Mizuho Bank 2021 RMB Outlook
The return of RMB rally

January 2021

East Asia Treasury Department, Treasury Marketing Section

Private and confidential
Global – Unsettling virus spread with flooding liquidity injection

- Global infected cases surpassed 60mn, with death tolls topping 1.7mn. The more contagious virus mutation weighed vaccine optimism. Global central banks injected massive liquidity along huge fiscal stimulus to support the growth.

- More than 80mn infected globally

- Surging infection, vaccination not yet materialize

- Massive liquidity injection from major CB

- Returning to the world of negative yield

(Source: Bloomberg, Mizuho HK)
The global reopening alongside vaccine development boosted inflation expectation. Commodity prices surged and copper/gold ratio jumped. Yet, the Baltic Dry Index was stuck at lows before the global reopening.

### Global – Reflation trade

- **Reflation expectation picked up**
  - 5Y5Y Inflation Swap Fwd
  - JPY, USD, EUR

- **Vaccine optimism lifted copper/gold ratio**
  - Copper/Gold ratio

- **Iron ore future surged on China strong growth**
  - AUD/USD
  - Iron Ore Future (RHS)

- **BDI stuck in low level**
  - Baltic Dry Index

(Source: Bloomberg, Mizuho HK)
**US Elections – Biden's victory + Blue Wave**

- The Biden’s victory with a dramatic flip to Blue Wave in the US Congress after the Georgia Senate run-off race brought the expectation of Biden’s policy agenda adjustments, such as near-term huge fiscal stimulus vs. medium-term tax hike and financial regulations tightening. Investors were also awaiting the fiscal policy stance to boost US recovery under the new US Treasury Secretary Yellen.

- 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.

- Under Biden’s presidency, he will likely focus on contain the pandemic, re-boost the economy and repair the relationship with US allies, while the trade policy will not be the primary concern.

### Senate Republicans vs. House Democrats

<table>
<thead>
<tr>
<th>Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Huge fiscal stimulus</td>
</tr>
<tr>
<td>Tax hikes</td>
</tr>
<tr>
<td>Financial regulations tightening</td>
</tr>
<tr>
<td>Against unilateral tariffs (Section 301)</td>
</tr>
</tbody>
</table>

**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. The job market recovery was moderating, with non-farm payrolls falling again.
- US Congress managed to break the deadlock and passed a smaller size stimulus bill of around USD 900bn. Biden called for huge stimulus amounting trillions dollars to support growth following the Blue Wave flip. The fiscal stimulus should help counter the downside risk but was not enough to boost US growth.

US non-farm payrolls dropped again

Initial jobless claims risk tilted to upside

US Q4 recovery momentum to recede

(Source: Bloomberg, Mizuho HK)
Fed – To keep QE until substantial further progress

- Fed strengthened its forward guidance to keep QE until making substantial further progress towards its employment and inflation goals, while still expected no rate hike until 2023-end. The FOMC rotation showed a dovish shift, with Harker, Mester (hawks) out and Evans, Daly (doves) in

Fed signaled no rate hike until 2023-end

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

Avg. inflation targeting to push back rate hike timing

UST yield curve steepening underway

( Source: Bloomberg, Mizuho HK )
USD (1) – Structural decline in 2021?

- Discussion over the USD structural decline ramped up. Looking back, the long-lasting USD downtrend was triggered by a critical event rather than the cyclical factor. We expect the USD to bottom out at Q1-21 and pick up afterwards
  - **Dovish Fed**: The Fed remained dovish and pledged not to deliver rate hikes in coming 3 years. Yet, the Fed will start to turn less dovish amid the global reopening and reflation. We expect the virus infection to peak out at Q1-21 and the return of UST yield advantage will bring support to the USD subsequently
  - **US debt expansion**: US implemented huge fiscal stimulus to support growth financed by US debts. However, the ballooning debt burden is the global phenomenon and the USD heavy debt burden is not the exceptional. Once the virus came under control, expectation for US fiscal stimulus and debt burden would recede
  - **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 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**

(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. However, these factors are subjected to reverse in 2021.
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

- **USD bn**
  - 2008: -500
  - 2009: -1000
  - 2010: -2000
  - 2011: -3000

### US Debt/GDP to breach 100% in 2021

- **US debt to GDP%**
  - 2019: 70
  - 2020: 85
  - 2021: 95

### Budget deficit widening as a global phenomenon

- **Budget Deficit % GDP**
  - UK
  - US
  - Japan
  - Eurozone
  - China

(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**

![Currency Composition of official FX Reserves](chart1)

