Mizuho Bank 2020 RMB Outlook
The return of RMB rally

September 2020

East Asia Treasury Department, Treasury Marketing Section
Global – USD collapse, dovish Fed & China-US tensions

- The USD extended its decline to its 2.5 year low as Fed Chair Powell made a dovish shift by changing policy framework to average inflation targeting. The upcoming US elections drew market attention and Biden’s victory is pre-assumed to be USD negative given Democrat’s call to reverse Trump corporate tax cut.

- Despite the escalating China-US tensions, both sides held a constructive trade talk and reaffirmed to implement the phase one deal. This suggested that the trade war is unlikely to return before US elections and the RMB soared towards 6.8 handle afterwards.

<table>
<thead>
<tr>
<th>Date</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sep-20</td>
<td>US: FOMC meeting, EZ: ECB meeting, JP: New PM contest</td>
</tr>
<tr>
<td>Oct-20</td>
<td></td>
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<tr>
<td>Nov-20</td>
<td>US: President Election</td>
</tr>
<tr>
<td>Dec-20</td>
<td>UK: Fall back to WTO terms if no trade deal</td>
</tr>
<tr>
<td>In the pipeline</td>
<td>Vaccine development, China-US tensions, EU-UK Brexit trade talks,</td>
</tr>
</tbody>
</table>

(Source: Media, Mizuho HK)
Global – Risk rally in the midst of pandemic

- Global infected cases surpassed 25mn, with death tolls topping 850K. US contagion pace has been slowing while Europe infection picked up. The global risk rally continued on central banks’ easing, and global PMI held up above 50

More than 25mn infected globally

US infection dipped, Europe picked up

The global risk rally goes on

Global PMI held up above 50

(Source: Bloomberg, Mizuho HK)
US Economy – Expiring stimulus clouded outlook

Strong recovery in Q3 after Q2 plunge

- Fed’s forecast model projected strong Q3 recovery after the lockdown. Labour market continued to improve, with falling unemployment rate and initial jobless claims.

- Yet, the expiring unemployment benefit and deadlocked coronavirus relief negotiation will cloud the growth outlook. The resurgent infection in the US also prompted some states to re-impose lockdown and the road to recovery is set to remain bumpy before vaccine ready to deploy.

US employment continued to recover

- US employment continued to recover with falling unemployment rate and initial jobless claims.

Initial jobless claim fell to around 1mn

- Initial jobless claims fell to around 1mn in recent months.

Fed’s model projected strong Q3 rebound

- Fed’s model projected strong Q3 rebound with positive %QoQ annualized growth.

( Source: Bloomberg, Mizuho HK )
Fed – Paradigm shift to average inflation targeting

- Fed Chair Powell announced a paradigm shift to average inflation targeting, which allows inflation overshooting 2%, and would base its policy decision on the assessments of shortfalls (prior deviation) from maximum employment.

Fed fund future market priced out negative rate

%  

Fed Fund Future Implied Rate

Aug20 Feb21 Aug21 Feb22 Aug22

Avg. inflation targeting to push back rate hike timing

YoY%  

US CPI  
US CPI Core  
US CPI (3-mth rolling avg.)  
US core CPI (3-mth rolling avg.)

Jan16 Jul16 Jan17 Jul17 Jan18 Jul18 Jan19 Jul19 Jan20 Jul20

Fed’s balance sheet to expand at $120bn per month

USD bn

Fed Bal. Sheet Size

Projection

08 09 10 11 12 13 14 15 16 17 18 19 20 21

USD bn

Fed Bal. Sheet Size

0
1,000
2,000
3,000
4,000
5,000
6,000
7,000
8,000
9,000
10,000

US Inflation expectation shot up

%  

US SYSY Forward Breakeven

Jan17 Jul17 Jan18 Jul18 Jan19 Jul19 Jan20 Jul20

( Source: Bloomberg, Mizuho HK )
USD – Perfect storm

- The abating safe-haven demand, dissipating USD yield advantage, Fed’s dovish shift and rising uncertainties over US election brought a perfect storm for the USD

