Mizuho Bank 2021 RMB Outlook
Steady but headwinds evolving

August 2021

East Asia Treasury Department, Treasury Marketing Section

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Global – Delta variant spread

- Market started to price in the risk of Delta variant spread, which could undermine vaccination efforts and bring back the lockdowns. The sinking 10Y UST yield to near1.2% highlighted the stagflation risk in the long term
- The Fed had taken their "first deep dive" into the tapering package but did not come up with the timing. The Delta variant spread could delay the Fed's tapering as the US economy is still far way off from achieving further substantial progress in its employment goal
- US inflation shot up to its decade high of +5.4%YoY, while the Fed reiterated its view of transitory inflation
- The PBoC surprisingly delivered a broad-based RRR cut, opening door for further easing in H2. While China Q2 data remained robust, the re-pricing of China regulation risk prompted foreign investors to offload Chinese investment

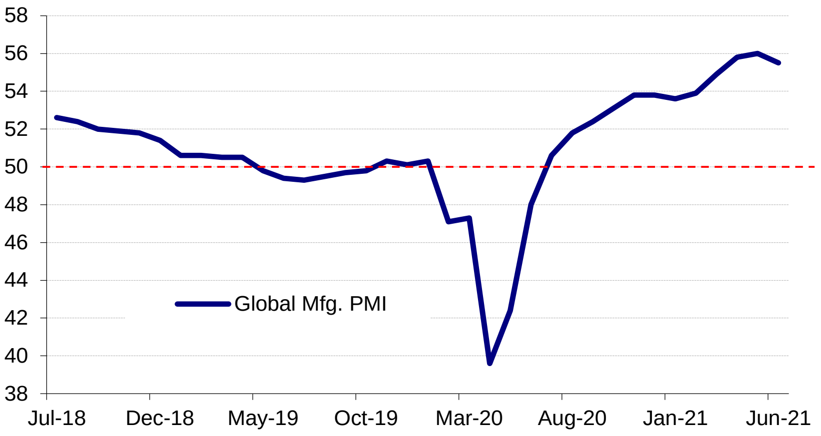
Date	Key Events for 2021
Aug	26-28 (**US)** Jackson Hole Symposium
Sep	23 **(US)** FOMC meeting
Oct	22 (**JP)** General election
Nov	4 **(US)** FOMC meeting
Dec	16 **(US)** FOMC meeting
Others	Vaccinations vs. Delta variant, US debt ceiling

Global – Stagflation risk

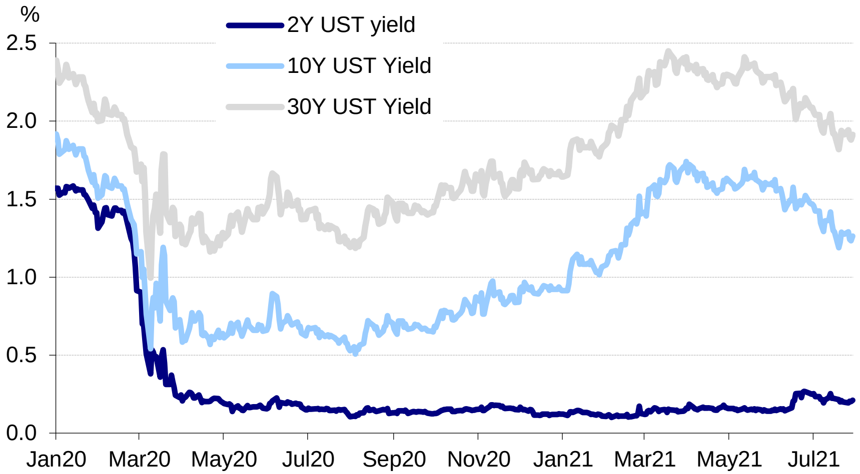
- Despite the Fed's hawkish shift, back-end UST yields continued to sink and the negative real yield pointed to the stagflation risk in the long term. After all, US equities extended their gains to record highs

Safe-haven demand propelling the USD

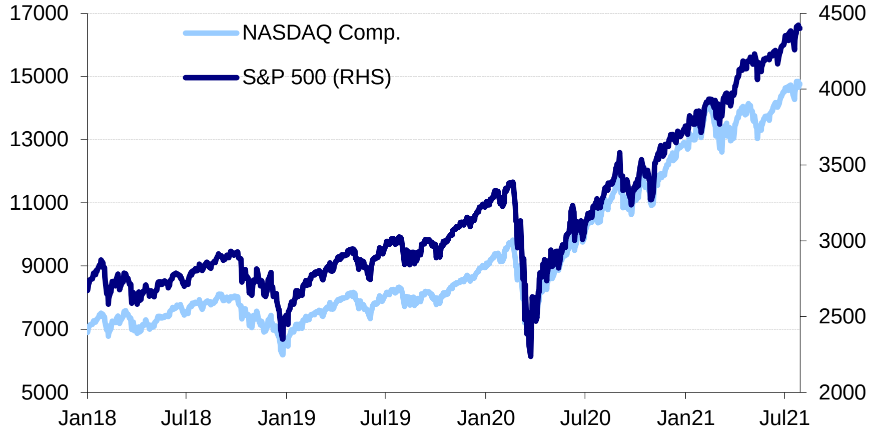
Global recovery momentum stalling



Back-end UST yield sank, stagflation coming?



US equities extended gains to record highs

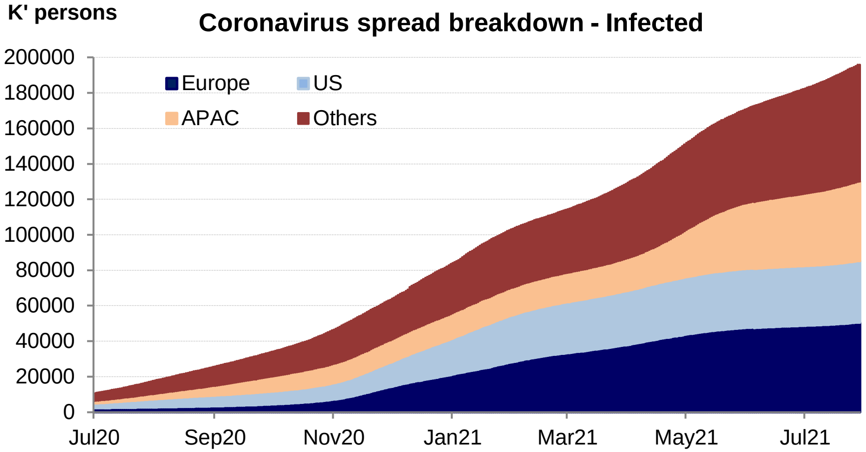


(Source: Bloomberg, Mizuho HK)

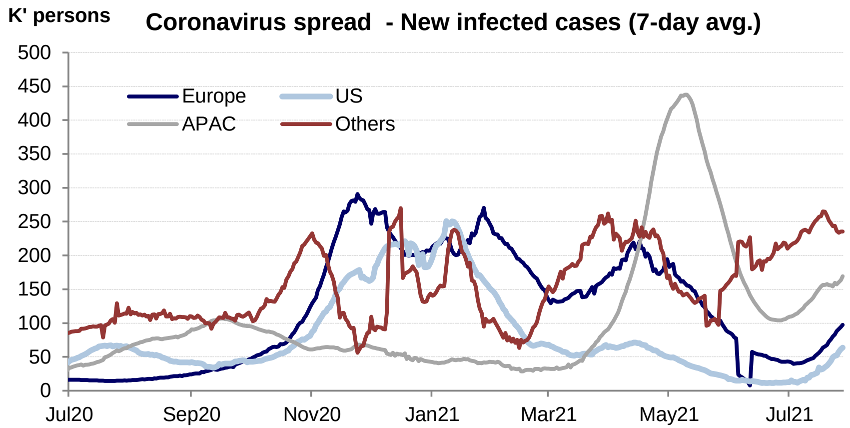
Virus – New wave of Delta variant

- Global infected cases climbed to near 200mn, with death tolls topping near 4.0mn. With herd immunity, the UK lifted all of its social distancing restrictions. Global cases picked up amid the wave of Delta variant

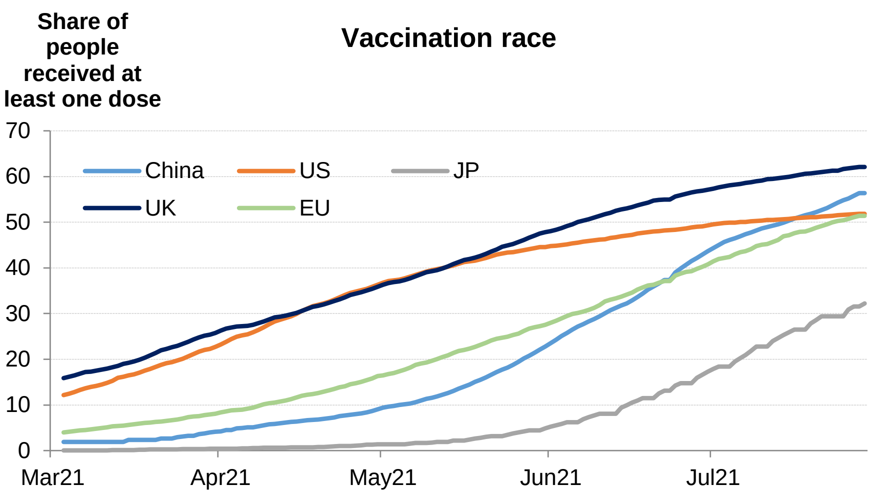
Near 200mn infected cases globally



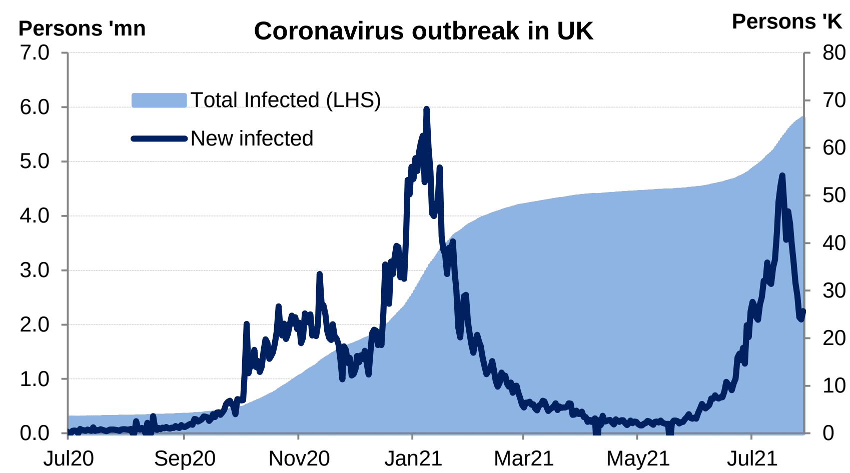
Infected cases picked up on Delta variant spread



UK reached herd immunity



UK new infected case fell after re-opening

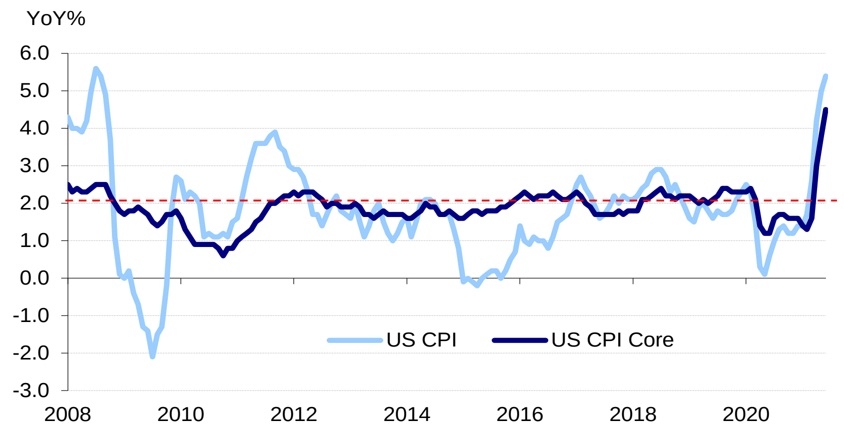


(Source: Bloomberg, Mizuho HK)

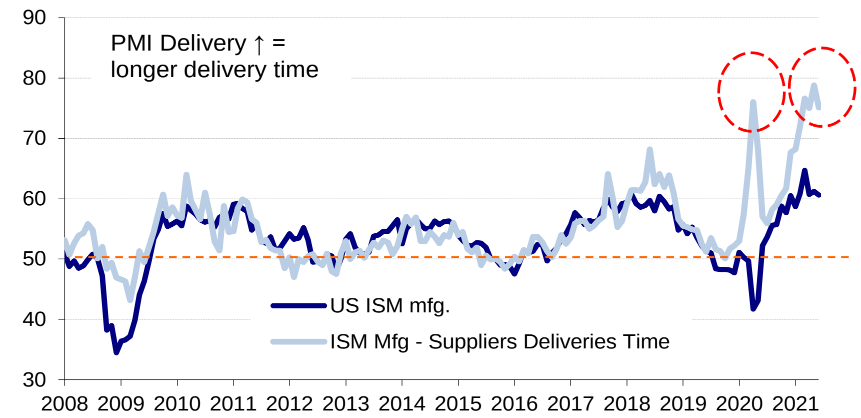
US Economy (1) – Inflation to be transitory or persistent?