**FX reserves manager reduced USD assets holding**

![Composition Change in Global FX Reserves](chart2)

**USD dominating global FX turnover**

![BIS survey: OTC FX turnover net-net basis (total 200%)](chart3)

**USD & EUR dominating in SWIFT payment**

![SWIFT payment % share at Nov20](chart4)

(Source: BIS, IMF, SWIFT, Bloomberg, Mizuho HK)
CNY rallied to below 6.50 handle in the beginning of 2021 as investors remained convinced with China exceptional growth story. Going onwards, the vaccine development will undermine China’s exceptional growth momentum and we look for moderate RMB appreciation up to 6.40 level

**China-US tensions:** In light of Biden’s stance against unilateral tariffs, new trade war risk should remain subdued. The return of China-US tensions could moderate capital inflow to RMB assets when Biden put his focus back to China in H2-21

**PBoC-Fed monetary divergence:** The Fed remained dovish but the US recovery and reflation following the vaccination would prompt the Fed to recalibrate its easing plan, leading to narrowing CNY-USD yield spread

**China FX policy:** Under the dual circulation development plan, China growth will less rely on export sector and PBoC is not against the RMB appreciation trend. Instead, the PBoC will take this window of opportunity to relax capital controls and broaden outbound investment channels

---

**RMB appreciation to moderate and hold steady at 6.4**

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

- The stronger China growth dynamic vs. G3 economy and widening CGB-UST yield spread encouraged capital inflow to RMB assets. Inflow could slow down when global yields began to pick up.

- CGB-UST yield spread stayed wide

- 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.

**China GDP V-shaped rebound**

**IP surpassed pre-pandemic level**

**Consumption recovered**

**Online sales remained solid after lockdown lifting**

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

- China deflation was proved to be temporary and the PBoC is unlikely to modify its policy accordingly. 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.

**China deflation proved to be temporary**

- China CPI and China PPI trends over time.

**FAI recovery lagging behind**

- FAI growth rates in Real Estate, Infrastructure, Mfg. sectors over time.

**China food prices rebounded**

- China CPI and China PPI YoY% trends over time.

**Mfg. PMI held up at 3-yr high**

- China Official Mfg. PMI and China Official non-mfg PMI trends over time.

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

- Surging exports for medical stuff continued to support China trade figures. External demand for major markets jumped after vaccine breakthrough, while global supply-chain excluding China has not yet restored. The narrowing tourism deficit under border controls in C/A narrowed also offered fundamental supports to China.
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 and overseas demand after vaccine development supported China trade

![Graphs showing bond issuance and default](image1.png)

**Bond financing dropped on year-on-year basis**

**Bond issuance to finance stimulus**

**Chinese SOE bond defaults raised concern**
Signing of RCEP to boost Asia growth

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.

![RCEP GDP share 30% of global GDP](chart1)

![RCEP to boost declining CN-JP trade](chart2)

![JP & KR benefitted most from RCEP](chart3)

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

Biden may change its style in handling China-US tensions but unlikely reverse hardline 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.** While the trade conflicts was in the background, the rise of China in financial influence and high-tech development prompted Trump to impose sanctions. Biden is unlikely to drop such tariffs/sanctions but take them as bargain chips for renegotiations

- 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. Human rights and IP protections issues will stay in focus

- Comparing to Trump, Biden’s foreign policy should be more predictable and multilateral. Biden will probably focus on repairing the relationship with US allies after taking office and turn attention back to China with allies back-up in H2-21

**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

(Source: Mizuho HK)
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. The actual China purchases were falling short of the targets, but both sides refrained from cancelling the 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**

### US trade deficit to China narrowing

#### China falling short of its agri purchase target

- **2020 target $32bn**

#### China’s shopping list

<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></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)
Chinese leaders recalibrated the economic development plan after the virus outbreak and deteriorating China-US tensions. The main tasks in CEWC are in line with dual circulation strategy and green development idea in 14th Five Year Plan. Regulations tightening is on the table to curb the influence of monopoly.

