Global – Resurgent infection fueled double-dip recession risk

- Global infected cases surpassed 60mn, with death tolls topping 1.4mn. US and Europe contagion pace slowed after new lockdowns. Vaccine optimism raised hopes for global recovery, lifting copper/gold ratio. Global PMI held above 50.
Biden won the US President Election, while the Congress remained divided, with Republicans retaining controls in Senate. Democrats kept the House majority.

Trump campaign demanded appeals but most of his legal battles ended in failure. Chance for overturning the US Presidential election result is slim.

The final Senate election outcome will be confirmed in the Georgia election run-off on 5th January 2021.
US Elections (2) – Biden's victory + Divided Congress

- The Biden’s victory without a Blue Wave scenario suggested No near term huge fiscal stimulus, No tax hikes and No financial regulations tightening. His nomination of former Fed Chair Yellen as US Treasury Secretary heightened expectation for the policy mix of fiscal expansion & monetary easing.

- Biden’s presidency should suppress the China-US trade war risk given his stance against unilateral tariffs. The tariffs implementation was authorized by the Section 301 Trade Act and the Congress approval is not needed to adjust the tariffs policy. In our view, *Biden will focus on containing the virus spread, re-boosting the economy and fixing its relationship with its allies* after taking office, while the trade policy is not his primary concern.

**US President Biden**

- Senate Republicans
- House Democrats

- Block

- Huge fiscal stimulus
- Tax hikes
- Financial regulations tightening
- Against unilateral tariffs (Section 301)

**US equities (+)**
**UST yields (-)**
**USD (-)**

**RMB (+)**

(Source: Media, Mizuho HK)
Bleak reality vs. vaccine optimism

- The fast contagion and new lockdown pointed to a sharp slowdown in Q4 growth. Labour market continued to improve but the recovery has been slowing down.

- The deadlocked coronavirus relief negotiations will cloud US growth outlook. A premature withdrawal of stimulus and ending the emergency lending facilities will fuel double-dip recession risk. Despite the vaccine development, the road to recovery is set to remain bumpy.
Fed – Discussed QE tweaks

- Fed discussed the asset purchase in November, with potential changes in composition, duration, size and life cycle. US Treasury refused Fed to extend some of the credit facilities, leaving Fed under pressure to ease further in Dec.

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to delay rate hike timing

Reflation trade opportunity?

- Fed – Discussed QE tweaks

Fed discussed the asset purchase in November, with potential changes in composition, duration, size and life cycle. US Treasury refused Fed to extend some of the credit facilities, leaving Fed under pressure to ease further in Dec.

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to delay rate hike timing

Reflation trade opportunity?

- Fed – Discussed QE tweaks

Fed discussed the asset purchase in November, with potential changes in composition, duration, size and life cycle. US Treasury refused Fed to extend some of the credit facilities, leaving Fed under pressure to ease further in Dec.

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to delay rate hike timing

Reflation trade opportunity?

- Fed – Discussed QE tweaks

Fed discussed the asset purchase in November, with potential changes in composition, duration, size and life cycle. US Treasury refused Fed to extend some of the credit facilities, leaving Fed under pressure to ease further in Dec.

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to delay rate hike timing

Reflation trade opportunity?

- Fed – Discussed QE tweaks

Fed discussed the asset purchase in November, with potential changes in composition, duration, size and life cycle. US Treasury refused Fed to extend some of the credit facilities, leaving Fed under pressure to ease further in Dec.

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to delay rate hike timing

Reflation trade opportunity?

- Fed – Discussed QE tweaks

Fed discussed the asset purchase in November, with potential changes in composition, duration, size and life cycle. US Treasury refused Fed to extend some of the credit facilities, leaving Fed under pressure to ease further in Dec.

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to delay rate hike timing

Reflation trade opportunity?
USD (1) – Structural decline in 2021?

