



China and Hong Kong Forex Market Developments

One-way appreciation carrying into the new year

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- The RMB entered the new year on a very rapid appreciation as the USDCNH breached 6.35 for the first time since August 2015. A weak dollar is a large part of the story as the dollar index has declined 3.4% in 2018 but not all. The domestic environment is also supportive in terms of tamed capital outflows, robust exports and strong GDP growth. The CFETS RMB Index is relatively stable and the CNY has depreciated 3% against the euro in 2018 so far.
- Interbank rates, especially 1M SHIBOR, softened significantly amid improved liquidity conditions in the beginning of the new year. The PBoC drained CNY350bn through OMOs in December to mop up the liquidity stemming from government deposits flooding into banks at year-end. However, liquidity was injected more generously since January. There is a risk of interest hike as a response to deleverage pressure and the Fed normalization, but the pace of the hike should be slow to maintain the growth momentum.
- FX reserves built up to USD3140bn helped by a positive valuation effect as all major currencies appreciated against the USD and improved market sentiment. Capital outflows in terms of the FX positions held by banks / clients increased on the margin in December, which shows some preference for RMB by domestic private sector.
- We expect the current one-way appreciation to continue in the near term, but some correction of the currency should arrive in the next few months, due to the larger divergence between in monetary policy between PBoC and FED (as we do not expect the PBoC to fully transfer the FED hikes as what has been in the past few cases). Furthermore, down the road, economic fundamentals do not support the one-way appreciation of the RMB. In fact, the upside potential of the USDCNY is limited by an expected deceleration in China's growth, mainly led by investment. It will, thus, be difficult for China to allow for a substantial reduction in the current account surplus. Hence we expect the RMB to slightly depreciate towards the second half of 2018.

1. CNH market

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2. CNY market

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1.

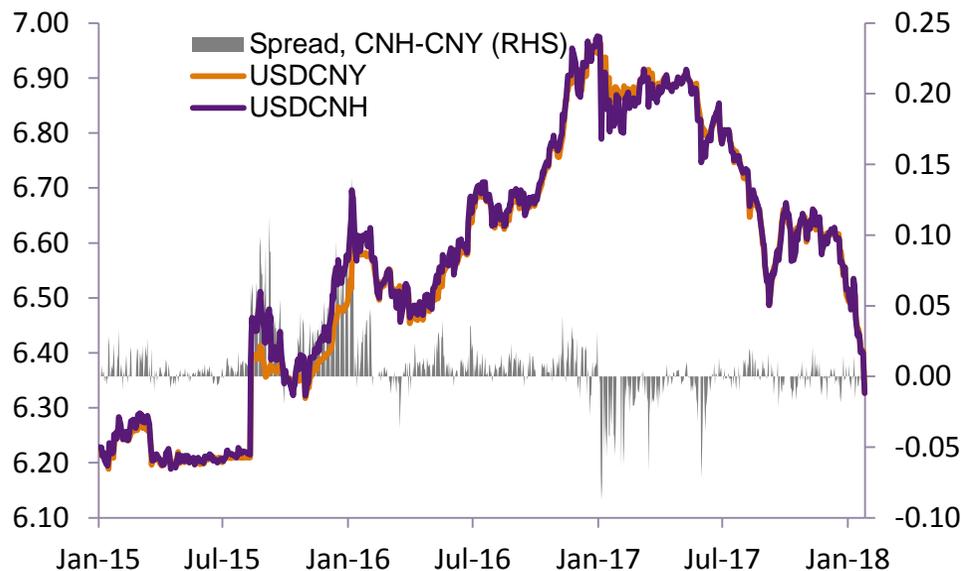
Key Development Offshore (CNH)

Onshore

Offshore

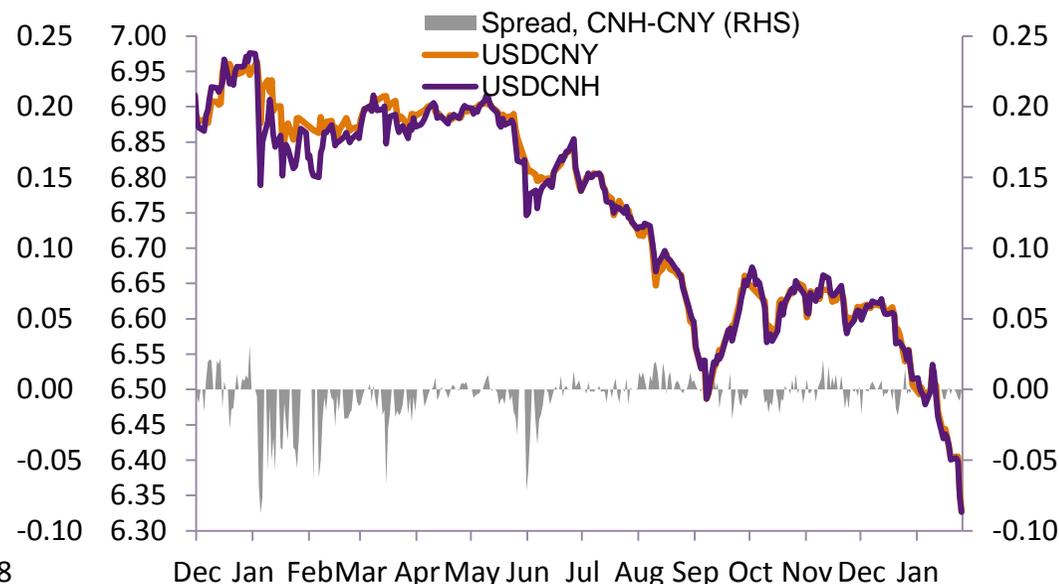
The RMB entered the new year on a positive note and the USDCNH breached 6.35 for the first time since August 2015.