**China Central Economic Working Conference**

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Strengthen national strategic technology power</td>
<td>Decisively implement new development plan</td>
</tr>
<tr>
<td>2</td>
<td>Increase industry supply-chain self-sufficiency</td>
<td>Fight the 3 though battles of preventing and defusing the substantial risks, targeted poverty alleviation and pollution control</td>
</tr>
<tr>
<td>3</td>
<td>Persist the expansion of domestic consumption</td>
<td>Ensure the improvement of resident living and social security protection</td>
</tr>
<tr>
<td>4</td>
<td>Push forward reform and open-up broadly</td>
<td>Continue to implement the proactive fiscal policy and prudent monetary policy</td>
</tr>
<tr>
<td>5</td>
<td>Resolve the good quality seeds and agricultural land problems and protect the food supply safety</td>
<td>Focus on high-quality development</td>
</tr>
<tr>
<td>6</td>
<td>Strengthen anti-trust and avert the disorderly capital expansion</td>
<td>Deepen the economic institutional reform</td>
</tr>
<tr>
<td>7</td>
<td>Resolve the housing problems in big cities and uphold &quot;housing for accommodation but not speculation&quot;</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Work on the carbon emission peak-out and carbon neutral campaigns</td>
<td></td>
</tr>
</tbody>
</table>
China Policy (2) – 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’s Dual Circulation**

- **Domestic Demand**
  - Consumption upgrade
  - Urbanization

- **Domestic Supply**
  - Supply-chain security: Energy & food
  - Innovation & mfg. upgrade: Tech supply self-sufficiency

- **International Demand**
  - Export growth as secondary

- **International Supply**
  - Resources & tech supply

**Income & Salary**

- FDI, technology imports, resources, FX supply

**Consumption & Investment**

- Exports, RMB internationalization

**External Circulation**

**Internal Circulation**

**Threats**: Trade war, US sanctions, CN-US decoupling, Pandemic hit

(Source: Mizuho HK)
China Policy (3) – 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's GDP share on PPP outsizing G3**

---

**China retail sales outstanding surpassed US**

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

( Source: Bloomberg, Mizuho HK )
PBoC Policy (2) – Turned more neutral

Rates to stay unchanged, while keep liquidity ample

- The PBoC turned more neutral as economy normalized. At the Q4 monetary policy committee meeting, the PBoC noted to keep the policy continuity, stability and sustainability, and pledged to align money supply & social financing in line with nominal GDP growth and stabilize the macro leverage ratio.

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

- The PBoC also highlighted the policy stability and vowed no policy U-turn, curbing expectation for abrupt policy tightening in the near term.

(CNH & CNY DF retreated)

(PBoC targets to stabilize macro leverage ratio)

(Rate cut cycle paused since April)
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. The PBoC pushed back the policy normalization while keep the liquidity condition ample to counter the shocks from credit events and regulations tightening impact.

- Under the guidance of strengthening antitrust and averting disorderly capital expansion, the internet micro-financing will be included in the regulation framework.
# Mizuho FX Forecasts

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jan - Dec</td>
<td>Jan - Mar</td>
<td>Apr - Jun</td>
<td>Jul - Sep</td>
</tr>
<tr>
<td><strong>USD/JPY</strong></td>
<td>101.18 ~ 112.23 (103.19)</td>
<td>98 ~ 105 (101)</td>
<td>98 ~ 105 (102)</td>
<td>100 ~ 107 (104)</td>
</tr>
<tr>
<td><strong>EUR/USD</strong></td>
<td>1.0636 ~ 1.2309 (1.2288)</td>
<td>1.19 ~ 1.24 (1.21)</td>
<td>1.17 ~ 1.22 (1.19)</td>
<td>1.15 ~ 1.20 (1.17)</td>
</tr>
<tr>
<td><strong>EUR/JPY</strong></td>
<td>114.43 ~ 127.23 (126.81)</td>
<td>121 ~ 130 (122)</td>
<td>120 ~ 129 (121)</td>
<td>119 ~ 129 (122)</td>
</tr>
<tr>
<td><strong>EUR/CNY</strong></td>
<td>7.5426 ~ 8.3256 (8.0273)</td>
<td>7.62 ~ 8.18 (7.87)</td>
<td>7.43 ~ 7.99 (7.68)</td>
<td>7.25 ~ 7.80 (7.49)</td>
</tr>
</tbody>
</table>

Notes:

1. Prepared by East Asia Treasury Department, Shanghai Treasury and Tokyo headquarter
2. Actual quotes updated at 31 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.