

# Trends in the Chinese Economy and in China's Onshore Market

August 2020

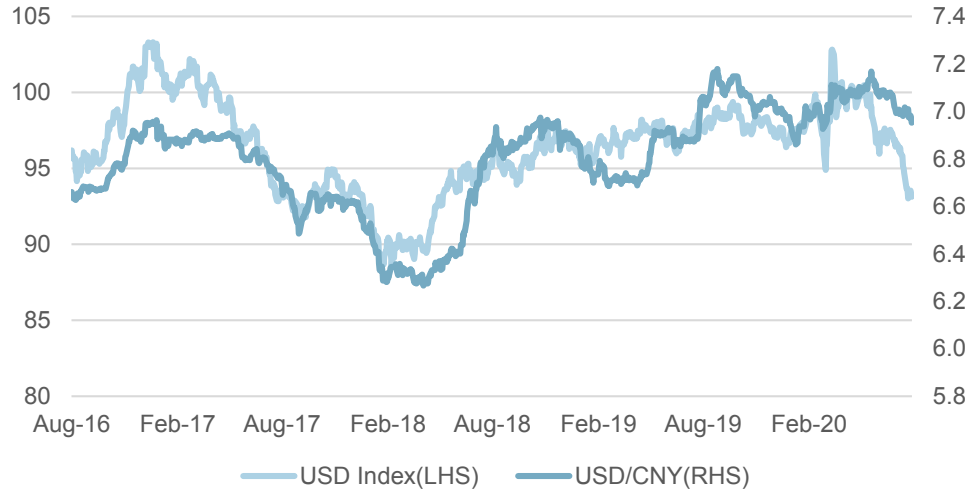
Mizuho Bank (China), Ltd.  
Treasury Department

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The Mizuho logo consists of the word "MIZUHO" in a bold, white, sans-serif font, positioned above a white horizontal line that curves slightly upwards at both ends.

