

WEBINAR – CHINA REVAL?

Presented by ANZ Asia Research &
Corporate Sales Europe

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PART 1 –
CNY REVAL? WHERE ARE WE NOW
AND WHAT WILL HAPPEN NEXT?

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Structure of the Presentation

- Where are we now?
- What will happen next?
- Implications for China's monetary policy
- Our Forecasts

Where are we now?

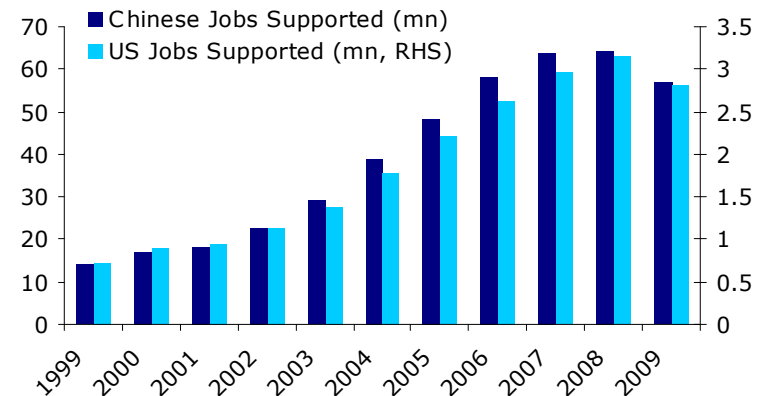
The standoff on the RMB issue appears to be over

- ❑ The US Treasury has postponed its 15 Apr currency report, indicating that US will refrain from naming China as a currency manipulator.
- ❑ President Hu goes to Washington on 12-13 Apr.
- ❑ Warming relationship suggests that the standoff is over, thus setting the stage for China to move on its own initiative.

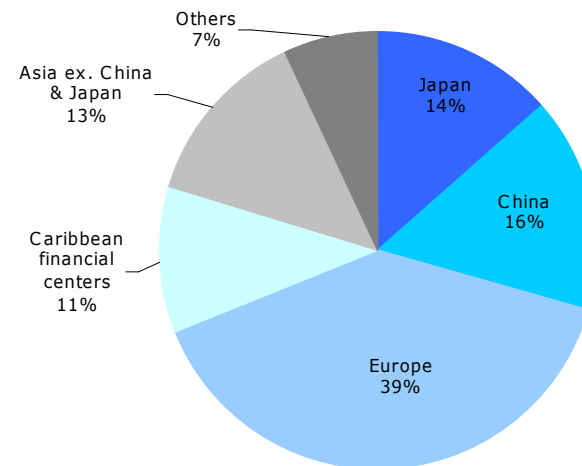
A trade war scenario can be catastrophic on both sides

- From the US perspective, the number of manufacturing jobs that could be affected due to China's likely response to US trade sanctions is close to 3 million.
- China held \$1.4tn of US financial assets at end-Jun 2009, around 16% of total foreign portfolio holdings of US financial assets, second only to European countries.
- If China were to merely signal selling US assets, the US capital market would likely see tremendous shocks.

Jobs Supported by Sino-US Trade



Total foreign holdings of US financial assets (as of Jun 2009)



A trade war scenario can be catastrophic on both sides

Impact of a 25% Import Tariff on China's Exports

	Assumption	Effect
Model 1: Exports		
Scenario 1	60% pass-through	-12.1%
Scenario 2	50% pass-through	-8.5%
Average		-10.3%
Model 2: Ordinary Exports		
Scenario 1	60% pass-through	-14.3%
Scenario 2	50% pass-through	-10.4%
Average		-12.4%
Model 3: Processing Exports		
Scenario 1	60% pass-through	-4.9%
Scenario 2	50% pass-through	-3.1%
Average		-4.0%