CNH and CNY



Positive spread indicates offshore yuan is weaker than onshore.
Source: Bloomberg, Natixis

CNH and CNY (short timeframe)



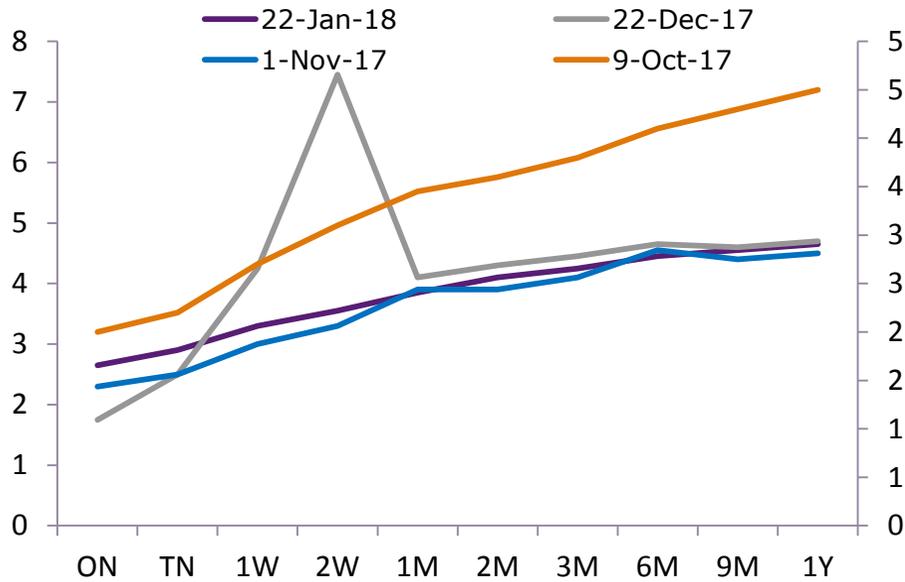
Positive spread indicates offshore yuan is weaker than onshore.
Source: Bloomberg, Natixis

USDCNH	CNH Depreciation (-,%)	End of Period	High of Period	Low of Period
January (till 25 th)	+2.88	6.3267	6.5350	6.3267
December 2017	+1.47	6.5143	6.6279	6.5143
2016	-6.20	6.9761	6.9761	6.4561

Onshore **Offshore**

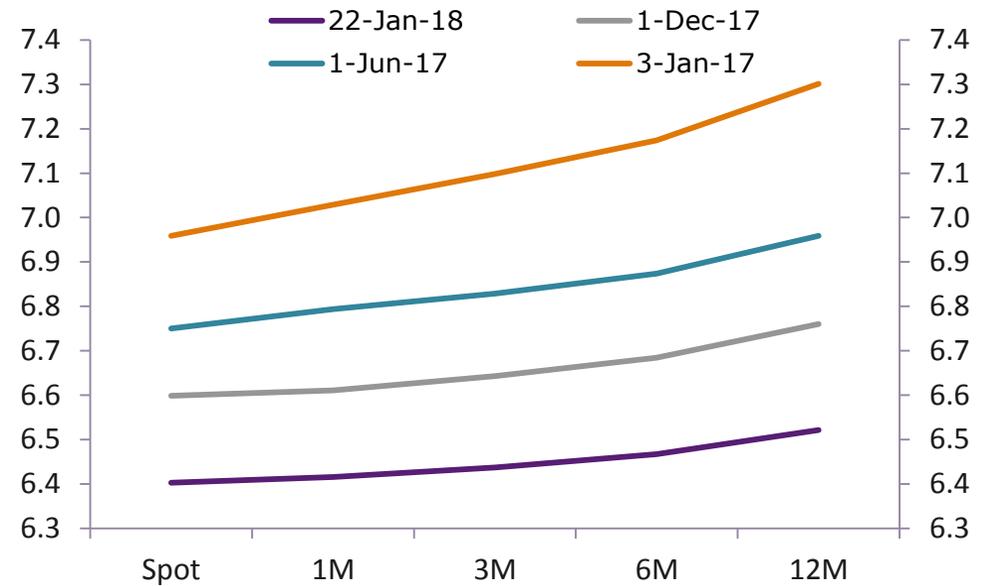
The interbank rates softened in the new year. The appreciation expectation for the RMB continue to build up in the market.