- Discussion over the USD structural decline mounted. Looking back, the long-lasting USD downtrend was triggered by a critical event rather than the cyclical factor. We look for modest USD decline in our forecast horizon.
  - **Dovish Fed**: Despite the vaccine development, the Fed is to remain dovish and pledges not to deliver rate hikes in coming 3 years. However, the relationship between UST curve and USD was not that obvious.
  - **US debt expansion**: US implemented huge fiscal stimulus to support growth financed by US debts. Yet, the ballooning debt burden is the global phenomenon. While Yellen may attempt to boost US economy via expansionary fiscal policy, the dividend Congress should keep the stimulus size in check.
  - **De-globalization**: The coronavirus outbreak heightened concern over the global supply-chain security. Alongside elevated China-US tensions, China will implement the dual circulation and the America-first trend is unlikely to reverse quickly under Biden’s presidency. The rebound in global trade volume next year should prove to be temporary and a sharp USD decline amid de-globalization trend will be in doubt.

---

**Structural USD decline took place with critical event, rather than UST yield curve change**

- **1985: Plaza Accord**
- **2001: China joined WTO, globalization began**
- **2020: Coronavirus outbreak, de-globalization?**

(Source: Bloomberg, Mizuho HK)
USD (2) – 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 in H2-20

**DXY lost ground to its 31-month low**

![DXY Index graph]

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

![VIX Index graph]

**Market remained heavy short USD**

![USD Net Positioning graph]

**USD losing its high yield advantage**

![10Y UST yield, 10Y German Bund yield, 10Y JGB yield graph]

(Source: Bloomberg, Mizuho HK)
USD (3) – 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/GDP to breach 100% in 2021

US budget deficit to deteriorate in long term

( Source: Bloomberg, Congressional Budget Office, Committee for a Responsible Federal Budget, Mizuho HK )
USD (4) – Reserve currency status at risk?

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

![USD share more than 60% global FX reserves](chart)

![FX reserves manager reduced USD assets holding](chart)

![USD dominating global FX turnover](chart)

![USD & EUR dominating in SWIFT payment](chart)

( Source: BIS, IMF, SWIFT, Bloomberg, Mizuho HK )
China-US Tensions – Conflicts beyond trade imbalance

Biden may change its style in handling China-US tensions but unlikely soften the stance

- **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.** Not only the trade imbalance, Trump took actions to contain China high-tech development and ban the US operations of Chinese software. The delisting risk of Chinese companies listed on US exchanges has been increasing

- 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 turn cold tensions into hot military conflicts

- **Conclusion**: China and US are falling into Thucydides trap. Biden is unlikely to reverse hardline stance against China but may shift the strategy from trade to other issues such as human rights and IP protection

---

### Political/Diplomatic
- China’s international influence: Belt & Road Initiative
- Human right issues in Xinjiang & HK. China National Security law for HK vs. HK Autonomy Act in US
- Taiwan issue
- Ideology between capitalism and socialism
- Coronavirus pandemic responsibility

### Economics
- Trade imbalance, currency manipulation
- China’s high-tech development and popular social app
- Forced technology transfer, Intellectual property protection for US corporates in China

### Financial
- RMB internationalization: rise of reserves currency status, RMB oil future settlement, digital RMB
- Chinese corporate listed in US exchanges

### Military
- South China Sea dispute
Phase one deal – Remain fully intact

Trade is not primary concern for Biden

- 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 missing US purchase target, China and US held a constructive trade talk and reaffirmed to implement the trade deal. As trade is not the primary concern for Biden, we expect the phase one deal to remain unchanged before resuming the new trade talks. **Given Biden’s stance against unilateral tariffs, new trade war looks unlikely.**

<table>
<thead>
<tr>
<th>US trade deficit to China narrowing</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="chart" alt="Graph showing US trade deficit to China narrowing" /></td>
</tr>
</tbody>
</table>

