



25 February 2015

# CNH: FX and rates highlights



**Dariusz Kowalczyk**  
**Senior Economist/Strategist – Asia ex-Japan**  
+852 2826 1519  
dariusz.kowalczyk@ca-cib.com  
<https://catalystresearch.ca-cib.com>

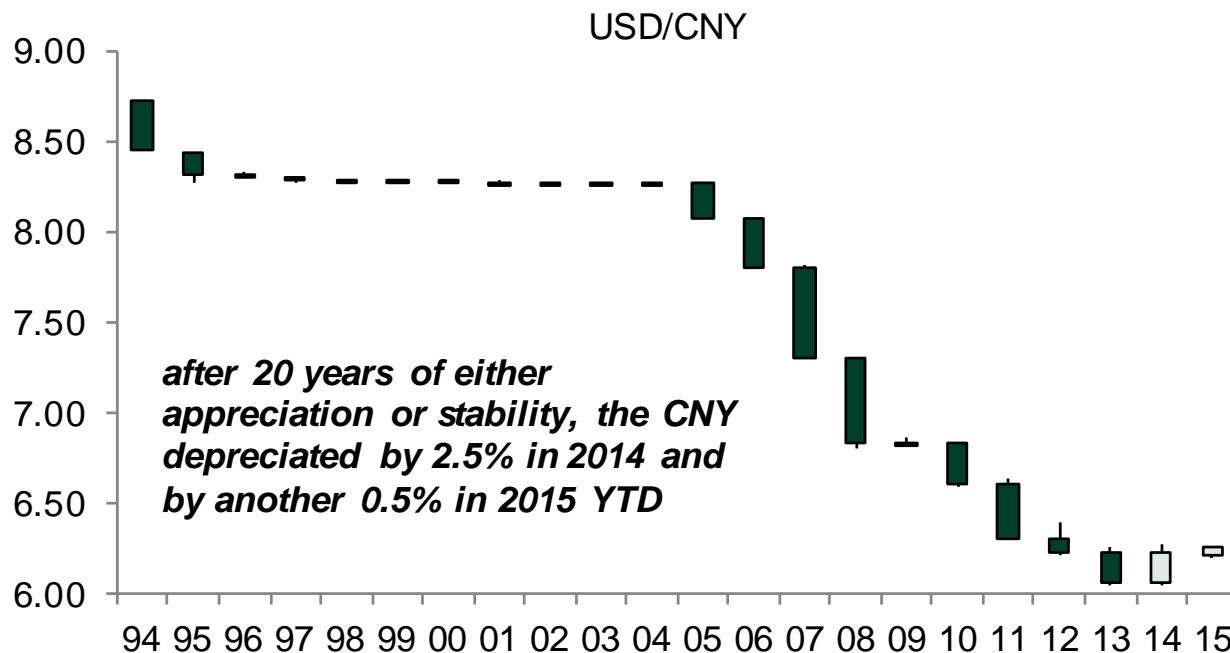
## Contents:

- p.2 CNY / CNH: under pressure
- p.19 CNH CCS: up, up and away
- p.28 Forecasts

# CNY / CNH: under pressure

# 2<sup>nd</sup> year of declines?

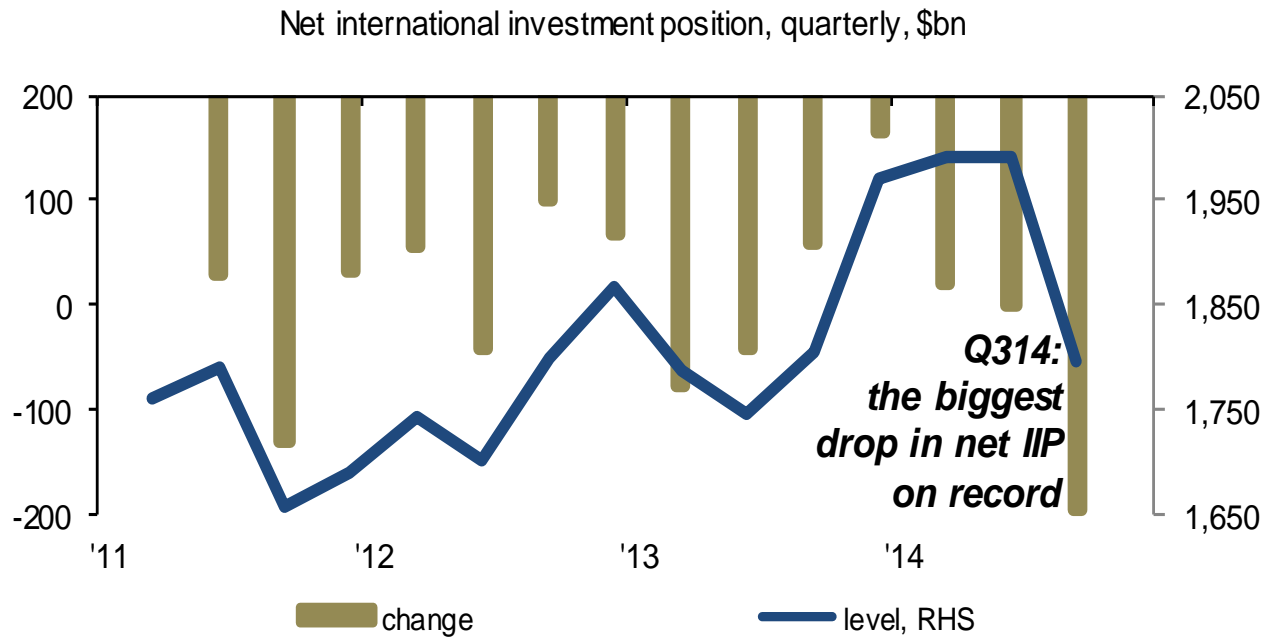
- RMB depreciated 2.5% in 2014 and is 0.6% down YTD
- ✓ Declines have been driven by foreign debt repayment by onshore corporates
- ✓ We expect downward pressure to continue in Q1 and Q2, towards 6.30 – 6.35
- ✓ The pressure will dissipate by mid-year and as we see a recovery in H2 to 6.16



Source all charts: Bloomberg, Crédit Agricole CIB

# Weakening fundamentals

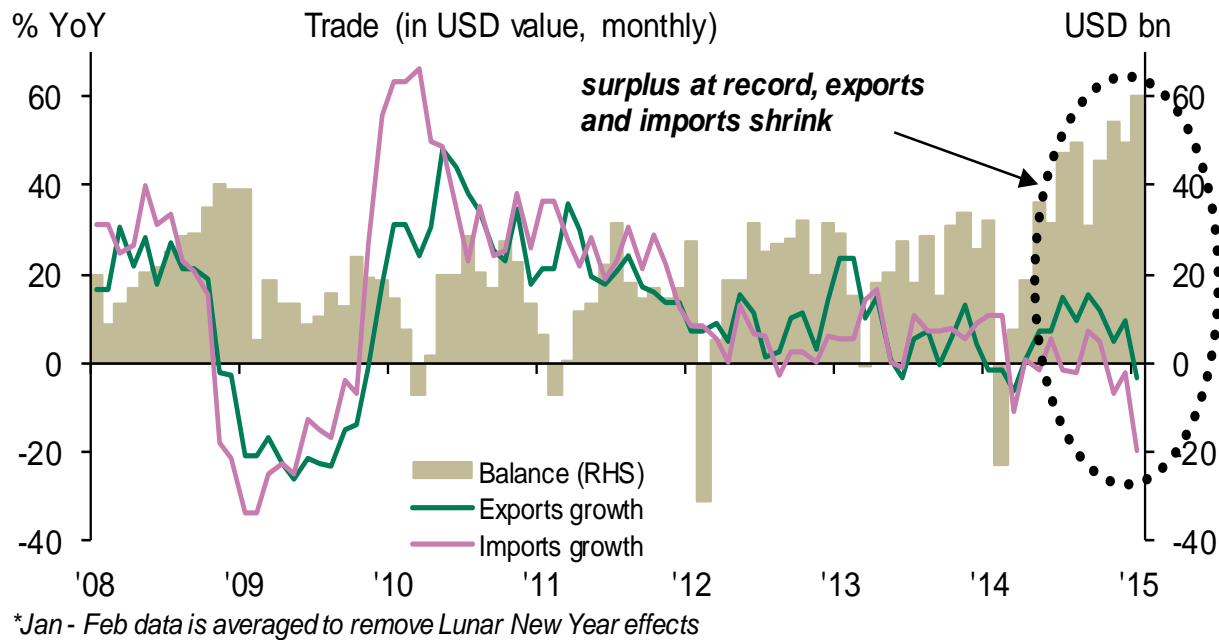
- RMB fundamentals have weakened
  - ✓ Growth is in decline
  - ✓ Net international investment position has shrunk
  - ✓ FX reserves have peaked



Source all charts: Bloomberg, Crédit Agricole CIB

# Despite a record surplus in goods trade...

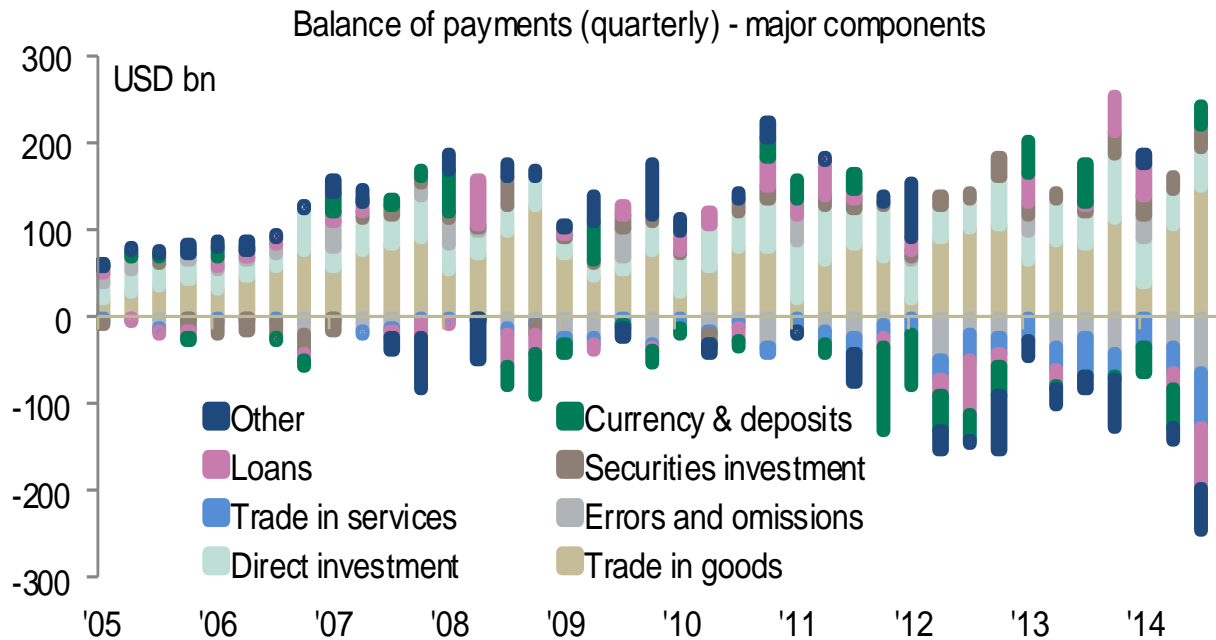
- Surplus in goods trade hit record \$60b in January
- ✓ However, it has been overwhelmed by outflows from other current account items and by capital account deficit