CNH HIBOR



Source: Bloomberg, Natixis

USDCNH forward

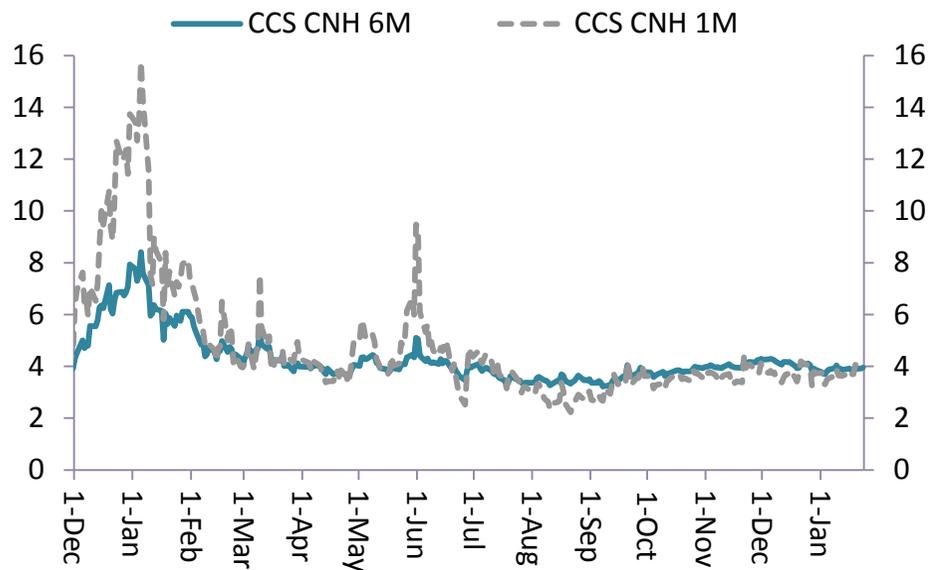


Source: Bloomberg, Natixis

Onshore Offshore

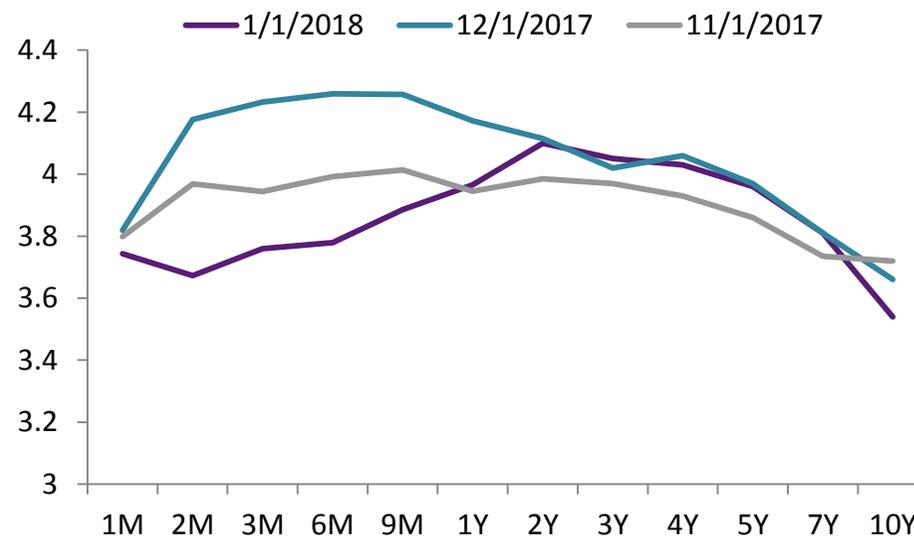
The CNH CCS rates normalized with the short-end rates declined but the long-end yield further dropped.