- US inflation hit its 13-year high of 5.4%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

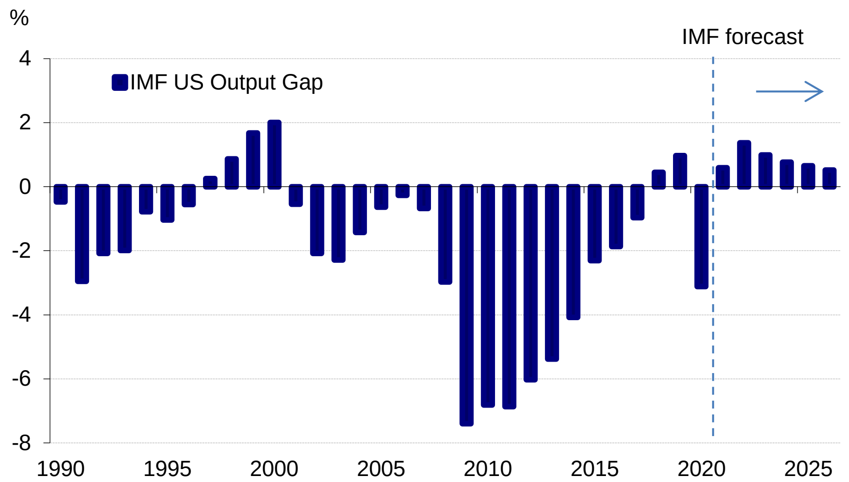
Soaring PPI pulling up CPI



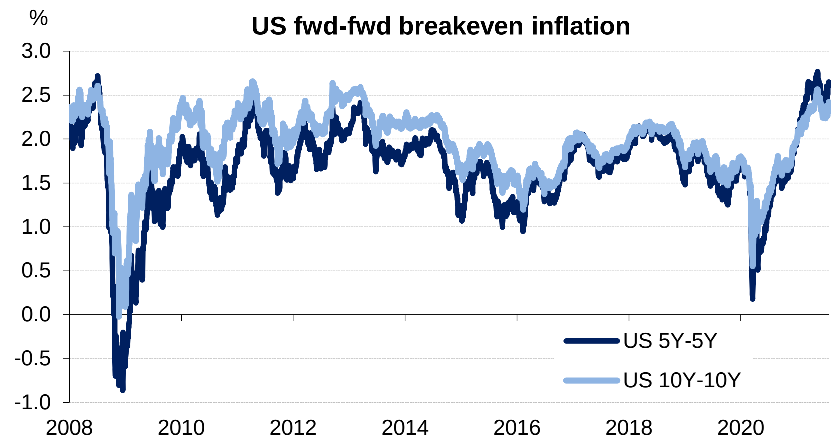
Longer delivery time reflected the bottle-neck



Positive output gap reflected inflationary pressure



US inflation expectation eased as Fed turned hawkish

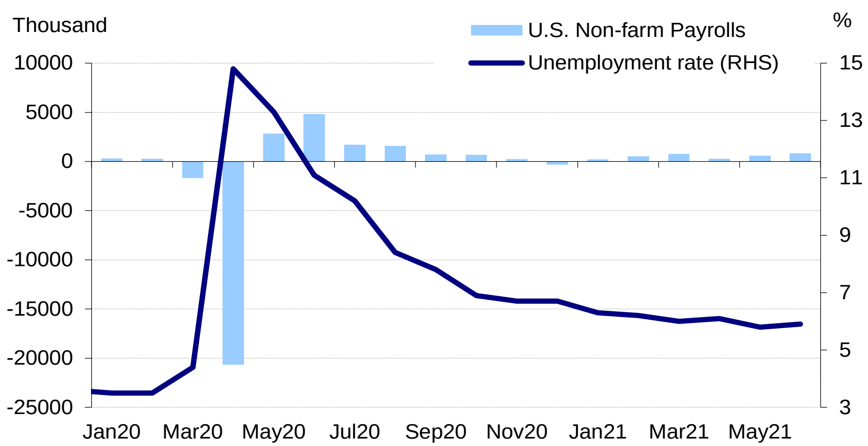


(Source: Bloomberg, Mizuho HK)

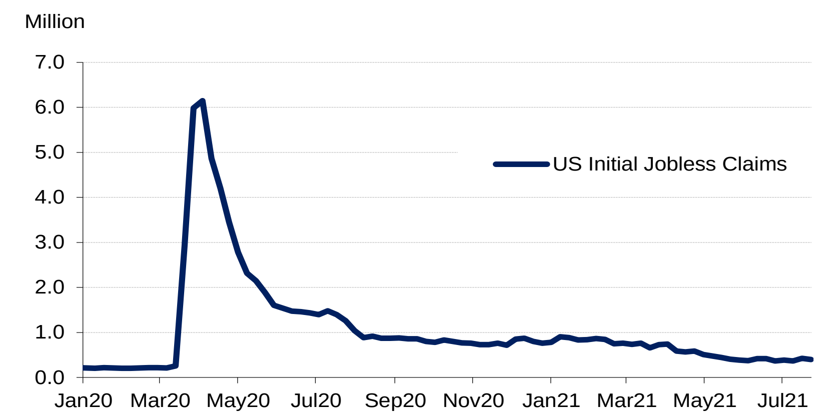
US Economy (2) – Labour market recovery

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

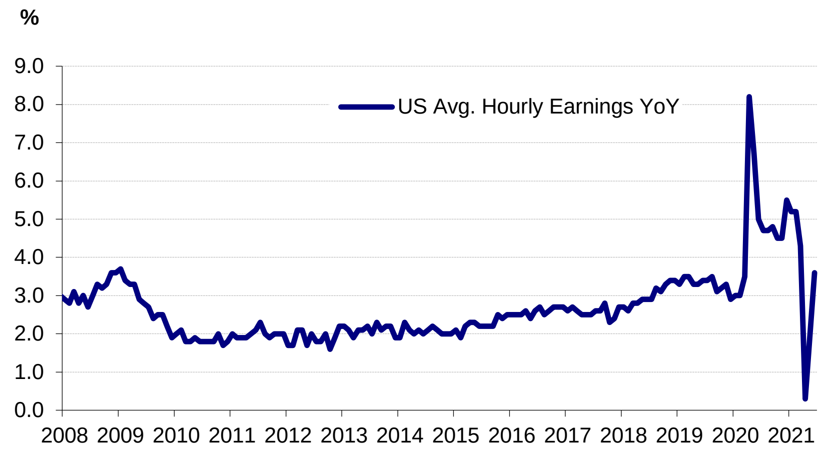
US labour market recovery at a gradual pace



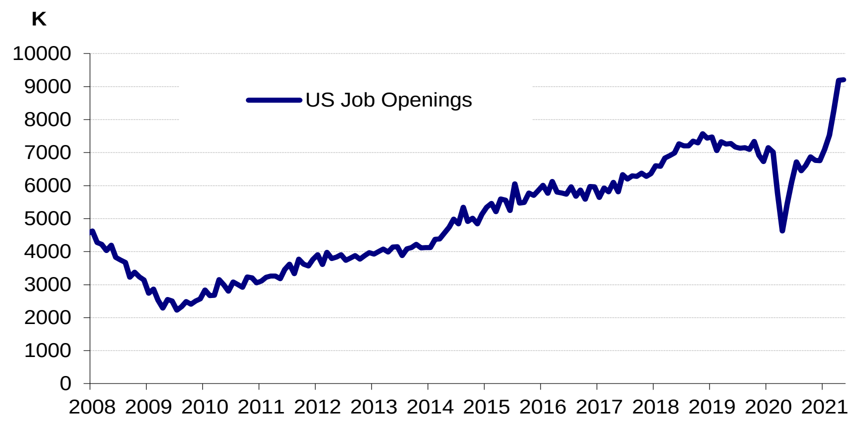
Initial jobless claims stopped falling



Upward pressure in salary growth



US job openings surged at the reopening

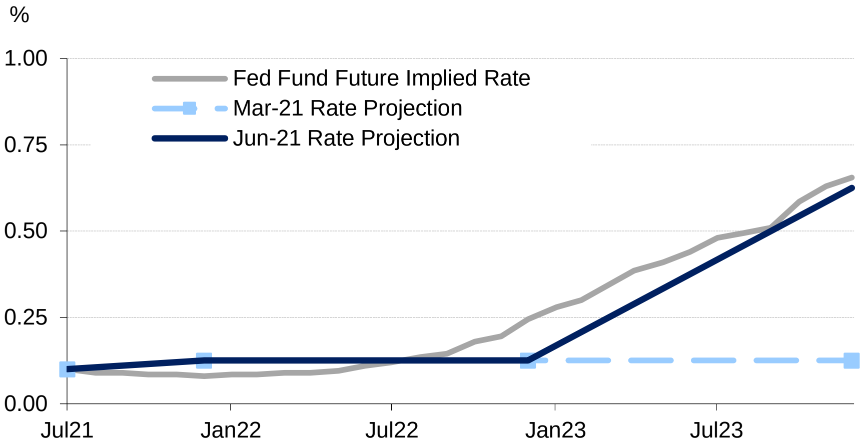


(Source: Bloomberg, Mizuho HK)

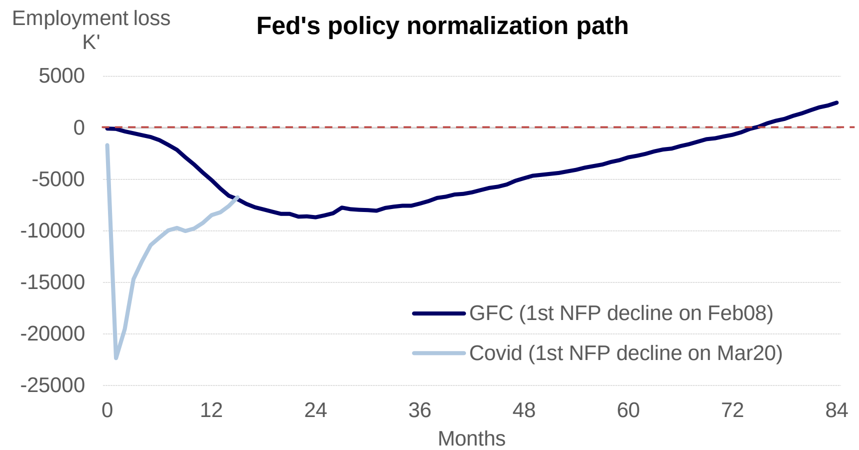
Fed – Dovish bias after hawkish shift

- Fed began to discuss details on the tapering package but no time frame has been fixed. Fed chair Powell reiterated his view of transitory inflation and it was still way from making substantial further progress towards the employment goal. The delta variant spread could postpone the tapering plan

