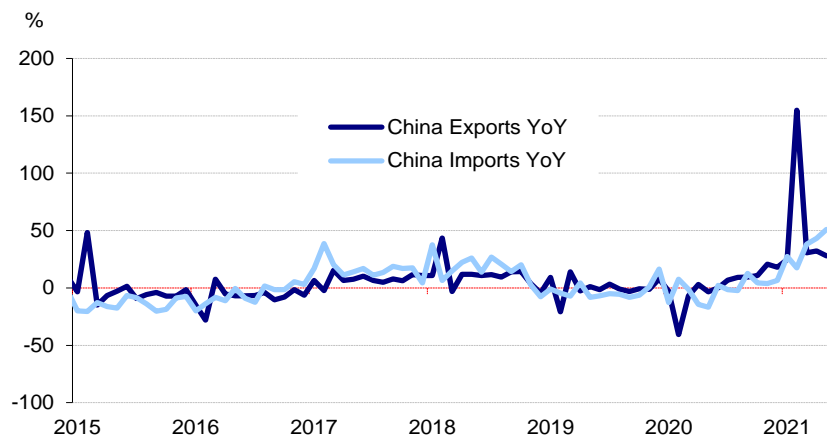
China PMIs softened but stayed above 50



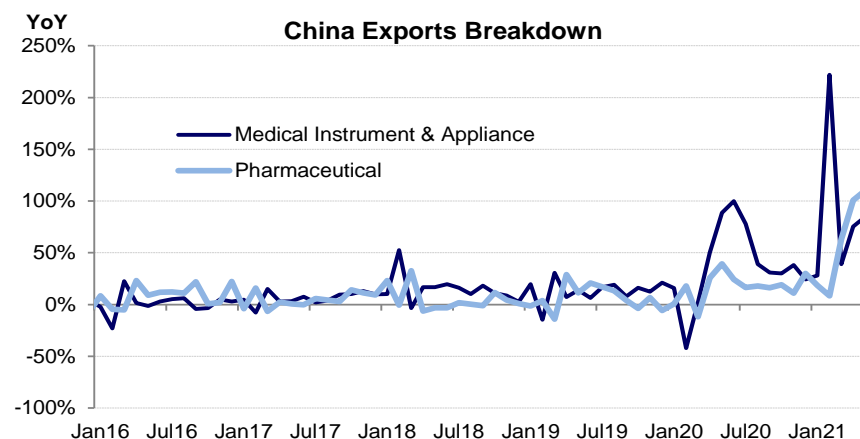
China economy (3) – RMB strength pressuring exports growth

- China exports growth momentum slowed on RMB strength. The supply-chain normalization will drive production back to Southeast Asia as virus spread eases. C/A deficit in service sector could expand again after border reopening

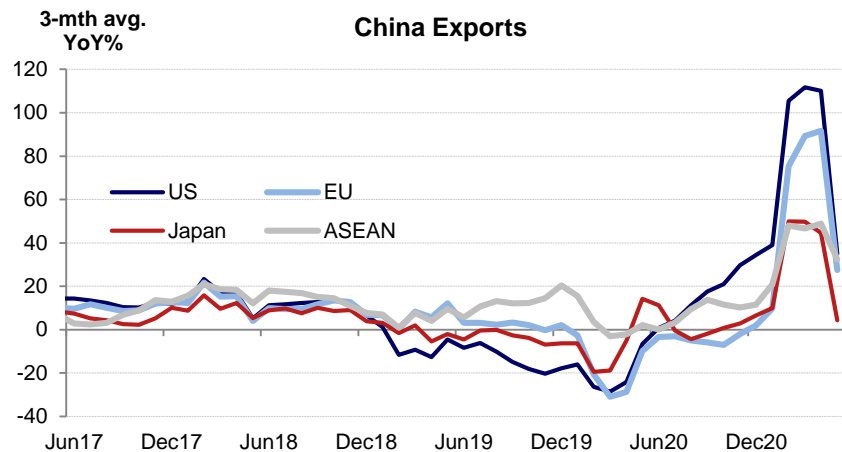
China exports momentum was softening



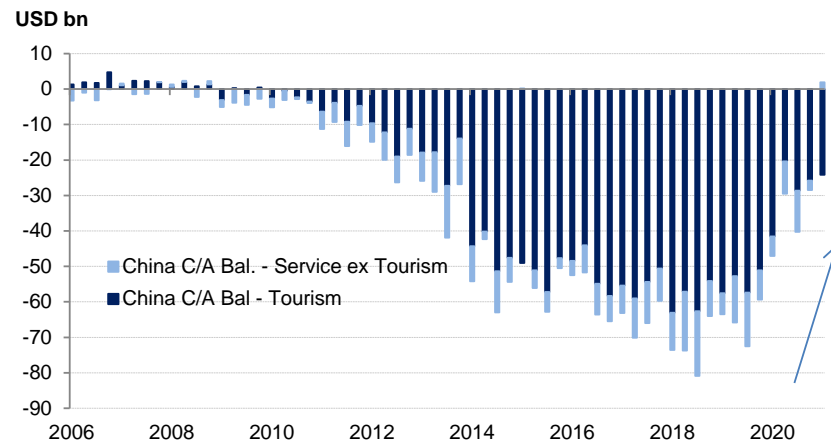
Medical exports con't to jump as virus unsettles