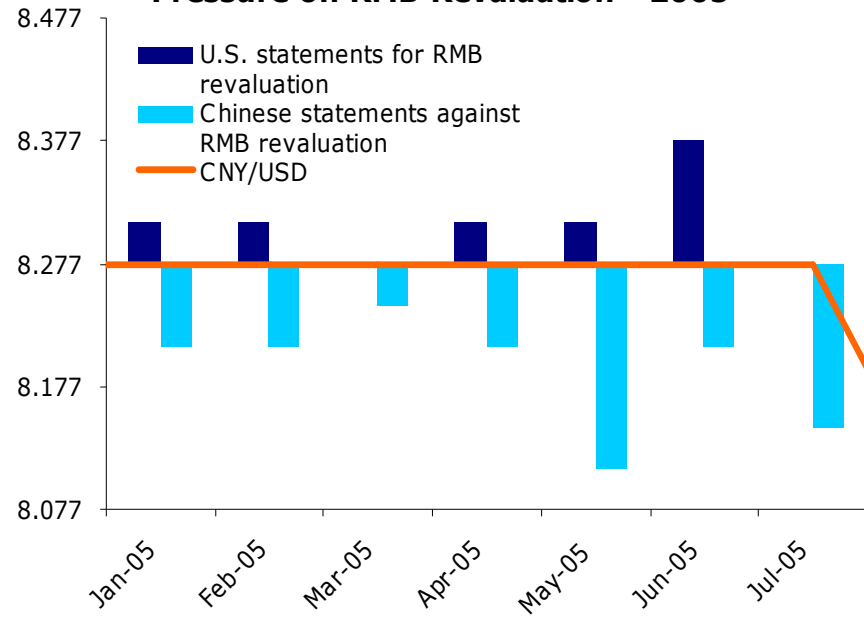
If the US were to impose a 25% punitive tariff on Chinese exports, as suggested by Paul Krugman, how damaging would it be?

We find that a 25% punitive tariff will bring about a double-digit decline in China's overall exports. This assumes that the G3 growth rate will be 2.5% for the next three years and that the pass-through effects of tariffs are partial (60% in Scenario 1, and 50% in Scenario 2).

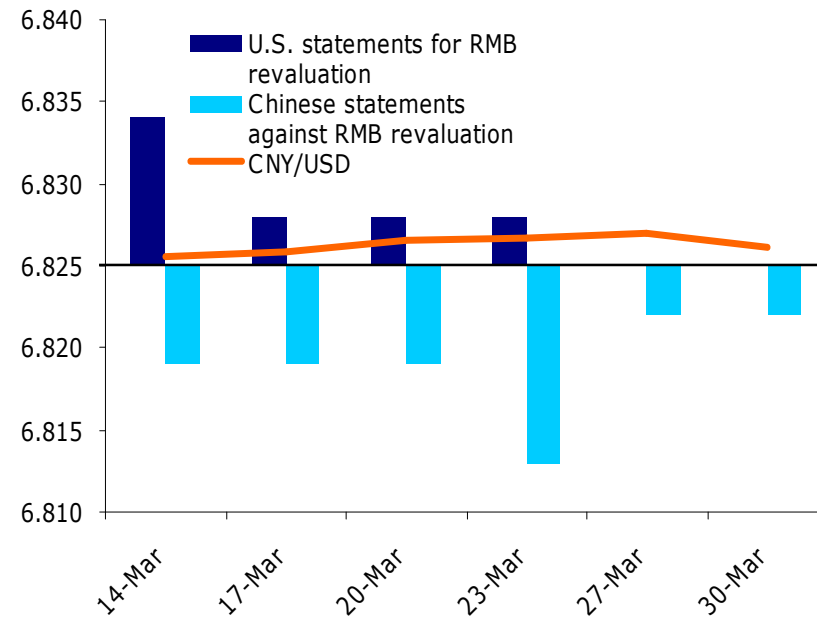
Specifically, a 25% import tariff would likely reduce China's total exports by 8.5% to 12.1%, with an average value of -10.3%. The impact on China's ordinary exports will be highest, falling by 12.4% on average. In contrast, the impact on China's processing exports is smaller, but still sizeable, at 4.0%.