**Fed’s rate cut outpaced other major CBs**

<table>
<thead>
<tr>
<th>Year</th>
<th>Fed Fund Target Rate</th>
<th>ECB Deposit Rate</th>
<th>BoJ Policy Rate</th>
<th>BoE Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>3.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.50</td>
</tr>
<tr>
<td>2016</td>
<td>2.50</td>
<td>0.00</td>
<td>0.00</td>
<td>0.50</td>
</tr>
<tr>
<td>2017</td>
<td>2.00</td>
<td>-0.50</td>
<td>0.00</td>
<td>0.50</td>
</tr>
<tr>
<td>2018</td>
<td>1.50</td>
<td>-1.00</td>
<td>0.00</td>
<td>0.50</td>
</tr>
<tr>
<td>2019</td>
<td>1.00</td>
<td>-1.50</td>
<td>0.00</td>
<td>0.50</td>
</tr>
<tr>
<td>2020</td>
<td>0.50</td>
<td>-2.00</td>
<td>0.00</td>
<td>0.50</td>
</tr>
</tbody>
</table>

**USD losing its high yield advantage**

**Safe-haven demand retreated as jitters eased**

**VIX Index**

**DXY Index**

( Source: Bloomberg, Mizuho HK )
USD – Budget deficit deteriorated after pandemic

- The US rolled out massive relief packages to counter pandemic impact, enlarging US budget deficit substantially. The stimulus will be financed by aggressive UST debt issuance and heavy US debt burden could come in concern.

US budget deficit surged on pandemic relief

US debt to GDP ratio to climb

US budget deficit to deteriorate in long term

(Source: Bloomberg, Congressional Budget Office, Committee for a Responsible Federal Budget, Mizuho HK)
USD – Reserve currency status at risk?

- USD maintained its dominance in global FX reserves despite the decline since 2016 Q4. The lion share of USD FX turnover and SWIFT payment share highlighted its importance in FX

USD share more than 60% global FX reserves

FX reserves manager reduced USD assets holding

USD & EUR dominating in SWIFT payment

SWIFT payment % share at Jul20

(Source: BIS, IMF, SWIFT, Bloomberg, Mizuho HK)
US President Election (1) – Biden vs. Trump

- Trump: Extending the Trumponomics & America first agenda
- Biden: Reverse Trump’s tax cut & dropped the unilateral tariffs approach in handling China-US relationship
  - Raising corporate tax rate will trigger capital outflow from the US, reversing the repatriation flow driven by Trump’s tax cut. **USD negative**
  - To retain hardline stance against China over the HK, Taiwan and Xinjiang issues as well as the South China Sea disputes without resorting to the unilateral tariff wars or falling into the trap of a new cold war. This opened the door for trade deal re-negotiation for tariff cut in exchange of other China reforms. **RMB positive**
- Biden’s victory alongside Democrats’ winning the Senate should boost the RMB outlook and sank the USD

<table>
<thead>
<tr>
<th>Biden’s Policy</th>
<th>FX impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax</td>
<td>USD (-)</td>
</tr>
<tr>
<td>- To reverse the Trump administration tax cut benefiting the wealthy and corporates shipping jobs oversea, raised the corporate tax</td>
<td></td>
</tr>
<tr>
<td>FX</td>
<td>Structurally USD (+)</td>
</tr>
<tr>
<td>- Against currency manipulation</td>
<td></td>
</tr>
<tr>
<td>- To preserve USD's world reserve currency status from improper financial sanctions</td>
<td></td>
</tr>
<tr>
<td>Trade/Tariff</td>
<td>RMB (+)</td>
</tr>
<tr>
<td>- Against the unilateral tariff wars</td>
<td></td>
</tr>
</tbody>
</table>


(Source: Mizuho HK)
Biden still led the US president election but his margin has been narrowing. While Trump’s approval poll rebounded, Biden kept his lead in swing states that contributed to Trump’s victory. Senate election will be neck-and-neck.