**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>-4.9</td>
<td>-10.2</td>
<td>-7.6</td>
<td>-4.2</td>
<td>-22.7</td>
</tr>
<tr>
<td>2018</td>
<td>5.8</td>
<td>1.9</td>
<td>5.8</td>
<td>3.8</td>
<td>11.3</td>
</tr>
<tr>
<td>2019</td>
<td>11.3</td>
<td>11.4</td>
<td>12.5</td>
<td>9.3</td>
<td>34.5</td>
</tr>
</tbody>
</table>

**China’s shopping list**

<table>
<thead>
<tr>
<th></th>
<th>Additional US exports to China on top of 2017 baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Year 1</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)
CNY extended its gains to its 2.5 year high of 6.54 after US elections. Biden’s victory should suppress the new trade war risk, while the vaccine breakthrough could undermine China’s exceptional growth momentum

- **China-US tensions:** In light of Biden’s stance against unilateral tariffs, new trade war risk should remain subdued. Yet, Trump’s actions targeting China before his departure could cause jitters in RMB market

- **PBoC-Fed monetary divergence:** The Fed remains dovish given the unsettling virus spread, while PBoC had turned more neutral. The widening CGB-UST yield differential above +200bps alongside CGB inclusion in global bond index should encourage capital inflow to onshore China market. It would be too early to say if the vaccine development will prompt the Fed to recalibrate its easing plan

- **China FX policy:** PBoC lowered the FX forward risk reserves and faded out the counter cyclical factor in CNY fixing to slow RMB appreciation pace. Under the dual circulation development plan, the PBoC should be comfortable with the RMB appreciation trend and steady capital inflow

---

**We maintain our bullish RMB view in the medium term**

(Source: Bloomberg, Mizuho HK)
RMB (2) – Asset allocation capital inflow

- The stronger China growth dynamic vs. G3 economy and widening CGB-UST yield spread should encourage capital inflow to RMB assets

CGB-UST yield spread widening

Healthy bull in China A-shares market

Stock Connect flow to A-share market

Foreign share in onshore bond increases

( Source: Bloomberg, Mizuho HK )
China economy (1) – Strong recovery after pandemic

- China Q3 GDP accelerated to 4.9% YoY and year-to-date growth turned positive of +0.7%, weathering the pandemic impact. Industrial production surpassed pre-pandemic level. Consumption recovery started to pick up, while online sales remained strong after lockdown lifting.

1. **China GDP V-shaped rebound**

2. **IP surpassed pre-pandemic level**

3. **Consumption recovered**

4. **Online sales remained solid after lockdown lifting**

( Source: Bloomberg, Mizuho HK )
China economy (2) – Strong recovery after pandemic

- China CPI inflation eased to below 1% YoY on falling food prices, while PPI deflation remained deep. FAI recovery was lagging behind after the pandemic as it takes time to rebuild business confidence. Upbeat non-mfg. PMI boded well for consumption recovery.

(C Source: Bloomberg, Mizuho HK)
China economy (3) – Strong recovery after pandemic

- Surging exports for medical stuff continued to support China trade figures. China exports to US jumped following the economy re-opening. Alongside narrowing tourism deficit under border controls current account of service narrowed and offered fundamental support to the RMB.

**Robust China exports in Q3**

**Medical exports surged amid pandemic**

**China exports to US and Japan recovered**

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

(Source: Bloomberg, Mizuho HK)
China economy (4) – Uneven recovery

- China rebounded sharply after pandemic and the wave of SOE bonds defaults raised concern over uneven recovery
  - **Consumption:** Consumption activities resumed under successful virus control. Tourism will not revive before border control eases. China will seek to expand domestic consumption under dual circulation development plan
  - **Industrial production:** The stable supply-chain will be essential to protect China IP
  - **Fixed asset investment:** Weak biz confidence suppressed capex, while foreign firms came under pressure to withdraw investment from China under de-globalization trend
  - **Trade:** Solid medical export demand supported China trade but new lockdown risk could weigh on external demand