# Trends in China's onshore market

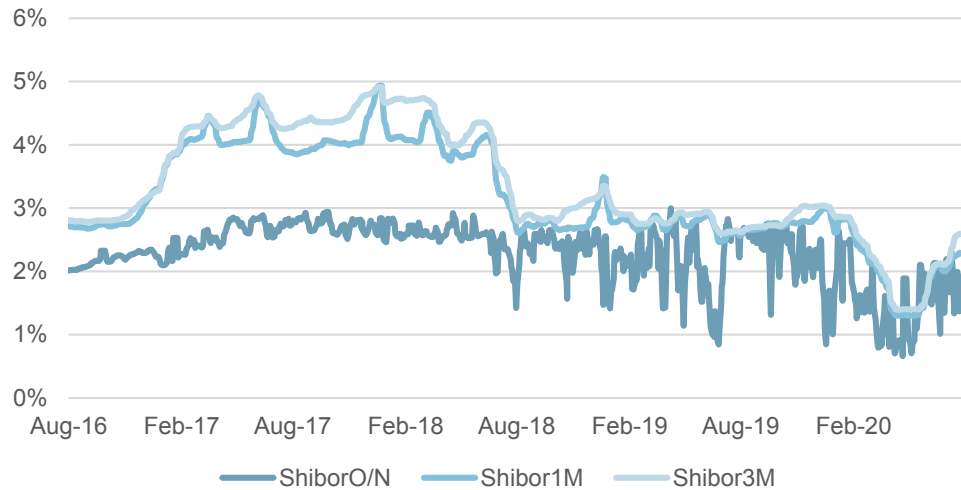
## Foreign exchange market



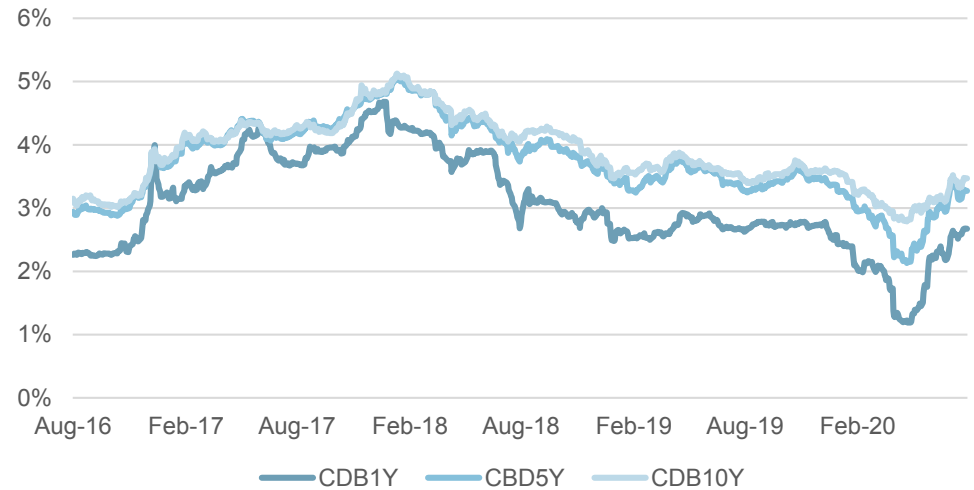
## Stock market



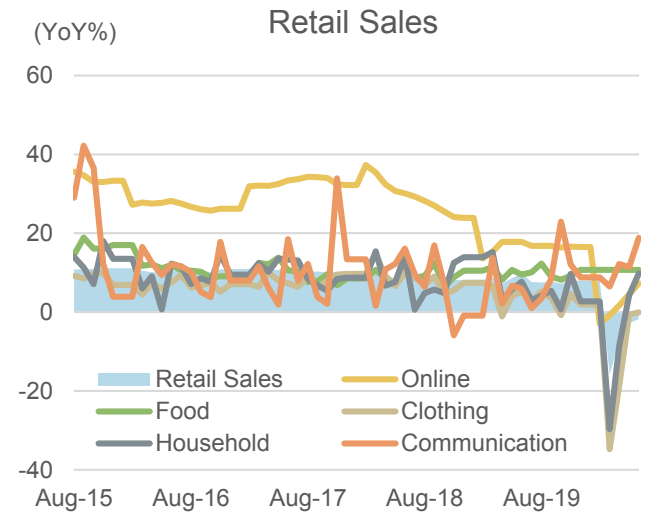