Source all charts: Bloomberg, Crédit Agricole CIB

# ...a balanced external position

- After years of surpluses, China's external position has become balanced
- ✓ Q414 actually saw a shortfall of \$30bn – the biggest ever

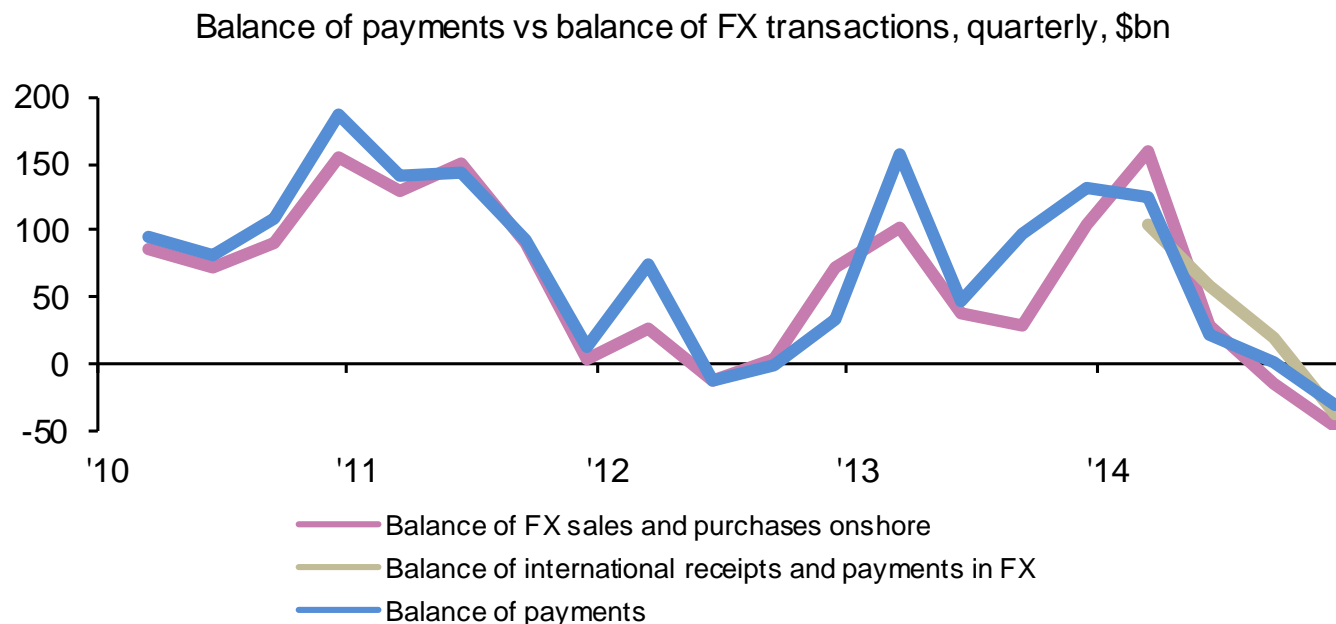


Source all charts: Bloomberg, Crédit Agricole CIB

# Negative balance of transactions



- While BoP is negative, balance of international FX receipts and payments looks even worse
- ✓ Balance of onshore transactions is showing a still deeper shortfall



Source all charts: Bloomberg, Crédit Agricole CIB

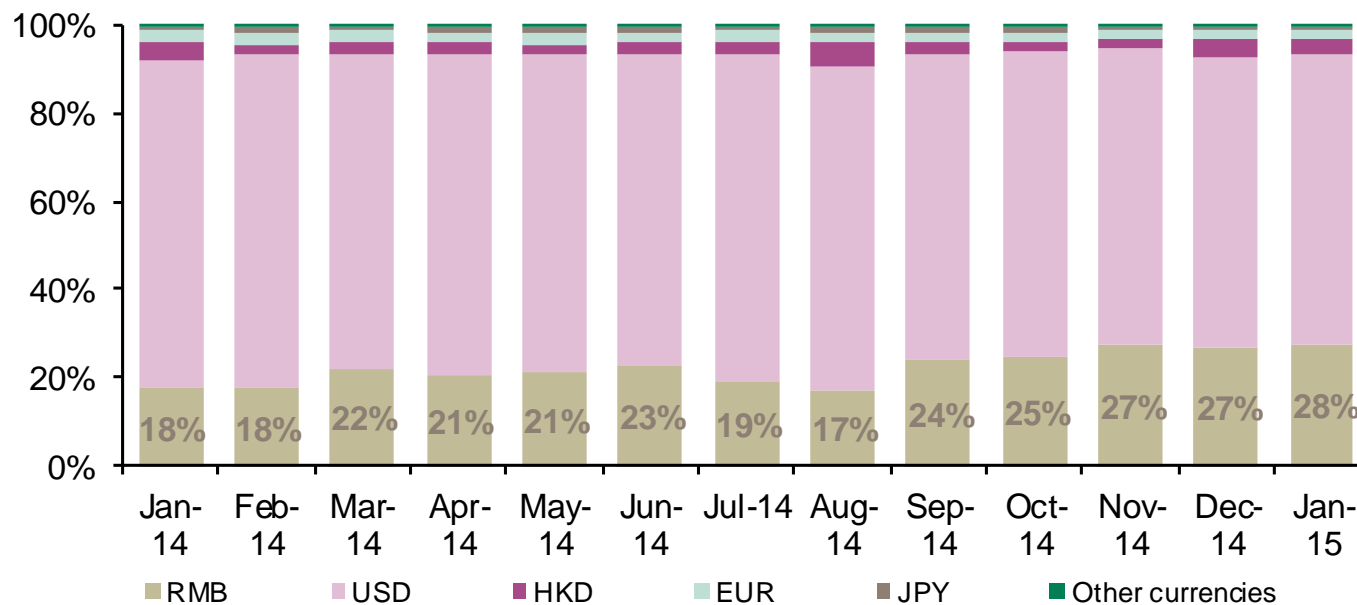


# RMB internationalization is a negative



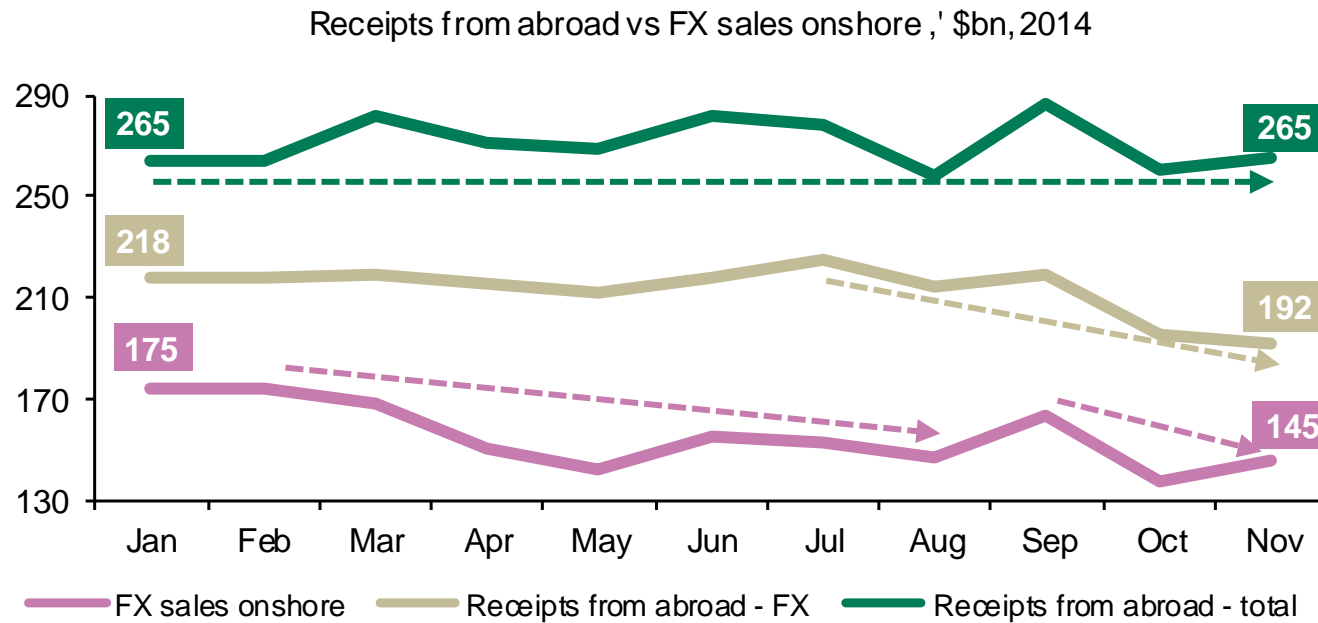
- Inflows are increasingly denominated in the RMB
- ✓ This leaves less FX inflows
- ✓ Outflows are more strongly biased towards FX