External demand retreated despite the reopening



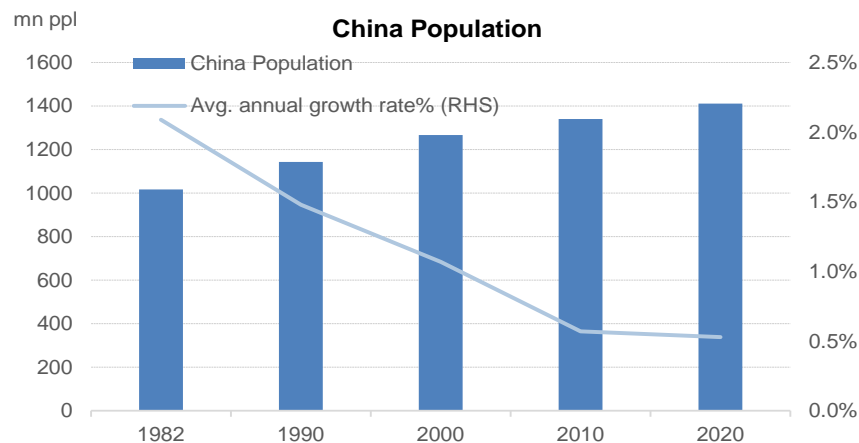
C/A service & tourism deficit to widen after reopening



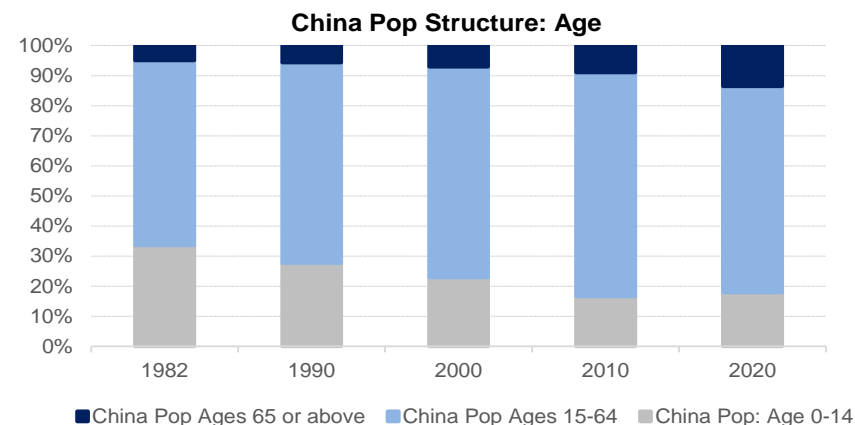
China census – Population structure problems to hinder its growth

