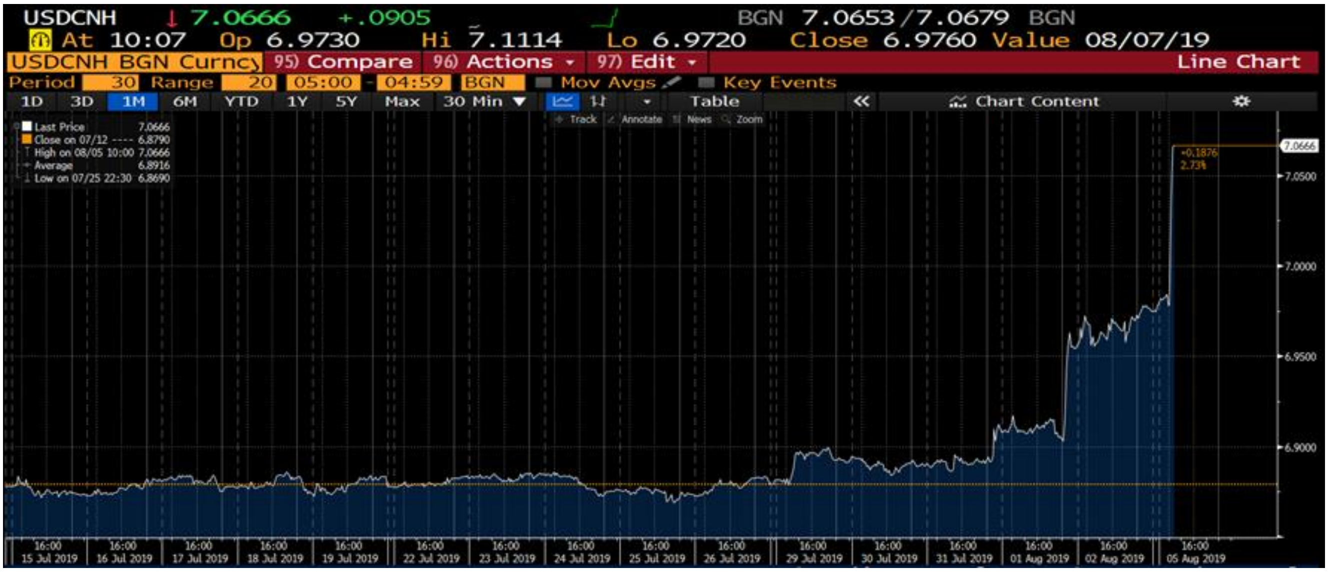
Update on RMB movement

As expected, the onshore and offshore yuan to USD have finally broken the 7 threshold, caused by the rise of unilateralism and protectionism, as well as market expectation on the increase of tariffs.
Although investors are turning risk averse now, the market correction has actually provided long-term investors with a good entry point. With the correction in stock market, the rise of geopolitical issues and risk-aversion sentiment, the fall of interest rates in the developed markets and the lack of investable assets, we feel it is a good timing to have another look at the on-shore China rates bonds:

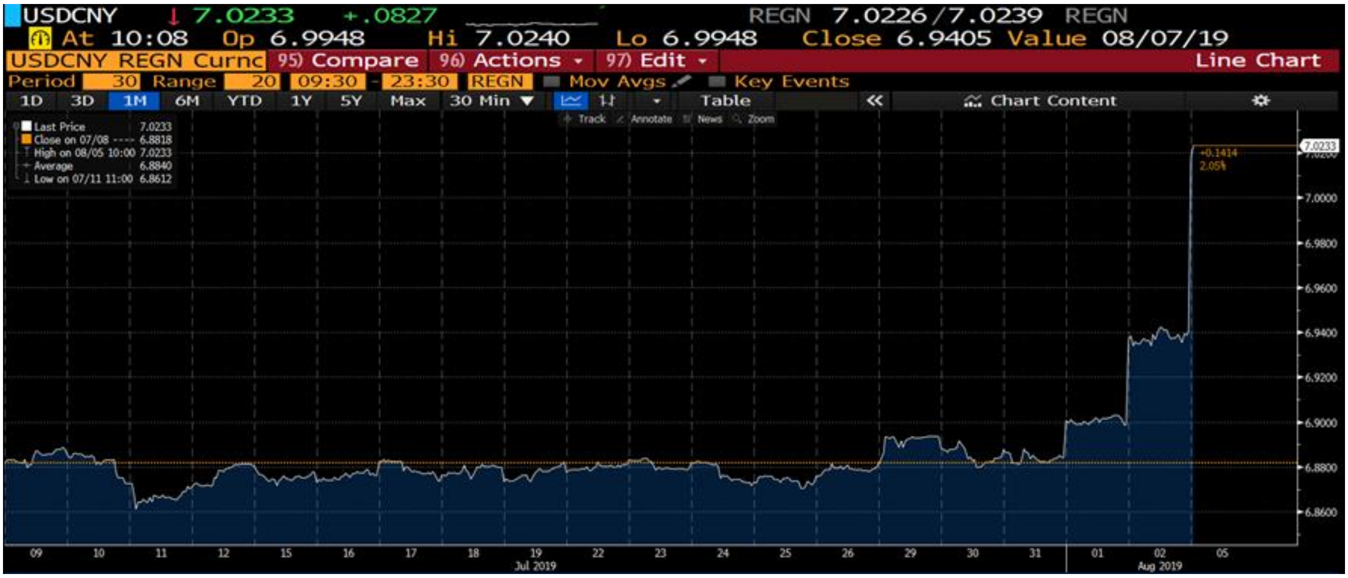
The main reasons are:

1. RMB FX rate is decided by fundamentals in long term. From a long-term perspective, Chinese economic fundamentals are still good, as the supply-side structural reform is optimizing the economic structure, the economic growth stays resilient amid global slowdown. Meanwhile, China's macro leverage ratio is basically stable, and the financial risks are generally controllable. Furthermore, China's cross-border capital flows remained stable, and supply and demand in the foreign exchange market was basically balanced. All of the above factors provided fundamental support for the RMB exchange rate. Therefore, the RMB exchange rate is likely to stabilize afterwards and there may even exist market expectations for RMB appreciation.
2. Compared with the developed economies such as Europe, America and Japan, the yield of Chinese government bonds is relatively high, and thus it can provide investors with a higher relative return. As the only country in the major economies whose monetary policy remains "Neutral", China's RMB assets still have a quite low valuation and relatively better stability, which implies China is expected to become a "squatting place" for global capital.
3. Risk-free interest rate may further decline, and the bond market is facing opportunities.

Reason 1: The onshore and offshore yuan to USD have finally broken the 7 threshold. The RMB exchange rate is likely to stabilize afterwards and there may even exist market expectations for RMB appreciation.

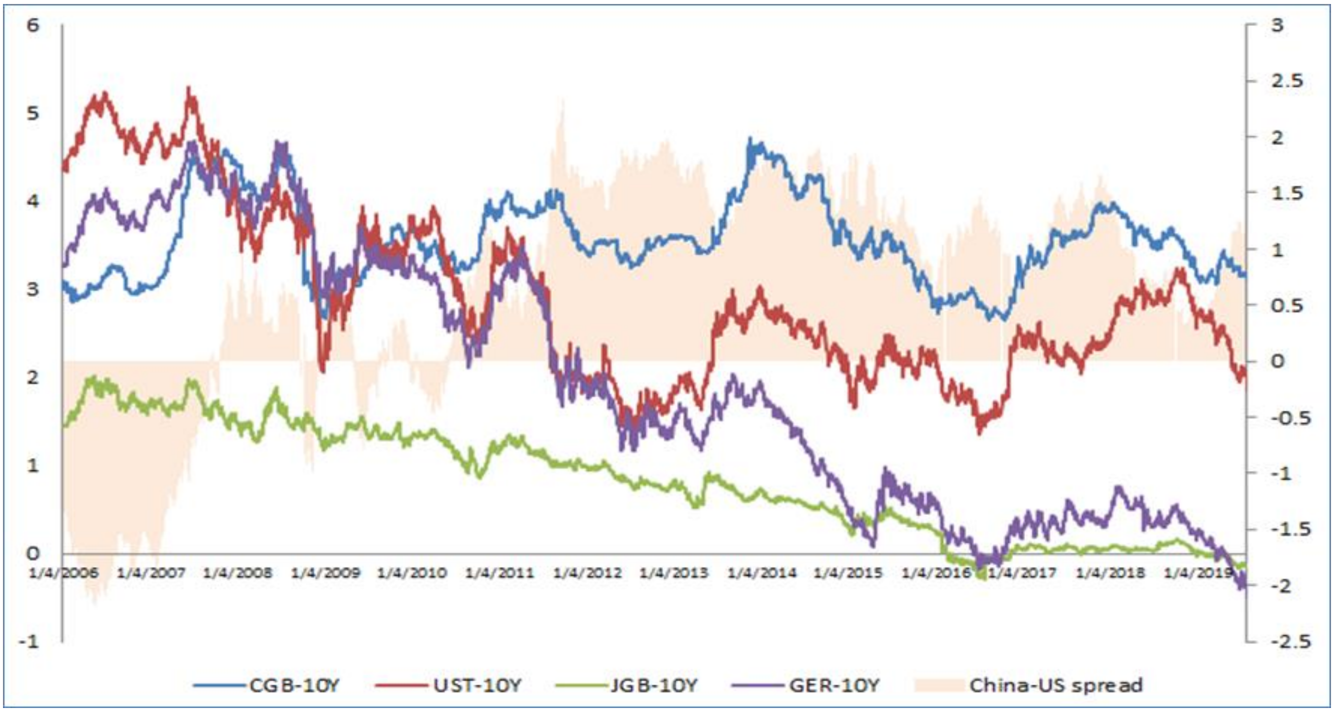


Source: Bloomberg, as of August 5, 2019



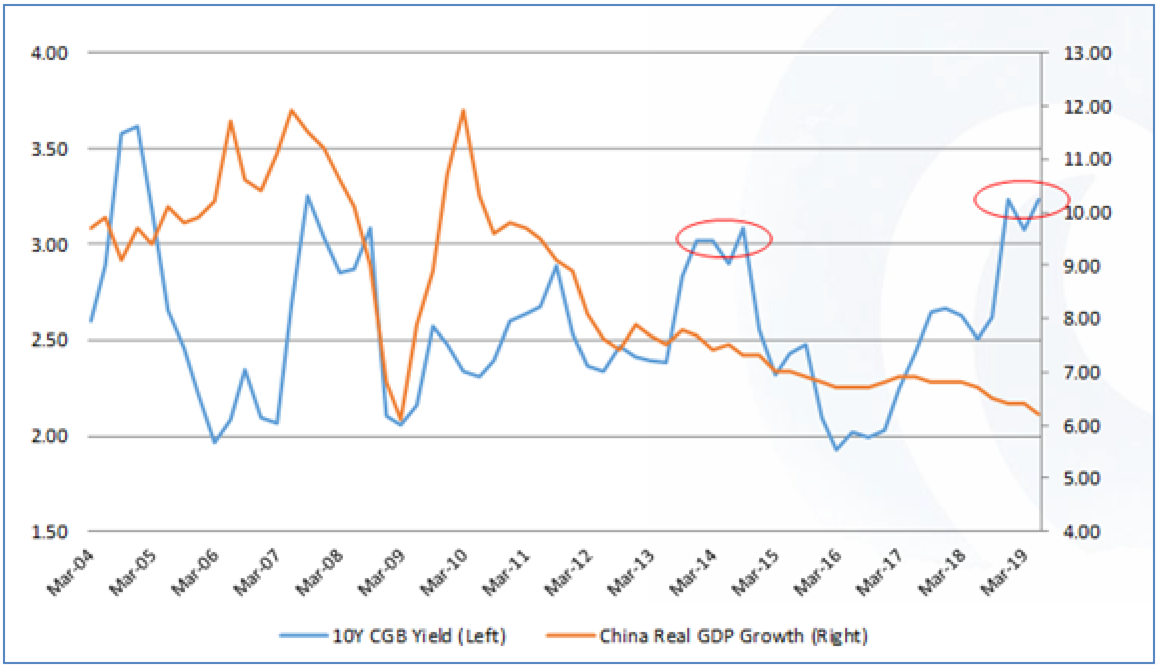
Source: Bloomberg, as of August 5, 2019

Reason 2: Compared with the developed economies such as Europe, America and Japan, the yield of Chinese government bonds is relatively high, and thus it can provide investors with a higher relative return.



Source: Bloomberg, from April 1, 2006 to August 1, 2019

Reason 3: China's long-term GDP growth rate will continue to slow down. Combined with the advancement of interest rate marketization, China's risk-free interest rate is expected to further decline in the future..



Source: Bloomberg, from March 2004 to June 2019

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