International client receipts - currency breakdown



Source all charts: Bloomberg, Crédit Agricole CIB

# A look at receipts

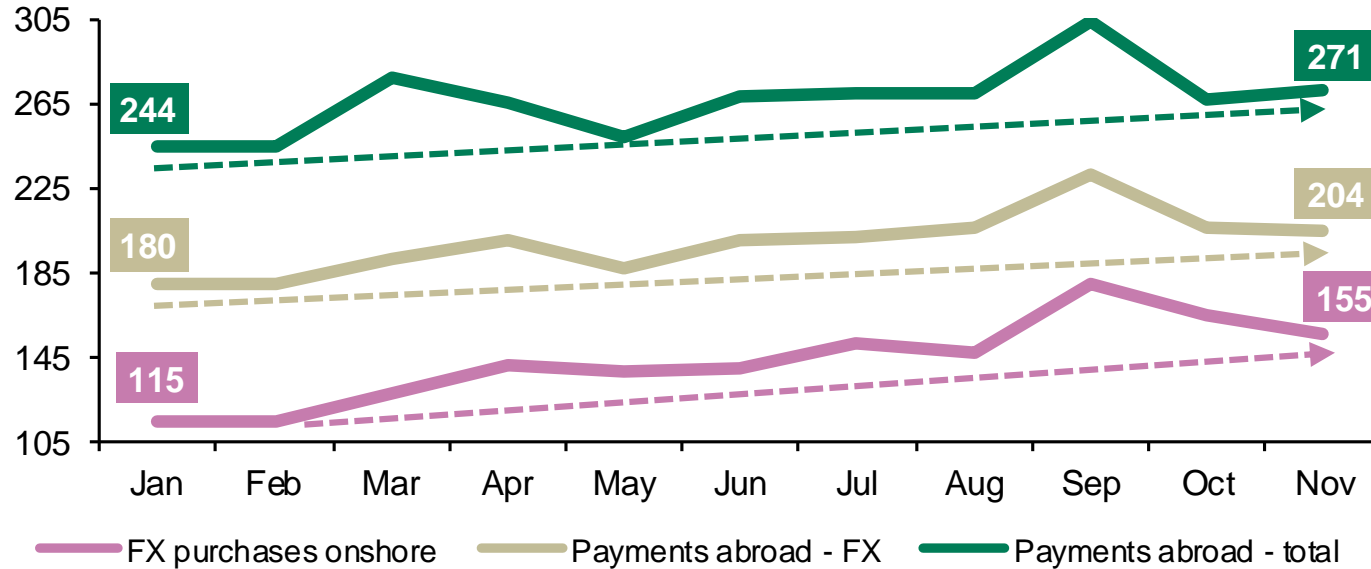


Source all charts: Bloomberg, Crédit Agricole CIB

# A look at payments



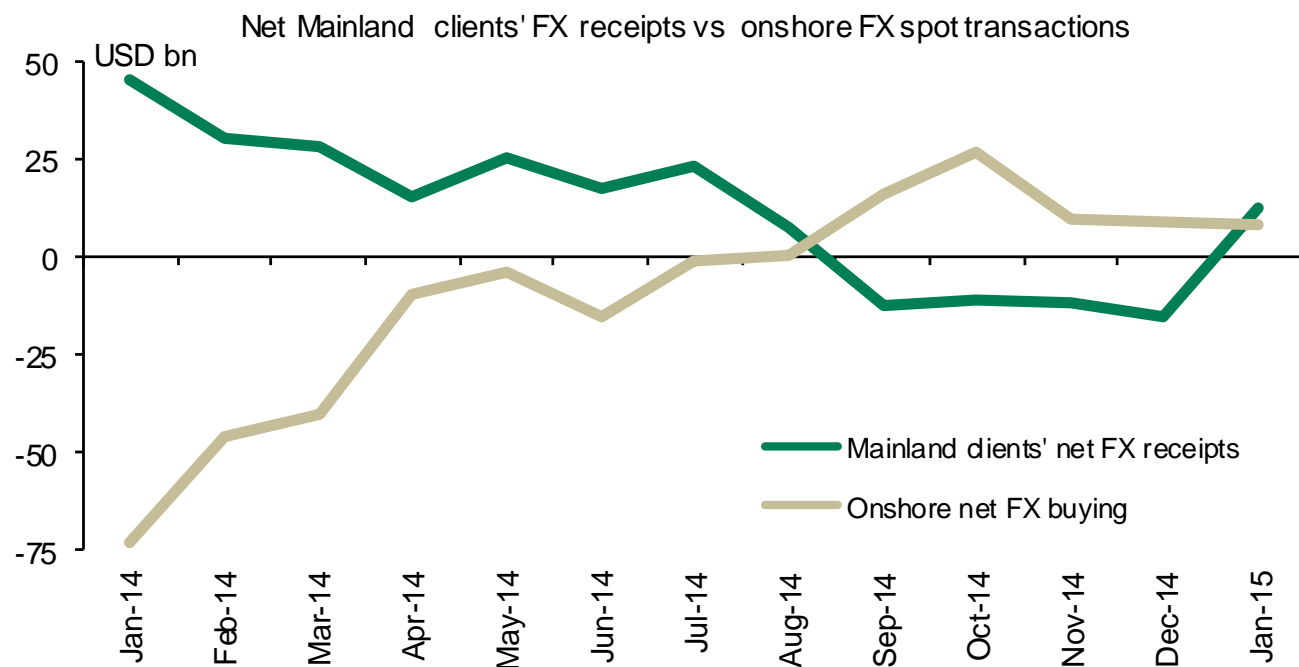
Payments abroad vs FX purchases onshore, \$bn, 2014



Source all charts: Bloomberg, Crédit Agricole CIB

# Monthly data shows net FX buying onshore

- Over four out of the past five months China had a net outflow of FX
- ✓ Over the past six months the onshore market saw net onshore FX purchases
- ✓ In January, net FX flow to China was positive again, but onshore market still saw net FX buying (probably as inflows were kept in FX)

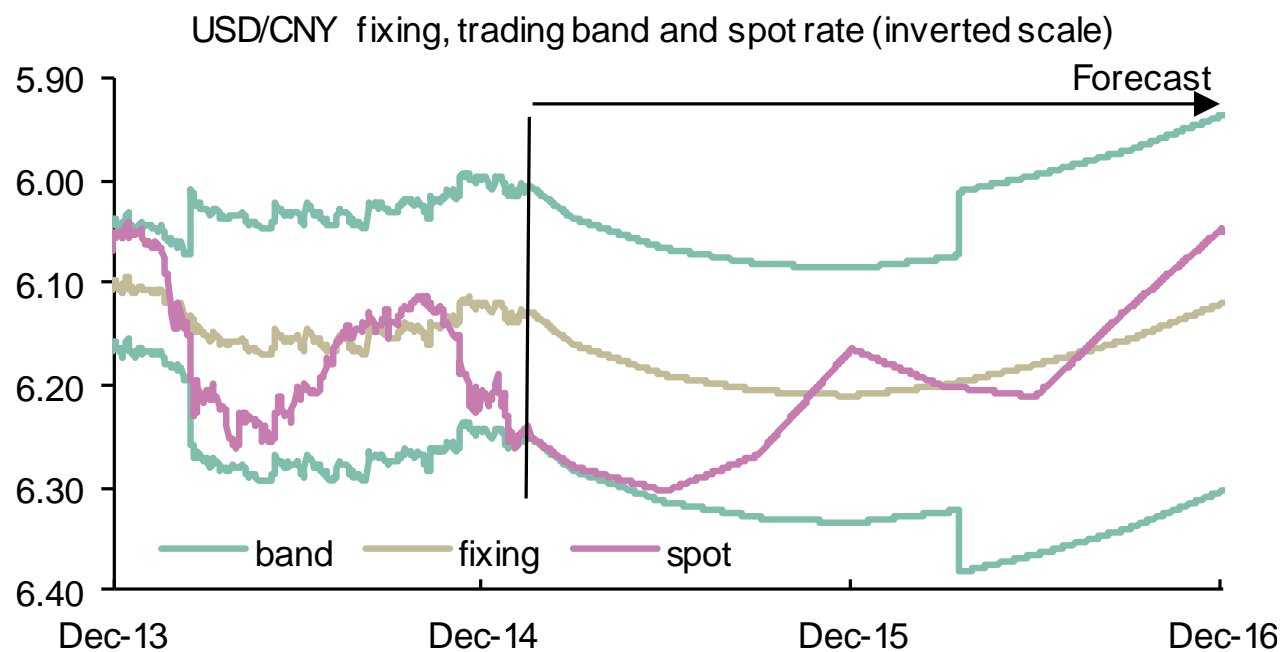


Source all charts: Bloomberg, Crédit Agricole CIB

# PBoC acts to stabilise USD/CNY exchange rate



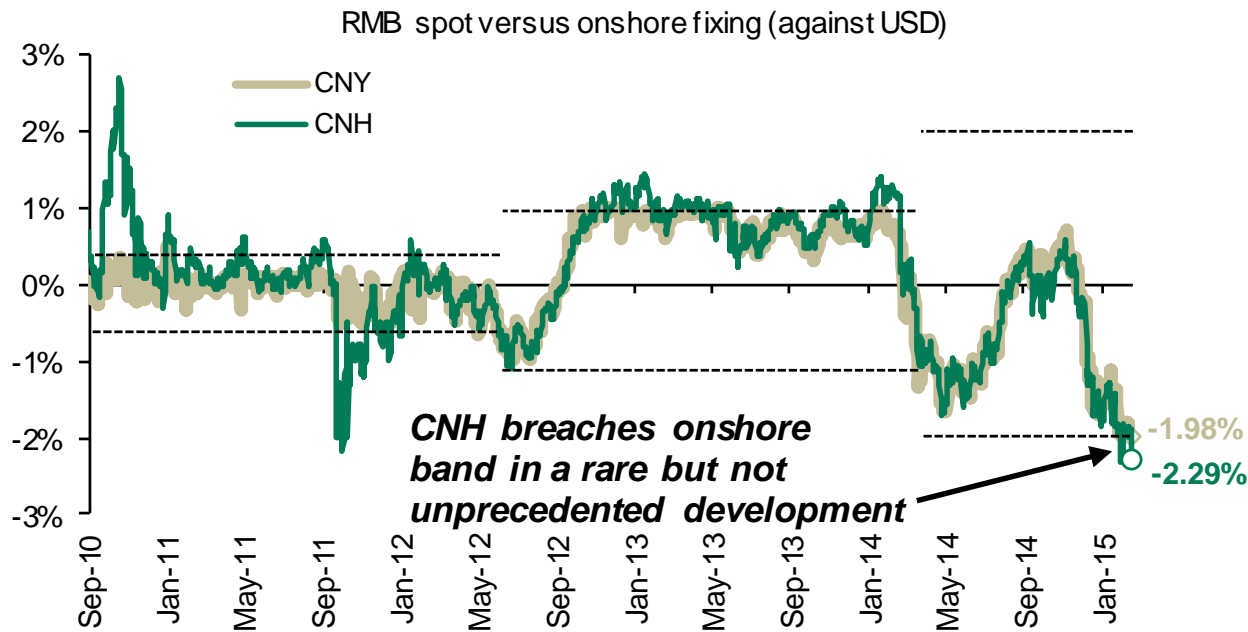
- Weakening of the fixing
- FX interventions
- How about band widening?
- ✓ Not under pressure!