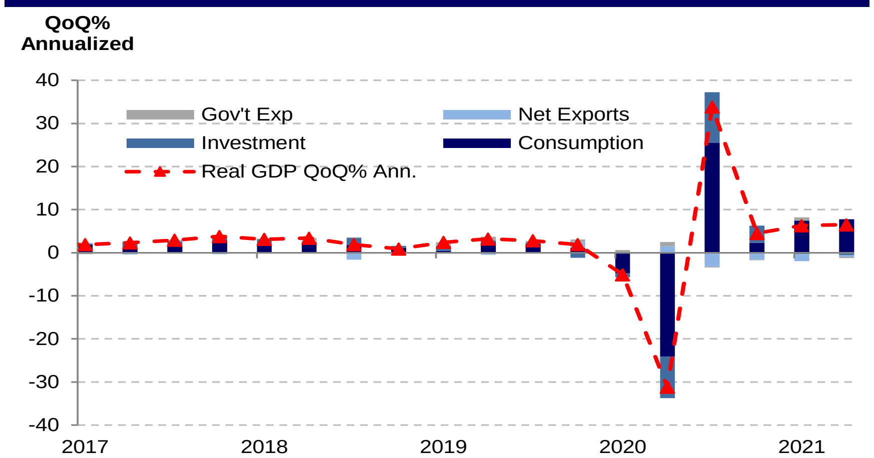
Fed projected 2 rate hike, catching up mkt pricing



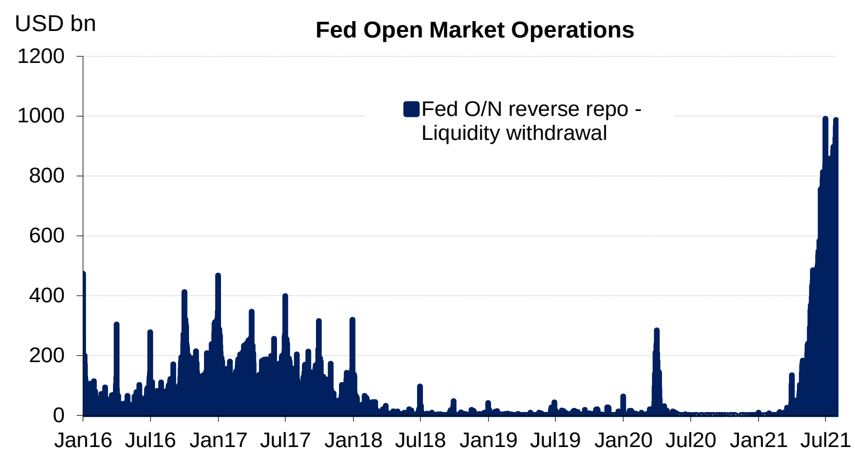
Fed's path to tapering on labour mkt recovery



US Q2 GDP growth less strong than expected



Fed's liquidity trap? Reverse Repo at record highs

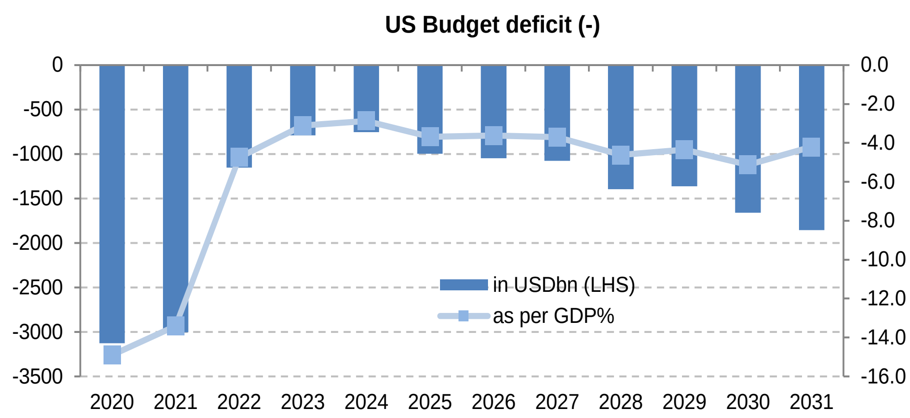


(Source: Bloomberg, Mizuho HK)

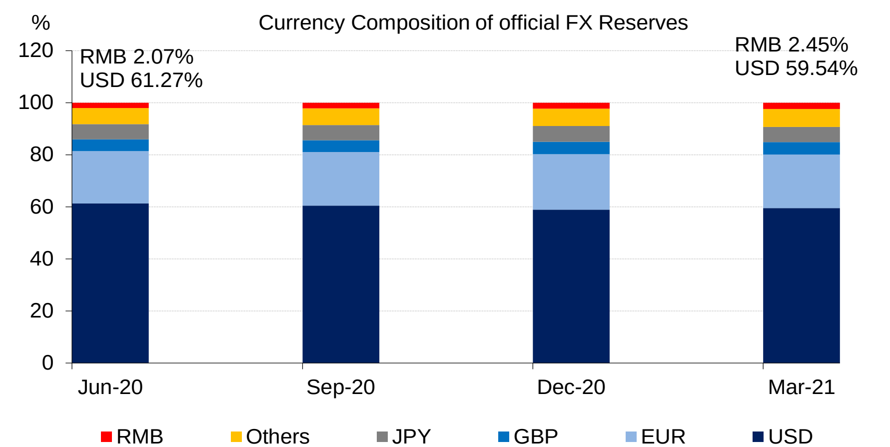
USD – Bottoming out

- As Fed formally began its tapering discussion, the hawkish Fed could support the USD. Encouragingly global central banks' USD sell-off paused. Yet, the declining back-end UST yields could narrow the USD gains. The deepening US budget deficit could also keep the USD rally in check

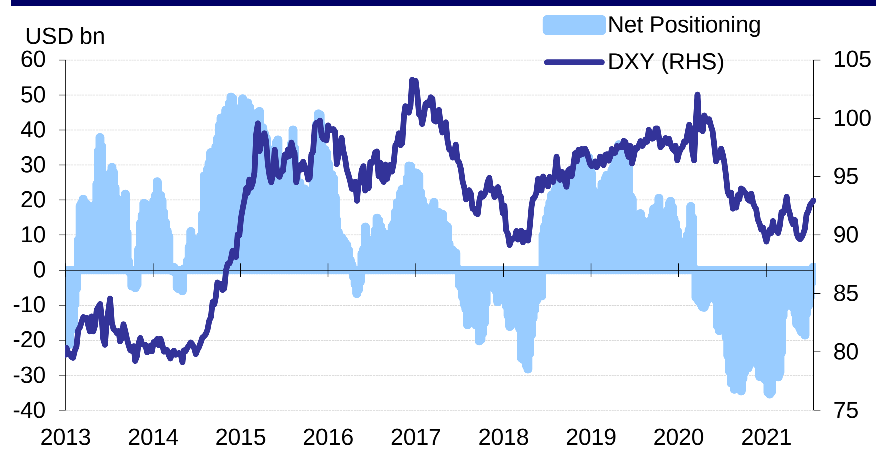
US budget deficit deepened after pandemic



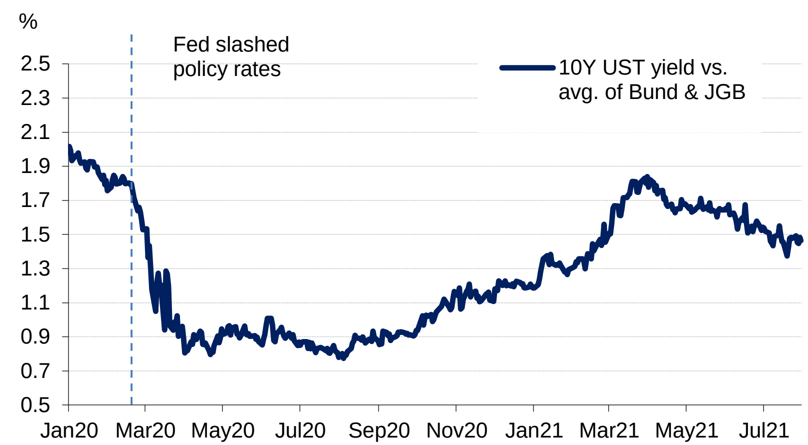
Central banks' USD sell-off paused



Speculative USD short positioning narrowed



Narrowing UST yield advantage despite hawkish Fed



(Source: Bloomberg, Mizuho HK)

RMB (1) – Steady but headwinds evolving

- The RMB outlook turned less bullish given the re-pricing of China regulation risk. The softer China growth momentum in H2 may prompt the PBoC to ease further in H2. In addition, the return of China-US tensions fueled risks of US sanctions on Chinese investment and subsequently discourage capital inflow to China
  - ***PBoC-Fed monetary divergence:*** While the Fed may walk back its tapering plan, the PBoC's RRR cut had opened door for further easing in H2. However, the back-end CGB-UST yield spread remained supportive given sinking 10Y UST yield
  - ***China-US tensions:*** Both sides stepped up the measures to regulate Chinese IPOs listed on US exchanges after two rounds of unsuccessful China-US talks. The mounting risks of US sanctions on Chinese investment and Beijing's regulation tightening could discourage inflow to China
  - ***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

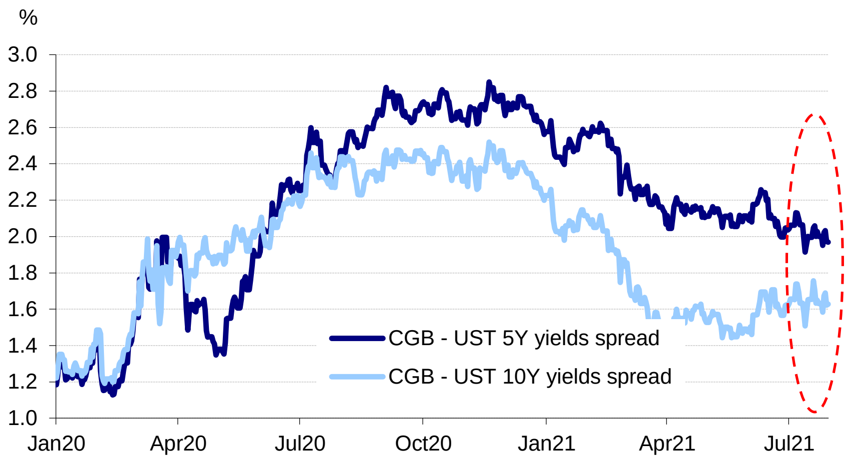
RMB to come under modest pressure in H2 but should remain steady largely

(Source: Bloomberg, Mizuho HK)

RMB (2) – Asset allocation capital inflow

- While firmer USD weighed on RMB, the RMB basket index stayed elevated on lingering capital inflow. Back-end CGB-UST yield spread remained supportive after Fed's hawkish shift