---

**Bond issuance to finance stimulus**

<table>
<thead>
<tr>
<th>Year</th>
<th>CNY bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>6000</td>
</tr>
<tr>
<td>2017</td>
<td>4500</td>
</tr>
<tr>
<td>2018</td>
<td>4000</td>
</tr>
<tr>
<td>2019</td>
<td>5000</td>
</tr>
<tr>
<td>2020</td>
<td>6500</td>
</tr>
</tbody>
</table>

**Chinese SOE bond defaults raised concern**

<table>
<thead>
<tr>
<th>Year</th>
<th>RMB bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>1</td>
</tr>
<tr>
<td>2015</td>
<td>6</td>
</tr>
<tr>
<td>2016</td>
<td>29</td>
</tr>
<tr>
<td>2017</td>
<td>23</td>
</tr>
<tr>
<td>2018</td>
<td>95</td>
</tr>
<tr>
<td>2019</td>
<td>153</td>
</tr>
<tr>
<td>2020</td>
<td>88</td>
</tr>
</tbody>
</table>
RCEP to push forward dual circulation strategy

- The Regional Comprehensive Economic Partnership (RCEP) was signed among China, Japan, Korea, ANZ and ASEAN 10 (excluding India) on 15 Nov.

- Despite the RCEP overlapping some free-trade agreement, the RCEP was the first free trade deal between China, Japan and South Korea. Peterson Institute for International Economics (PIIE) estimated JP & KR to benefit 1% real income gain by 2030, while RCEP should push forward its dual circulation strategy. Apart from tariffs cut, the RCEP will bring the unifications to rule of origin.

- Looking forward, it will take time for RCEP ratification. Including India and agricultural trade into RCEP will be next target.
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 retail sales outstanding surpassed US**

<table>
<thead>
<tr>
<th>Year</th>
<th>China Retail Sales Value</th>
<th>US Nominal Retail Sales Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2001</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2002</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>2003</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>2004</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>2005</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>2006</td>
<td>600</td>
<td>600</td>
</tr>
<tr>
<td>2007</td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>2008</td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td>2009</td>
<td>900</td>
<td>900</td>
</tr>
<tr>
<td>2010</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>2011</td>
<td>1,100</td>
<td>1,100</td>
</tr>
<tr>
<td>2012</td>
<td>1,200</td>
<td>1,200</td>
</tr>
<tr>
<td>2013</td>
<td>1,300</td>
<td>1,300</td>
</tr>
<tr>
<td>2014</td>
<td>1,400</td>
<td>1,400</td>
</tr>
<tr>
<td>2015</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>2016</td>
<td>1,600</td>
<td>1,600</td>
</tr>
<tr>
<td>2017</td>
<td>1,700</td>
<td>1,700</td>
</tr>
<tr>
<td>2018</td>
<td>1,800</td>
<td>1,800</td>
</tr>
</tbody>
</table>

---

**China’s GDP share on PPP outsizing G3**

<table>
<thead>
<tr>
<th>Year</th>
<th>US GDP share%</th>
<th>Eurozone GDP share%</th>
<th>China GDP share%</th>
<th>Japan GDP share%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>25</td>
<td>20</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>1990</td>
<td>20</td>
<td>15</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>2000</td>
<td>15</td>
<td>10</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>2010</td>
<td>10</td>
<td>5</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>2020</td>
<td>5</td>
<td>2</td>
<td>1</td>
<td>0</td>
</tr>
</tbody>
</table>

(Source: Bloomberg, Mizuho HK)
PBoC Policy (1) – Slowing RMB appreciation pace

Lowering FX forward risk reserves ratio and fading out the CCF

- PBoC lowered FX forward risk reserves ratio to 0% from 20% and faded out the counter cyclical factor (CCF) adjustment in the CNY fixing to curb RMB appreciation bias
- Under the dual circulation plan and onshore financial market open-up, the RMB appreciation trend should be welcomed while too fast RMB appreciation could hurt China recovery
- China still reserves ample tools to curb RMB rally, such as expanding the Qualified Domestic Institutional Investors (QDII) quota to relax outward investment channel
PBoC Policy (2) – Turned more neutral

Rates to stay unchanged, while keep liquidity ample

- The PBoC turned more neutral as economy normalized. Q3 Monetary Policy Report noted to keep money supply control gate, stabilize the macro leverage ratio, and strengthen financial market infrastructures.