Source all charts: Bloomberg, Crédit Agricole CIB

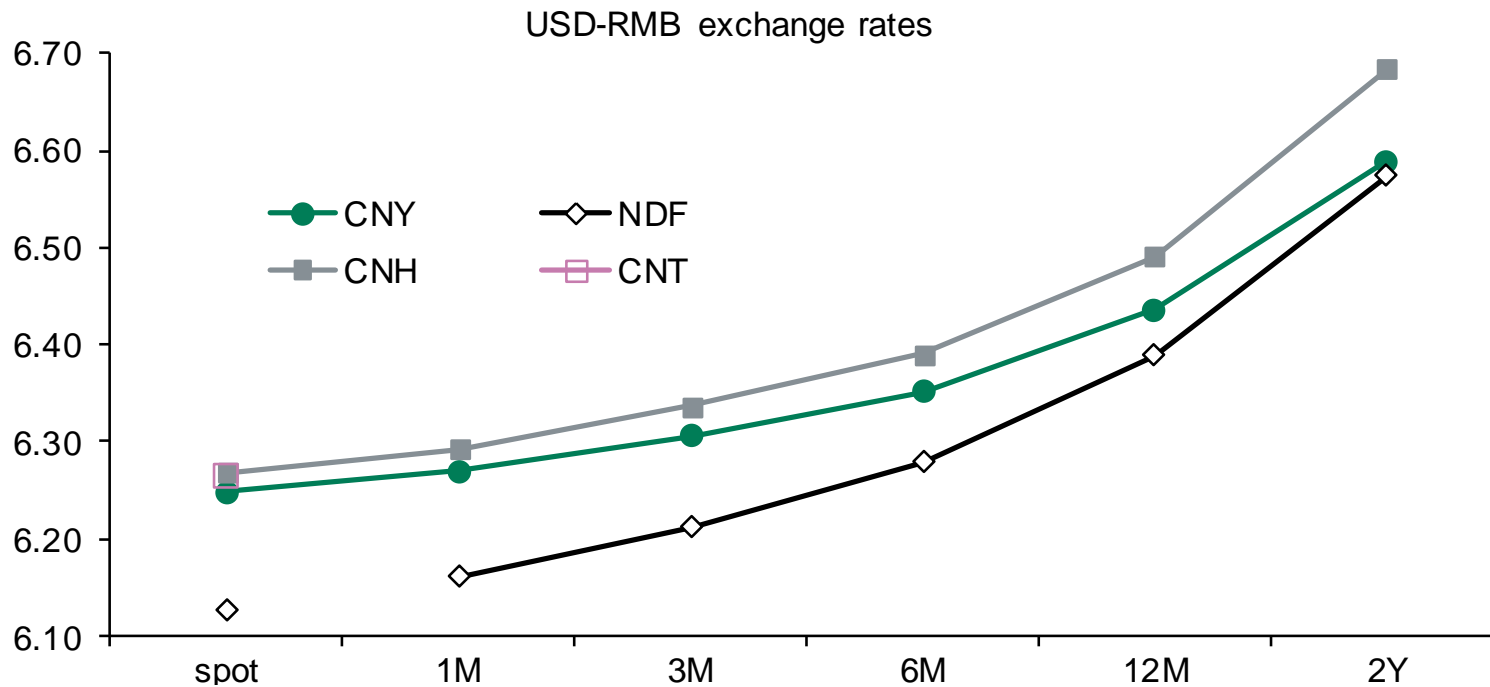
# Low end of the band

- Onshore RMB is trading closer to the low end of the band than ever
- ✓ CNH is again outside of the band



Source all charts: Bloomberg, Crédit Agricole CIB

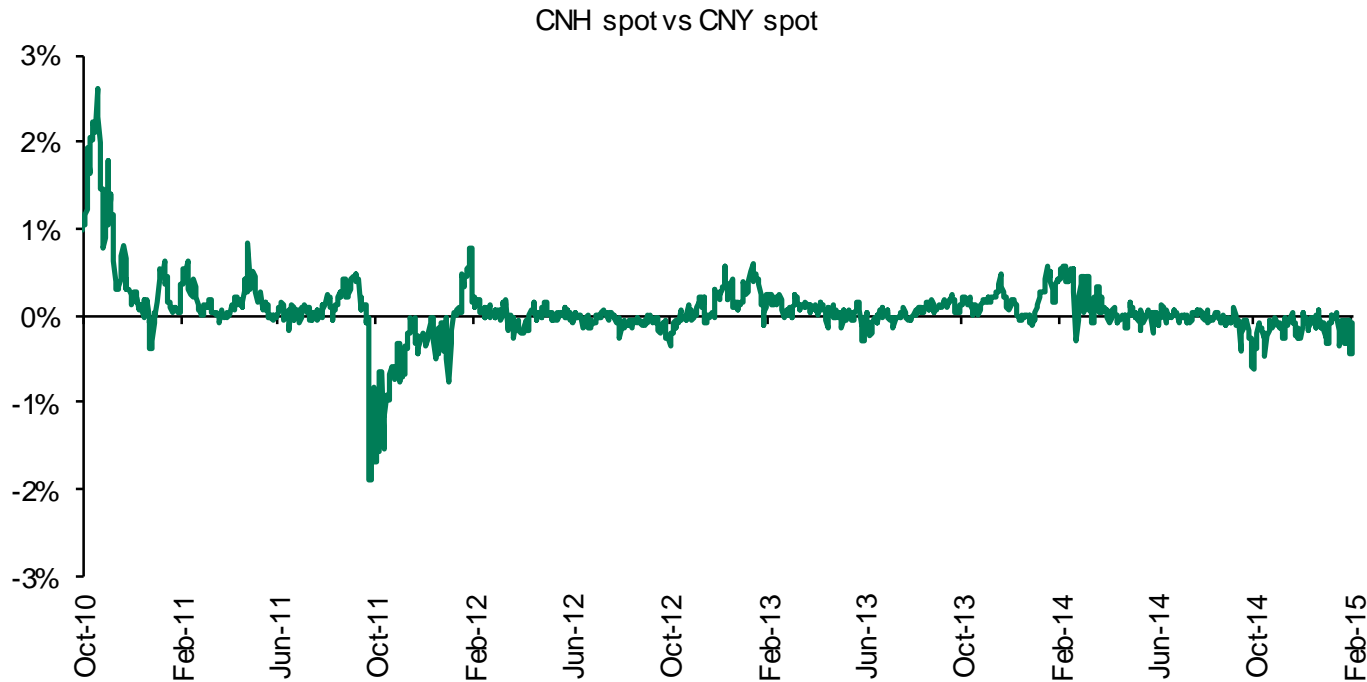
# Spot – forward RMB curve overview



Source all charts: Bloomberg, Crédit Agricole CIB

# CNH spot at a discount again

- CNH is trading at a discount to onshore RMB due to:
  - ✓ Lack of PBoC interventions offshore
  - ✓ Foreign exporters hedging in the CNH market

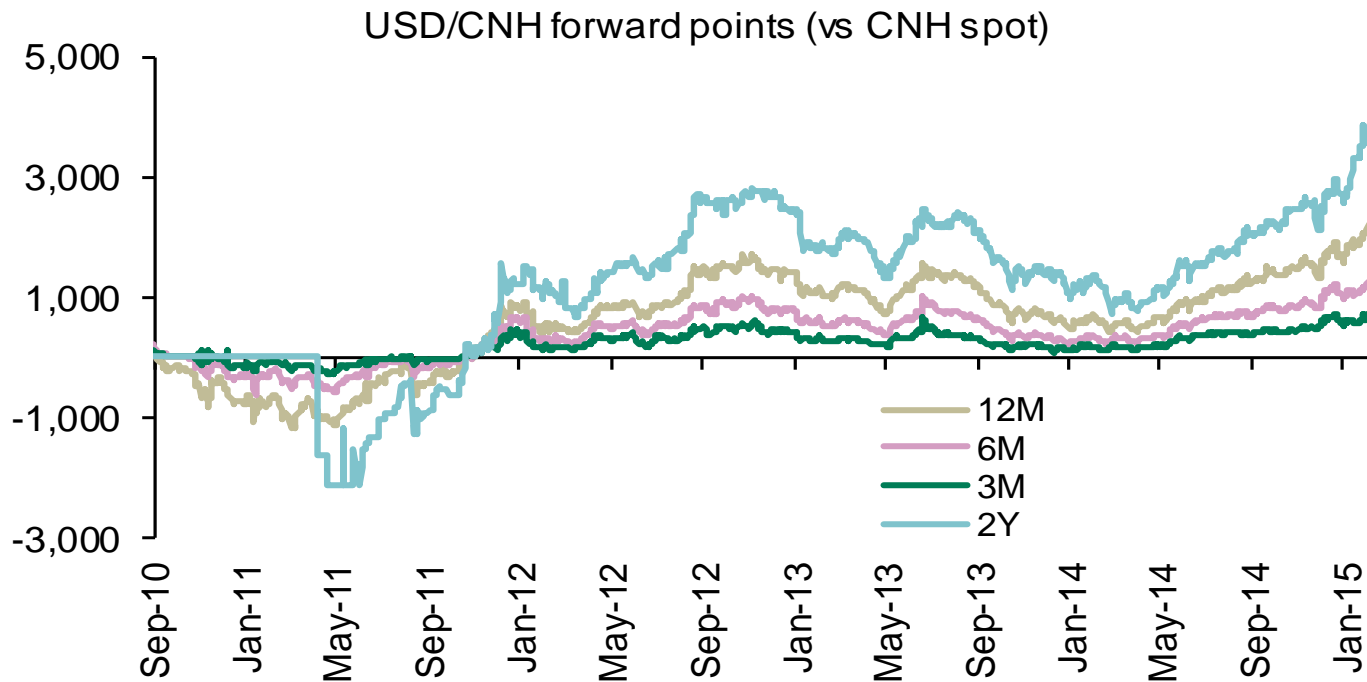


Source all charts: Bloomberg, Crédit Agricole CIB



# Record levels of FX swap points

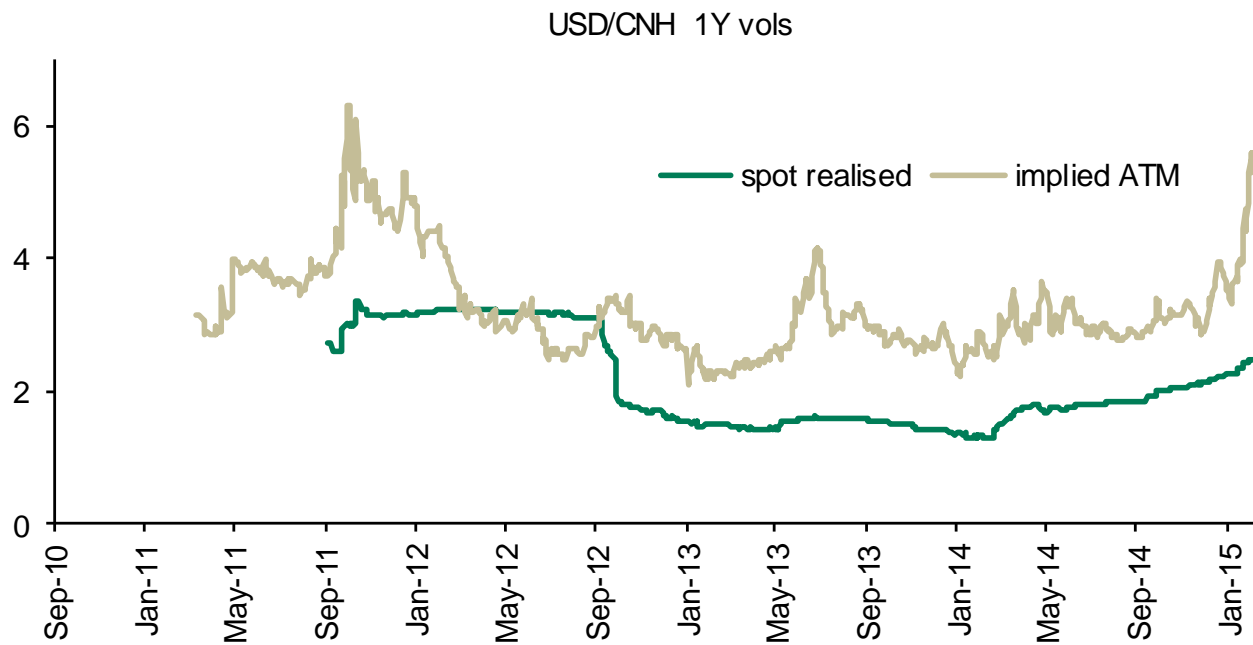
- CNH market liquidity has tightened due to:
  - ✓ Higher onshore money market rates
  - ✓ Net outflows of liquidity to the onshore market
- CNH forward points are at record highs due to tight liquidity and foreign exporter hedging