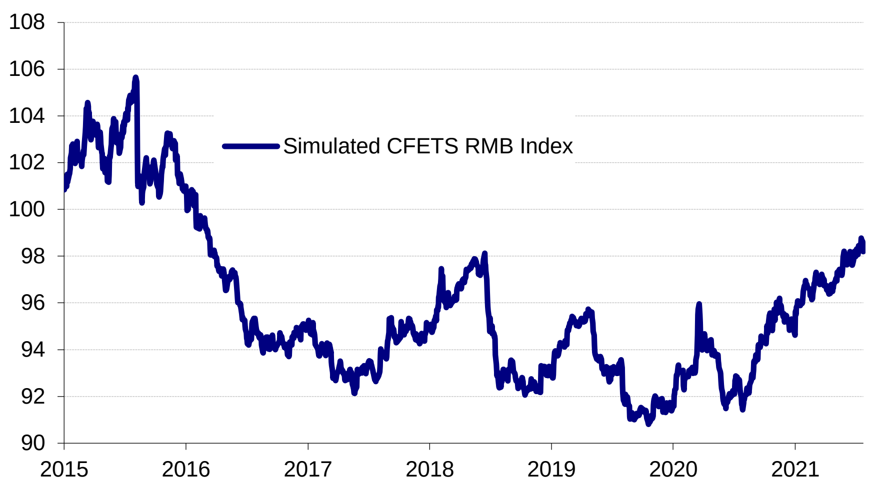
CGB-UST yield spread stabilized in back-end



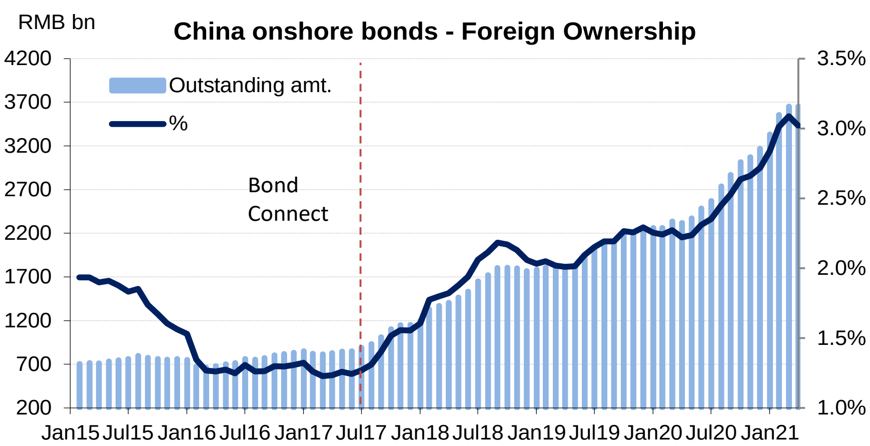
Passive inflow to continue but in smaller size

Major Bond Indices	Inclusion date	Phase over period (months)	Estimated AUM benchmarked to Index (US$ bn)	China Index weight	Estimated capital inflow (US$ bn)
BBG-Barclays Global Aggregate Bond Index (AGG)	Apr-19	20	~2500	6%	~150
JPM GBI-EM Global Diversified	Feb-20	10	~220	10%	~25
FTSE World Gov't Bond Index (WGBI)	Oct-21	36	~2500-4000	5%	~150

RMB basket index climbed to its 5-year high



Foreign share in onshore bond climbed robustly



(Source: Bloomberg, Mizuho HK)

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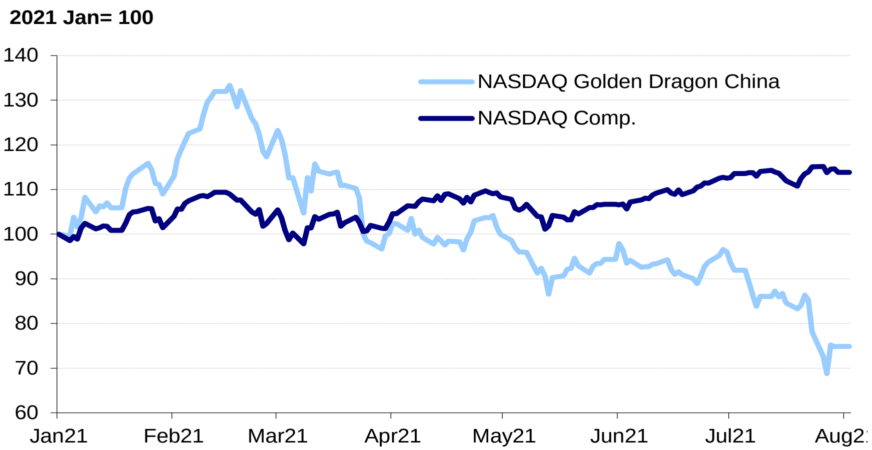
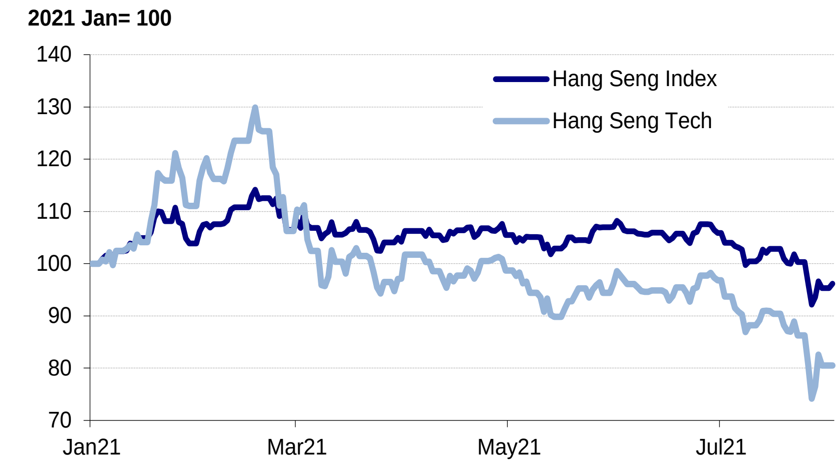
RMB (3) – Foreign investors offloading Chinese investment

- The re-pricing of mounting China regulation risk prompted foreign investors to offload Chinese investment. Not only the China tech giants, Chinese investment broadly came under heavy sell-off pressure

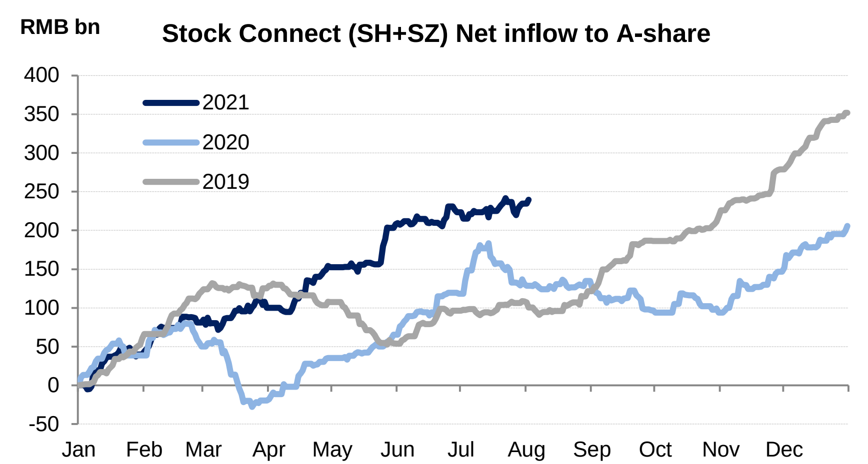
Underperforming Chinese stock listed on US



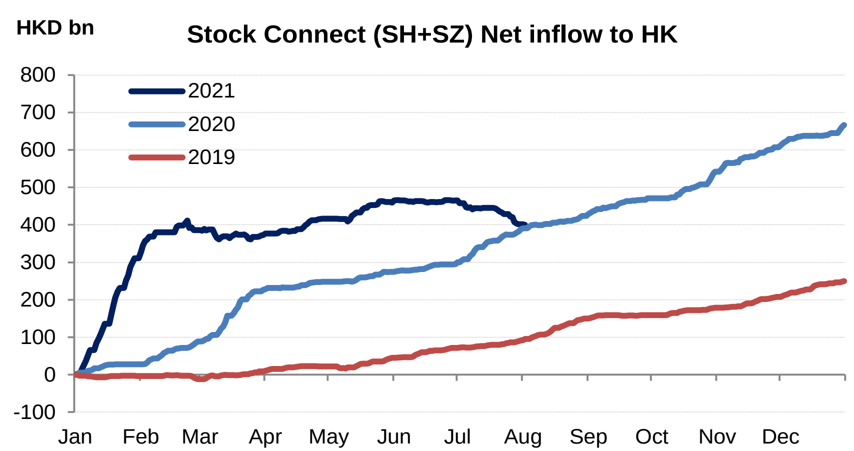
China tech rout sank Hang Seng Index



Stock Connect flow to A-share slowing



Investors accelerated to offload China tech giants

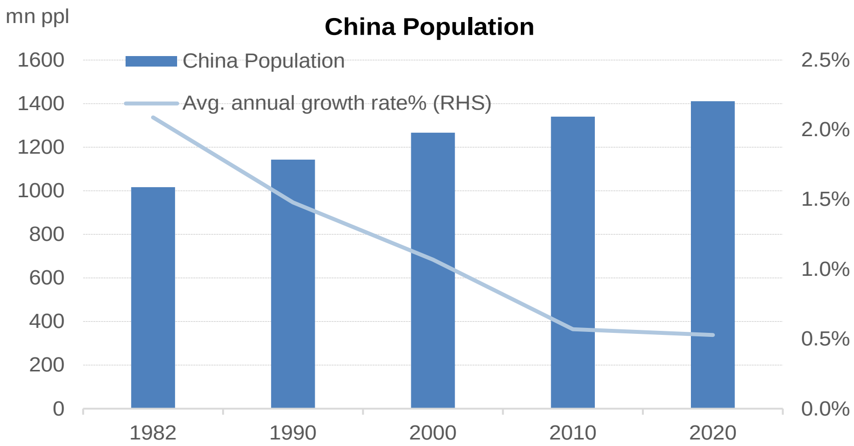


(Source: Bloomberg, Mizuho HK)

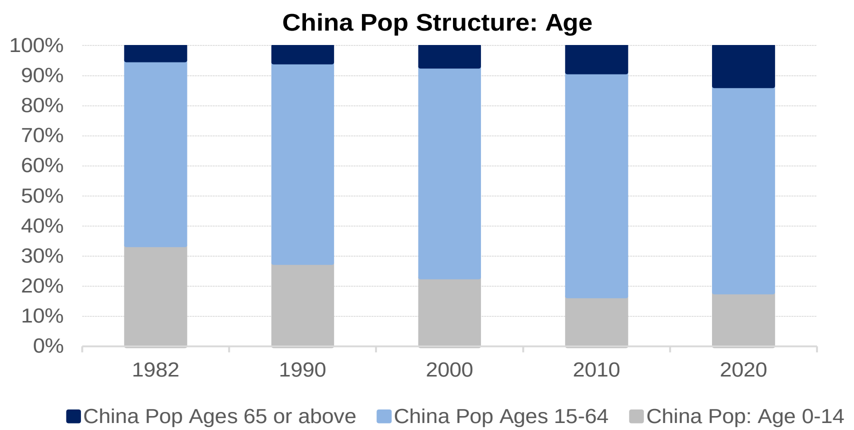
China census – Population structure problems to hinder its growth

- 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 hinter growth prospect. The urbanization could be running its course after climbing to above 60%. In response, the Politburo meeting decided to implement three-child policy