- 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

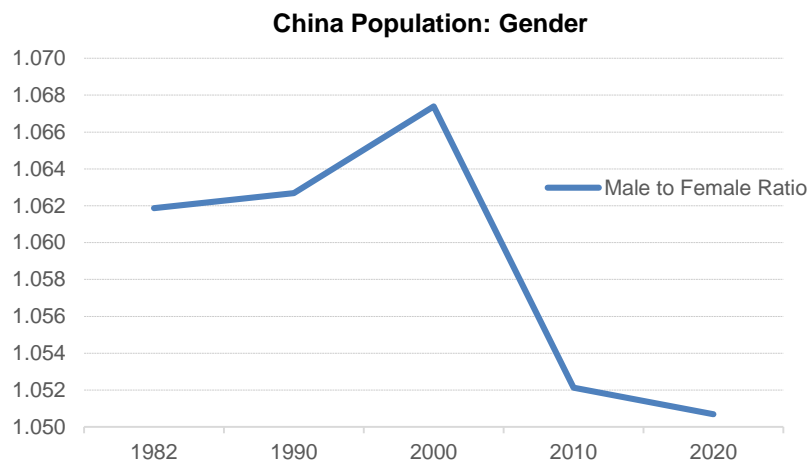
Slowing population growth



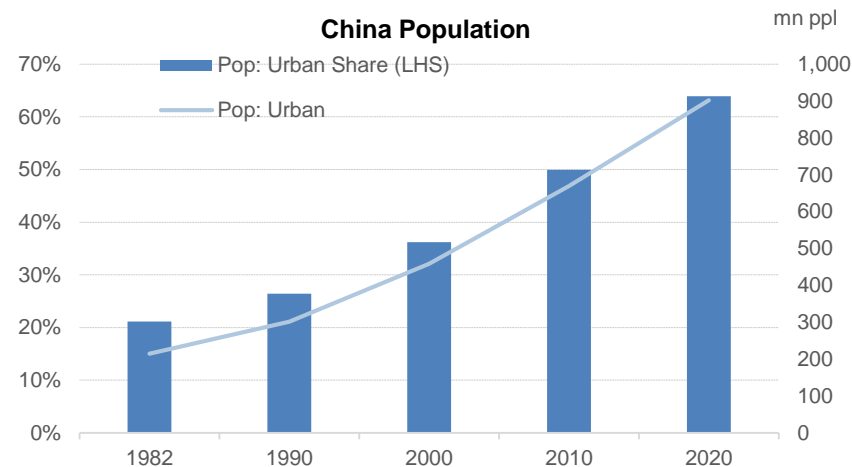
China: aging population



Gender imbalance more or less the same



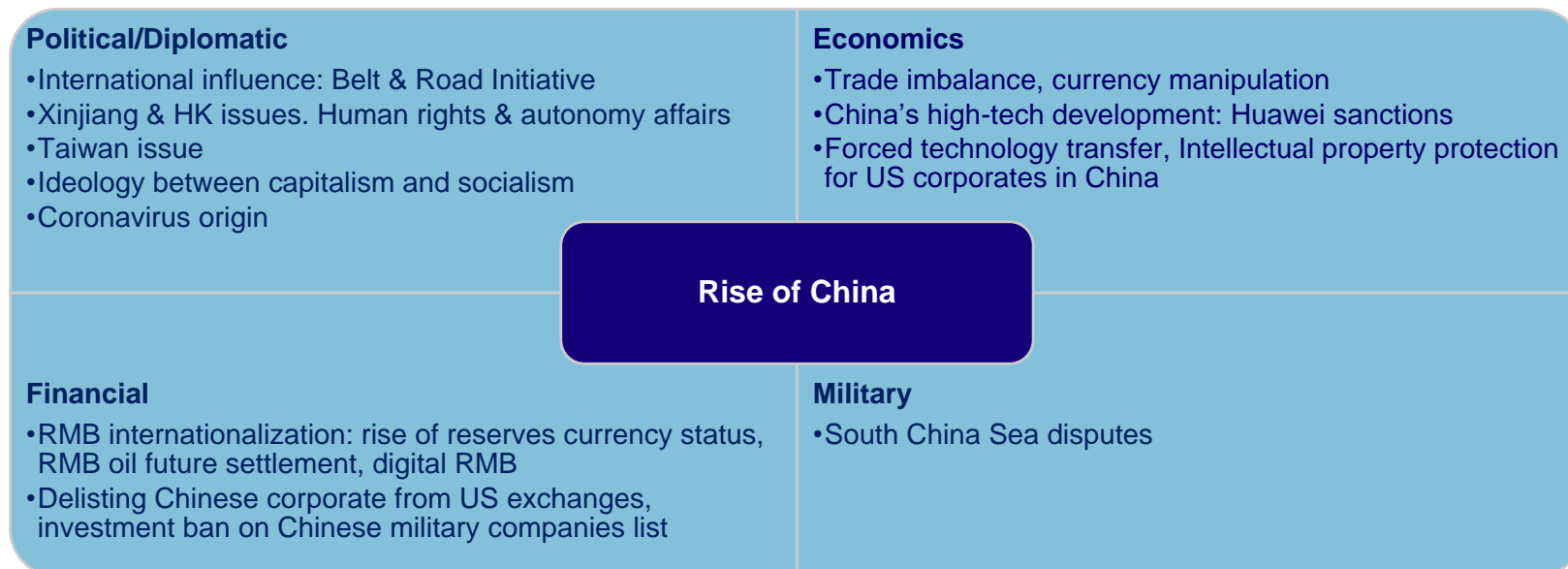
Urbanization to run its course?



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 retains Trump's hardline stance against China. The Biden's administration upholds the phase one deal and keeps tariffs unchanged. Furthermore, he expands the investment blacklist linking to China military and criticize China on HK, Taiwan and Xinjiang issues
- Fundamentally China and US share different ideologies. The hardline stance against China is the consensus in the US and China-US tensions are unlikely to reverse. Meanwhile, Biden's presidency signaled the return of multilateralism, and any coordinated sanctions against China would prove to be more threatening to China