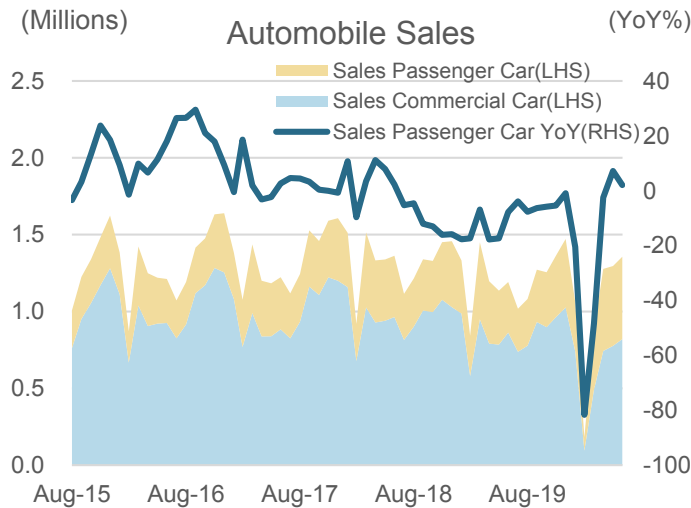
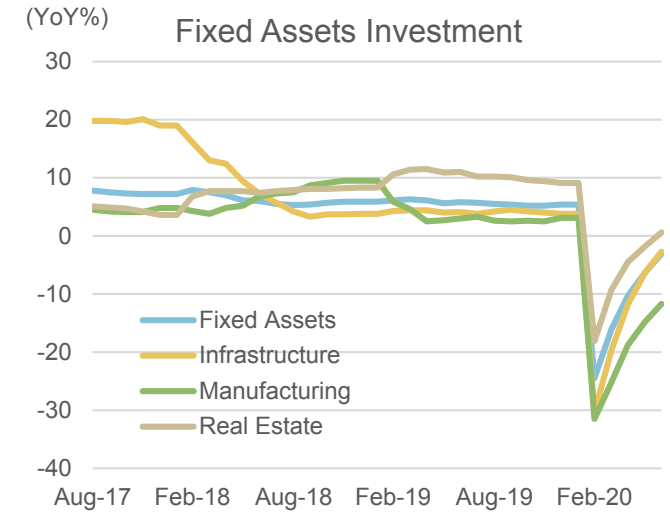
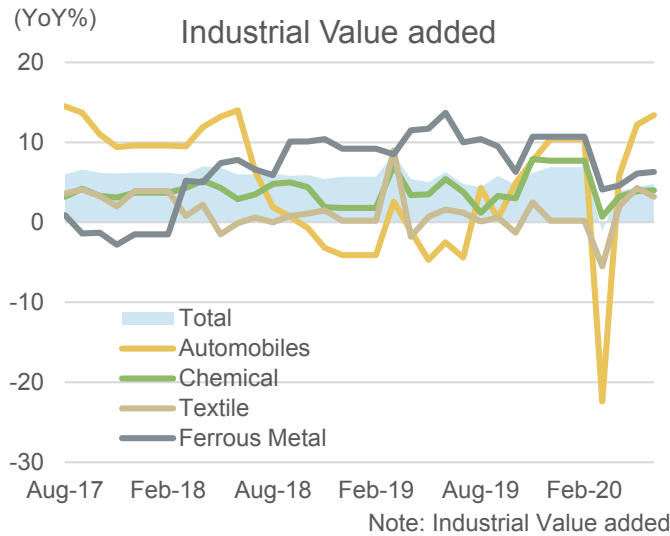
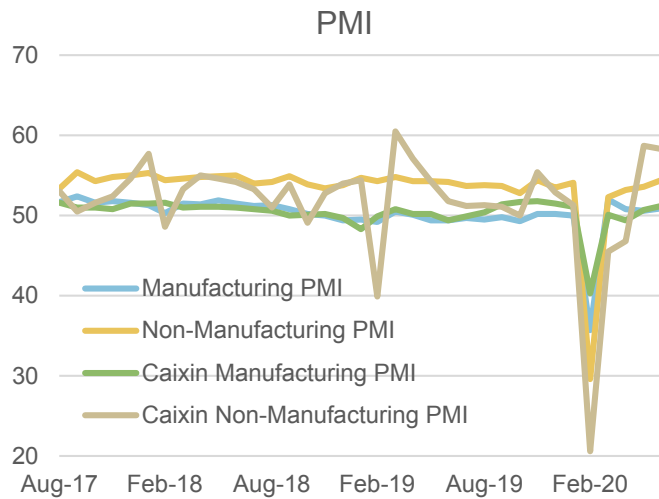
## Short-term interest rate market