CNH/USD CCS



Source: Bloomberg, Natixis

CCS Curves



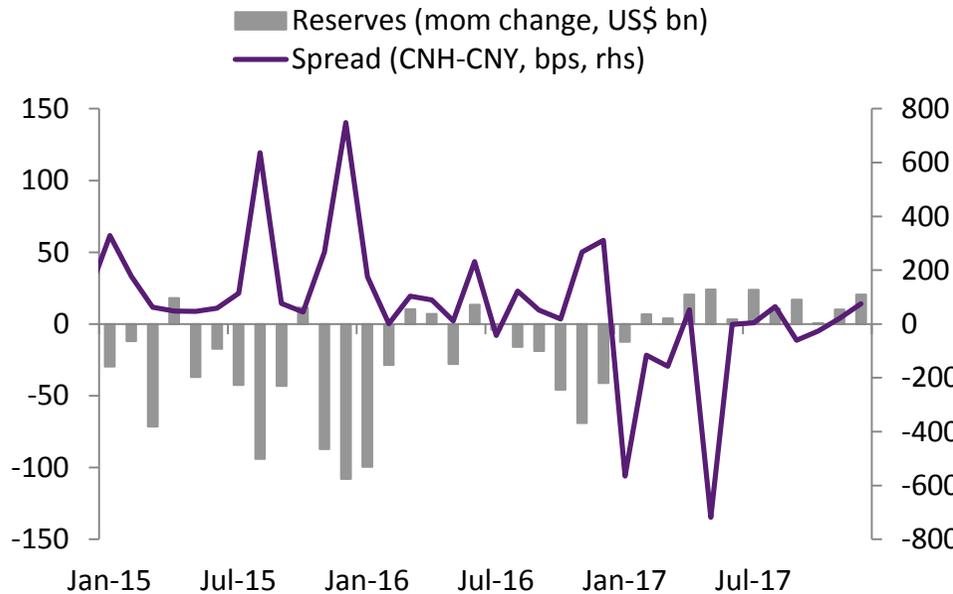
Source: Bloomberg, Natixis

Onshore

Offshore

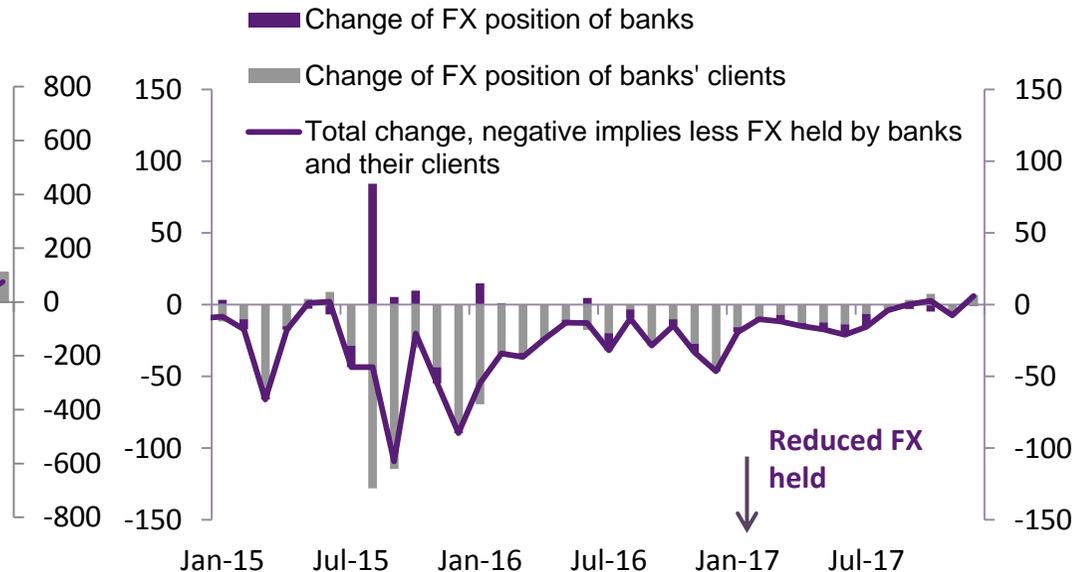
FX reserves built up to USD3140bn helped by positive valuation effect and improved market sentiment. Capital outflows in terms of the FX positions held by banks / clients only increased on the margin in December.

China FX Reserves and Currency Spread



Source: Bloomberg, Natixis

Change of FX position of banks and their clients (USD bn)



Source: Bloomberg, Natixis

Onshore Offshore

2.

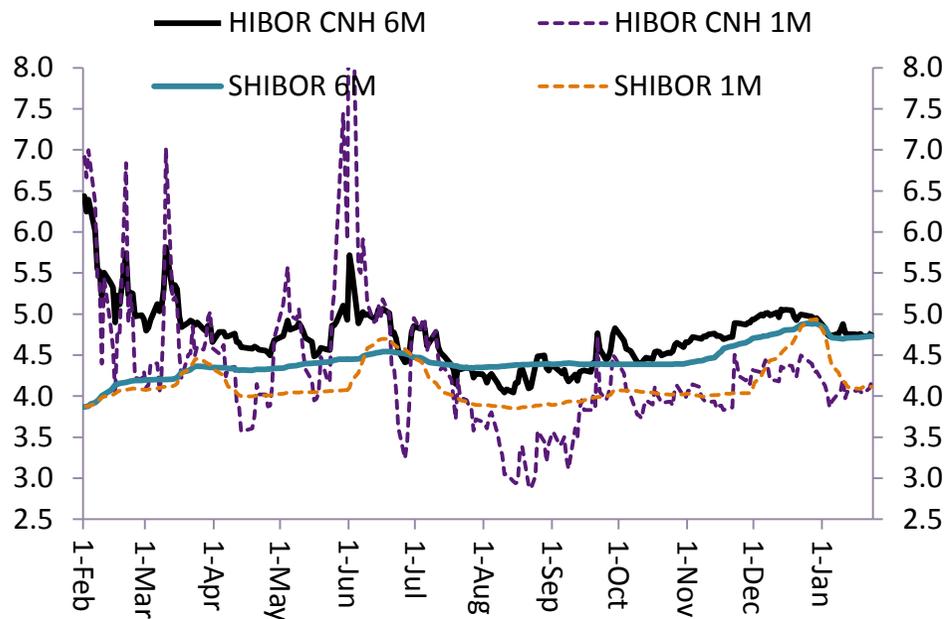
The onshore market (CNY)

Onshore

Offshore

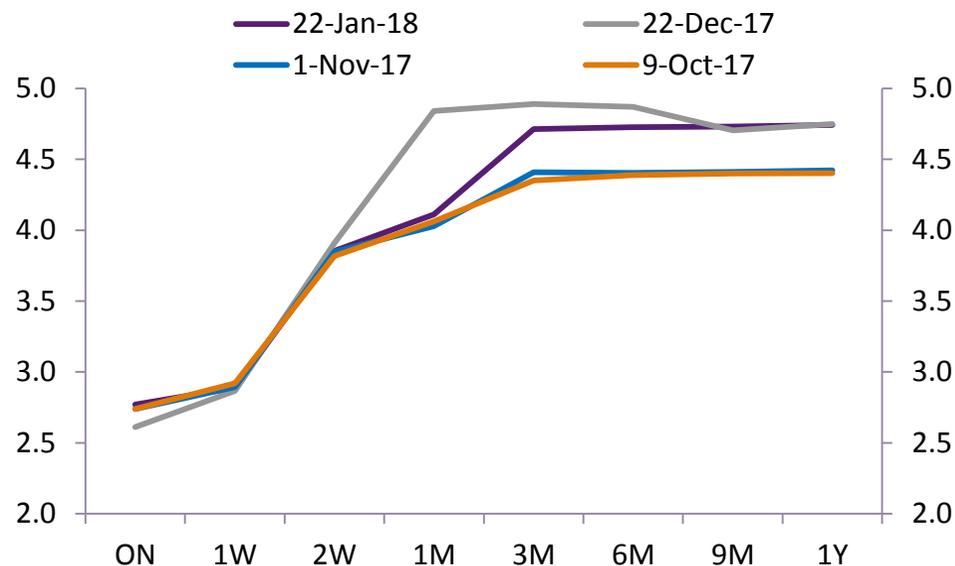
Interbank rates, especially 1M SHIBOR, softened significantly amid generous liquidity injection by the PBoC and improved liquidity condition in the beginning of the new year.