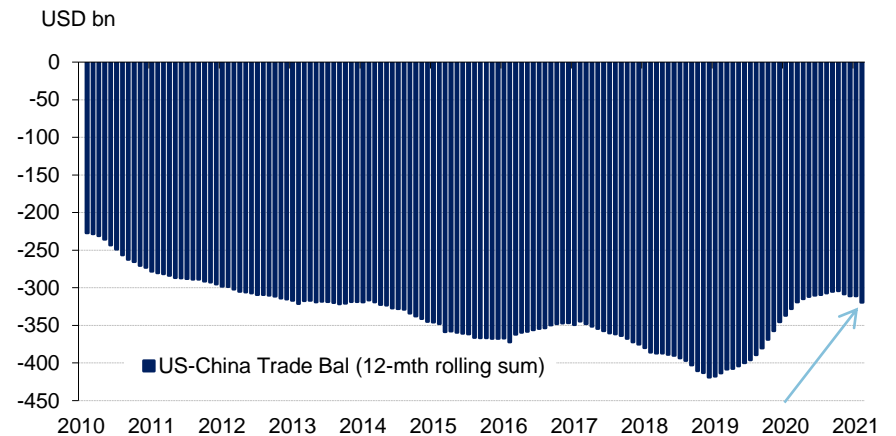


Phase one deal – To continue under Biden’s presidency

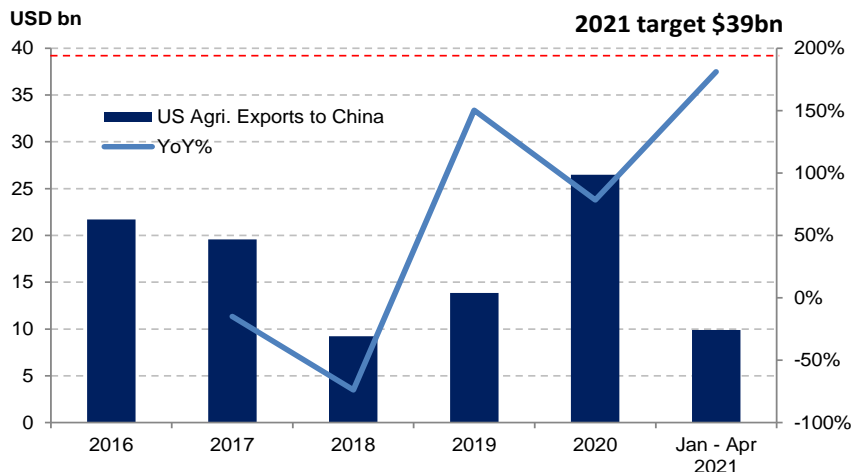
Top US officials in trade and finance held the first call with Chinese Vice Premier Liu He

- 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 Trade Representative and Secretary of Treasury held a first call under Biden’s presidency with Chinese Vice Premier Liu He. Despite more constructive atmosphere, making a progress in negotiations will take time

US trade deficit to China widening again



China purchase target for 21 more challenging



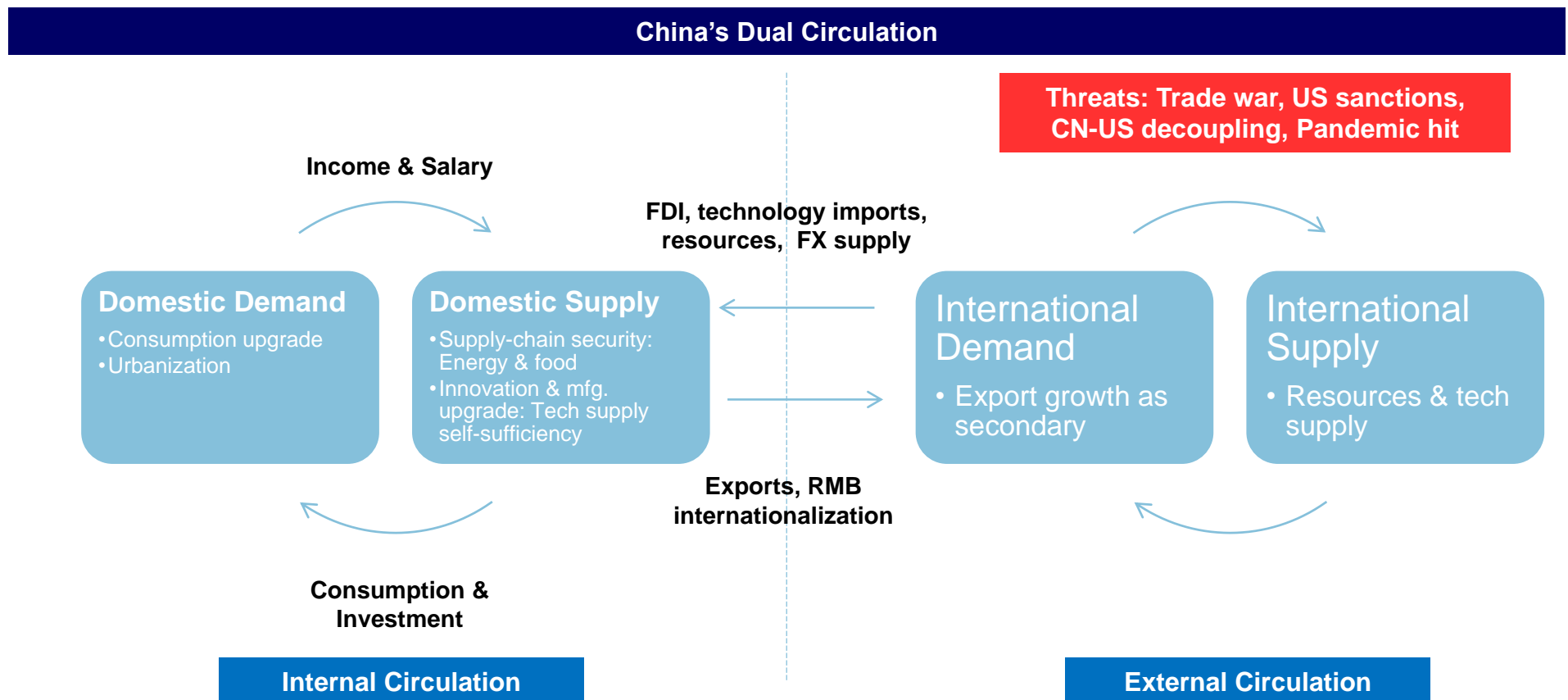
China’s shopping list

(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
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