Source all charts: Bloomberg, Crédit Agricole CIB

# Vols are surging

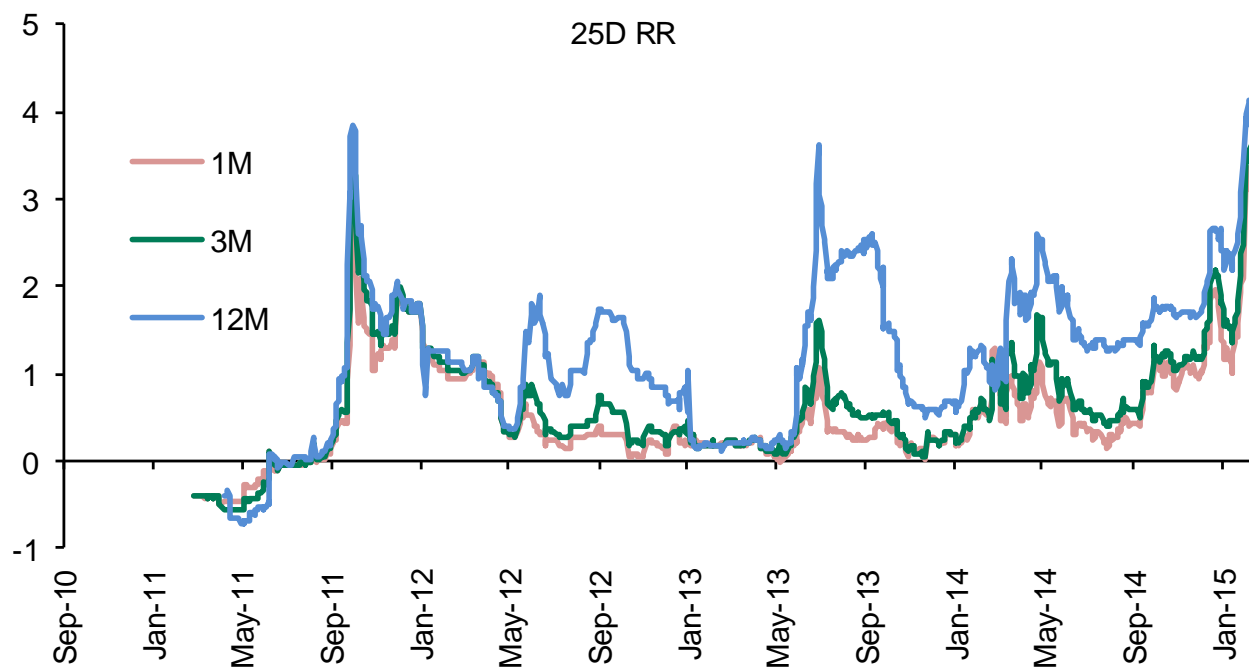
- CNH implied vols have risen to the highest level since late 2011
- ✓ Realized volatility is slowly catching up
- ✓ Vols corrected in February after spo stabilised
- ✓ There is still some limited near-term and larger medium-term upside to vols



Source all charts: Bloomberg, Crédit Agricole CIB

# Risk reversals highest ever

- Risk reversals have surged
- ✓ Markets fear further spot depreciation

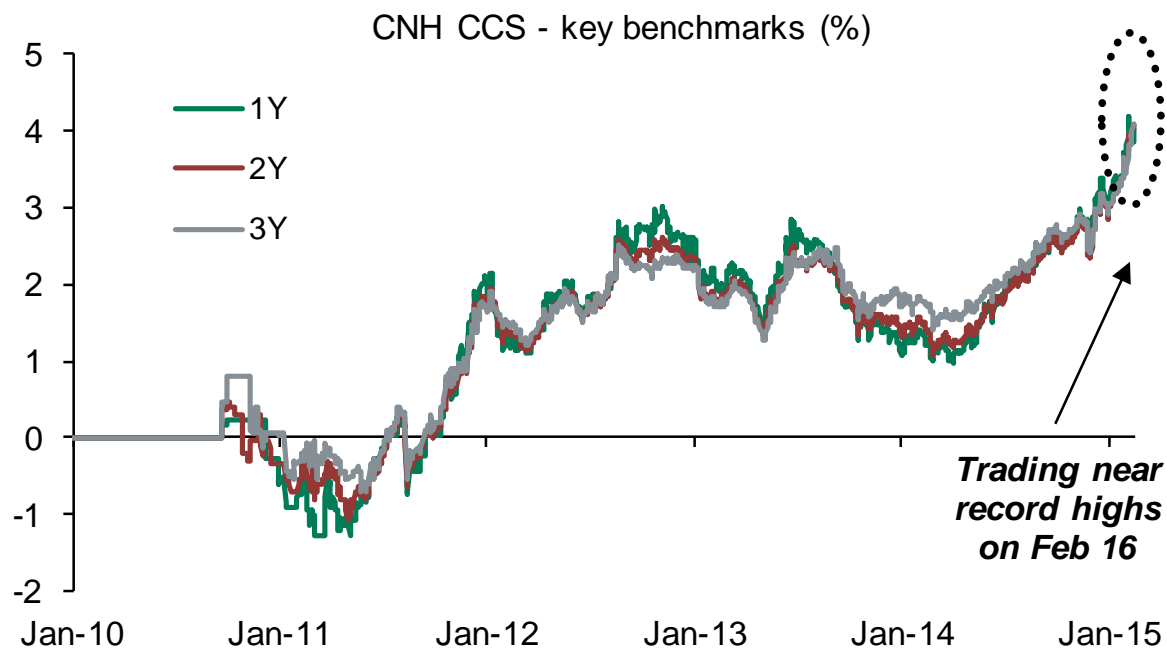


Source all charts: Bloomberg, Crédit Agricole CIB

# CNH CCS: up, up and away

# CNH CCS at record highs

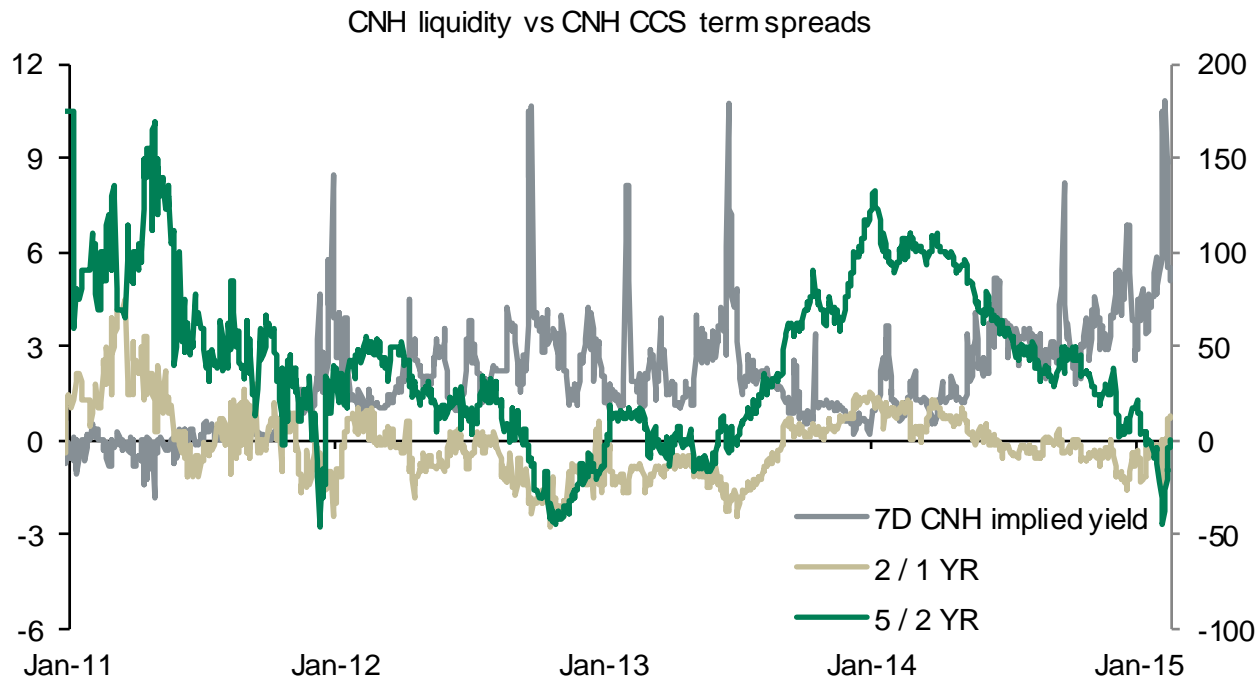
- CNH CCS rates have trended higher YTD, reaching record high levels
- ✓ Tightening of CNH liquidity
- ✓ Shift to the right of CNH FX swap points



