ГАЗПРОМБАНК

View on CNY and CGB in 2022

CNY exchange rate forecast

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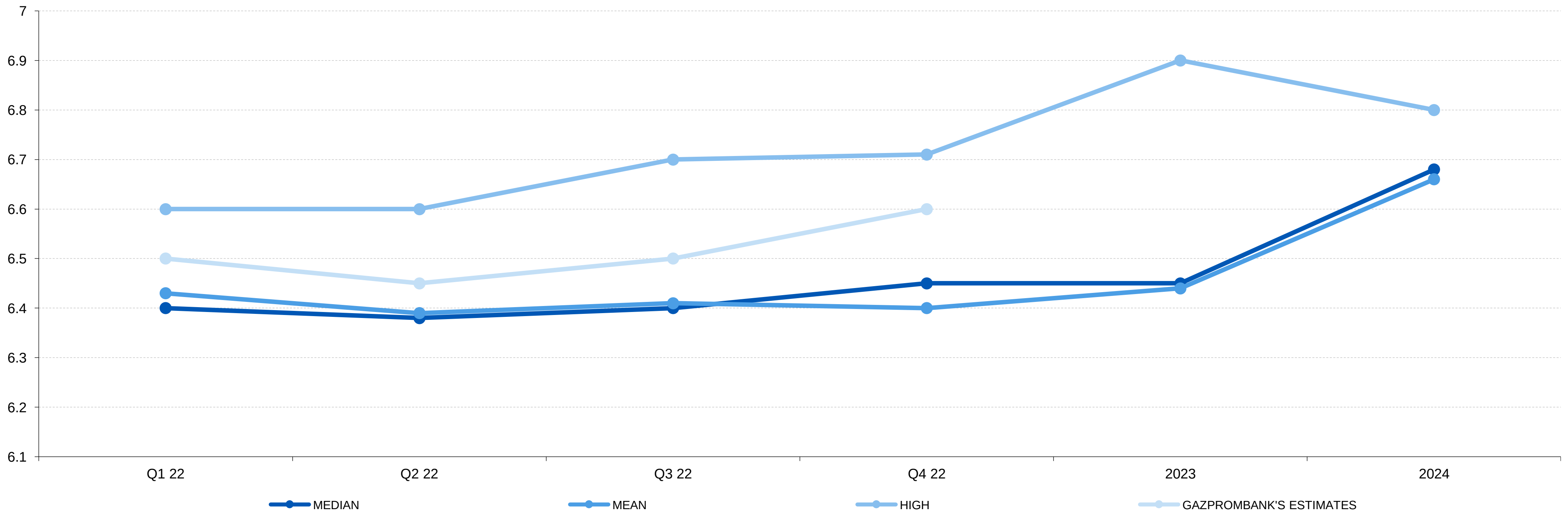
- Rising UST yields will put all global currencies under pressure. The CNY will not be an exception, likely **weakening from 6.37 currently to 6.4-6.45 in the next three months and 6.5-6.55 in the next nine months**.
- Such minor weakening will be a result of counter-balancing factors such as resilient China trade surplus, CNY assets portfolio inflows and PBoC current preference for CNY's strength.