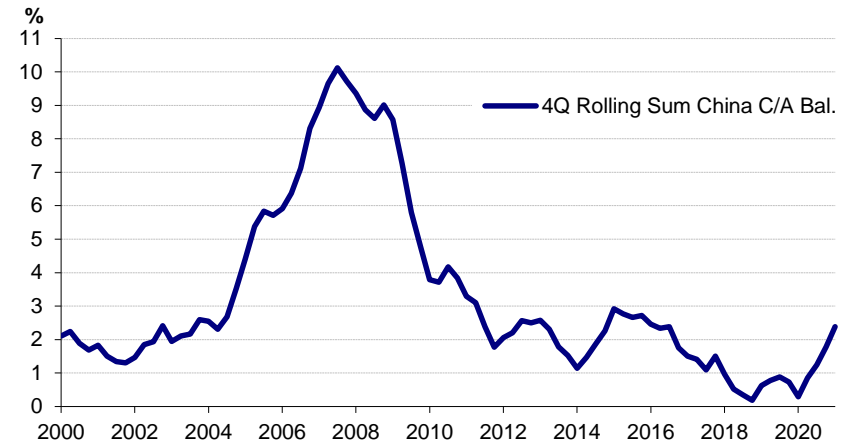


China Policy (2) – Dual circulation

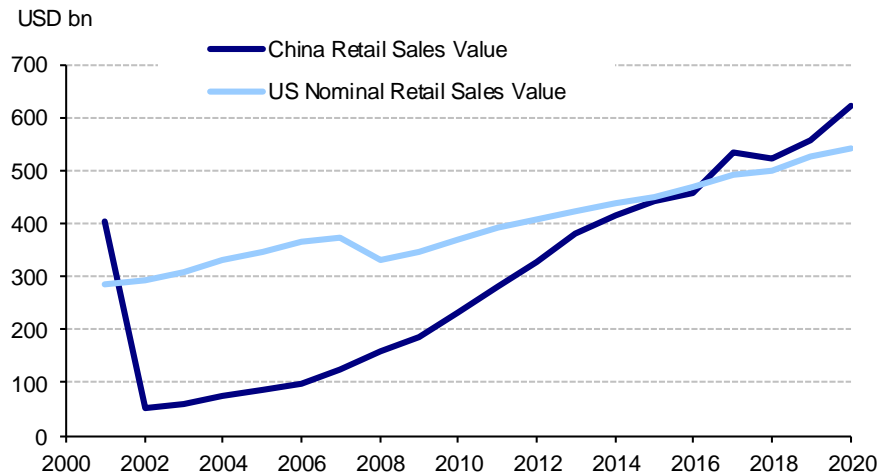
Less motivated to use weak RMB to stimulate growth

- 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

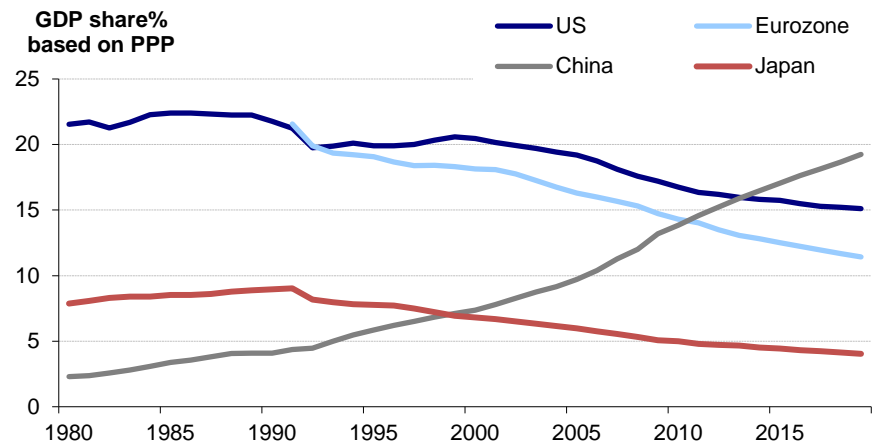
China C/A surplus shrank since 2007



China retail sales outstanding surpassed US



China's GDP share on PPP outsizing G3



PBoC Policy (1) – Curb RMB one-way appreciation

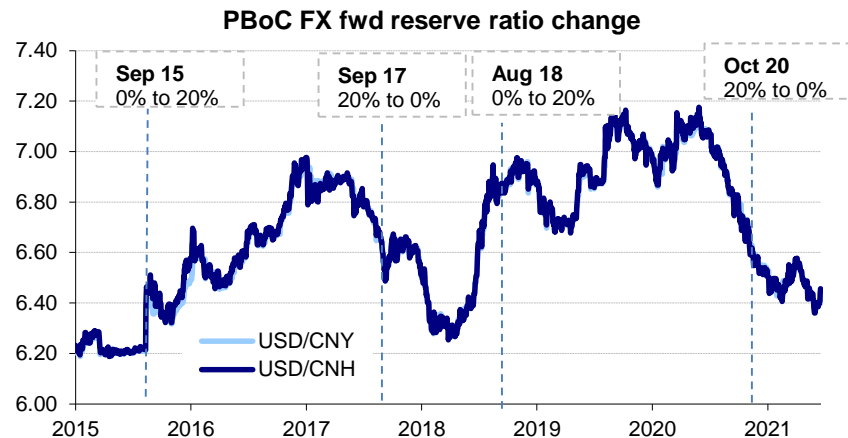
PBoC raised FX RRR for the 1st time since 2007