Source all charts: Bloomberg, Crédit Agricole CIB

# Inverted relationship between liquidity and spreads

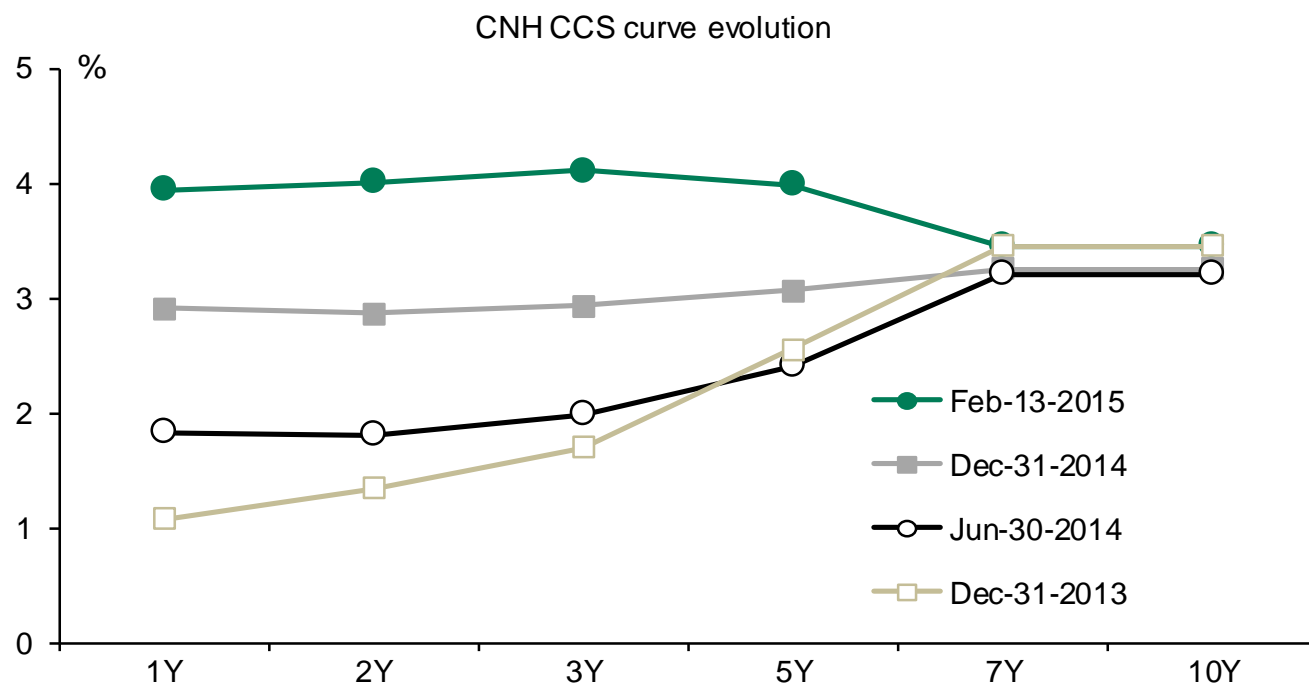
- As a result of the liquidity tightness, in January the CNH CCS curve to become fully inverted



Source all charts: Bloomberg, Crédit Agricole CIB

# The curve is inverted beyond 3Y

- All CNH CCS tenors have moved upwards
- ✓ The short end has seen the steepest increase
- ✓ The curve is inverted beyond the 7Y tenor

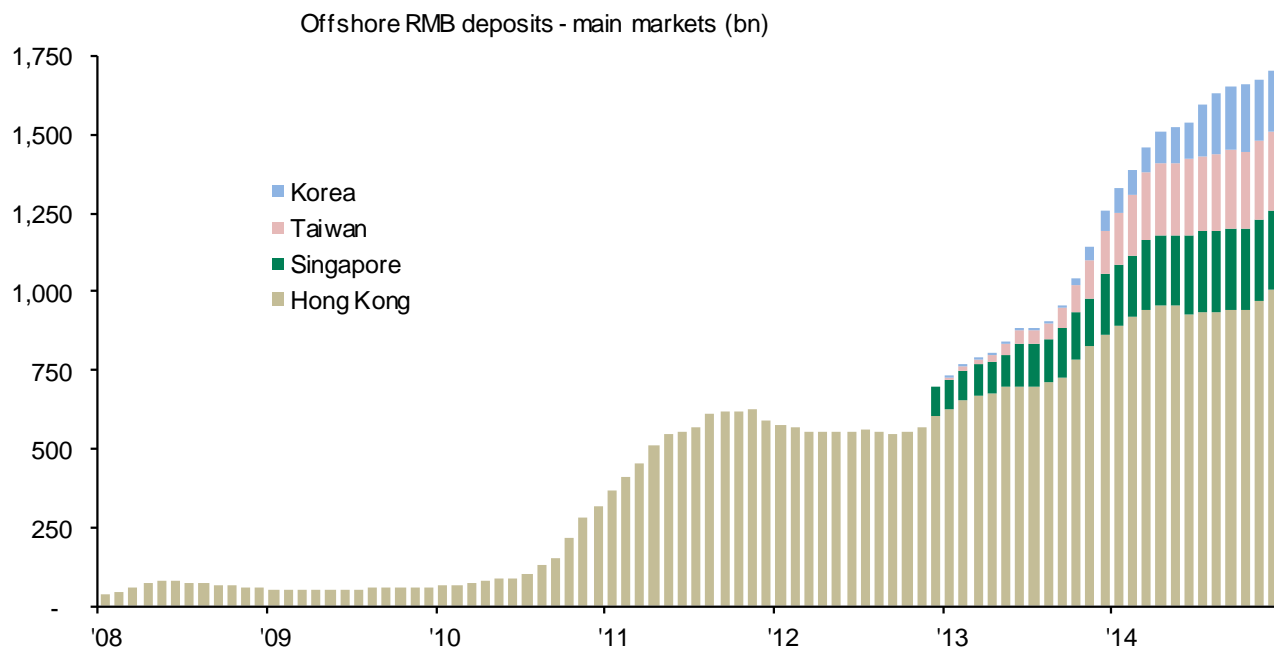


Source all charts: Bloomberg, Crédit Agricole CIB

# Offshore RMB deposits: are they really on the rise?



- In January, deposit pool shrunk in Korea but rose in Taiwan



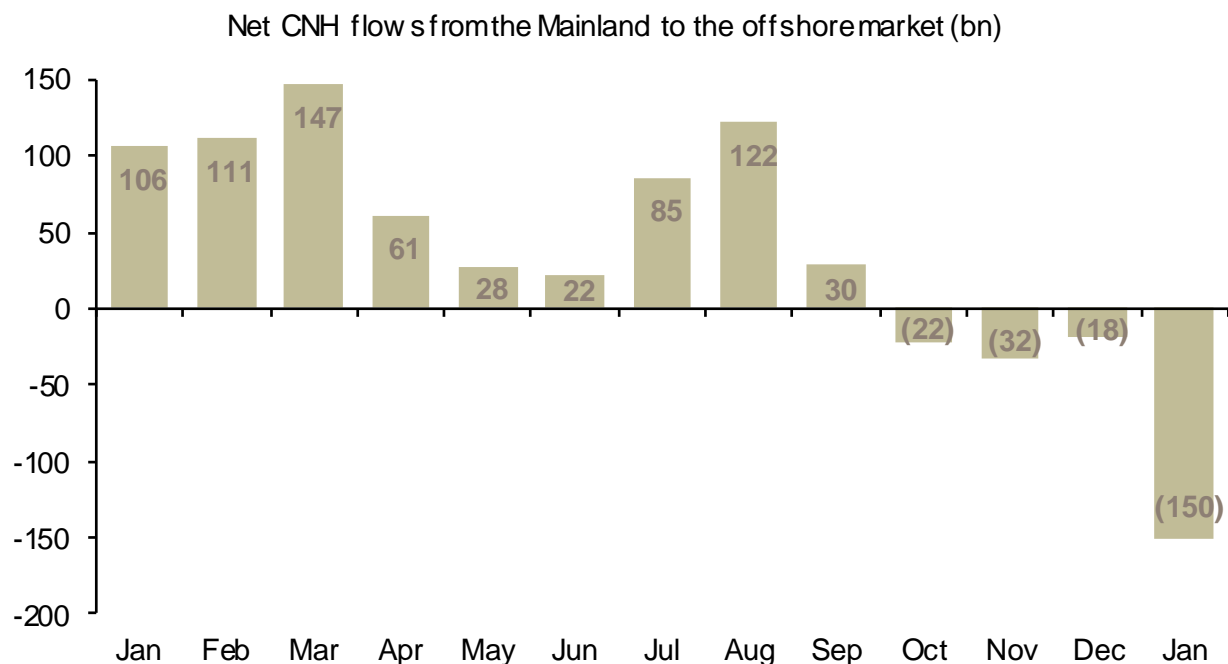
Source all charts: Bloomberg, Crédit Agricole CIB



# It's all about liquidity



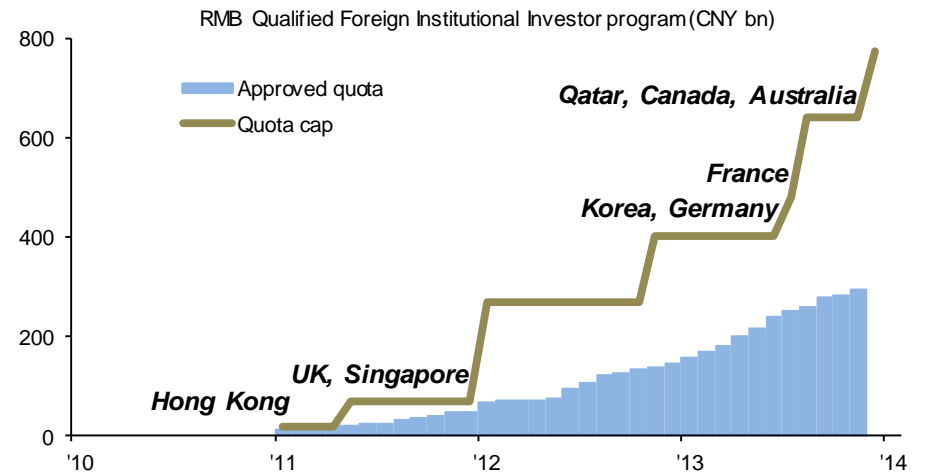
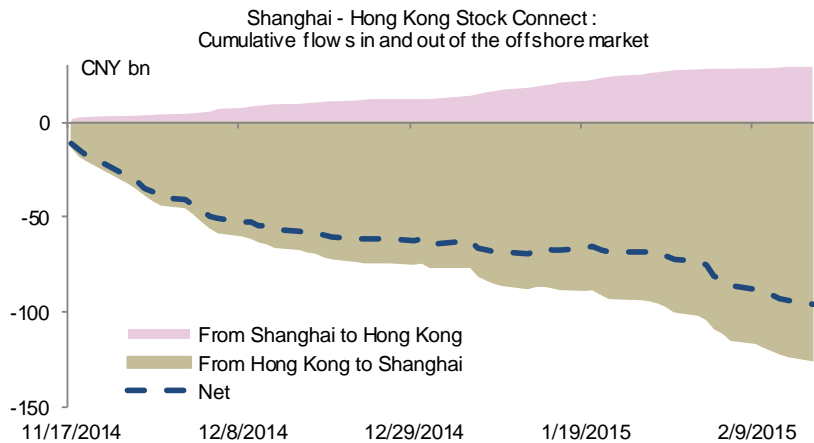
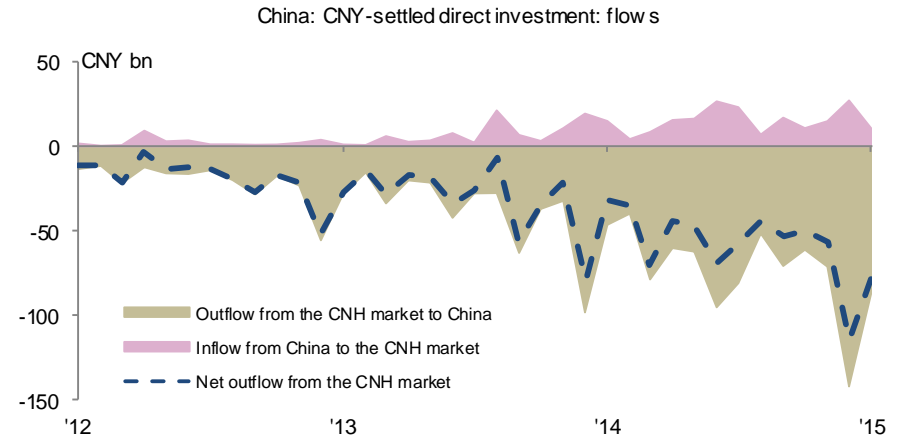
- Offshore money market rates have surged above onshore rates
- ✓ Since October the RMB has been leaving the offshore market and moving back onshore
- ✓ This is partly due to the fact that CNH has been trading at a discount versus CNY, making the RMB more valuable onshore
- ✓ Liquidity will remain tight for the foreseeable future
- CNH liquidity should improve in H215 due to:
  - ✓ RMB globalization policy
  - ✓ RRR cuts and resulting liquidity easing onshore