( Source: Predict It, RealClear Politics, Bloomberg, Mizuho HK )
The RMB rallied to its 16-month high of 6.81 on the constructive trade talks and USD decline. Investors shrugged off concern over China-US tensions and shifted focus to solid China fundamentals. **We revised our year-end CNY forecasts stronger to 6.85 from 7.00.** Yet, Trump’s unpredictable move could cap further RMB appreciation in check before US election this November

- **Re-escalation of China-US tensions:** The reaffirmation of trade deal in the constructive trade talks suggested that the trade war is unlikely to return before US elections, despite the escalating China-US tensions in different areas. The US President election will pose key event risk in the rest of this year

- **PBoC-Fed monetary divergence:** While the Fed turned more dovish, the PBoC refrained from slashing policy rates and shifted its policy focus to targeted easing from massive easing. The CGB-UST yield differential above +200bps as well as A-share bullish market will encourage capital inflow to onshore China market

- **Coronavirus outbreak:** The second wave is taking place in the US while the virus spread was largely contained in China. The diverging growth dynamic between China and US economy will help support RMB

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The RMB embarked a strong rally after the trade talks

( Source: Bloomberg, Mizuho HK )
The stronger China growth dynamic vs. G3 economy, bullish A-share market and widening CGB-UST yield spread should encourage capital inflow to RMB assets.
CNH/CNY market at a glance

- The decoupling of RMB Index from DXY suggested investors shrugged off CN-US tensions impact on RMB. A-share may be entering into a gradual bullish market. 1Y CNH DF jumped to +1700 to reflect widening PBoC-Fed divergence

**RMB Index decoupling from DXY**

**China A-share healthy bull underway**

**CNH deposit pared back loss**

**1Y CNH DF hit +1700 points**

(Source: Bloomberg, Mizuho HK)
Overview – Virus contagion stayed under control

- China managed to contain coronavirus spread after the initial outbreak. Production and people’s living have returned to normal.
- Lockdown in Wuhan was lifted in April while the focus shifted to suppress imported infected cases and domestic rebound. New infections were reported in different parts in China but the spread was being contained shortly.

From outbreak to normalization

- **20 Jan** President Xi ordered resolute efforts to curb virus spread.
- **23 Jan** Wuhan city implemented lockdown.
- **12 Feb** Hubei province included clinical diagnosis in the confirmed cases.
- **8 Apr** Wuhan city lockdown was lifted.
- **10 Mar** President Xi paid the first visit to Wuhan since the virus outbreak.
- **12 May** Small scale outbreak in Jilin Province.
- **15 May** China conducted massive virus testing for Wuhan city.
- **14 Jun** Virus outbreak in Beijing’s Xinfadi food wholesale market.
- **15 Jul** Infection in Xinjiang.

( Source: Bloomberg, China National Health Commission, Johns Hopkins CSSE, Mizuho HK )
China economy (1) – Recovery after pandemic hit

- China Q2 GDP turned positive to +3.2%YoY, reflecting robust growth momentum after the pandemic hit. Industrial production has returned to the pre-pandemic level. Consumption recovery is lagging behind, while online dining buoyed amid the lockdown.

### China Q2 GDP turned positive to +3.2%YoY

- %
- China GDP YoY

### IP returned to pre-pandemic level

- YoY%
- China IP YoY%

### Consumption recovery lagging behind

- YoY%
- China Retail Sales YoY%
- Auto

### Online dining as the winner in lockdown

- YoY%
- China online retail sales YTD

(Source: Bloomberg, Mizuho HK)
China economy (2) – Recovery after pandemic hit

- China CPI inflation stayed at below 3% alongside resurgent food prices after the flooding. Fixed Asset Investment recovery was soft given uncertainties over China-US tensions and virus spread. Solid non-mfg. PMI bodes well on consumption recovery.

CPI inflation stabilized; PPI decline narrowed

YoY%

<table>
<thead>
<tr>
<th>Year</th>
<th>China CPI</th>
<th>China PPI</th>
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<tbody>
<tr>
<td>2008</td>
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<td>2009</td>
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<td>2020</td>
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</tbody>
</table>

Resurgent food prices amid flooding

<table>
<thead>
<tr>
<th>Year</th>
<th>China CPI Food YoY%</th>
<th>China CPI Non Food YoY%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td></td>
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<td>2012</td>
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<td>2020</td>
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</tbody>
</table>

FAI recovery lagging behind

YoY%

<table>
<thead>
<tr>
<th>Year</th>
<th>China FAI</th>
<th>Real Estate</th>
<th>Infrastructure</th>
<th>Mfg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
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<td>2020</td>
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</tbody>
</table>

Mfg. PMI held steady, non-mfg. PMI jumped

YoY%

<table>
<thead>
<tr>
<th>Year</th>
<th>China Official Mfg. PMI</th>
<th>China Official non-mfg PMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td></td>
<td></td>
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<tr>
<td>2008</td>
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<td>2009</td>
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<td>2019</td>
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<tr>
<td>2020</td>
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</tbody>
</table>

(Source: Bloomberg, Mizuho HK)
China economy (3) – External sector

- China Q2 exports were surprisingly resilient to the global lockdown while surging exports for medical stuff continued to support trade figures. China tourism deficit will continue to narrow as many countries retain their border control.