- The PBoC took action to curb the RMB gains by raising FX Required Reserve Ratio (RRR) to 7% from 5%. 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. Yet, the PBoC refrained from activating counter cyclical factor to anchor the RMB expectation
- The USD rebound after Fed's hawkish shift cooled RMB appreciation expectation further and the PBoC should stay on hold in the near term

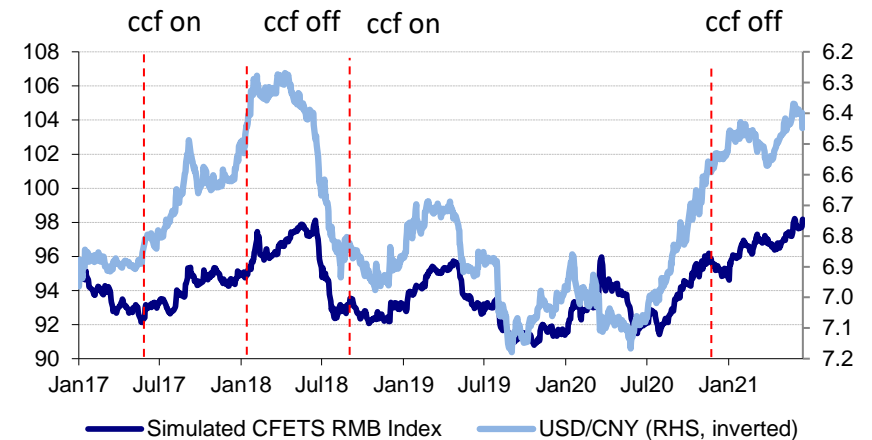
China expanded QDII quota



No change in FX risk reserves since 2020



PBoC refrained from activating ccf

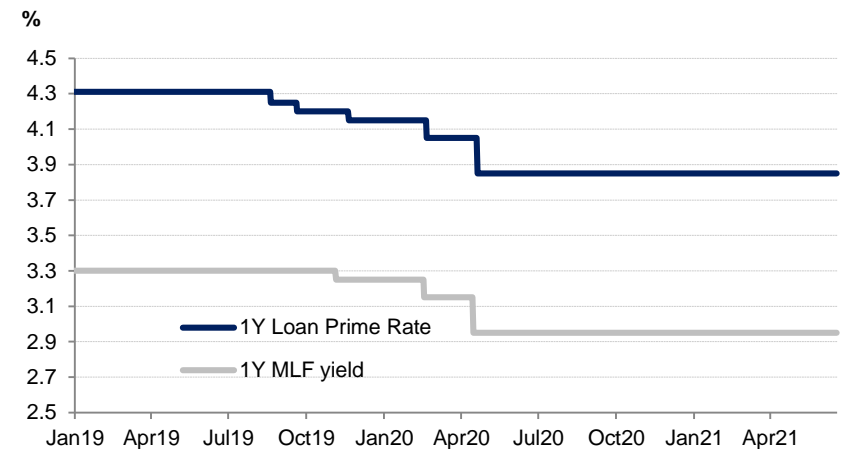


PBoC Policy (2) – No policy U-turn

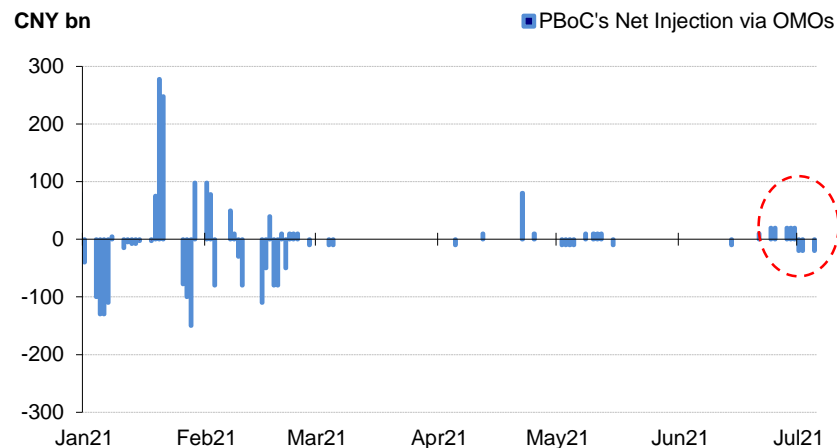
PBoC ramped up OMOs temporarily but policy stays prudent

- PBoC reiterated 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
- The PBoC ramped up its opened market operations but the liquidity injection unlikely indicated a dovish shift
- At PBoC MPC Q2 meeting, the central bank noted China economy is stabilizing and consolidating and would prevent the external shock