## Bond (CDB yield) market



# Updates on Chinese economic indices

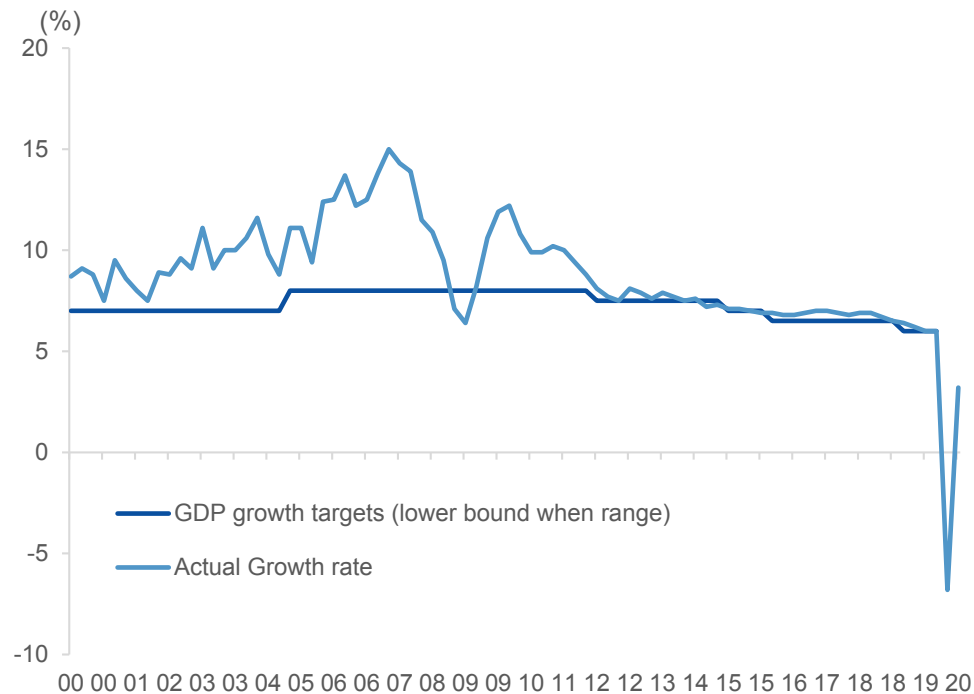


Source: Bloomberg

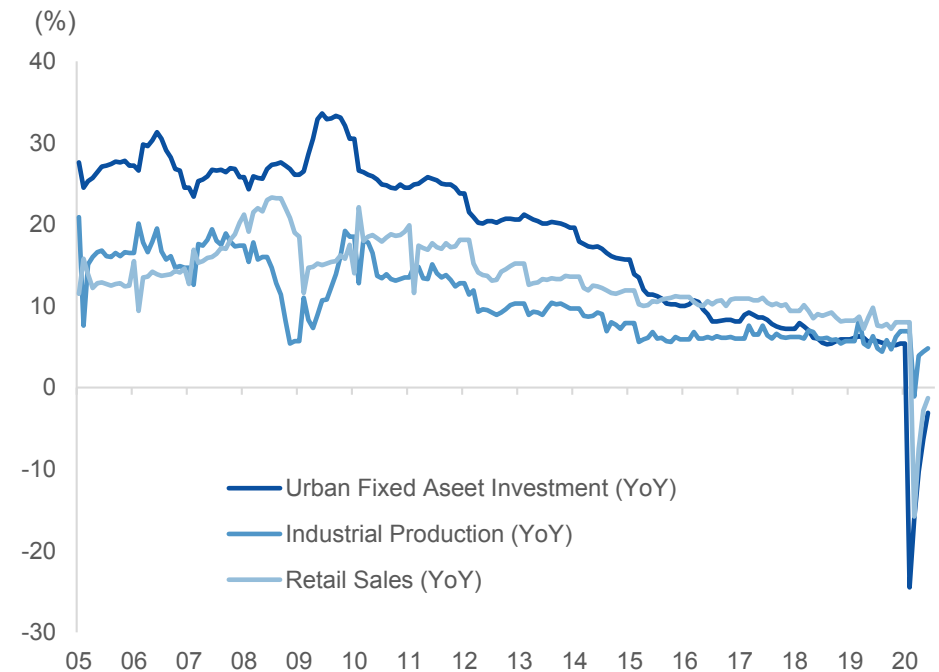
# TOPICS: Second-quarter GDP of China records positive growth rate at +3.2%

- On July 16, the second-quarter GDP figure of China was released, turning positive at +3.2% year-on-year. This revealed that economic activities have resumed thanks to thorough measures against the spread of COVID-19.
- On the same day, the industrial production, fixed-asset investment, and retail sales results figures were also announced, showing +4.8% (market estimate: +4.8%), -3.1% (market estimate: -3.3%), and -1.8% (market estimate: +0.5%), respectively. While growth in fixed-asset investment exceeded the market estimate, growth in industrial production was at the same level as the market estimate, and retail sales turned out to be lower than the market estimate, showing mixed results.
- Due to the growing second wave of COVID-19 spread, the situation worsened in many parts of the world, and this could hamper demand for products and services from China, putting a serious brake on the recovery of the Chinese domestic economy in the times ahead.