USD/CNY TO GRADUALLY TREND UPWARDS IN 2022



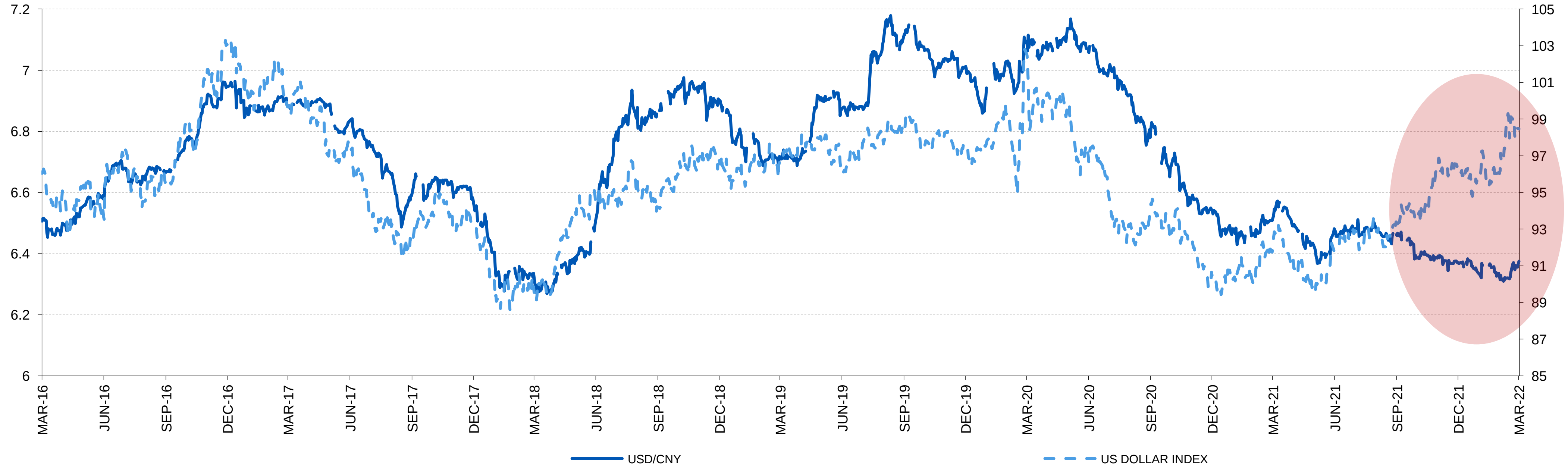
Key support drivers of CNY strength

- **China's market consensus GDP growth of 5.1% YoY for 2022-2023 compares well against IMF's** GDP growth forecast of 3.9% YoY for DMs and 4.8% for EMs.
- **Current account balance should stay strong** as China's buffers strengthened following the record trade surplus of $676 bln in 2021.
- **Ongoing inflows in CNY denominated assets** in form of FDI and in liquid public instruments.
- **Further policies to boost economic growth and stabilize the capital markets** as China's State Council committed to more supportive fiscal, monetary and regulatory policies to stabilize China's economy.

Key depreciation drivers of CNY

- **Diverging monetary policy between China and US.** PBoC started moderate easing in January, while the US Federal Reserve has signaled a beginning of rate hike cycle in March and reduction of asset purchases.
- **Softening export growth may require weaker CNY for support**: expecting increasing competition in global trade and shifting demand from goods to services.
- **Possible escalation of US-China tensions** may exert downward pressure on CNY at various points in 2022 as heightened geopolitical risks will result in outflows from CNY assets.

USD/CNY TREND DIVERGED FROM DXY INDEX



What to expect from PBoC

PBoC's preference for maintaining CNY strength shall be relatively high in 1H22, helping to limit the weakening of USD/CNY to 6.4-6.45.

- Maintaining CNY strength mitigates heightened imported inflation
- PBoC's preference for a stronger CNY to prevent excessive capital outflows from CNY assets

PBoC's preference for maintaining CNY strength could be lower in 2H22, leading to USD/CNY weakening to 6.5-6.55 by the end of 2022.

- More aggressive Federal Reserve rate hikes in May-June will lead to further widening of the US-China yield differential and outflows from CNY assets may intensify
- Should China's export growth slow in 2H22 PBoC may want to allow limited CNY weakening to increase Chinese good's competitiveness.

CNY in mid-term

The fundamentals of the Chinese economy and a structural shift in global asset allocation support a stronger CNY in the next 2-3 years.

- **Demand growth for CNY assets to remain strong** as China remains underweight in foreign investor portfolios.
- **Structural shift of FX reserves allocation**. Global central banks can increase their CNY holdings from ~2.4% currently to 5-6% which would result in $400 bln of inflows.
- **China GDP market consensus growth of 5.1% YoY for 2022-2023 compares well above** growth forecast of 3.9% YoY for DMs and 4.8% for EMs.
- **Chinese government's longer-term aim of CNY being a global reserve currency**. This may be accelerated with the introduction of e-CNY in cross-border trade settlements.
- **Potential weakening of dollar hegemony**. Increased diversification of foreign exchange reserves and growing willingness to price sales of some goods in CNY (i.e. news of Saudi Arabia selling oil in CNY) over longer period bring more demand for CNY.

China Government Bonds forecast

Cautious in the near term…

Short term trade in China Government Bonds (CGB) looks crowded, and we are cautious on a possible pick-up of 20-25bps in yields in 2Q-3Q. We also stay cautious of fiscal stimulus and its market perception and expect rising US rates to negatively affect CGBs.

- Pause in monetary easing may contribute to weaker performance of CGBs
- The scale of China’s monetary or fiscal stimulus may fall below market expectations in 2H22
- Divergence of US and China monetary policies narrowed the current yield premium of ~45-60bps between 10Y CGB and 10Y UST, the lowest level since 2019.

… and constructive mid- to long-term

Mid- to long-term fundamentals of CGBs are supported by the following drivers:

Ongoing inclusion in major global bond indices

Increase in flows from various fixed income indices (Bloomberg Barclays Global Aggregate Index in 2019 and JPMorgan GBI-EM Global Diversified index in 2020) is estimated at $250 bn.