![Robust China exports in Q2](chart)

![Medical exports surged amid pandemic](chart)

![China exports to G3 rebounded](chart)

![China tourism deficit narrowed](chart)

(Source: Bloomberg, Mizuho HK)
China economy (4) – More balancing recovery in Q3

- China Q2 GDP recovered by 3.2%YoY and Q3 growth will be more balancing as consumption started to pick up
  - **Consumption**: Retail sales to pick up as regular consumption activities resumed under successful virus control. Tourism will remain weak before border control eases
  - **Industrial production**: Limited room for improvement as IP had returned to pre-crisis level
  - **Fixed asset investment**: Weak business confidence suppressed capex, while foreign firms came under pressure to withdraw investment from China
  - **Trade**: Stalling global demand for medical instruments may drag on China exports but relaxing lockdown policy should support external demand

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**China Q2 GDP rebounded sharply**

**Budget deficit target increased to ~3.6%**

**Bond issuance to finance stimulus**
China Policy (1) – Dual circulation

Shifting growth engine to domestic market

- Alongside the reiteration of 6 stability and 6 protection tasks, the Politburo meeting called for accelerating development of dual circulation
- This new development strategic plan will be principally based on the domestic circulation development interacting with the international circulation development, pointing to a shift of core growth engine to domestic market
- 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 retail sales outstanding surpassed US

- USD bn
- China Retail Sales Value
- US Nominal Retail Sales Value

China’s GDP share on PPP outsizing G3

- GDP share%
- based on PPP
- US
- Eurozone
- China
- Japan

China C/A surplus shrank substantially

- 4Q Rolling Sum China C/A Bal.
China Policy (2) – PBoC turning more flexible, more precise

Shifted policy focus to targeted easing

- With more policy flexibility and preciseness, PBoC aims at enhancing policy delivery and improving structure of its existing targeted easing. PBoC will also refrain from launching a massive stimulus, signaling limited room for RRR and LPR cut.

- The relending and rediscounting credit facility, alongside the tools of postponing expiring corporate debt financing and expanding credit loan, will be actively used to support enterprises.

- PBoC announced the repo rate for depositary institutions (DR rate) will be the key short term reference rate, moving towards interest rate liberalization by formalizing the interest rate corridor.

(targeted RRR cut to support rural sector)

PBoC rate cut cycle paused again

(DR0007 as the key short-term rate)

(PBoC’s Interest Rate Corridor)
Tolerating fast credit expansion & corporate rate cut

- China set up the relending and rediscounting credit facility (totaling CNY 1.8tn) to support small-and-micro enterprises and the enterprises suffered by coronavirus outbreak. The State Council also drove the CNY 1.5tn profit transfer to corporate sector from banking system.

- The acceleration of M2 and aggregate financing growth since the virus outbreak came off lately from its 3-year high, fueling concern over tapering monetary easing.
China-US Tensions: Round two after coronavirus outbreak

2020

Coronavirus Outbreak

Jan 2020
Trump signed the phase one deal with Chinese Vice Premier Liu He in White House on 15 Jan