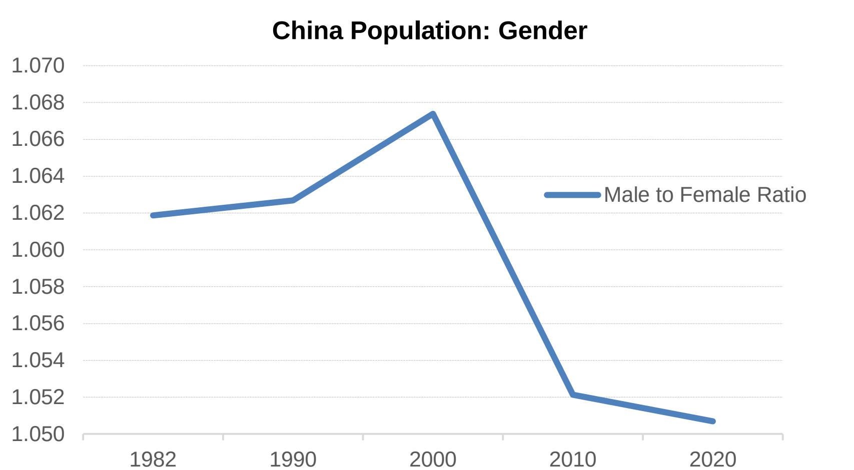
Slowing population growth



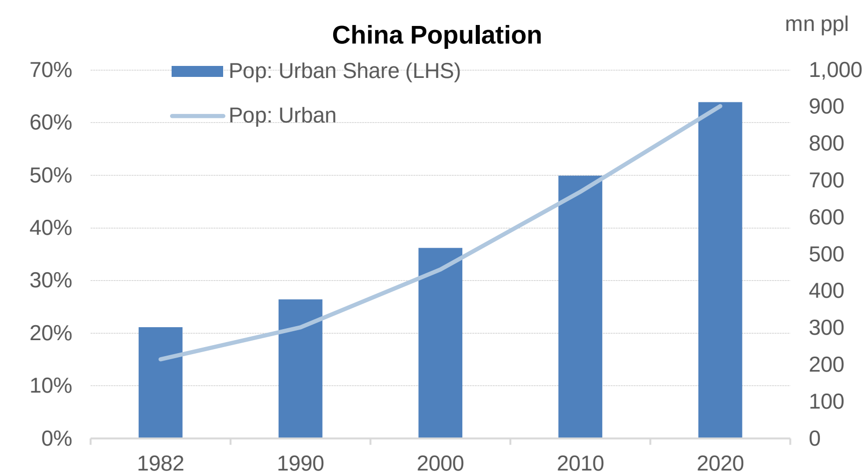
China: aging population



Gender imbalance more or less the same



Urbanization to run its course?



(Source: Bloomberg, Mizuho HK)

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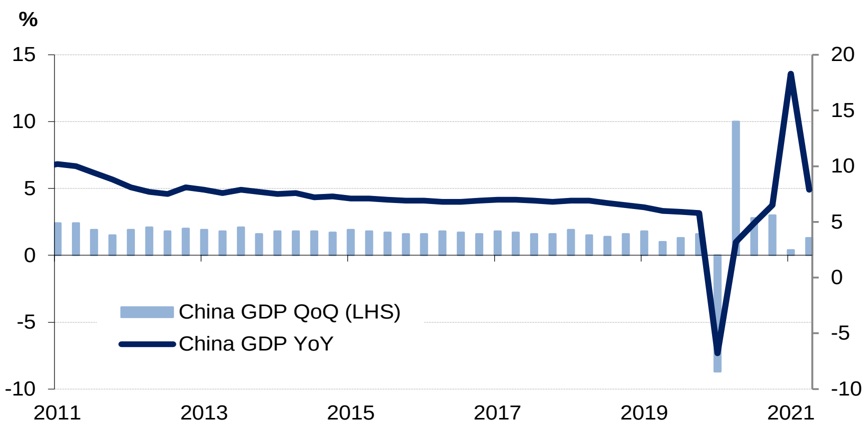
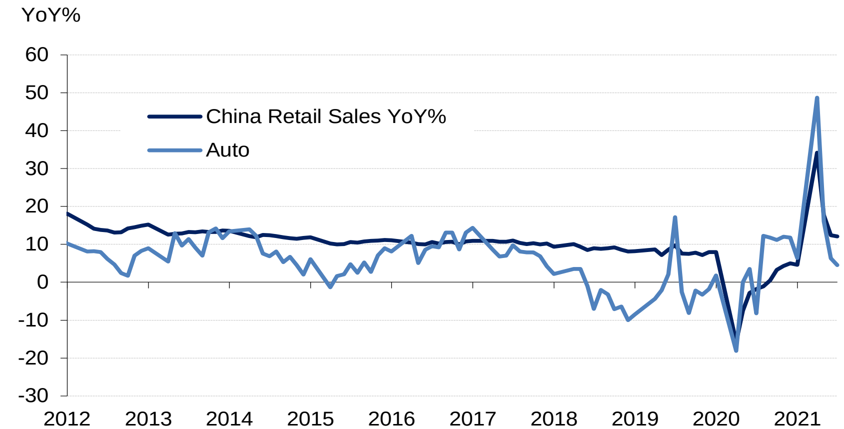
China economy (1) – Growth momentum slowing

- China growth momentum remained robust in H1, with accelerating QoQ growth in Q2. Still, 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

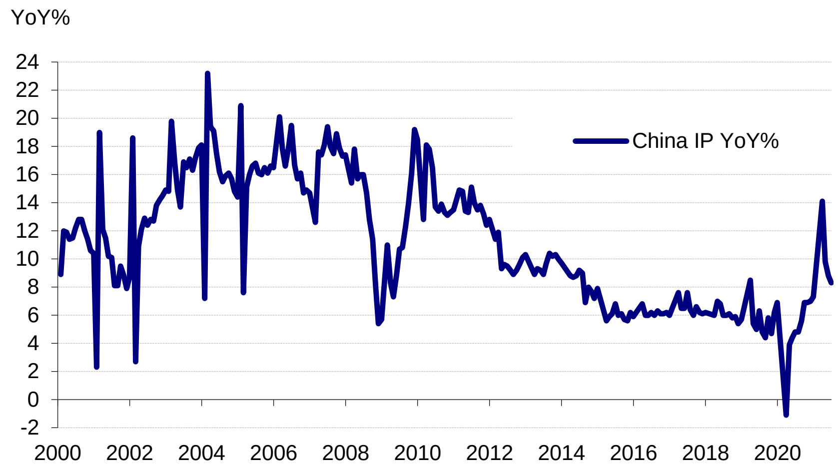
Robust growth momentum in H1



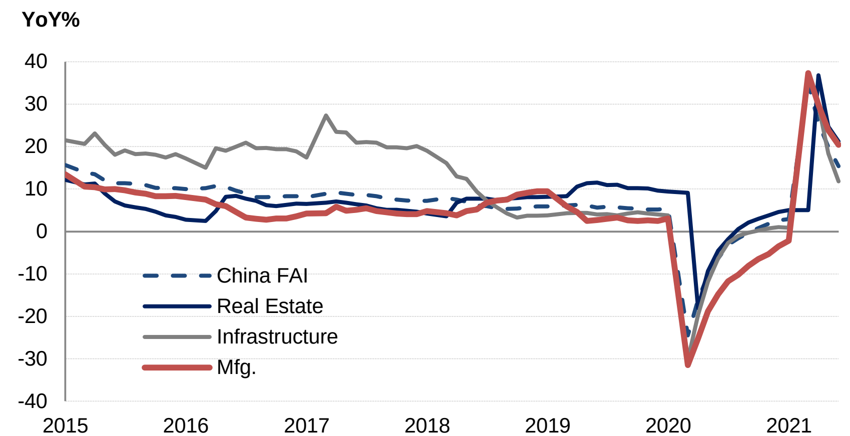
Consumption recovery rather soft



Manufacturers facing with rising production costs



Soft FAI expansion on slow local govies issuance



(Source: Bloomberg, Mizuho HK)

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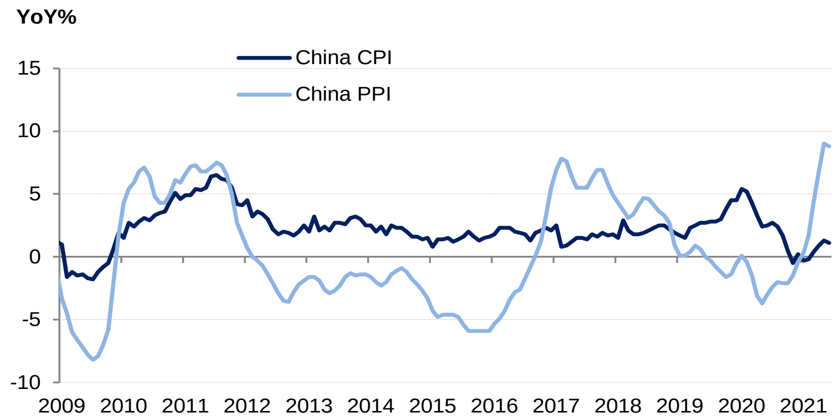
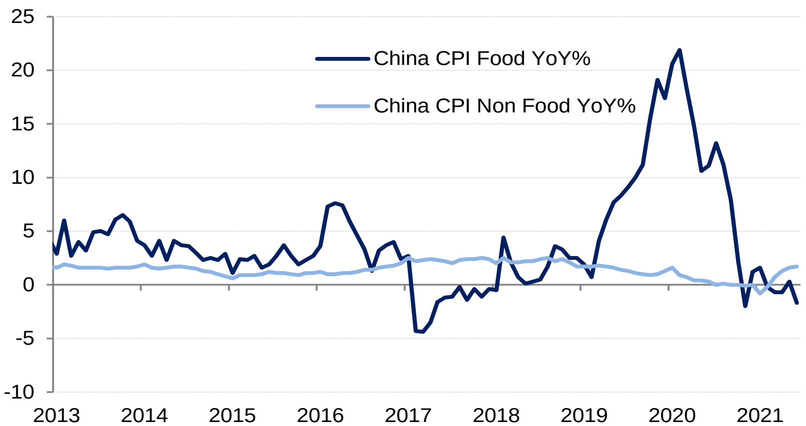
China economy (2) – Benign inflationary pressure

- China CPI pressure was anchored by falling pork prices, while PPI was peaking out after government measures to curb soaring commodity prices. China mfg. and non-mfg. PMIs fell but stayed above 50 expansion mark

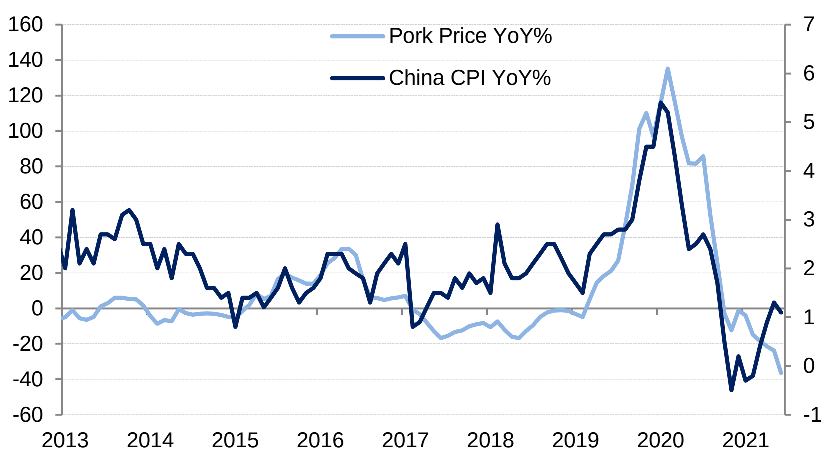
China CPI stayed benign, PPI peaking out



