Mizuho Bank 2021 RMB Outlook
The return of RMB rally

May 2021

East Asia Treasury Department, Treasury Marketing Section
USD and UST yields retreated as investors digested Biden’s strong stimulus plan. His tax rate hike plan to raise capital gain tax to around 40% dealt a blow to risk assets but the sell-off was proved to be short-lived.

The Fed upgraded the US economic outlook but refrained from discussing its tapering plan. Inflationary pressure has been building up due to the transitory factors largely.

The global virus spread remains unsettling, with resurgent of India daily infections to above 300k, while the vaccinations progress helped contain virus spread in Europe and US.

<table>
<thead>
<tr>
<th>Date</th>
<th>Key Events for 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 6 (GB)</td>
<td>Scottish parliamentary elections</td>
</tr>
<tr>
<td>Jun 23 (JP)</td>
<td>Summer Olympics</td>
</tr>
<tr>
<td>Jul</td>
<td>1 (HK) Equities stamp duty hike</td>
</tr>
<tr>
<td>Aug</td>
<td>22 (JP) General election</td>
</tr>
<tr>
<td>Sep</td>
<td>Vaccination, global reopening in H2?</td>
</tr>
</tbody>
</table>

In the pipeline
Global – Reflation trade still in play

- Global inflation picked up amid surging commodity prices. Cryptocurrency surged as a tool to hedge inflation and central bank easing risk. Global yields returned to pre-pandemic level. US equities pushed back to their record highs.

**Copper price hit its decade high of US$10K per ton**

**Global yields back to pre-pandemic level**

**Cryptocurrency frenzy**

**US equities returned to record highs**

(Source: Bloomberg, Mizuho HK)
Global infected cases surpassed 150mn, with death tolls topping 3.2mn. The vaccination roll-out slowed virus spread in Europe and US, while India turned to be a new epicenter. Global mfg. PMI climbed above 50 expansion mark.
Biden’s huge stimulus materializing to boost growth

- The vaccine rollout and Biden’s huge stimulus plan led to an upgrade on US growth outlook. Biden unveiled his USD 1.8tn American Families Plan to be financed by the tax hike for wealthiest groups in the US.
- With the solid recovery in US labour market and the direct payment to US families in March, the strong Q1 consumption boosted Q1 GDP growth notably. Yet, the recovery remains uneven.

**US Economy – Strong policy support**

**Consumption boosted US Q1 growth**

**Improvement in US jobs market regained momentum**

**Initial jobless claims fell further**

(Source: Bloomberg, Mizuho HK)
Fed – Too early to discuss tapering

- The Fed upgraded the economic outlook at April meeting but chair Powell said it was too early to discuss the tapering plan given uneven recovery, and the central bank would act on actual data, not its forecasts.

Is the Fed behind the curve?

Fed upgraded the 2021 growth outlook sharply

Avg. inflation targeting: more tolerance on inflation

Fed tolerates higher UST yields

(Source: Bloomberg, Mizuho HK)
USD (1) – Is US inflation transitory or persistent?

- US inflation risk is subjected to upside given soaring PPI, rising salary growth and mounting inflation expectation. With strong stimulus, US output gap is set to turn positive and persistent inflation will pressure the Fed to discuss tapering sooner this year.

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**Soaring PPI could pull up CPI**

**Upward pressure in salary growth**

**US inflation expectation hit decade high**

**IMF expect US output gap to turn positive**

(Source: Bloomberg, Mizuho HK)
USD (2) – Safe-haven status undergoing change

- USD yield advantage has been recovering while the Fed may have to discuss the tapering plan sooner given the US stimulus boost, posing a change to the USD’s safe-haven status. US fiscal deficit worsened, while investors kept speculative USD short position.

US not only one facing with worsening budget deficit

<table>
<thead>
<tr>
<th>Country</th>
<th>2020</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>US</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Japan</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Eurozone</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>China</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Budget Deficit % GDP

VIX Index

USD’s safe-haven status undergoing change

Speculative USD short positioning remains

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Positioning</th>
<th>DXY (RHS)</th>
</tr>
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<tbody>
<tr>
<td>2016</td>
<td>-40</td>
<td>88</td>
</tr>
<tr>
<td>2017</td>
<td>-30</td>
<td>90</td>
</tr>
<tr>
<td>2018</td>
<td>-20</td>
<td>92</td>
</tr>
<tr>
<td>2019</td>
<td>-10</td>
<td>94</td>
</tr>
<tr>
<td>2020</td>
<td>0</td>
<td>96</td>
</tr>
<tr>
<td>2021</td>
<td>10</td>
<td>98</td>
</tr>
</tbody>
</table>

USD regaining its yield advantage

- Fed slashed policy rates
- 10Y UST yield vs. avg. of Bund & JGB

( Source: Bloomberg, Mizuho HK )
USD (3) – Central banks trimmed USD exposure in FX reserves in Q4-20

- Despite USD’s dominance in global FX reserves, USD share dropped to its 25-year low of 59% amid the prevailing bearish USD sentiment. The significant share of USD FX turnover and SWIFT payment highlighted its FX importance.

