Trends in the Chinese Economy and in China’s Onshore Market

March 2021

Mizuho Bank (China), Ltd.
Treasury Department
Trends in China’s onshore market

Foreign exchange market
- USD Index (LHS)
- USD/CNY (RHS)

Stoke market
- *The stock chart shows data since June 2014

Short-term interest rate market
- ShihorO/N
- Shihor1M
- Shihor3M

Bond (CDB yield) market
- CDB1Y
- CBD5Y
- CDB10Y

Source: Bloomberg
Updates on Chinese economic indices

Source: Bloomberg
TOPICS 1: Chinese economic recovery continued despite decline in the January PMI

- On January 31, the National Bureau of Statistics of China announced its manufacturing Purchasing Manager Index (PMI) for January 2021, and the outcome was 51.3 with a decline of 0.6 points from the previous month, while the non-manufacturing PMI was 52.4 with a decline of 0.3 points from the previous month. Both indices exceeded 50, the level used to judge if the economy is expanding or shrinking, for the 11th consecutive month. The non-manufacturing PMI declined due to significant negative growth in the service sector, and this is considered a result of the propagation of COVID-19 in some parts of China.

- In terms of the global economy, the Chinese and U.S. economies are on a recovery, while the Japanese and European economies are still struggling, due to a delay in recovery that resulted from the propagation of COVID-19 cases in some parts domestically, as well as due to restrictions on various activities. The difference between China and other countries in economic recovery is likely to contribute to the Chinese yuan exchange market, leading the Chinese yuan to strengthen.

Source: Bloomberg
TOPICS 2: January total social loans grew more than estimated in the market

- On February 9, the People’s Bank of China (PBOC) announced the January total social loans (flow), and the outcome was CNY 5.17 trillion with an increase of USD 3.4508 trillion from the previous month, exceeding CNY 4.6 trillion, which was the market estimate. The social loan balance (stock) turned out to be +13.0% in January, with a slowdown from the previous month, which was +13.3% year-on-year. The January growth in the M2 money supply turned out to be +9.4%, with a slowdown from the +10.1% recorded in December.
- These strong figures are based on steady credit demand backed by economic recovery after the COVID-19 crisis. Therefore, the PBOC is not likely to significantly change its monetary policy, keeping the Chinese yuan interest rates stable.
- Last year, the money supply increased due to the propagation of COVID-19 cases, and therefore year-on-year growth is likely to decline again for both the social loan balance (stock) and the M2 money supply.

Source: Bloomberg
TOPICS 3: Current account surplus increased for the October–December quarter of 2020

- On February 19, the State Administration of Foreign Exchange of China announced the current account balance for the October–December quarter of 2020, revealing a surplus of USD 130.2 billion, with an increase from the USD 92.2 billion recorded in the July–September quarter, becoming the highest level in 10 years. This is mainly a result of the expansion of the trade surplus and a decrease in the deficit in the service balance.
- The expansion of the trade surplus is thanks to growth in the export of medical equipment and appliances for telecommuting as a result of the propagation of COVID-19 cases. The majority of the deficit in the service sector comes from the tourism industry, based on a decrease in international tourism.
- In 2021, demand for goods manufactured in China is likely to continue increasing, and, as a result, the trade balance is expected to see a large amount of surplus. The service balance is likely to remain low due to restrictions on overseas travel. The continuing surplus in the current account balance is likely to be a positive factor for the Chinese yuan exchange market.