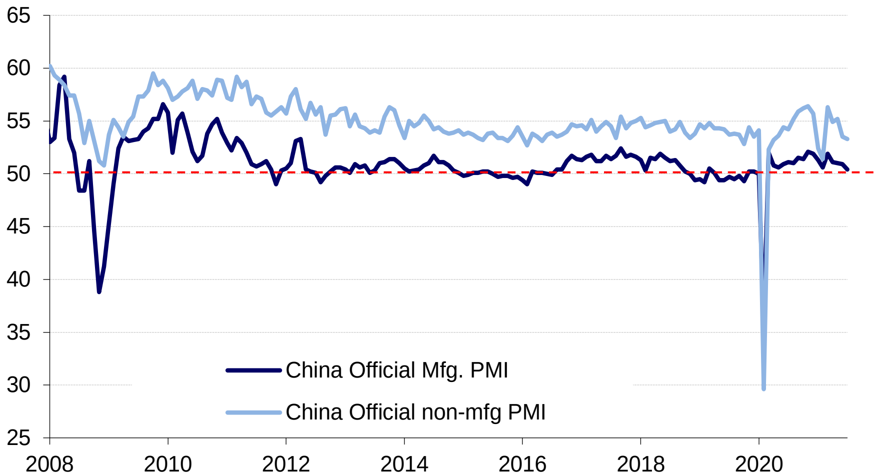
Non-food CPI picking up



Falling pork prices anchored CPI inflation



China PMIs softened but stayed above 50

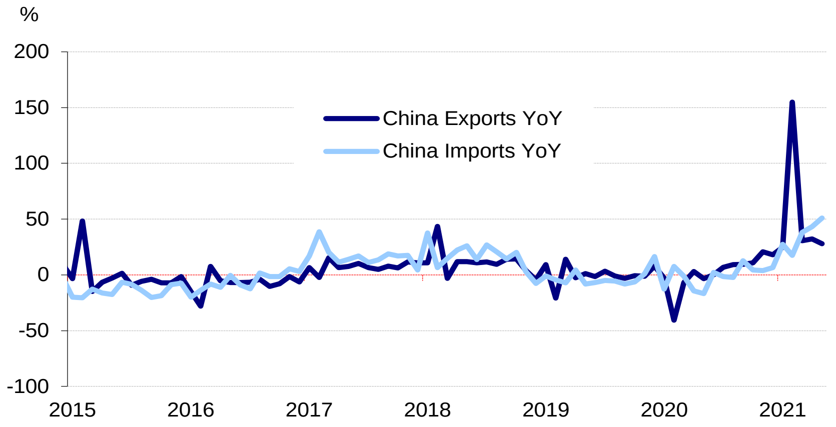


(Source: Bloomberg, Mizuho HK)

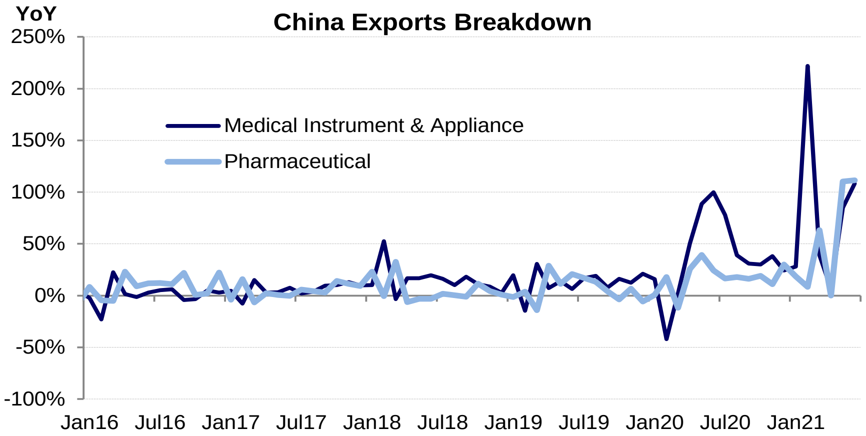
China economy (3) – RMB strength pressuring exports growth

- China exports growth momentum are facing with broad 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

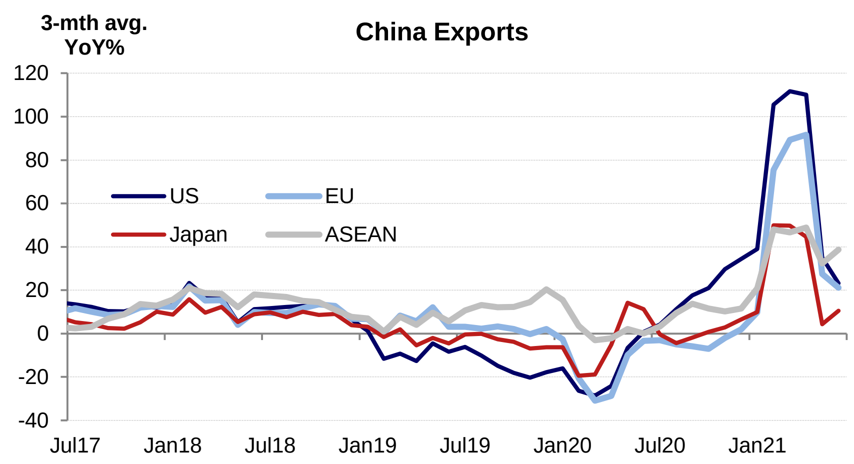
RMB strength put exports on the back foot



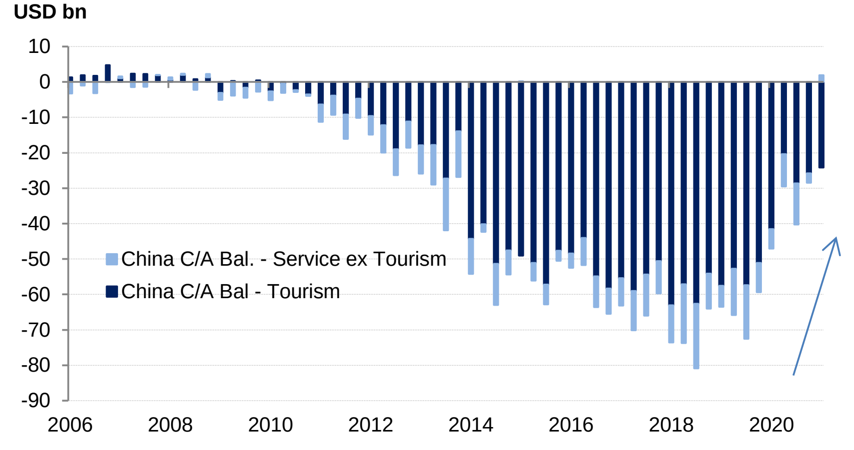
Solid medical exports as virus spread unsettles



External demand retreated despite the reopening



C/A service & tourism deficit to widen after reopening



(Source: Bloomberg, Mizuho HK)

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. Senior level China-US talks ended with strong criticisms over each other, highlighting elevated China-US tensions

Political/Diplomatic
- International influence: Belt & Road Initiative
- Xinjiang & HK issues. Human rights & autonomy affairs
- Taiwan issue
- Ideology between capitalism and socialism
- Coronavirus origin

Economics
- Trade imbalance, currency manipulation
- China's high-tech development: Huawei sanctions
- Forced technology transfer, Intellectual property protection for US corporates in China

Rise of China

Financial
- RMB internationalization: rise of reserves currency status, RMB oil future settlement, digital RMB
- Delisting Chinese corporate from US exchanges, investment ban on Chinese military companies list

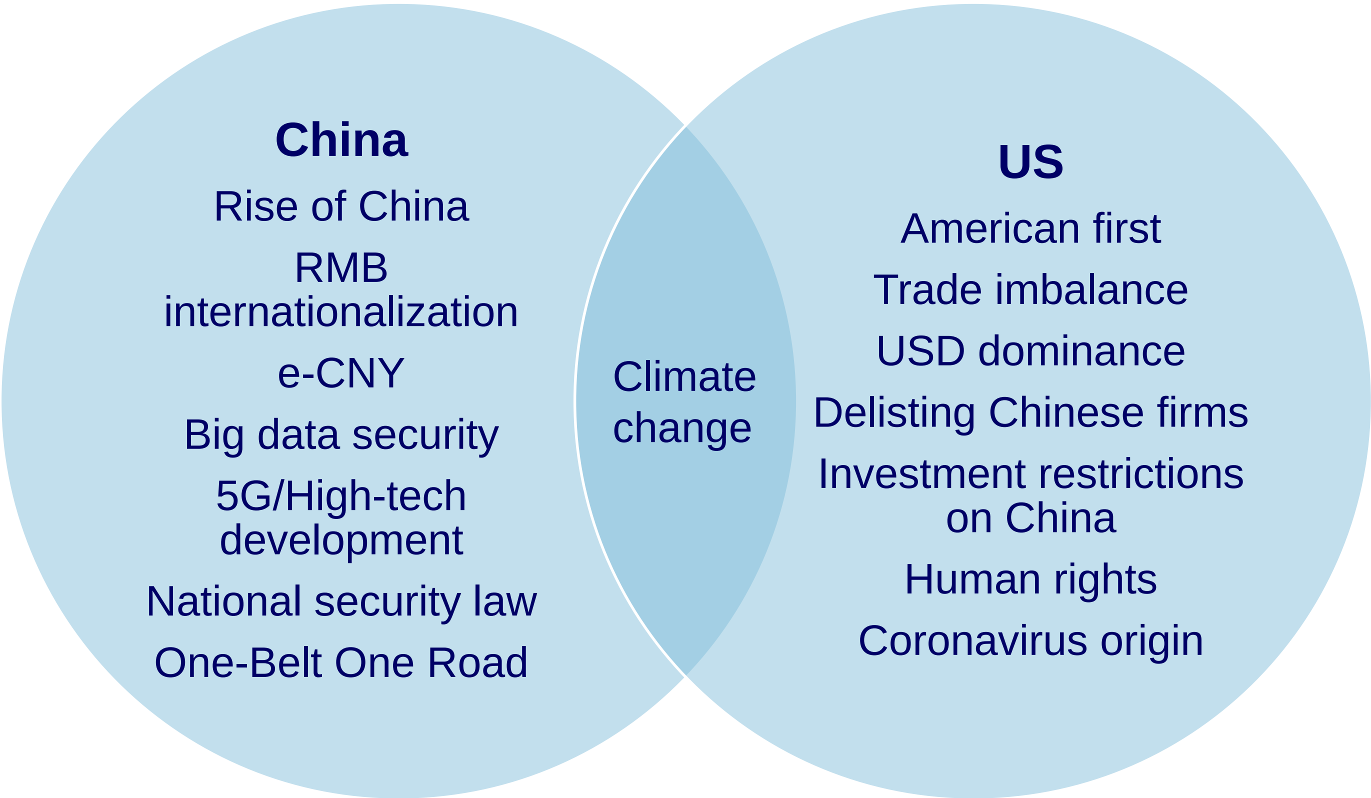
Military
- South China Sea disputes

(Source: Mizuho HK)

China-US Tensions – Competitions & co-operations

Competitions in most areas, few room for co-operation

- From the US perspective, the rise of China is regarded as a threat with the confrontations in economic, finance, technology development and human rights issues. US restricted exports for chips/high-tech components and blocked investment on Chinese enterprises linked to the military. US investment restrictions could dampen inflow to China
- China started to censor the IPOs on US exchanges involved in sensitive big data analysis. The leaders employ the dual circulation strategy to enhance its supply-chain security and open domestic consumption market to counter the China-US de-coupling risk. Climate change will be the only area available for co-operation



(Source: Mizuho HK)