- USD share of global FX reserves dropped to <60%

- USD dominating global FX turnover

- USD & EUR dominating in SWIFT payment

( Source: BIS, IMF, SWIFT, Bloomberg, Mizuho HK )
The RMB pared back its year-to-date loss from the tapering tantrum, and we expect the RMB modest appreciation path to resume amid the robust recovery given the successful epidemic controls.

- **PBoC-Fed monetary divergence**: The Fed pledged to keep its easing measures despite the brighter US growth outlook. With the unsettling Chinese bond market, the PBoC refrained from starting the rate hike cycle. Both China and US will lead global recovery and their monetary divergence will be narrowing.

- **Vaccinations progress**: The fast vaccination rollout in the US slowed the virus spread and boosted US growth outlook. While the vaccination will undermine China growth exceptionalism, the upgrade in global outlook will support China export sector and counter the downside risk towards 6% annual growth.

- **China-US tensions**: Biden kept the hardline stance against China, and the return of China-US tensions, especially on the financial sanctions front, could moderate capital inflow to RMB assets. The broader tensions between China and Western countries pointed to higher risks of multilateral sanctions.

### RMB to resume modest appreciation path

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

- The narrowing CGB-UST yield spread and undermining China growth exceptionalism pointed to less appealing RMB investment. A-share inflow stalled, while bond inflow climbed robustly amid global bond indices inclusion.
China economy (1) – Data surged on based effect

- China Q1 GDP growth soared by a record of +18.3%YoY due to the strong base effect. China industrial production and retail sales for March also surged and the recovery looked more even. Online sales maintained high growth.

China Q1 GDP YoY hit a record, QoQ decelerated

IP surged as China was in lockdown last year

Consumption jumped sharply on base effect

Online sales maintained high growth

( Source: Bloomberg, Mizuho HK )
China economy (2) – Data surged on based effect

- China CPI halted its back-to-back deflation while soaring PPI fueled global reflation concern. FAI also shot up on base-effect and strong real estate investment. China PMIs dipped but stayed above 50 expansion mark

- China CPI subdued, PPI jumped

- Non-food CPI drifted lower

- FAI recovery lagging behind

- China PMIs dipped but remained above 50

( Source: Bloomberg, Mizuho HK )
China economy (3) – Pent-up demand boosted exports

- China exports surged on the base effect and the pent-up demand for global reopening, with still robust demand for medical products. The narrowing tourism deficit under border controls in C/A narrowed offered fundamental supports to RMB.

**Strong China exports in Q1**

![Graph showing China Exports YoY and China Imports YoY]

**External demand up after vaccine breakthrough**

![Graph showing 3-mth avg. YoY% for China Exports]

**Medical exports con’t to jump as virus unsettles**

![Graph showing Medical exports Breakdown]

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

![Graph showing USD bn for China C/A Bal. - Service ex Tourism and Tourism]
China-US Tensions – Conflicts beyond trade imbalance

Biden retained 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.** 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’s administration will uphold the phase one deal and the existing tariffs before renegotiation in the future

- 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 fuel geopolitical risks. The Xinjiang issue broadened tensions between China and Western countries

- Biden’s presidency signaled the return of multilateralism. Yet, the first high-level diplomatic meeting which opened with tensions and ended up without statement reflected no improvement under Biden’s presidency

### Rise of China

**Political/Diplomatic**
- China’s international influence: Belt & Road Initiative
- Xinjiang & HK issues. 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
- Delisting Chinese corporate from US exchanges, Expansion in US investment blacklist for Chinese corporate

**Military**
- South China Sea dispute

(Source: Mizuho HK)
Phase one deal – To continue under Biden’s presidency

New TR to keep the tariffs & phase one deal

- 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
- The US Trade Representative said China has fallen short on its commitments to protect American intellectual property in the phase one deal. Any updates on the renegotiations of phase one deal will be watched

