

## A steadier RMB exchange rate in 2017

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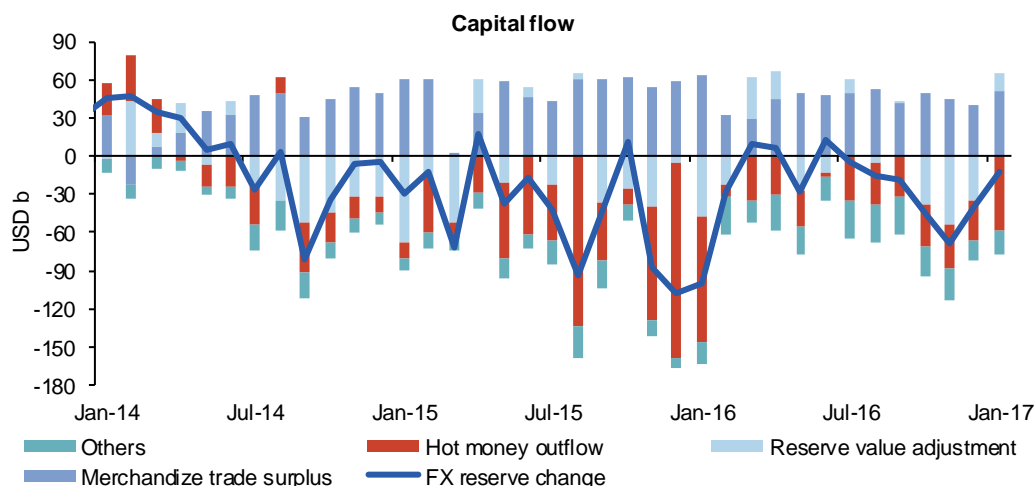
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■ We revise our RMB/USD assumption to 6.9 (range: 6.8-7.0) for end 1H17 and to 7.1 (range: 6.9-7.3) for end 2017. Tighter capital controls, interest rate hikes by the PBoC plus better than expected economic fundamentals should support the currency. Since further RMB depreciation could fuel Sino-US trade friction, China may be more willing to maintain a broadly stable RMB this year.

The RMB gained ground against the USD in January, in contrast to market expectations of a sizable depreciation. From end 2016 to 14 February, the onshore and offshore RMB appreciated by 1.2% and 1.8% respectively. Compared with nearly 7% depreciation in 2016, we believe the RMB will depreciate at a slower pace in 2017.

**First, capital controls should continue to squeeze capital outflows.** Since late December, the government has further tightened measures to stop capital outflows, including imposing new requirements on Chinese citizens (USD50,000 annual exchange limit), encouraging Chinese enterprises to borrow in foreign currency and tightening rules on Chinese citizens opening offshore bank accounts (see [Capital controls trigger liquidity squeeze in offshore RMB market](#), 6 January 2017). These measures have reduced capital outflows and will continue to do so this year. FX reserve and trade data suggest that implicit capital outflows in January hit USD58.1b, a significant drop from January 2016.

**Fig 1** Capital outflows fell significantly in January 2017



**Second, interest rate hikes support the RMB.** The PBoC's policy stance changed in late October. Yields on several types of financial assets, including bonds, money market funds and wealth management products (WMPs) have risen (see [Revisiting China's new monetary policy framework](#), 10 February). The central bank's rate hikes around Chinese New Year reinforced this shift towards a tightening monetary policy (see [Further rate hikes confirm tightening stance](#), 6 February). Indeed, the yield spread between China and US 10-year treasuries has widened since November 2016.

**Fig 2** Yield spread between 10-year treasury bonds (China-US)



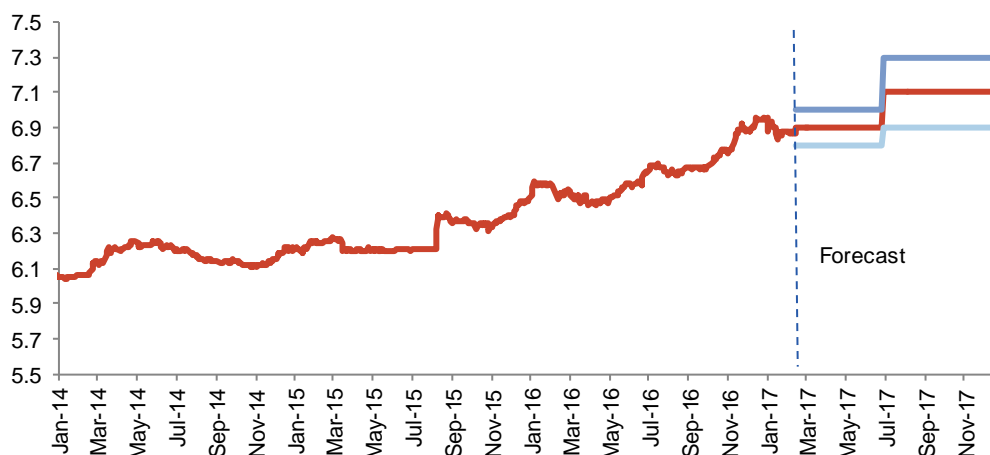
Source: Wind, Mizuho research

Higher domestic interest rates reduced the attractiveness of foreign assets and helped to stabilize the RMB. We anticipate that the PBoC will tighten monetary policy further in 2017, and this in turn will support the currency.

**Third, economic recovery has bolstered investor confidence.** Trade data (customs department), headline inflation data (National Bureau of Statistics, NBS) plus financial statistics (PBoC) released in the past two weeks suggest that China is growing faster than expected (see [Rising inflation and total social financing justify modest monetary tightening](#), 15 February). The H share Index has increased by over 10% since the start of 2017. The robust economy has boosted investor confidence and lent support to the RMB.

**A more stable RMB may ease Sino-US trade friction.** President Trump’s protectionist policy stance suggests that China will need to carefully manage its economic relationship with the US (see [What is China’s Trump card in a trade war?](#), 15 February). As Mr Trump has criticized the exchange policies of major trading partners running big trade surpluses with the US, and particularly China, we believe further RMB depreciation could trigger a potential Sino-US trade war. So we believe China’s policy makers may be more willing to maintain a relatively strong RMB in 2017. **We assume the onshore RMB:USD exchange rate will be 6.9 (range: 6.8-7.0) by end 1H17 and 7.1 (range: 6.9-7.3) by end 2017.**

**Fig 3** RMB: USD Exchange rate



Source: Wind, Mizuho research

*Rocky Fan of Mizuho assisted in the preparation of this report.*

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