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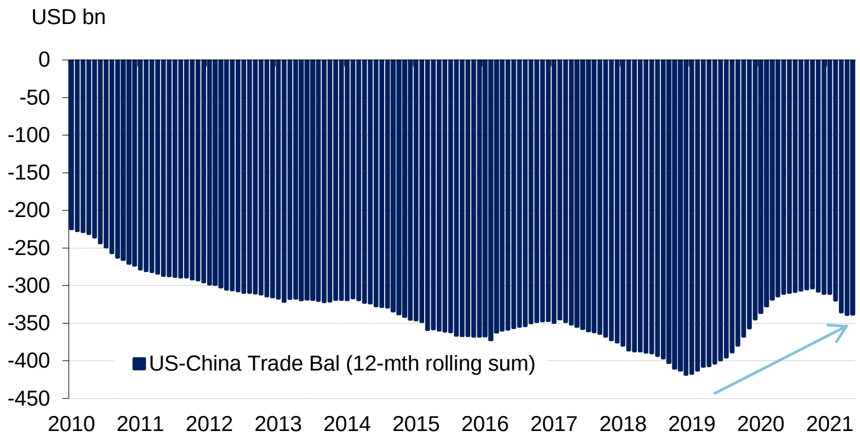
Phase one deal – To continue under Biden's presidency

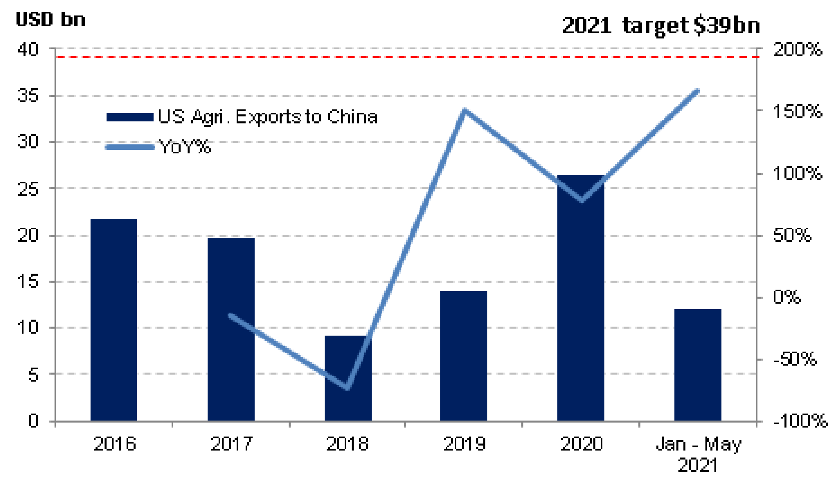
Top US officials in trade and finance held the first call with Chinese Vice Premier Liu He

- 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

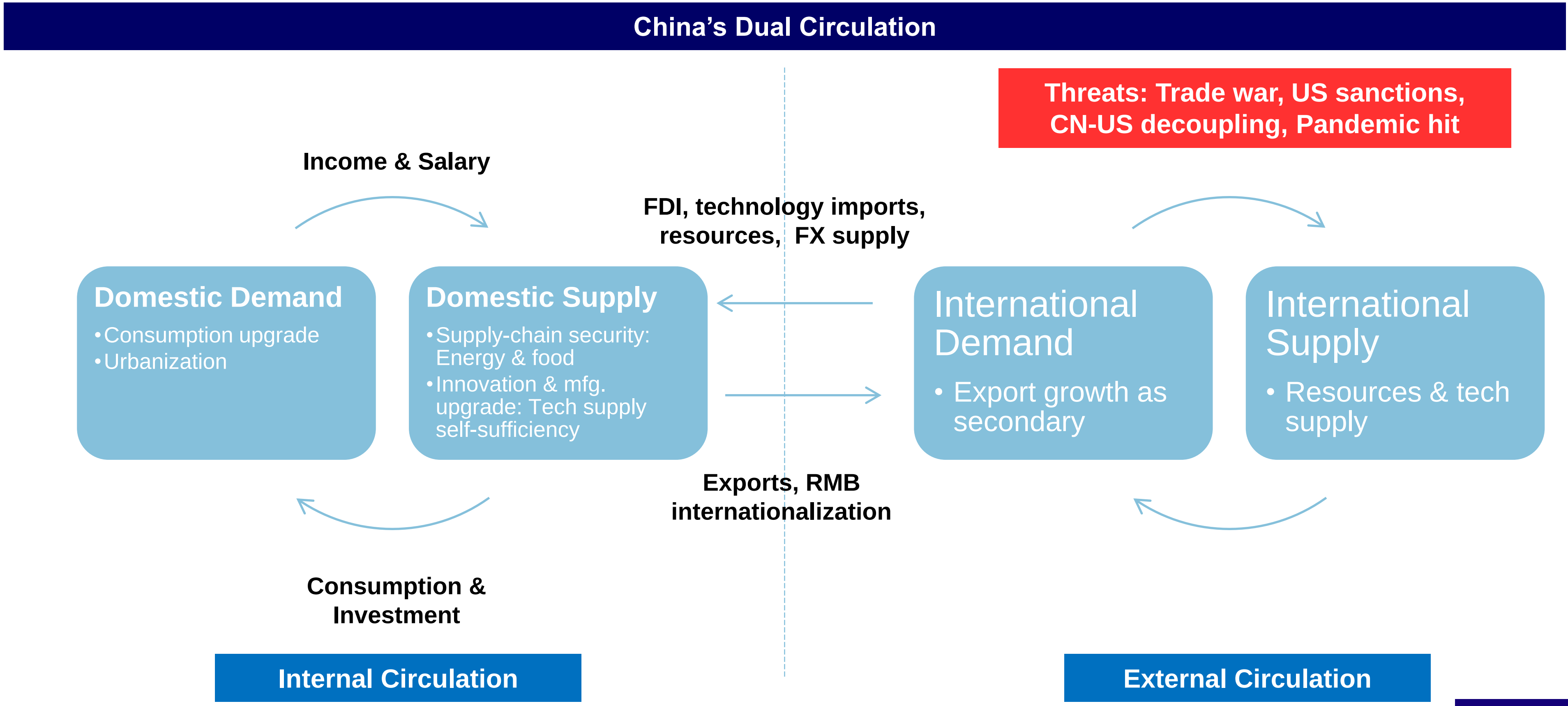
(in USD bn)	Additional US exports to China on top of 2017 baseline		
	Year 1	Year2	2-Year Total
Manufactured goods	32.9	44.8	77.7
Agriculture	12.5	19.5	32
Energy	18.5	33.9	52.4
Services	12.8	25.1	37.9
Total	**76.7**	**123.3**	**210**

(Source: US FAS, Bloomberg, Mizuho HK)

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



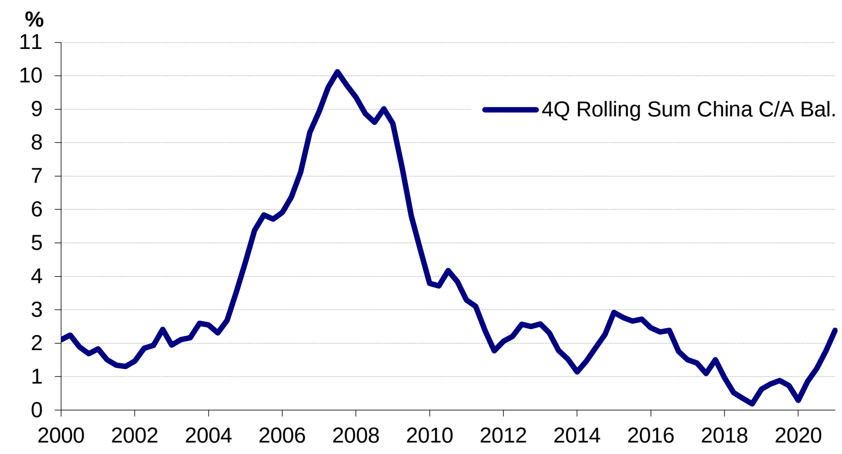
(Source: Mizuho HK)

China Policy (2) – Dual circulation

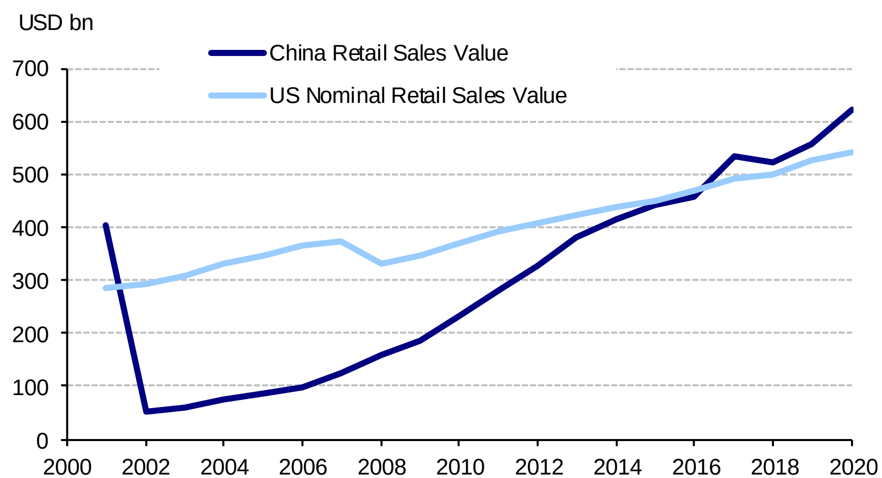
Less motivated to use weak RMB to stimulate growth

- 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

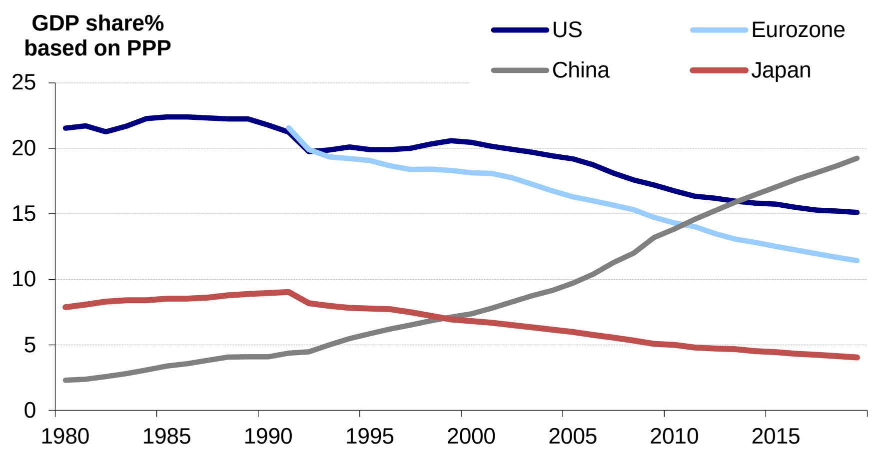
China C/A surplus shrank since 2007



China retail sales outstanding surpassed US



China's GDP share on PPP outsizing G3



(Source: Bloomberg, Mizuho HK)

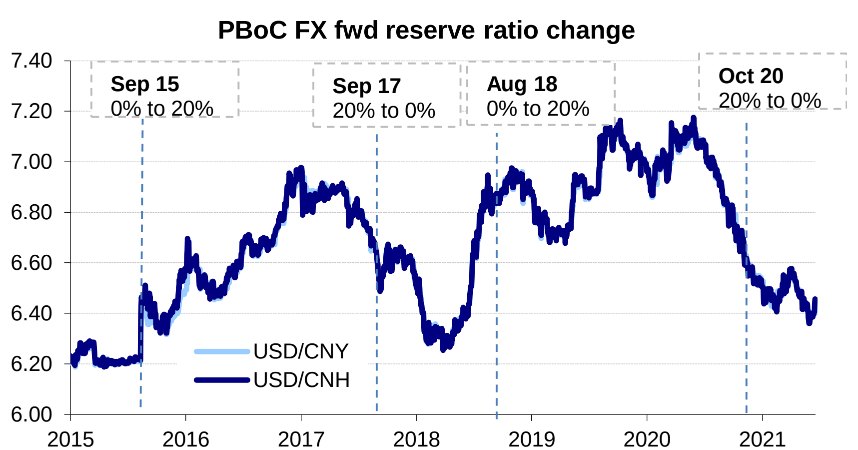
PBoC Policy (1) – RMB appreciation bias eased