Source: Bloomberg
## Outlook for the Chinese yuan exchange market: Key issues of the US dollar/Chinese yuan exchange market

<table>
<thead>
<tr>
<th>Macro economy in China and the direction of policy measures</th>
<th>2021 Q1</th>
<th>2021 Q2</th>
<th>2021 Q3</th>
<th>2021 Q4 onwards</th>
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<tbody>
<tr>
<td>(+) Appreciation of the yuan (-) Depreciation of the yuan</td>
<td>Excessive investment, efforts to resolve the excessive debt problem, painful structural changes (-)</td>
<td>Chinese economic recovery (+) / Effect of fiscal expansion on the economy (+) / The superior interest rates of Chinese domestic financial assets (+)</td>
<td>Promotion of targeted monetary measures (+)</td>
<td>Tolerance of the appreciation of the Chinese yuan by the People’s Bank of China (+)</td>
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<table>
<thead>
<tr>
<th>Trade frictions between the US and China</th>
<th>The revival of trade frictions between the US and China (-) / Exclusion of Chinese companies in the U.S. (-)</th>
</tr>
</thead>
</table>

| Internationalization of the Chinese yuan | Improvement of the status of the Chinese yuan as a currency for global foreign currency reserves (+) / Further liberalization of Chinese capital accounts (+) |

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<tr>
<th>Factors in the US</th>
<th>Dovish attitude of the FRB (+)</th>
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| Factors in Europe | Second wave of COVID-19 infection in Europe (-) / Confusion about Brexit (-) |

| Risk factors | Concerns of fund outflows from emerging economies on a global economic slowdown (-) / Worsening US/China relations (-) / A second wave of COVID-19 infections (-) |
Outlook for the Chinese yuan exchange market

**USD/CNY**

- **Upper end** 6.60
- **Lower end** 6.40

- **Upper end** 6.55
- **Lower end** 6.35

- **Upper end** 6.50
- **Lower end** 6.30

- **Upper end** 6.50
- **Lower end** 6.30

- **Upper end** 6.50
- **Lower end** 6.30

**CNY/JPY**

- **Upper end** 17.6
- **Lower end** 16.3

- **Upper end** 17.3
- **Lower end** 16.2

- **Upper end** 17.5
- **Lower end** 16.2

- **Upper end** 17.6
- **Lower end** 16.3

- **Upper end** 17.6
- **Lower end** 16.3

**Outlook range**

Source: Compiled based on past data provided by Bloomberg and on estimates by MHBK
**Outlook for other major currencies**

<table>
<thead>
<tr>
<th>Currency Pair</th>
<th>Current situation</th>
<th>Outlook</th>
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<tr>
<td><strong>USD/CNY</strong></td>
<td>In February, the U.S. dollar/Chinese yuan exchange rate continued fluctuating at around CNY 6.46 without going in any direction. Before the holidays of the Chinese New Year, market participants actively sold the U.S. dollar with expectations for additional economic stimulus in the U.S., leading the U.S. dollar/Chinese yuan exchange rate to fall momentarily to the CNY 6.43 level. On the other hand, at the end of the month, the U.S. dollar appreciated as a result of the rise in U.S. long-term interest rates, and the U.S. dollar/Chinese exchange rate once rose to the CNY 6.48 level while fluctuating in both directions at around CNY 6.46.</td>
<td>The Chinese economy continued to recover, and the upward pressure on the Chinese yuan is likely to remain in the market based on the expansion of the Chinese market backed by domestic demand as well as on the difference in monetary policy between the U.S. and China. On the other hand, the depreciation of the U.S. dollar is slowing down, as U.S. interest rates are on the rise, based on advancement in COVID-19 vaccination as well as on expectations for economic recovery accelerated by additional economic stimulus. Thus, the U.S. dollar/Chinese yuan exchange rate is forecast to remain stable.</td>
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<td><strong>USD/JPY</strong></td>
<td>In February, the U.S. dollar/Japanese yen exchange market opened trading at the upper-JPY 104 level, after which the exchange rate rose to the mid-JPY 106 level. The 10-year U.S. bond yield rose sharply from the upper-1.0% level observed at the beginning of the month momentarily to the 1.6% level at the end of the month. Following this trend, the Japanese yen depreciated against the U.S. dollar.</td>
<td>In the U.S., interest rates are on the rise, as an additional economic stimulus has been approved, while COVID-19 vaccination has continued, which has been accelerating the appreciation of the U.S. dollar against the Japanese yen. FRB Chair Jerome Powell has not made any remark to warn about a rise of interest rates. However, at the end of February, stock prices fell to some extent. Thus, the rise of the U.S. dollar/Japanese yen exchange rate is forecast to slow down, although it is likely to continue rising.</td>
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<td><strong>EUR/USD</strong></td>
<td>In February, the euro/U.S. dollar exchange market opened at the USD 1.21 level, after which the U.S. dollar temporarily appreciated against the euro and the exchange fell below the USD 1.20 level. However, the market remained stable, and the euro/U.S. dollar exchange rate continued fluctuating at around the USD 1.21 level.</td>
<td>As a result of the rise of U.S. interest rates, the depreciation of the U.S. dollar has slowed down. Therefore, the euro/U.S. dollar exchange rate is expected to start falling. On the other hand, there are reasons for market participants to buy the euro, as the eurozone has the largest current account surplus in the world. Thus, with transactions based on actual demand, the fall of the euro/U.S. dollar exchange rate is likely to be a moderate one.</td>
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# Outlook for the Chinese yuan exchange market