If history is a guide, China's exchange rate move could be imminent

Pressure on RMB Revaluation - 2005



Pressure on RMB Revaluation - 2010



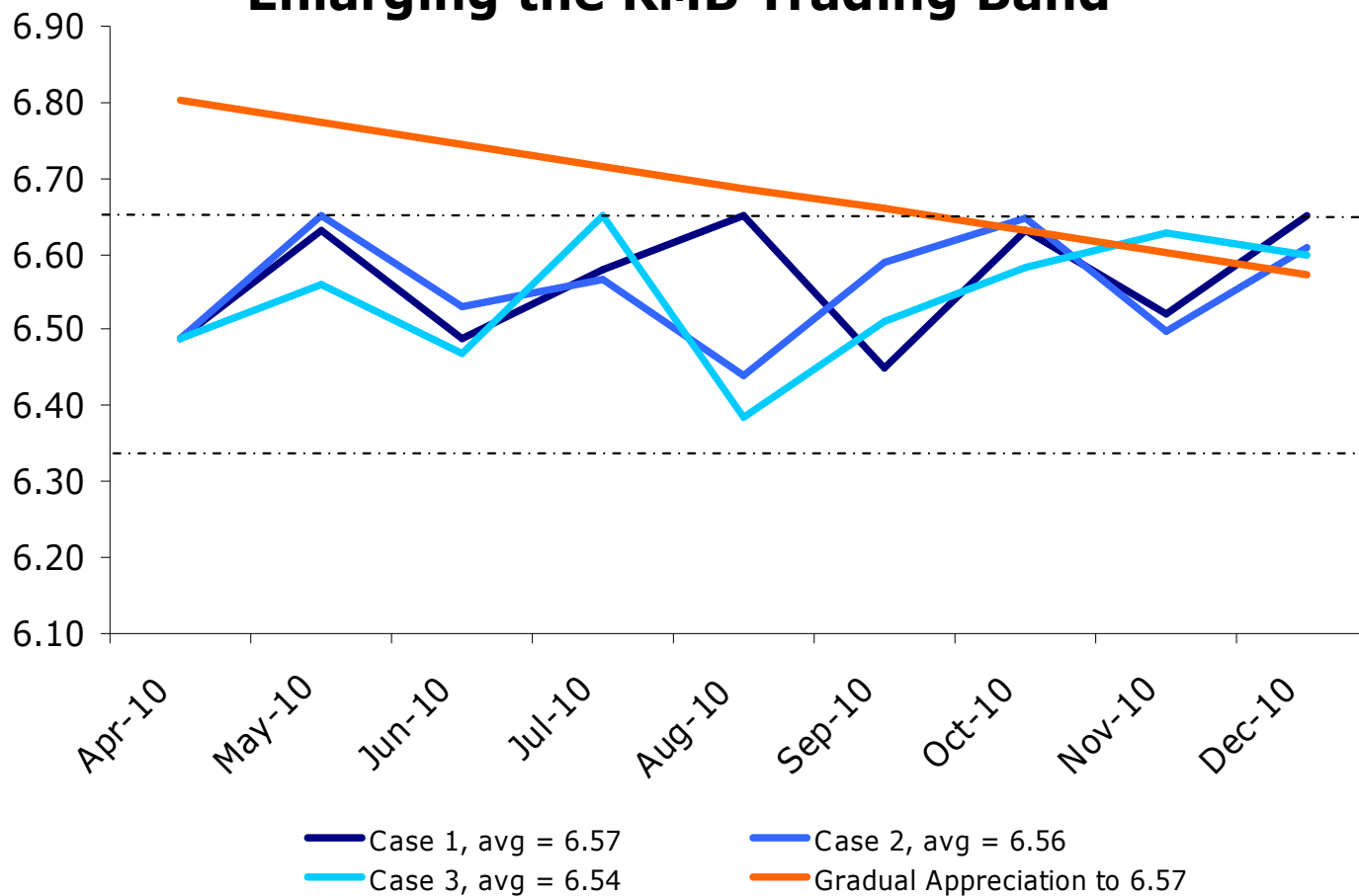
What will happen next?

What options does China have?