30 Apr 2020
Trump started the blame game over the virus origin from China

15 May 2020
Trump expanded Huawei ban on foreign companies using US technology

21 May 2020
US Senate passed bill that could lead to Chi companies delisting from US

30 May 2020
Trump said US to revoke HK special status as HK is losing its autonomy

23 Jun 2020
Trump said China trade deal “fully intact” after Navarro’s confusing remark

10 Jul 2020
US sanctioned Chinese officials over Xinjiang human right issues

13 Jul 2020
US hardened its stance against China’s territorial claims in South China Sea

15 Jul 2020
Trump ended HK’s special status and signed HK Autonomy Act into law

22 Jul 2020
US orders China to close its Houston consulate

23 Jul 2020
US Secretary of State Pompeo called for ending engagement with China

7 Aug 2020
Trump banned US business connection to Tiktok & Wechat

8 Aug 2020
US sanctioned 11 Chinese and HK officials over human rights & national security law

18 Aug 2020
Trump expanded the Huawei ban to its affiliates

24 Jul 2020
China orders US to close its Chengdu consulate

25 Aug 2020
China & US held a constructive trade talk

28 May 2020
China passed National Security law for HK at the NPC

30 Jun 2020
China National People’s Congress Standing Committee approved the HK national security law

( Source: Media, Mizuho HK )
Phase one deal – Remain fully intact

No change in trade deal before US elections

- 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, China’s agricultural purchase is lagging behind its schedule given the pandemic outbreak.

- Despite the difficulty to achieve US purchase target, China and US held a constructive trade talk and reaffirmed to implement the trade deal. We reckon that the trade renegotiation will only take place after US elections in November and the trade war is not going to return to stage in the near term.

China falling short of its agri purchase target

<table>
<thead>
<tr>
<th>Year</th>
<th>Manufactured goods</th>
<th>Agriculture</th>
<th>Energy</th>
<th>Services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>32.9</td>
<td>12.5</td>
<td>18.5</td>
<td>12.8</td>
<td>76.7</td>
</tr>
<tr>
<td>2016</td>
<td>44.8</td>
<td>19.5</td>
<td>33.9</td>
<td>25.1</td>
<td>123.3</td>
</tr>
<tr>
<td>2017</td>
<td>77.7</td>
<td>52.4</td>
<td></td>
<td>37.9</td>
<td>200</td>
</tr>
</tbody>
</table>

China's shopping list

(in USD bn) Additional US exports to China on top of 2017 baseline

<table>
<thead>
<tr>
<th>(in USD bn)</th>
<th>Additional US exports to China on top of 2017 baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>Year 2</td>
</tr>
<tr>
<td>Manufactured goods</td>
<td>32.9</td>
</tr>
<tr>
<td>Agriculture</td>
<td>12.5</td>
</tr>
<tr>
<td>Energy</td>
<td>18.5</td>
</tr>
<tr>
<td>Services</td>
<td>12.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>76.7</strong></td>
</tr>
</tbody>
</table>

(Source: US FAS, Bloomberg, Mizuho HK)
Conflicts between China-US are structural and spreading over multi-dimensions

- **Thucydides trap:** When one great power threatens to displace another, war is almost always the result. USD dominance and US supremacy is under threat amid rise of China

- Implementation risk exists in phase one deal with China's possible under-delivery in reducing trade imbalance, banning forced technology transfer, and enhancing IP protection. The coronavirus pandemic outbreak and the blame game over virus spread just worsened the China-US tensions

- **China-US tensions spreading over different areas.** US continued to restrict China 5G development. Senate passed the bill that could delist Chinese companies from US exchanges. Trump’s removal of HK’s special status after national security law legislation, Pompeo’s hardline speech against China brought the new cold war closer

- **Conclusion:** China and US are falling into Thucydides trap and it would take long time to reach a deal to settle down disputes between two great powers. Risk of new cold war is increasing

### China-US Tensions

- **Political/Diplomatic**
  - China’s growing international influence
  - One belt One Road Initiative
  - National Security law for HK, human rights for Xinjiang
  - Ideology between capitalism and socialism
  - Coronavirus pandemic responsibility
  - Taiwan issue

- **Economics**
  - Trade imbalance, currency manipulation
  - Forced technology transfer, Intellectual property protection, leading 5G technology and AI
  - Manufacturing production (Made in China 2025)

- **Financial**
  - RMB as international reserves currency
  - RMB oil future settlement
  - RMB financing via RMB bonds, FX swap line by central banks

- **Military**
  - South China Sea dispute

(Source: Mizuho HK)
# Mizuho FX Forecasts

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR/USD</td>
<td>Jan - Aug: 1.0636 ~ 1.1966 (1.1910)</td>
<td>Sep: 1.17 ~ 1.20 (1.18)</td>
</tr>
</tbody>
</table>

### 2020

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
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### Notes:

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