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<tr>
<th></th>
<th>2021</th>
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<tr>
<td></td>
<td>Mar</td>
<td>Apr-Jun</td>
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<tr>
<td><strong>USD/CNY</strong></td>
<td>6.40 ~ 6.60 (6.50)</td>
<td>6.35 ~ 6.55 (6.45)</td>
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<tr>
<td><strong>100 JPY/CNY</strong></td>
<td>5.93 (6.13) ~ 6.29</td>
<td>5.77 (6.03) ~ 6.24 (5.93)</td>
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<tr>
<td><strong>CNY/JPY</strong></td>
<td>15.91 (16.31) ~ 16.88 (16.59)</td>
<td>16.03 (16.88) ~ 17.32 (17.03)</td>
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<tr>
<td><strong>EUR/CNY</strong></td>
<td>7.62 (7.87) ~ 8.12</td>
<td>7.43 (7.74) ~ 7.99</td>
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* Outlook for major currencies

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<td>Mar</td>
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<tr>
<td><strong>USD/JPY</strong></td>
<td>105 (106) ~ 108</td>
<td>105 (107) ~ 110</td>
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<tr>
<td><strong>EUR/USD</strong></td>
<td>1.19 (1.21) ~ 1.23 (1.20)</td>
<td>1.17 (1.18) ~ 1.22 (1.17)</td>
</tr>
<tr>
<td><strong>EUR/JPY</strong></td>
<td>125 (128) ~ 131 (129)</td>
<td>124 (128) ~ 131 (128)</td>
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Forecast by MHBK (China)

The figures in parentheses are forecasts for the closing rate of each quarter.
Outlook for the Chinese yuan interest rate market: Chinese bond yields rising

- Since 2018, the Chinese monetary authorities have been rapidly taking measures to mitigate the sense of uncertainty and concerns over an economic slowdown based on trade friction through active fiscal expenditures and monetary easing including infrastructure investment, while also slowing down the pace of the restriction on deleveraging and shadow banking. Under such circumstances, interest rates have been falling, as the liquidity level remains high.

- Since April 2019, expectations for additional monetary easing subsided as economic indices and the stock market achieved a recovery that was more remarkable than expected. As a result, interest rates have been rising again. However, in February 2020, interest rates fell sharply with the growing sense of uncertainty caused by the outbreak of the COVID-19 crisis.

- In June 2020, the economy bottomed out, after which the Chinese monetary authorities continued measures of monetary easing. However, the dovish attitude of the Chinese monetary authorities has weakened, and interest rates have started rising. Furthermore, interest rates could continue rising in China, as its economic recovery is expected relatively early compared to other countries that have been expanding monetary and fiscal measures so as to tackle the COVID-19 crisis.
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