CNH HIBOR and SHIBOR



Source: Bloomberg, Natixis

SHIBOR

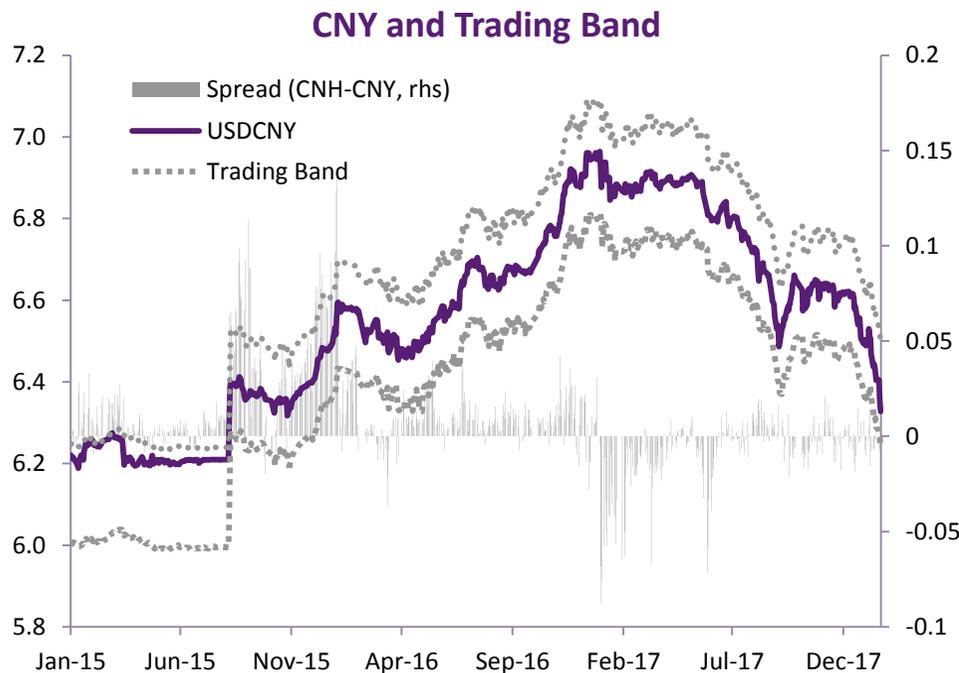


Source: Bloomberg, Natixis

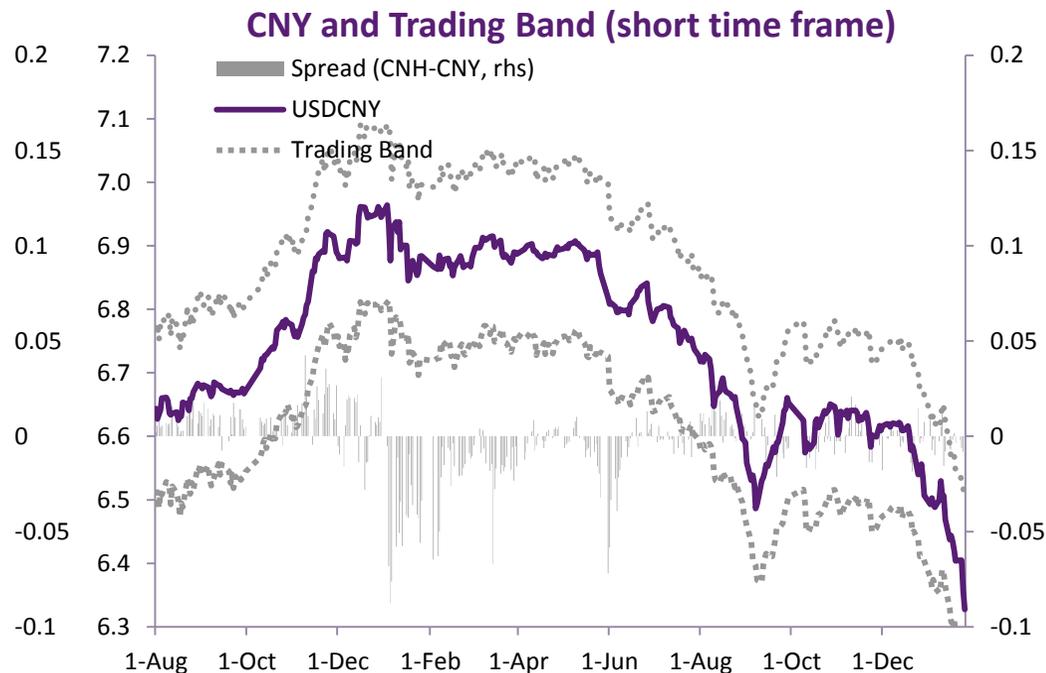
Onshore

Offshore

The USDCNY reached a two-year record low at 6.35 amid dollar weakness and supportive domestic environment including tamed capital outflows, robust exports and GDP growth.