No change in policy rates since Apr 20



PBoC ramped up OMOs at quarter-end



PBoC targets stabilizing macro leverage ratio

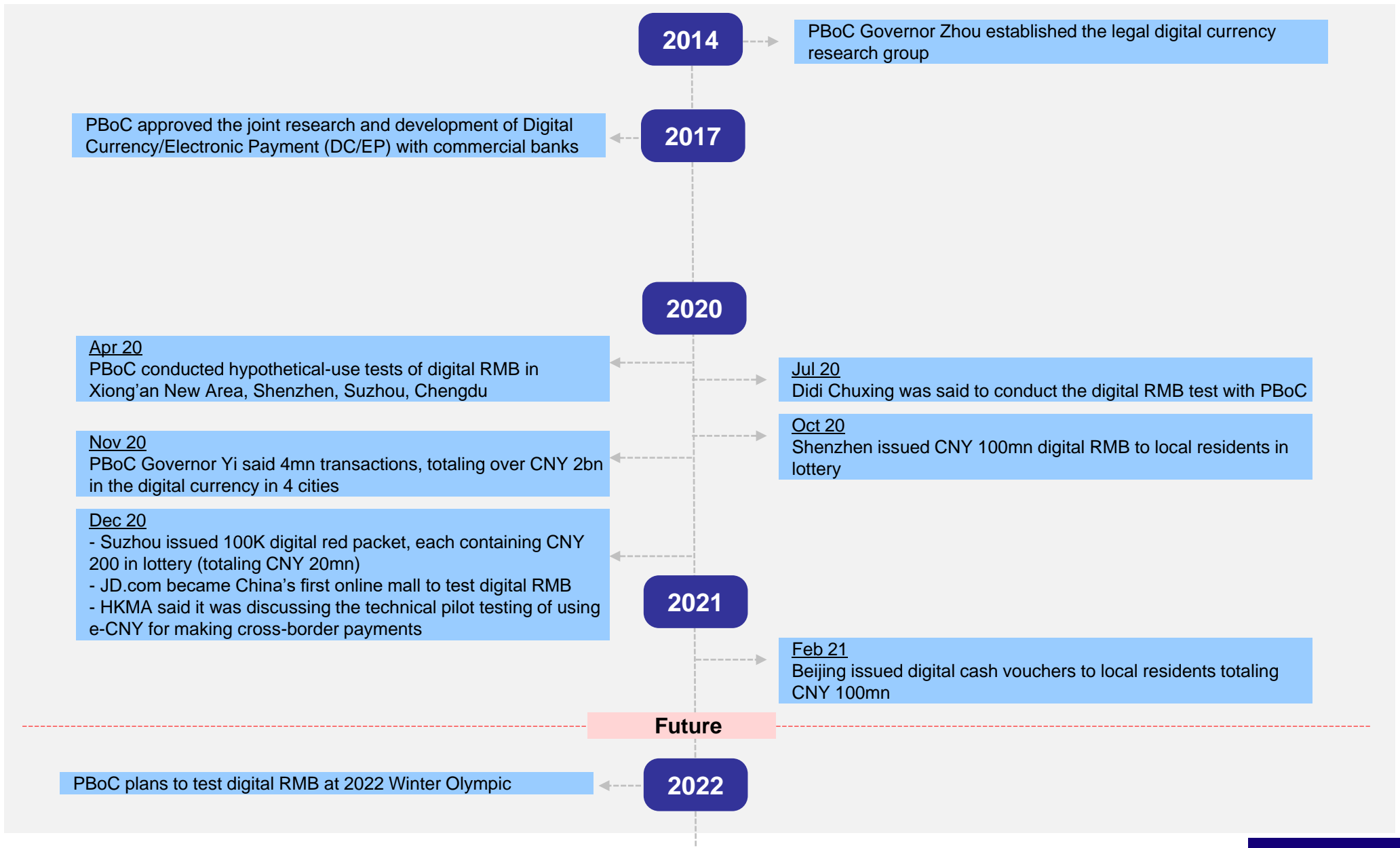


China's Digital RMB – e-CNY

- 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

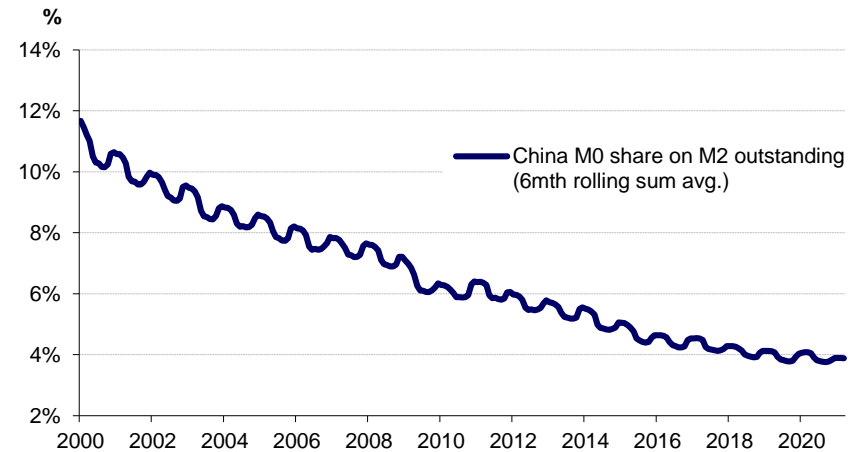
Payment method	e-CNY	Alipay/WeChat	Cash	Cryptocurrency
Anonymity	Limited	No	Yes	Yes
Offline payment	Yes	No	Yes	No
Issuer	Government	Private	Government	Private
Efficiency	High	High	Low	Low
Volatility	Low	Low	Low	High
Technology	Centralized/Blockchain	QR Code, network	N/A	Blockchain