China purchase target for 21 more challenging

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>2-Year Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufactured goods</td>
<td>32.9</td>
<td>44.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td>12.5</td>
<td>19.5</td>
</tr>
<tr>
<td>Energy</td>
<td>18.5</td>
<td>33.9</td>
</tr>
<tr>
<td>Services</td>
<td>12.8</td>
<td>25.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>76.7</strong></td>
<td><strong>123.3</strong></td>
</tr>
</tbody>
</table>

( 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

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**China’s Dual Circulation**

- **Internal Circulation**
  - Domestic Demand • Consumption upgrade • Urbanization
  - Domestic Supply • Supply-chain security: Energy & food • Innovation & mfg. upgrade: Tech supply self-sufficiency

- **External Circulation**
  - International Demand • Export growth as secondary
  - International Supply • Resources & tech supply

- **Income & Salary**
  - Consumption & Investment

- **FDI, technology imports, resources, FX supply**

- **Exports, RMB internationalization**

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

(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.

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

**China retail sales outstanding surpassed US**

**China C/A surplus shrank since 2007**

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

FX forward risk reserves ratio cut and neutralizing 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, PBoC should have more tolerance on the RMB appreciation but too fast RMB appreciation could hurt 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. The regulators could modify the FX forward risk and CCF to curb RMB appreciation bias and tame capital inflow
**PBoC Policy (2) – No policy U-turn**

**Rates to stay unchanged, while keep liquidity ample**

- 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, with no policy U-turn
- In order to keep liquidity condition reasonably ample, the PBoC rolled over the MLF while its open market operations (OMOs) were not that active in recent weeks
- With uneven recovery and unsettling Chinese bond market, the PBoC is unlikely resume its tightening cycle. Impact from the Huarong issue should prove to be short-lived given the PBoC’s help

**China Q1 nominal GDP growth spiked**

**Bond financing shrinking since the SOEs default**

(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 Alipay and WeChat pay

- Chinese officials stressed the e-CNY is for the domestic retail use at initial stage while we reckon that the e-CNY will play a role to drive RMB internationalization when the cross-order settlement is available

- In comparison to the online payment platforms, the e-CNY settlement is available without the internet and bank accounts

- PBoC ruled out the complete anonymity of the e-CNY in order to monitor crimes such as money laundering, illegal financing and tax evasion

- **FX Implication:** At this stage the e-CNY will serve as the digital format of currency in circulation and its immediate impact on the CNY will be largely muted. In the future when the e-CNY is available for the cross-border settlement (given its nature of partially traceable), it will help accelerate China capital account open-up and RMB internationalization by containing outflow risk via underground channels. The rise of RMB as an international currency will be bullish to the RMB exchange rate
The development of e-CNY: Timeline

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
- 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
- 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

2021
- Feb 21: Beijing issued digital cash vouchers to local residents totaling CNY 100mn

Future
- 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 cryptocurrency, the e-CNY is an unit of account with government backstop and high price volatility is not involved.

- The PBoC said the digital RMB will co-exist with Alipay and WeChat (these are actually claims of bank deposit), and provides the backup to the dominating online payment platforms when the internet and bank accounts are not available. The PBoC’s assess to the e-CNY circulation information will help formulate its monetary policy and enhance the stability of electronic payment system operated by private companies.

Comparisons between currencies/payment methods

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

(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.
### Mizuho FX Forecasts

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jan - Apr</td>
<td>May - Jun</td>
</tr>
<tr>
<td><strong>USD/JPY</strong></td>
<td>102.60 ~ 110.85 (108.85)</td>
<td>106 ~ 112 (109)</td>
</tr>
<tr>
<td><strong>EUR/USD</strong></td>
<td>1.1704 ~ 1.2349 (1.2125)</td>
<td>1.17 ~ 1.21 (1.19)</td>
</tr>
<tr>
<td><strong>EUR/JPY</strong></td>
<td>125.10 ~ 132.35 (132.00)</td>
<td>128 ~ 134 (130)</td>
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<tr>
<td><strong>EUR/CNY</strong></td>
<td>7.6801 ~ 8.0559 (7.8382)</td>
<td>7.49 ~ 8.11 (7.79)</td>
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<tr>
<td><strong>CNY/JPY</strong></td>
<td>15.731 ~ 16.919 (16.808)</td>
<td>15.82 ~ 17.50 (16.64)</td>
</tr>
</tbody>
</table>

**Notes:**

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