Source all charts: Bloomberg, Crédit Agricole CIB

# It's all about liquidity (2)

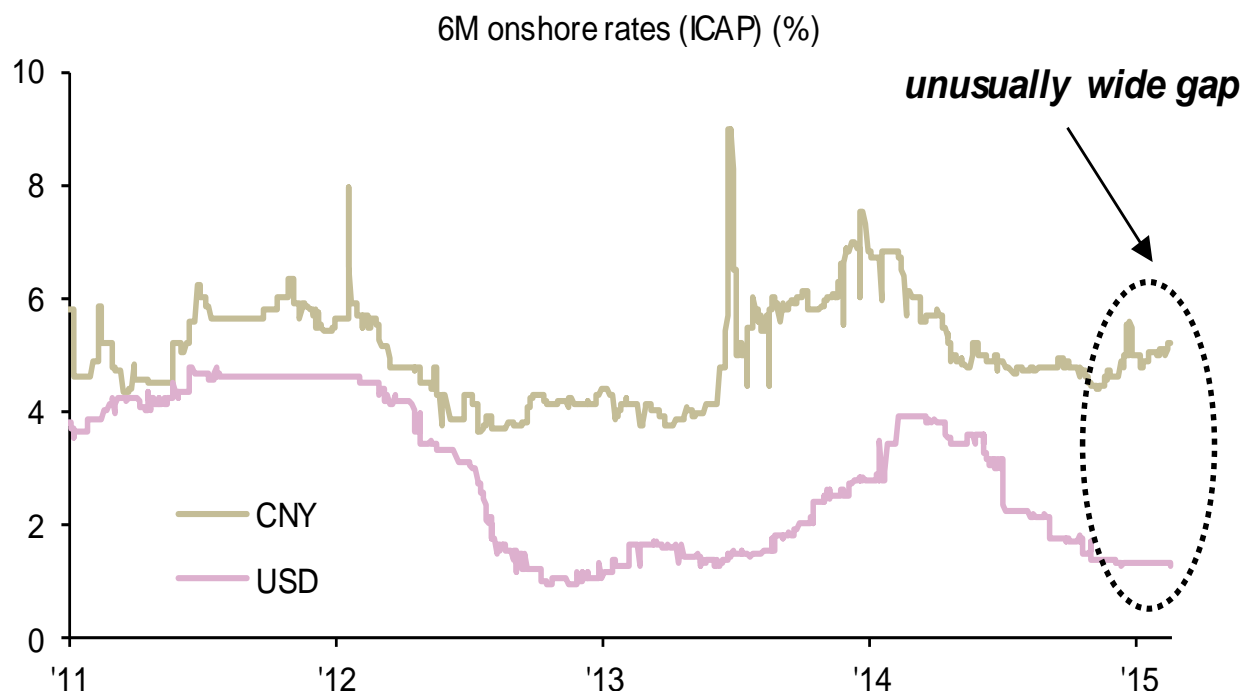
- Main avenues of liquidity flows from offshore to onshore markets:
  - ✓ CNY-settled direct investment (biggest source of drainage)
  - ✓ RQFII program
  - ✓ Shanghai - Hong Kong Stock Connect program



Source all charts: Bloomberg, Crédit Agricole CIB

# FX swap points have moved to the right

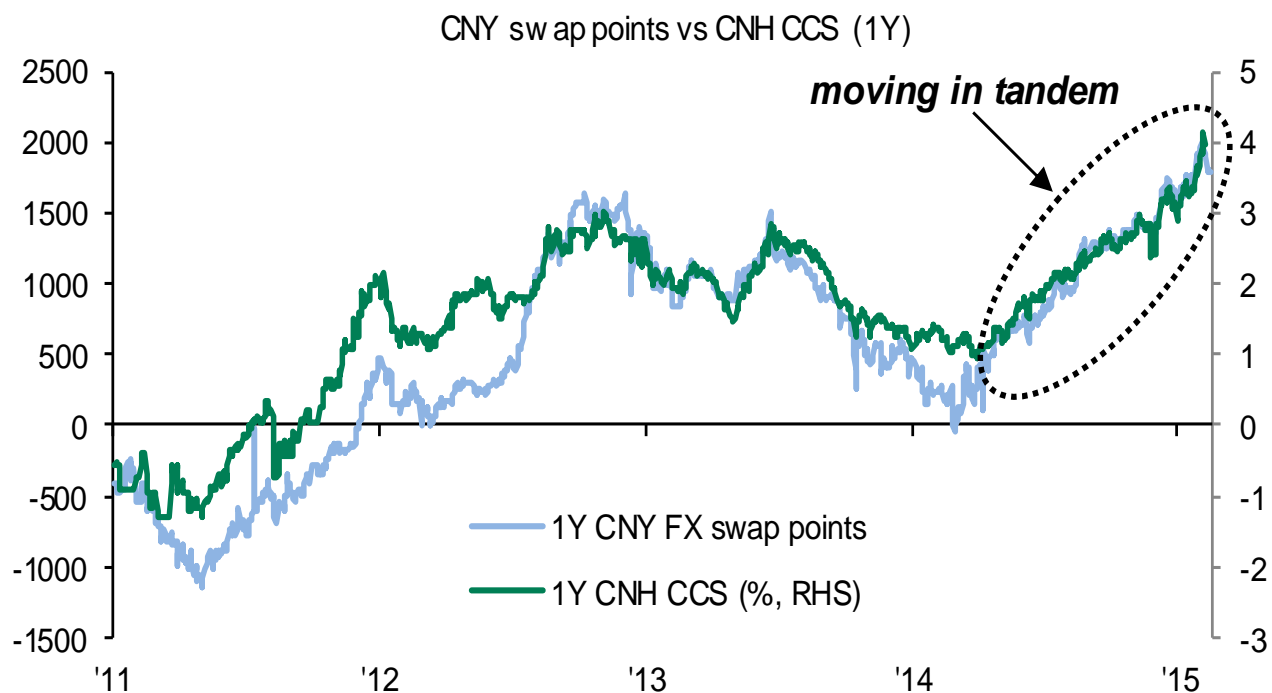
- Divergence of onshore USD and RMB rates – but likely to be reversed via monetary easing and post LNY
- Relentless EUR and GBP buying against the CNH by European corporates in – but usually only in Q1



Source all charts: Bloomberg, Crédit Agricole CIB

# Rising CNH swap points and CCS rates

- Strong correlation between FX swap points and CCS
- ✓ It ensures that the smaller (CCS) market is following the larger (FX swap) market higher
- Capital account opening in the SFTZ
- ✓ It puts a floor at short-term onshore levels under offshore rates, raising long-dated CNH CCS
- Shorter rates will be supported by tight offshore liquidity



Source all charts: Bloomberg, Crédit Agricole CIB

# Forecast

# Quarterly forecasts

	Q1 '13	Q2 '13	Q3 '13	Q4 '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14	Q1 '15	Q2 '15	Q3 '15	Q4 '15	Q1 '16	Q2 '16	Q3 '16	Q4 '16
<b>GDP</b>																
QoQ (%)	1.7	1.8	2.3	1.8	1.6	1.9	1.9	1.5	1.4	1.9	1.8	1.7	1.5	1.7	1.7	1.6
QoQ (% , annualised)	7.0	7.4	9.5	7.4	6.6	7.8	7.8	6.1	5.7	7.6	7.4	7.0	6.1	7.0	6.8	6.6
YoY (%)	7.8	7.5	7.9	7.6	7.4	7.5	7.3	7.3	6.9	6.8	6.7	6.9	7.0	6.9	6.7	6.6
<b>CPI (% , YoY)</b>																
Average	2.4	2.4	2.8	2.9	2.3	2.2	2.0	1.5	1.1	1.3	1.4	1.8	2.8	2.8	2.8	2.8
Quarter-end	2.1	2.7	3.1	2.5	2.4	2.3	1.6	1.5	1.2	1.2	1.4	2.1	2.8	2.8	2.8	2.8
<b>Monetary policy</b>																
1Y PBoC deposit rate (%)	3.00	3.00	3.00	3.00	3.00	3.00	3.00	2.75	2.50	2.50	2.50	2.50	2.75	2.75	3.00	3.00
1Y PBoC lending rate (%)	6.00	6.00	6.00	6.00	6.00	6.00	6.00	5.60	5.35	5.35	5.35	5.35	5.60	5.60	5.85	5.85
Required reserve ratio (%)	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	19.5	19.0	18.5	18.5	18.0	17.5	17.5	17.5
<b>FX rates</b>																
USD/CNY	6.21	6.14	6.12	6.05	6.22	6.20	6.15	6.21	6.28	6.30	6.27	6.16	6.20	6.21	6.13	6.05
USD/CNH	6.20	6.14	6.12	6.06	6.22	6.21	6.14	6.22	6.27	6.29	6.26	6.15	6.19	6.20	6.12	6.04
EUR/CNY	7.96	7.99	8.26	8.33	8.56	8.47	7.74	7.54	6.91	6.87	6.77	6.47	6.70	6.83	6.74	6.72
EUR/CNH	7.95	7.98	8.26	8.34	8.52	8.47	7.73	7.56	6.90	6.86	6.76	6.46	6.69	6.82	6.74	6.71
<b>CNY IRS</b>																
2Y	3.37	3.85	3.98	5.20	4.35	3.74	3.30	3.42	2.90	2.50	2.60	2.70	2.85	3.00	3.10	3.15
5Y	3.67	3.80	4.17	5.25	4.55	4.10	3.53	3.55	3.04	2.72	2.84	2.96	3.13	3.30	3.45	3.56
10Y	3.87	4.01	4.37	5.44	4.72	4.29	3.72	3.74	3.25	3.05	3.20	3.35	3.55	3.75	3.95	4.15
<b>CGB</b>																
2Y	3.01	3.33	3.71	4.35	3.57	3.73	3.93	3.31	3.05	2.55	2.60	2.65	2.75	2.85	2.90	2.90
5Y	3.38	3.44	3.94	4.56	4.25	4.06	4.05	3.51	3.29	2.87	2.89	2.91	2.98	3.05	3.10	3.11
10Y	3.70	3.68	4.06	4.78	4.63	4.11	4.02	3.62	3.45	3.20	3.25	3.30	3.40	3.55	3.65	3.80
<b>CNH CCS</b>																
1Y	2.13	2.49	1.78	1.08	0.97	1.83	2.61	2.91	4.10	4.00	3.80	3.60	3.70	3.75	3.80	3.85
2Y	1.99	2.23	1.82	1.34	1.18	1.81	2.58	2.86	4.30	4.20	4.00	3.80	3.70	3.80	3.90	4.00
5Y	1.92	2.24	2.46	2.55	2.24	2.41	3.04	3.07	4.20	4.15	4.05	3.95	3.90	3.95	4.00	4.10