PBoC to keep the RMB steady

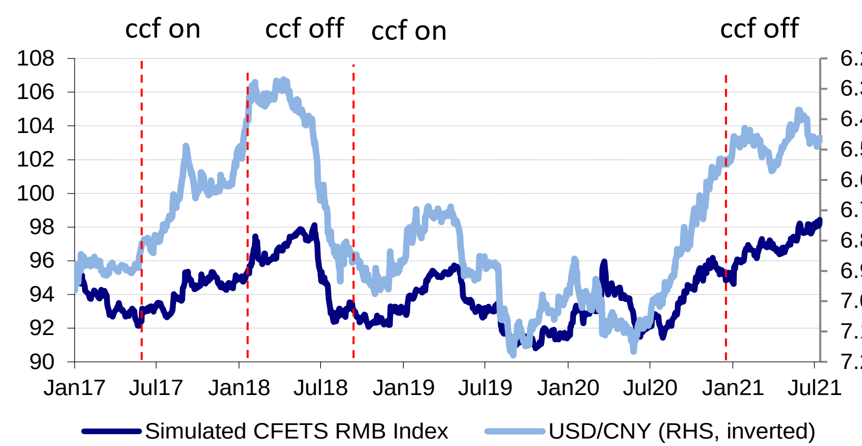
- In early June, the PBoC took action to curb the RMB gains by raising FX Required Reserve Ratio (RRR) to 7% from 5%. The FX RRR hike drained USD 20bn liquidity
- The USD rebound after Fed's hawkish shift cooled RMB appreciation expectation. The mounting China regulation risks prompted foreign investors to offload Chinese investments and related outflow pressure will be negative to RMB outlook. The **PBoC will target a RMB range trading between 6.4-6.6 to support growth this year, in our view**

China expanded QDII quota

No change in FX risk reserves since 2020



PBoC refrained from activating ccf



(Source: Bloomberg, Mizuho HK)

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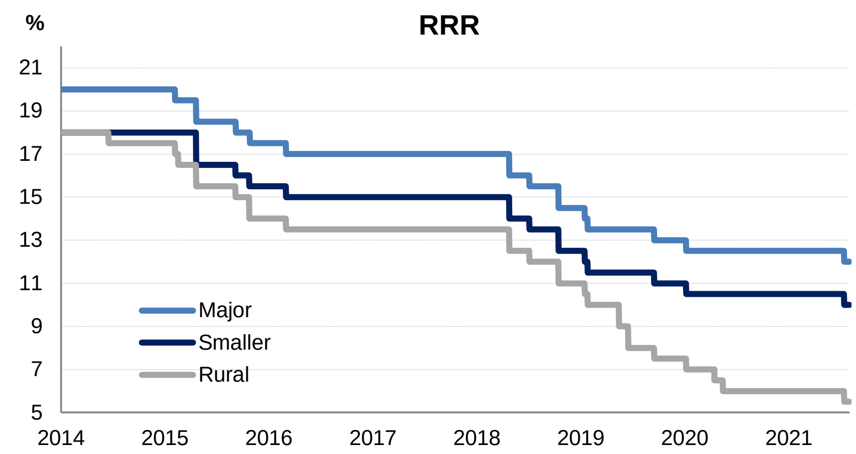
PBoC Policy (2) – Surprising RRR cut

RRR cut opened the door for further easing

- PBoC delivered a broad-based 0.5ppt RRR cut surprisingly, net injecting CNY 1tn of liquidity. PBoC explained the RRR cut did not signal a policy shift and will keep monetary policy stability. At the PBoC's Work Conference, the central bank pledged to keep policy stable and focus on supporting real economy
- CPI inflation will remain benign. PBoC sees annual inflation will stay below 2% and no basis for long-term inflation or deflation
- ***Mizuho view:*** PBoC's RRR cut opened the door for easing in H2 given the slowing growth momentum. PBoC may lower 1Y LPR slightly but 5Y LPR will remain unchanged given tight property policy

PBoC broke the silence and cut RRR broadly



Aggregate financing continue to drop year-on-year

PBoC targets stabilizing macro leverage ratio

(Source: Bloomberg, Mizuho HK)

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 Ailpay 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

(Sources: Internet, Mizuho HK)

The development of e-CNY: Timeline

2014

PBoC Governor Zhou established the legal digital currency research group

2017

PBoC approved the joint research and development of Digital Currency/Electronic Payment (DC/EP) with commercial banks

2020

Apr 20
PBoC conducted hypothetical-use tests of digital RMB in Xiong'an New Area, Shenzhen, Suzhou, Chengdu

Jul 20
Didi Chuxing was said to conduct the digital RMB test with PBoC

Oct 20
Shenzhen issued CNY 100mn digital RMB to local residents in lottery

Nov 20
PBoC Governor Yi said 4mn transactions, totaling over CNY 2bn in the digital currency in 4 cities

Dec 20
- Suzhou issued 100K digital red packet, each containing CNY 200 in lottery (totaling CNY 20mn)
- JD.com became China's first online mall to test digital RMB
- HKMA said it was discussing the technical pilot testing of using e-CNY for making cross-border payments

2021

Feb 21
Beijing issued digital cash vouchers to local residents totaling CNY 100mn

Future

2022

PBoC plans to test digital RMB at 2022 Winter Olympic

(Source: Media, Mizuho HK)

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 crytocurrency, 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	Crytocurrency
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

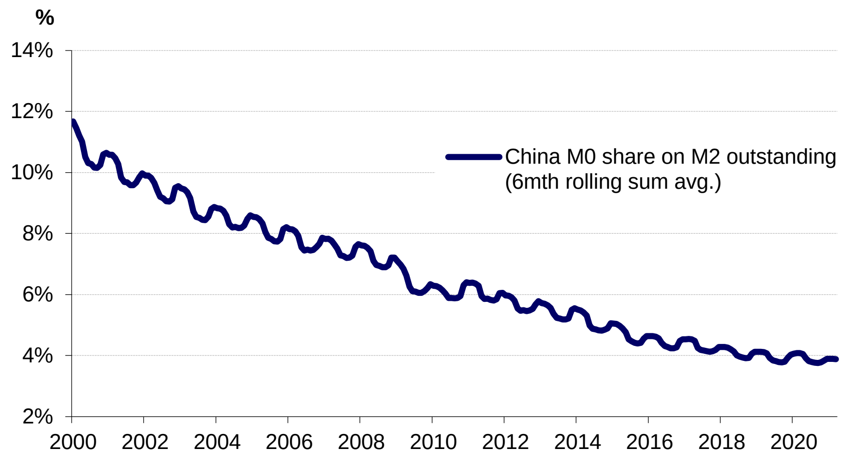
(Source: Bloomberg, Mizuho HK)

e-CNY - FX implications

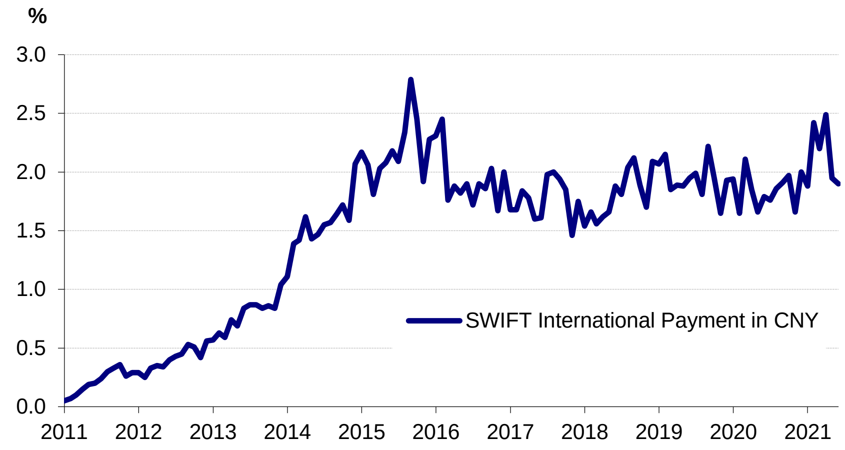
Limited in the near-term, positive in the medium term

- 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

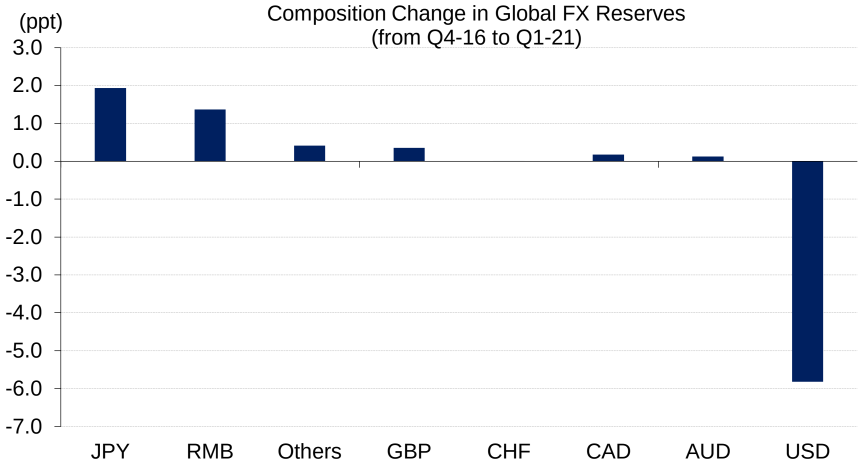
China moving towards cashless society



CNY global payment share moving sideways



RMB reserves share rose on USD share decline



(Source: Bloomberg, Mizuho HK)

Mizuho FX Forecasts

	2021			2022		
	Jan - Jul	Aug - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep
USD/JPY	102.60 ~ 111.63 (109.49)	109 ~ 113 (111)	110 ~ 115 (113)	111 ~ 116 (114)	111 ~ 116 (115)	111 ~ 117 (116)
EUR/USD	1.1704 ~ 1.2349 (1.1883)	1.16 ~ 1.20 (1.17)	1.15 ~ 1.20 (1.16)	1.14 ~ 1.19 (1.15)	1.14 ~ 1.19 (1.15)	1.13 ~ 1.19 (1.14)
EUR/JPY	125.10 ~ 134.12 (130.09)	128 ~ 133 (130)	129 ~ 136 (131)	129 ~ 136 (131)	130 ~ 137 (132)	131 ~ 139 (132)

	2021			2022		
	Jan - Jul	Aug - Sep	Oct - Dec	Jan - Mar	Apr - Jun	Jul - Sep
USD/CNY	6.3570 ~ 6.5793 (6.4629)	6.40 ~ 6.70 (6.55)	6.35 ~ 6.65 (6.50)	6.30 ~ 6.60 (6.45)	6.25 ~ 6.55 (6.40)	6.25 ~ 6.55 (6.40)
EUR/CNY	7.6108 ~ 8.0559 (7.6624)	7.42 ~ 8.04 (7.66)	7.30 ~ 7.98 (7.54)	7.18 ~ 7.85 (7.42)	7.13 ~ 7.79 (7.36)	7.06 ~ 7.79 (7.30)
CNY/JPY	15.731 ~ 17.286 (16.987)	16.27 ~ 17.66 (16.95)	16.54 ~ 18.11 (17.38)	16.82 ~ 18.41 (17.67)	16.95 ~ 18.56 (17.97)	16.95 ~ 18.72 (18.13)

Notes:

1. Prepared by East Asia Treasury Department, Shanghai Treasury and Tokyo headquarter

2. Actual quotes updated at 30 July from Bloomberg

3. In the forecast columns, the exchange rates in parentheses are quarter-end forecasts.

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