Source: Bloomberg, Natixis



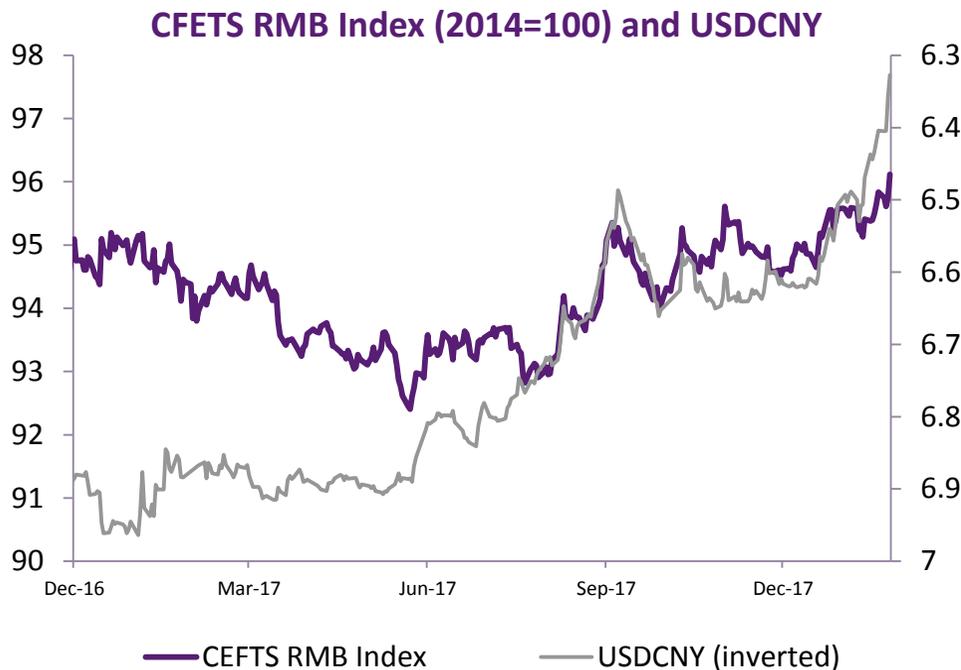
Source: Bloomberg, Natixis

USDCNY	CNY Depreciation (-,%)	End of Period	High of Period	Low of Period
January (till 25 th)	+2.55	6.3275	6.5297	6.3275
December 2017	+1.55	6.5068	6.6215	6.5068
2016	-6.95	6.9450	6.9615	6.4536

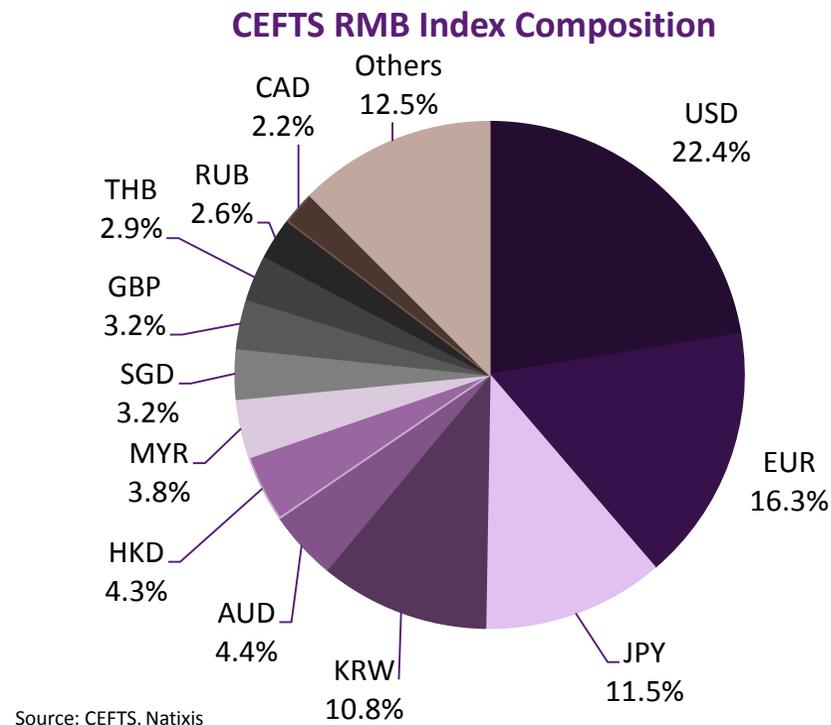
Onshore

Offshore

The CFETS RMB Index is relatively stable and the CNY has depreciated 3% against the euro in 2018 so far.