Source: Bloomberg, CEIC, Crédit Agricole CIB

# Annual forecasts

	'12	'13	'14	'15	'16
<b>Economy</b>					
<b>GDP (% YoY)</b>	7.8	7.7	7.4	7.1	6.9
<i>Contributions (ppt)</i>					
Consumption	4.2	3.9	3.8	3.8	3.8
Investment	3.6	4.2	3.6	3.6	3.5
Trade	-0.1	-0.3	0.0	-0.3	-0.4
<b>CPI (% YoY)</b>					
<i>Year-end</i>	2.5	2.5	1.5	2.1	2.8
<i>Average</i>	2.7	2.6	2.0	1.4	2.8
<b>Current account balance</b>					
<i>% of GDP (PBoC)</i>	2.6	1.9	2.1	1.3	0.5
Trade balance (goods)					
<i>USD bn (Customs)</i>	233	261	380	444	420
<i>% of GDP</i>	2.8	2.8	3.7	4.0	3.4
Exports (volume, %, YoY)	9.5	7.9	5.1	4.7	5.0
Imports (volume, %, YoY)	5.2	7.2	3.4	5.7	6.3
<b>Budget balance</b>					
<i>Official, CNY bn</i>	-800	-1200	-1131	-1650	-1950
<i>Official, % of GDP</i>	-1.5	-2.0	-1.8	-2.4	-2.6
<i>Our estimate, % of GDP</i>	-6.6	-8.9	-7.5	-6.5	-6.0

	'12	'13	'14	'15	'16
<b>Monetary policy</b>					
1Y PBoC deposit rate (%)	3.00	3.00	2.75	2.50	3.00
1Y PBoC lending rate (%)	6.00	6.00	5.60	5.35	5.85
Required reserve ratio (%)	20.0	20.0	20.0	18.5	17.5
<b>Market</b>					
<b>FX</b>					
USD/CNY	6.23	6.05	6.21	6.16	6.05
USD/CNH	6.22	6.06	6.22	6.15	6.04
EUR/CNY	8.22	8.33	7.54	6.47	6.72
EUR/CNH	8.21	8.34	7.56	6.46	6.71
<b>CNY IRS</b>					
2Y	3.35	5.20	3.42	2.70	3.15
5Y	3.64	5.25	3.55	2.96	3.56
10Y	3.83	5.44	3.74	3.35	4.15
<b>CGB</b>					
2Y	3.05	4.35	3.31	2.65	2.90
5Y	3.33	4.56	3.51	2.91	3.11
10Y	3.64	4.78	3.62	3.30	3.80
<b>CNH CCS</b>					
1Y	2.56	1.08	2.91	3.60	3.85
2Y	2.33	1.34	2.86	3.80	4.00
5Y	2.18	2.55	3.07	3.95	4.10

Source: Bloomberg, CEIC, Crédit Agricole CIB

# Disclaimer



© 2015, CRÉDIT AGRICOLE CORPORATE AND INVESTMENT BANK All rights reserved.

This research report or summary has been prepared by Crédit Agricole Corporate and Investment Bank or one of its affiliates (collectively “Crédit Agricole CIB”) from information believed to be reliable. Such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness.

This report is a “commercial communication” as defined in article 6 of the Directive 2000/31/CE of 8 June 2000. For the avoidance of doubt, it is not a “*communication à caractère promotionnel*” within the meaning of the *Règlement General AMF*. It is provided for information purposes only. Nothing in this report should be considered to constitute investment, legal, accounting or taxation advice and you are advised to contact independent advisors in order to evaluate this report. It is not intended, and should not be considered, as an offer, invitation, solicitation or personal recommendation to buy, subscribe for or sell any of the financial instruments described herein, nor is it intended to form the basis for any credit, advice, personal recommendation or other evaluation with respect to such financial instruments and is intended for use only by those professional investors to whom it is made available by Crédit Agricole CIB. Crédit Agricole CIB does not act in a fiduciary capacity to you in respect of this report.

Crédit Agricole CIB may at any time stop producing or updating this report. Not all strategies are appropriate at all times. Past performance is not necessarily a guide to future performance. The price, value of and income from any of the financial instruments mentioned in this report can fall as well as rise and you may make losses if you invest in them. Independent advice should be sought. In any case, investors are invited to make their own independent decision as to whether a financial instrument or whether investment in the financial instruments described herein is proper, suitable or appropriate based on their own judgement and upon the advice of any relevant advisors they have consulted. Crédit Agricole CIB has not taken any steps to ensure that any financial instruments referred to in this report are suitable for any investor. Crédit Agricole CIB will not treat recipients of this report as its customers by virtue of their receiving this report.

Crédit Agricole CIB, its directors, officers and employees may effect transactions (whether long or short) in the financial instruments described herein for their own accounts or for the account of others, may have positions relating to other financial instruments of the issuer thereof, or any of its affiliates, or may perform or seek to perform securities, investment banking or other services for such issuer or its affiliates. Crédit Agricole CIB may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Crédit Agricole CIB is under no obligation to ensure that such other reports are brought to the attention of any recipient of this report. Crédit Agricole CIB has established a “Policy for Managing Conflicts of Interest in relation to Investment Research” which is available upon request. A summary of this Policy is published on the Crédit Agricole CIB website: <http://www.ca-cib.com/group-overview/the-markets-in-financial-instruments-directive-mifid.htm>. This Policy applies to its investment research activity.

None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party without the prior express written permission of Crédit Agricole CIB. To the extent permitted by applicable securities laws and regulations, Crédit Agricole CIB accepts no liability whatsoever for any direct or consequential loss arising from the use of this document or its contents.

France: Crédit Agricole Corporate and Investment Bank is authorised by the Autorité de Contrôle Prudentiel et de Résolution (“ACPR”) and supervised by the ACPR and the Autorité des Marchés Financiers (“AMF”). United Kingdom: Approved and/or distributed by Crédit Agricole Corporate and Investment Bank, London branch. Crédit Agricole Corporate and Investment Bank is authorised by the ACPR and supervised by the ACPR and the AMF in France and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from us on request. United States of America: This research report is distributed solely to persons who qualify as “Major U.S. Institutional Investors” as defined in Rule 15a-6 under the Securities and Exchange Act of 1934 and who deal with Crédit Agricole Corporate and Investment Bank. Recipients of this research in the United States wishing to effect a transaction in any security mentioned herein should do so by contacting Crédit Agricole Securities (USA), Inc. (a broker-dealer registered with the Securities and Exchange Commission). The delivery of this research report to any person in the United States shall not be deemed a recommendation of Crédit Agricole Securities (USA), Inc. to effect any transactions in the securities discussed herein or an endorsement of any opinion expressed herein. Italy: This research report can only be distributed to, and circulated among, professional investors (*operatori qualificati*), as defined by the relevant Italian securities legislation. Spain: Distributed by Crédit Agricole Corporate and Investment Bank, Madrid branch and may only be distributed to institutional investors (as defined in article 7.1 of Royal Decree 291/1992 on Issues and Public Offers of Securities) and cannot be distributed to other investors that do not fall within the category of institutional investors. Hong Kong: Distributed by Crédit Agricole Corporate and Investment Bank, Hong Kong branch. This research report can only be distributed to professional investors within the meaning of the Securities and Futures Ordinance (Cap.571) and any rule made there under. Japan: Distributed by Crédit Agricole Securities Asia B.V. which is registered for securities business in Japan pursuant to the Law Concerning Foreign Securities Firms (Law n°5 of 1971, as amended), and is not intended, and should not be considered, as an offer, invitation, solicitation or recommendation to buy or sell any of the financial instruments described herein. This report is not intended, and should not be considered, as advice on investments in securities which is subject to the Securities Investment Advisory Business Law (Law n°74 of 1986, as amended). Luxembourg: Distributed by Crédit Agricole Corporate and Investment Bank, Luxembourg branch. It is only intended for circulation and/or distribution to institutional investors and investments mentioned in this report will not be available to the public but only to institutional investors. Singapore: Distributed by Crédit Agricole Corporate and Investment Bank, Singapore branch. It is not intended for distribution to any persons other than accredited investors, as defined in the Securities and Futures Act (Chapter 289 of Singapore), and persons whose business involves the acquisition or disposal of, or the holding of capital markets products (as defined in the Securities and Futures Act (Chapter 289 of Singapore)). Switzerland: Distributed by Crédit Agricole (Suisse) S.A. This report is not subject to the SBA Directive of January 24, 2003 as they are produced by a non-Swiss entity. Germany: Distributed by Crédit Agricole Corporate and Investment Bank, Frankfurt branch and may only be distributed to institutional investors. Australia: Distributed to wholesale investors only. This research, and any access to it, is intended only for “wholesale clients” within the meaning of the Australian Corporations Act.

THE DISTRIBUTION OF THIS DOCUMENT IN OTHER JURISDICTIONS MAY BE RESTRICTED BY LAW, AND PERSONS INTO WHOSE POSSESSION THIS DOCUMENT COMES SHOULD INFORM THEMSELVES ABOUT, AND OBSERVE, ANY SUCH RESTRICTIONS. BY ACCEPTING THIS REPORT YOU AGREE TO BE BOUND BY THE FOREGOING.

09/10/13