## GDP of China



## Industrial production, fixed-asset investment in urban areas, and retail sales of China

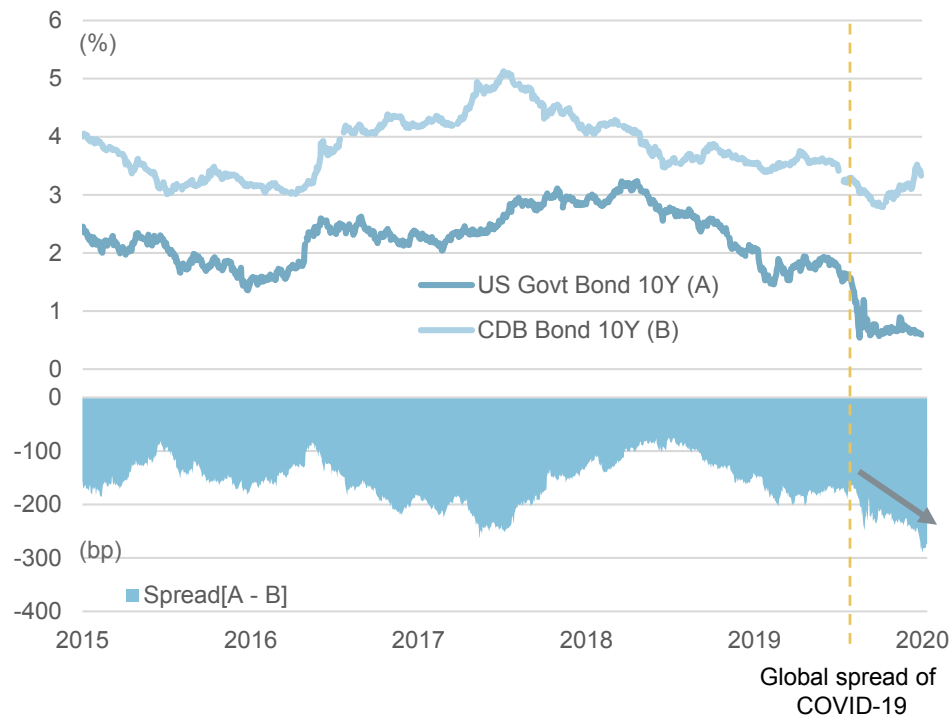


Source: Bloomberg and Mizuho HK

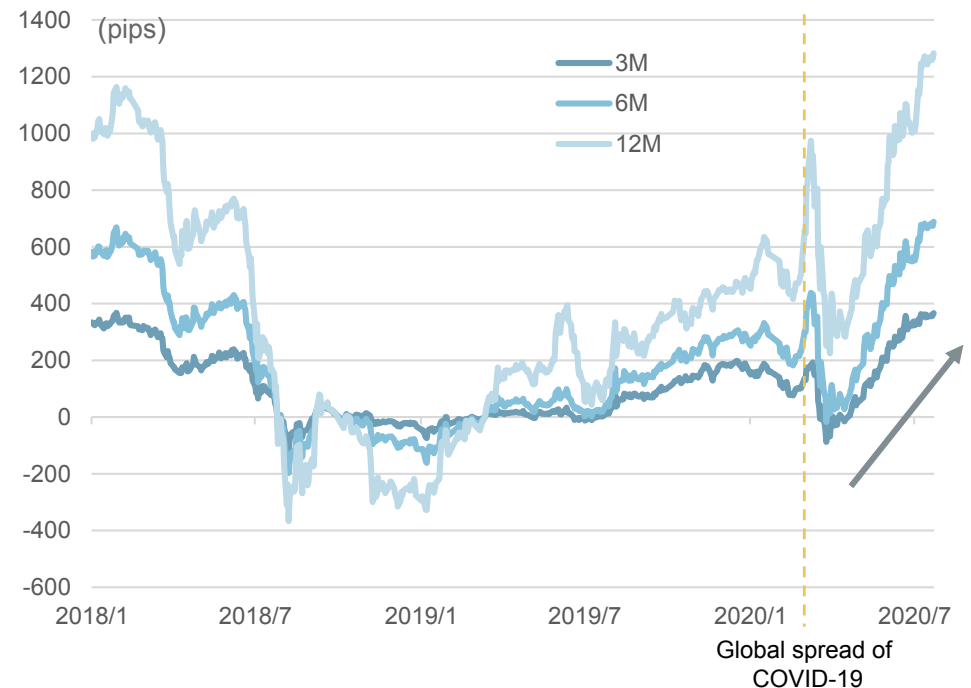
# TOPICS: Interest rate differentials widening between US and China