Source: Bloomberg, Natixis

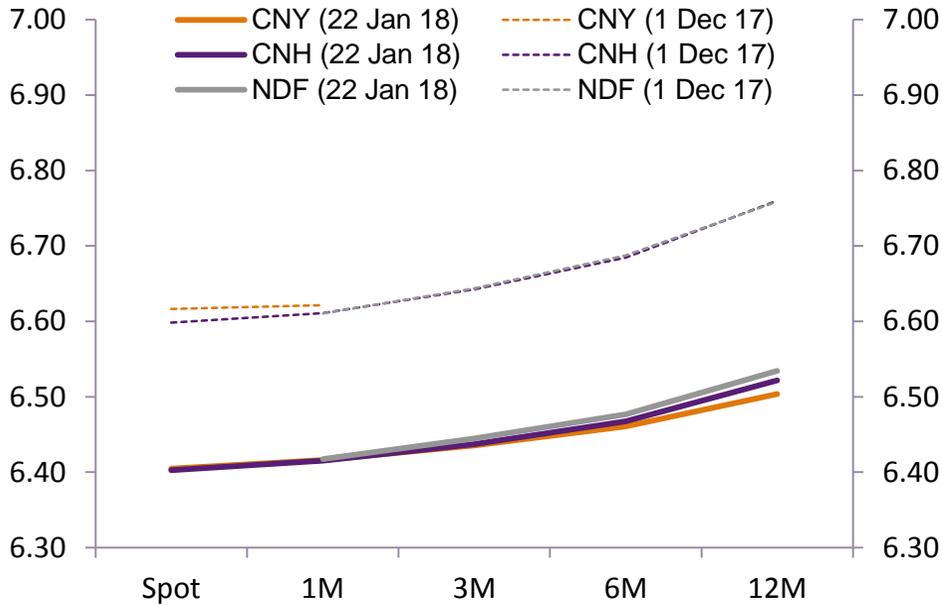


CFETS RMB	RMB Depreciation (-,%)	Last	High	Low
January (till 25 th)	+0.58	96.12	96.12	95.13
December 2017	+1.11	95.58	95.58	94.52
2016	-6.13	94.72	100.04	93.67

Onshore Offshore

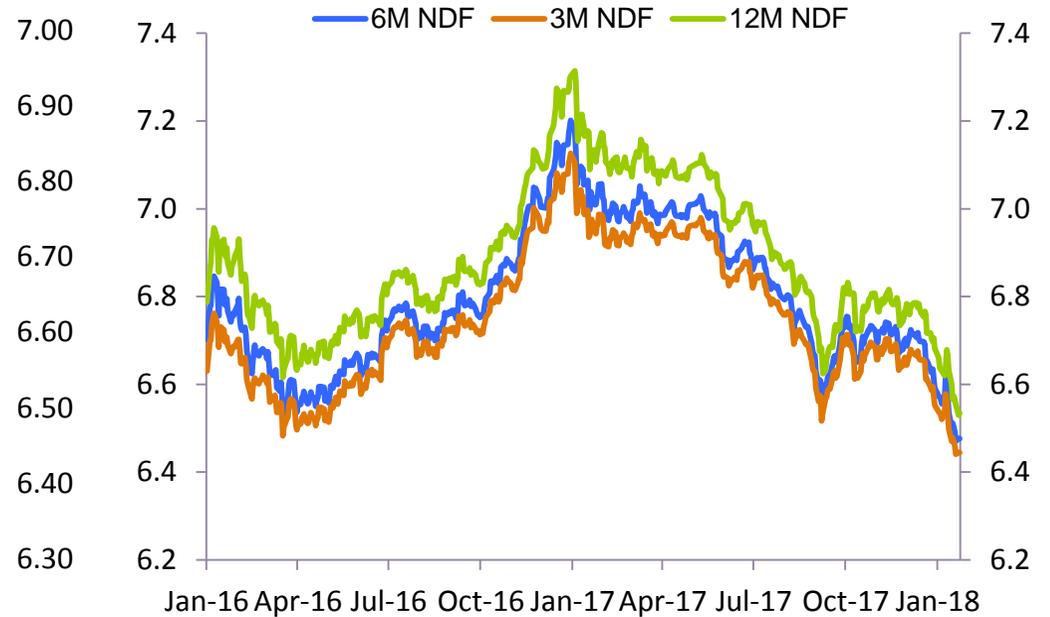
Forward rates moved down from last month.