e-CNY - FX implications

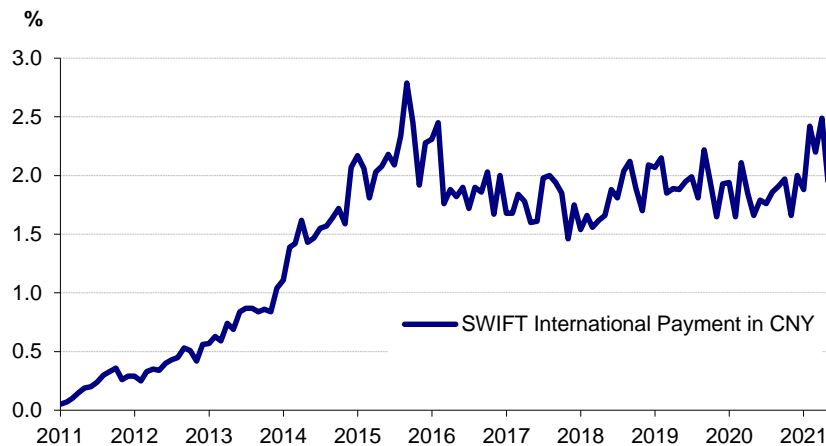
Limited in the near-term, positive in the medium term

- 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

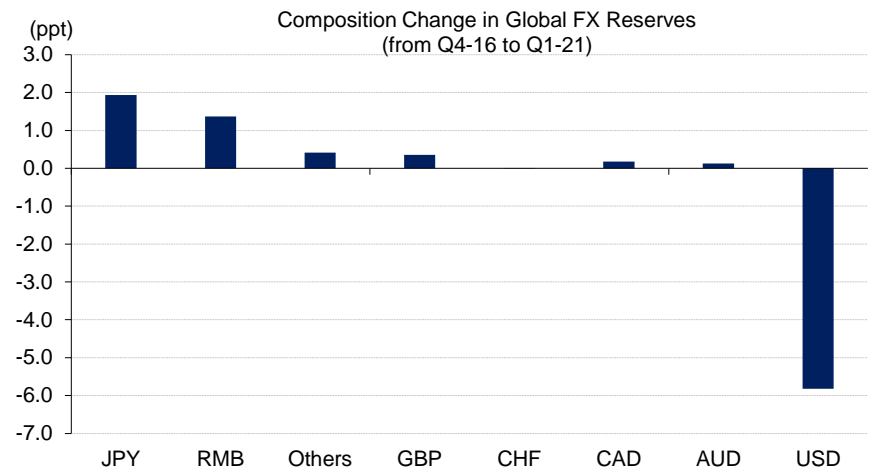
China moving towards cashless society



CNY global payment share moving sideways



RMB reserves share rose on USD share decline



Mizuho FX Forecasts

	2021			2022		
	Jan - Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep
USD/JPY	102.60 ~ 111.11 (110.58)	109 ~ 114 (112)	110 ~ 115 (113)	111 ~ 116 (114)	111 ~ 116 (114)	111 ~ 116 (115)
EUR/USD	1.1704 ~ 1.2349 (1.1900)	1.18 ~ 1.22 (1.19)	1.17 ~ 1.22 (1.18)	1.16 ~ 1.22 (1.18)	1.15 ~ 1.21 (1.17)	1.14 ~ 1.20 (1.16)
EUR/JPY	125.10 ~ 134.12 (131.59)	132 ~ 138 (133)	132 ~ 139 (133)	133 ~ 140 (135)	132 ~ 139 (133)	131 ~ 138 (133)

	2021			2022		
	Jan - Jun	Jul - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep
USD/CNY	6.3570 ~ 6.5793 (6.4625)	6.35 ~ 6.65 (6.50)	6.30 ~ 6.60 (6.45)	6.25 ~ 6.55 (6.40)	6.20 ~ 6.50 (6.35)	6.20 ~ 6.50 (6.35)
EUR/CNY	7.6801 ~ 8.0559 (7.7878)	7.49 ~ 8.11 (7.74)	7.37 ~ 8.05 (7.61)	7.25 ~ 7.99 (7.55)	7.13 ~ 7.87 (7.43)	7.07 ~ 7.80 (7.37)
CNY/JPY	15.731 ~ 17.286 (17.188)	16.39 ~ 17.95 (17.23)	16.67 ~ 18.25 (17.52)	16.95 ~ 18.56 (17.81)	17.08 ~ 18.71 (17.95)	17.08 ~ 18.71 (18.11)

Notes:

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

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