- While COVID-19 cases continue to increase, the US maintains the largest economic measures ever seen and a zero-interest rate policy. On the other hand, China has shifted to a more-targeted monetary policy while maintaining the general principle of monetary easing. The governor of the People's Bank of China (PBOC) mentioned an exit strategy from monetary easing (on June 18), and the Loan Prime Rate (LPR) has been kept flat for the third consecutive month, showing the fact that the Chinese monetary authorities now hold a less-dovish attitude. Thus, differences in monetary policy between the US and China have been growing.
- Such differences in monetary policy are leading to a widening of interest rate differentials, impacting the Chinese yuan swap rates. Also, the USD/CNY futures swap premium has been rapidly increasing, raising hedge costs.

Interest rate differentials widening between the US and China



USD/CNY swap rates



Source: Bloomberg

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

(+) Appreciation of the yuan  
(-) Depreciation of the yuan

2020 Q2

2020 Q3

2020 Q4

2021 Q1 onwards

## Macro economy in China and the direction of policy measures

Excessive investment, efforts to resolve the excessive debt problem, painful structural changes (-)

Chinese economic recovery (+) / Effect of fiscal expansion on the economy (+) / The superior interest rates of Chinese domestic financial assets (+)

Shift to monetary easing (-)

Effect of monetary policy on the economy (+)

Measures to stabilize the foreign exchange rate taken by the PBOC (+)

Liberalization of the financial markets (+)

## Trade frictions between the US and China

The revival of trade frictions between the US and China (-)

## 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 (+)

## Factors in the US

Dovish attitude of the FRB (+) / Worsening relations between US President Donald Trump and the FRB (+)

Growing sense of uncertainty regarding economic downturn in the US and political situations (+)

## Factors in Europe

Political uncertainty in Europe (-) / Concerns over the ECB rate cuts and monetary easing (-) / 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



# Outlook for other major currencies

## USD/CNY

### Current situation

The USD/CNY pair fell in July. The exchange rate once fell below CNY 7.0 against the US dollar as a result of the rise of domestic stock prices, as well as due to the interest rate differentials between the US and China. Even though the Chinese yuan depreciated briefly after the media report on the closure of a Chinese embassy in the US, the USD/CNY exchange rate remained at around the CNY 7.0 level.

### Outlook

Even though the Chinese monetary authorities have maintained a general principle of monetary easing, their attitude has been less dovish than before. The normalization of the economy after the COVID-19 crisis has been more advanced in China than in other countries, which leads market participants to focus on differences in monetary policy between the US and China, along with the fundamentals. As the relationship between the US and China has not improved so far as of yet, the Chinese yuan could depreciate when risk-averse sentiment grows in the market as a result of the worsening of the relationship between these two countries. However, from a medium- to long-term perspective, the Chinese yuan is forecast to appreciate.

## USD/JPY

### Current situation

The USD/JPY pair fell in July. After fluctuating within a narrow range at around JPY 107, the Japanese yen appreciated during the second half of the month with the overall depreciation of the US dollar, and the exchange rate once fell below the JPY 105 level.

### Outlook

The currency markets are increasingly becoming 'a world without interest-rate differentials,' so fundamentals will probably grow more important by comparison. Japan has the 'world's the largest net external asset balance' and a 'current account surplus,' so the yen looks set to move strongly on supply and demand. Furthermore, the fiscal deficit of the US is likely to expand, which could also lead the US dollar to depreciate.