- In order to keep liquidity condition reasonably ample, the PBoC expanded the MLF and turn more flexible in open market operations.

- The PBoC also downplayed the disinflation risk and is unlikely to cut rate to boost inflation expectation.

( Source: Bloomberg, Mizuho HK )
SOE bond defaults raised concern over fin. stability

- China set up the relending and rediscounting credit facility (totaling CNY 1.8tn) to support small-and-micro enterprises under pandemic. It guided banks to delay loan and interest repayment at the cost of banking profits. Medium-term loan to corporate to support real economy was encouraged.

- The SOEs bond defaults exposed the uneven recovery and alerted policy makers. Chinese Vice Premier Liu He held the State Council Financial Stability Committee meeting and vowed zero tolerance for intended bond violations. Top regulators called for setting up the mechanism to handle substantial financial risk. No relief in property tightening.
### Mizuho FX Forecasts

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jan - Nov Dec</td>
<td>Jan - Mar Apr - Jun Jul - Sep Oct - Dec</td>
</tr>
<tr>
<td><strong>USD/JPY</strong></td>
<td>101.18 ~ 112.23 (103.86)</td>
<td>98 ~ 105 (101)</td>
</tr>
<tr>
<td></td>
<td>100 ~ 105 (103)</td>
<td></td>
</tr>
<tr>
<td><strong>EUR/USD</strong></td>
<td>1.0636 ~ 1.2014 (1.1972)</td>
<td>1.16 ~ 1.20 (1.18)</td>
</tr>
<tr>
<td></td>
<td>1.18 ~ 1.21 (1.19)</td>
<td></td>
</tr>
<tr>
<td><strong>EUR/JPY</strong></td>
<td>114.43 ~ 127.06 (124.35)</td>
<td>121 ~ 128 (120)</td>
</tr>
<tr>
<td></td>
<td>120 ~ 126 (123)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jan - Nov Dec</td>
<td>Jan - Mar Apr - Jun Jul - Sep Oct - Dec</td>
</tr>
<tr>
<td></td>
<td>6.50 ~ 6.70 (6.60)</td>
<td></td>
</tr>
<tr>
<td><strong>EUR/CNY</strong></td>
<td>7.5426 ~ 8.3256 (7.8603)</td>
<td>7.55 ~ 8.11 (7.79)</td>
</tr>
<tr>
<td></td>
<td>7.67 ~ 8.11 (7.85)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>14.93 ~ 16.15 (15.61)</td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**

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

Legal, Account & Taxation Advice
All information included in this proposal should not be regarded as any legal, accounting or taxation advice from Mizuho. No person should rely on the contents of such information without obtaining prior advice from any qualified professional expert(s) in each relevant sector. If Mizuho’s service under this proposal calls for specific professional advice or service, client shall seek independent professional expert(s)’ help. Alternatively, if Mizuho’s assistance is required for referral of relevant expert(s), there is no extra referral fee for such referral and Mizuho is not liable for the advice or service given by such expert(s).

Confidentiality
All information included in this proposal is strictly exclusive for Mizuho’s clients’ internal use only. No disclosure to any third party from clients should be allowed.

Copyrights
All rights reserved. No part of content of this proposal may be reproduced or copied in any form or by any means.

Liability and Responsibility
Mizuho disclaims all and any liability and responsibility to any person upon correctness, reliability and completeness of the whole or any part of the contents of this proposal. No assurance on the acquisition of approval for any permit application is included. The services provided by any member of the Mizuho Financial Group are subject to applicable laws, regulations and supervision of applicable regulatory authorities’ in the jurisdictions where the services are provided.