RMB forward curves



Source: Bloomberg, Natixis

Offshore NDF curves

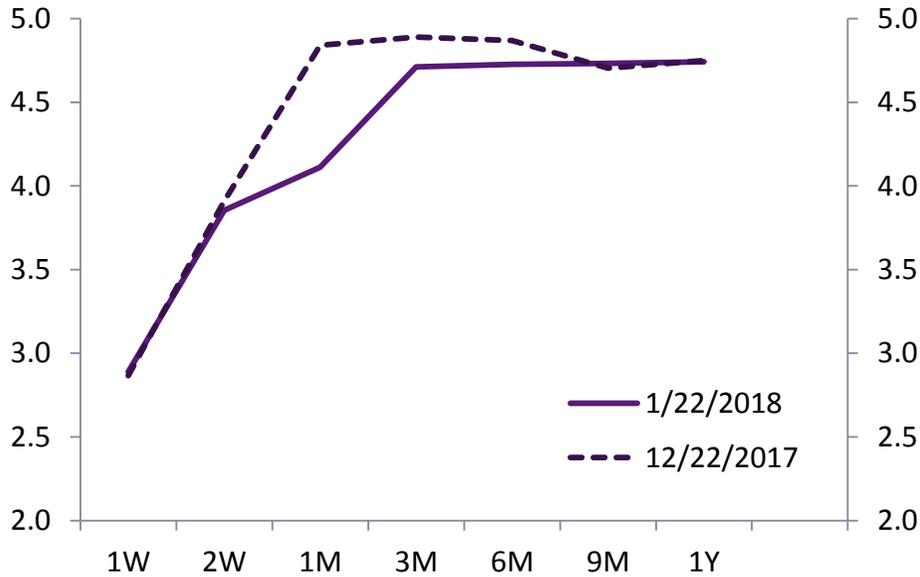


Source: Bloomberg, Natixis

Onshore Offshore

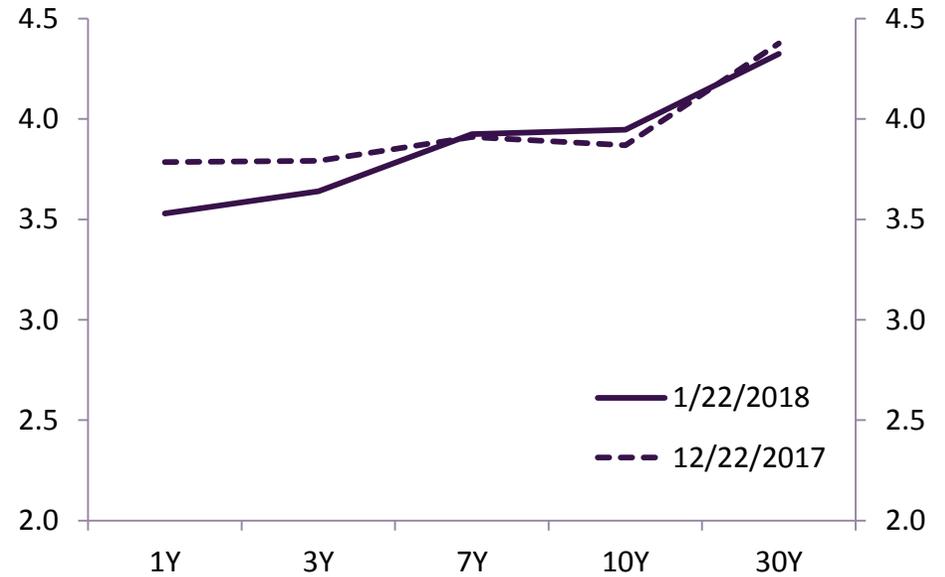
China sovereign yields at the short end softened compared to a month ago along with improved market sentiment and liquidity condition. But the 10Y bond yield still lingers close to the 4.0 threshold.

SHIBOR fixing yield curve (%)



Source: Bloomberg, Natixis

Sovereign yield curve (%)



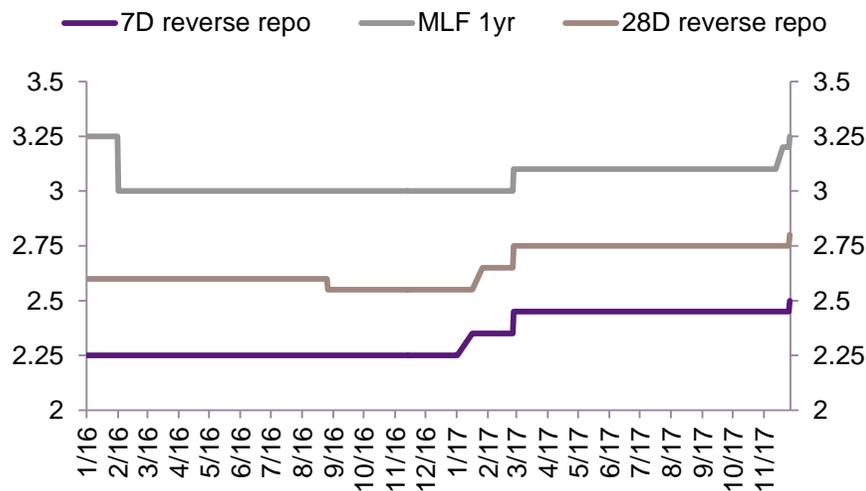
Source: Bloomberg, Natixis

Onshore

Offshore

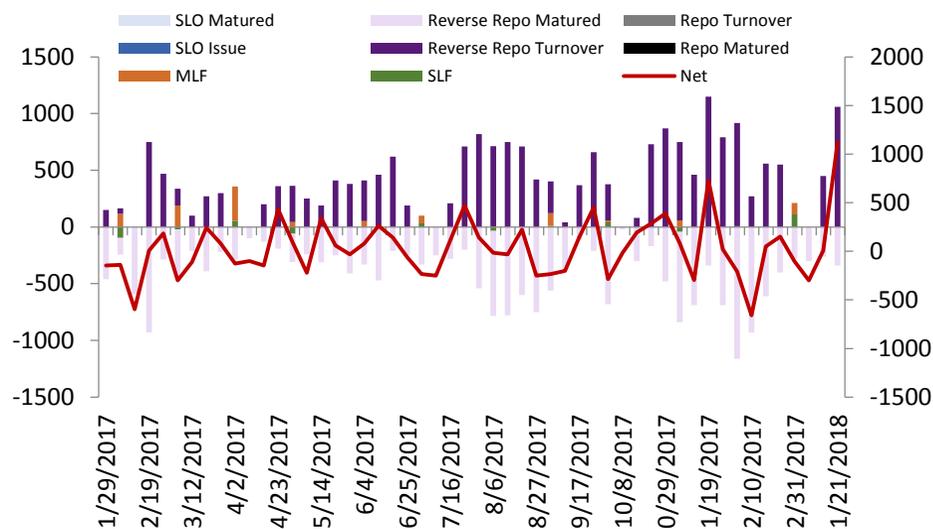
The PBoC becomes more generous in the new year. There is a risk of interest hike as a response to deleverage pressure and the Fed normalization, but the pace of the hike should be slow to maintain the growth momentum.

PBoC OMO rates (%)



Source: Bloomberg, Natixis

China PBoC Weekly Open Market Operations (CNY bn)



Source: Bloomberg, Natixis

Net injection	CNY (bn)
November 2017	+507.2
December 2017	-349.8
January 2018 (till 25 th)	214.5

Onshore Offshore

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