## EUR/USD

### Current situation

The EUR/USD pair rose in July. Expectations grew in the market after the agreement on the EU Recovery Fund, steadily pushing the euro upward from the USD 1.12 level to the USD 1.18 level.

### Outlook

As it has become clear that the US economy has been left behind in terms of the European economy, it is possible for this economic structure to start impacting the EUR/USD exchange market. When interest rate differentials narrow between the US and Europe, positive impact on the euro is the result. Given that the euro is one of the few currencies in the world that reflect negative interest rates, the EUR/USD exchange rate is expected to approach USD 1.20; however, that could take some time to occur.



# Outlook for the Chinese yuan exchange market

	2020 Aug-Sep	Oct-Dec	2021 Jan-Mar	Apr-Jun	Jul-Sep
USD/CNY	6.90 ~ 7.20 (7.05)	6.85 ~ 7.15 (7.00)	6.85 ~ 7.15 (7.00)	6.80 ~ 7.10 (6.95)	6.75 ~ 7.05 (6.90)
100JPY/CNY	6.45 ~ 7.06 (6.78)	6.46 ~ 7.15 (6.86)	6.52 ~ 7.30 (7.00)	6.54 ~ 7.32 (6.88)	6.49 ~ 7.27 (6.70)
CNY/JPY	14.17 ~ 15.51 (14.8)	13.99 ~ 15.47 (14.6)	13.71 ~ 15.33 (14.3)	13.66 ~ 15.29 (14.5)	13.76 ~ 15.41 (14.9)
EUR/CNY	8.00 ~ 8.64 (8.25)	7.95 ~ 8.65 (8.26)	7.95 ~ 8.65 (8.33)	7.96 ~ 8.66 (8.20)	7.83 ~ 8.53 (8.07)

## \* Outlook for major currencies

	2020 Aug-Sep	Oct-Dec	2021 Jan-Mar	Apr-Jun	Jul-Sep
USD/JPY	102 ~ 107 (104)	100 ~ 106 (102)	98 ~ 105 (100)	97 ~ 104 (101)	97 ~ 104 (103)
EUR/USD	1.16 ~ 1.20 (1.17)	1.16 ~ 1.21 (1.18)	1.16 ~ 1.21 (1.19)	1.17 ~ 1.22 (1.18)	1.16 ~ 1.21 (1.17)
EUR/JPY	118 ~ 127 (122)	117 ~ 126 (120)	117 ~ 125 (119)	116 ~ 126 (119)	116 ~ 127 (121)

Forecast by MHBK (China)

The figures in parentheses are forecasts for the closing rate of each quarter.

# Outlook for the Chinese interest rate market: Outlook for the interest rate market in China

- With the authorities growing more cognizant of the risk of US/China trade tensions, they have shifted macro-economic policy in an easing direction in order to boost domestic demand.
- The authorities have introduced a series of policies to tackle uncertainty caused by trade frictions and concerns about an economic slowdown. While easing the pace of deleveraging and the crackdown on the shadow banking sector, they have introduced an aggressive package of fiscal spending (including infrastructure investment) and monetary easing. As such, interest rates have trended lower on ample liquidity. From April 2019, interest rates have risen again at times as expectations for further easing wane on better-than-expected economic indicators and improved stock markets, but concerns about the direction of the economy are growing on US/China trade frictions and Covid-19.
- While maintaining the general principle of monetary easing, the attitude of the Chinese monetary authorities has become less dovish than before, reversing the trend and leading interest rates to rise. It should also be mentioned that China is expecting a relatively early economic recovery, while other countries are expanding their monetary and fiscal measures to support their economies against the COVID-19 crisis, and this is another factor that depresses any rise of interest rates in China.



Source: Bloomberg

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Inquiries regarding this document should be addressed to:

Customer Team, Treasury Department, Mizuho Bank (China), Ltd.

(Tel: 86-21-3855-8888)