FTSE WGBI phasing its inclusion of China bonds over three years since October 2021 and could result in over $125 bn of inflows.

CGBs look attractive against global bonds

In a yield-starved global environment characterized by low interest rates and high inflation, CGBs look attractive by offering solid outperformance over peers.

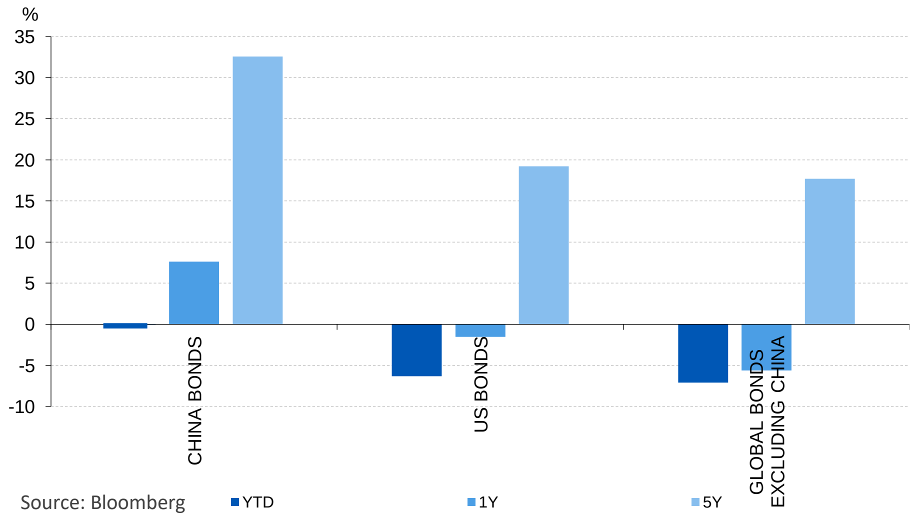
Adjusting for inflation, CGB offered a positive 6.7% real return in 2021 vs negative 6.2% return for US bonds

Improved standing of CGBs as an investable asset for global investors

CGBs accessibility has greatly improved supported by China's financial market reforms, introduction of QFII, CIBM Direct, BondConnect and broadening availability of hedging tools.

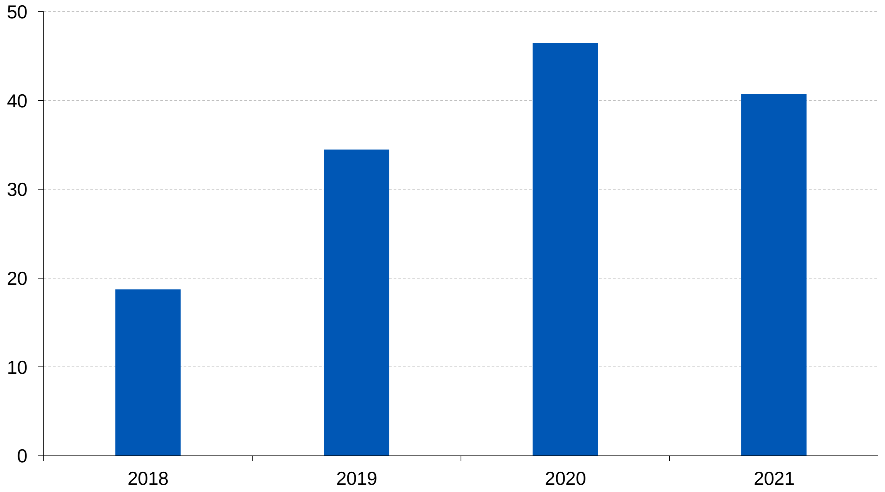
Improved secondary market liquidity where annual trading volume doubled since 2018

TOTAL RETURNS OF CGB OUTPERFORMING US AND GLOBAL BONDS



Source: Bloomberg

CGB ANNUAL TRADING VOLUME (CNY, TLN)



Source: WIND

Positioning

- 10Y CGBs may widen by 20-25bps on tail risks of another round of risk reduction prior to the next Federal Reserve hike in May-June.

- CGB curve is likely to steepen further as PBoC may seek to reduce interest rates in 2Q-3Q; yield compression potential of shorter duration CGBs could come in stronger than 10Y CGBs for this period.

- Positioning in 10Y CGBs to maintain a comfortable yield pick-up may be considered should the pause in PBoC's easing cycle becomes apparent in 2Q.

Thank you for your attention