1. Maintain stability (clearly out)
2. Opt for a small appreciation and return stability (not optimal)
3. Opt for a small one-step revaluation (2 to 3%), followed with gradual appreciation (old regime, possible but not optimal)
4. Opt for a sizeable revaluation (5%) followed with enlarged trading band with increased flexibility (possible and preferred option)
5. Opt for a large revaluation (20%) followed with stability or flexibility (possible but costs too high for Chinese exporters)

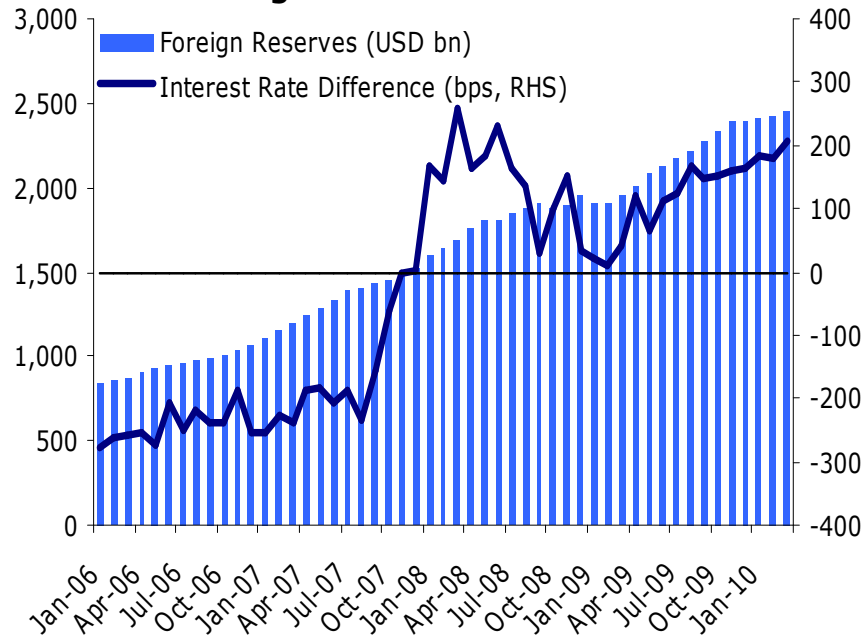
Why option 4 is preferred? No more certainty on the RMB exchange rate

Enlarging the RMB Trading Band

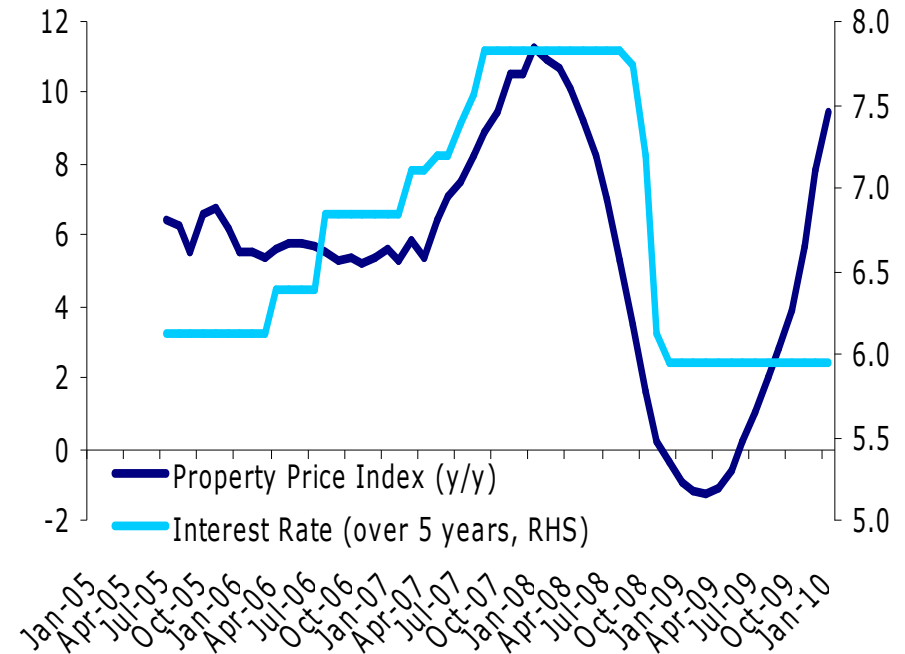


Implications for monetary policy: Enhancing policy effectiveness

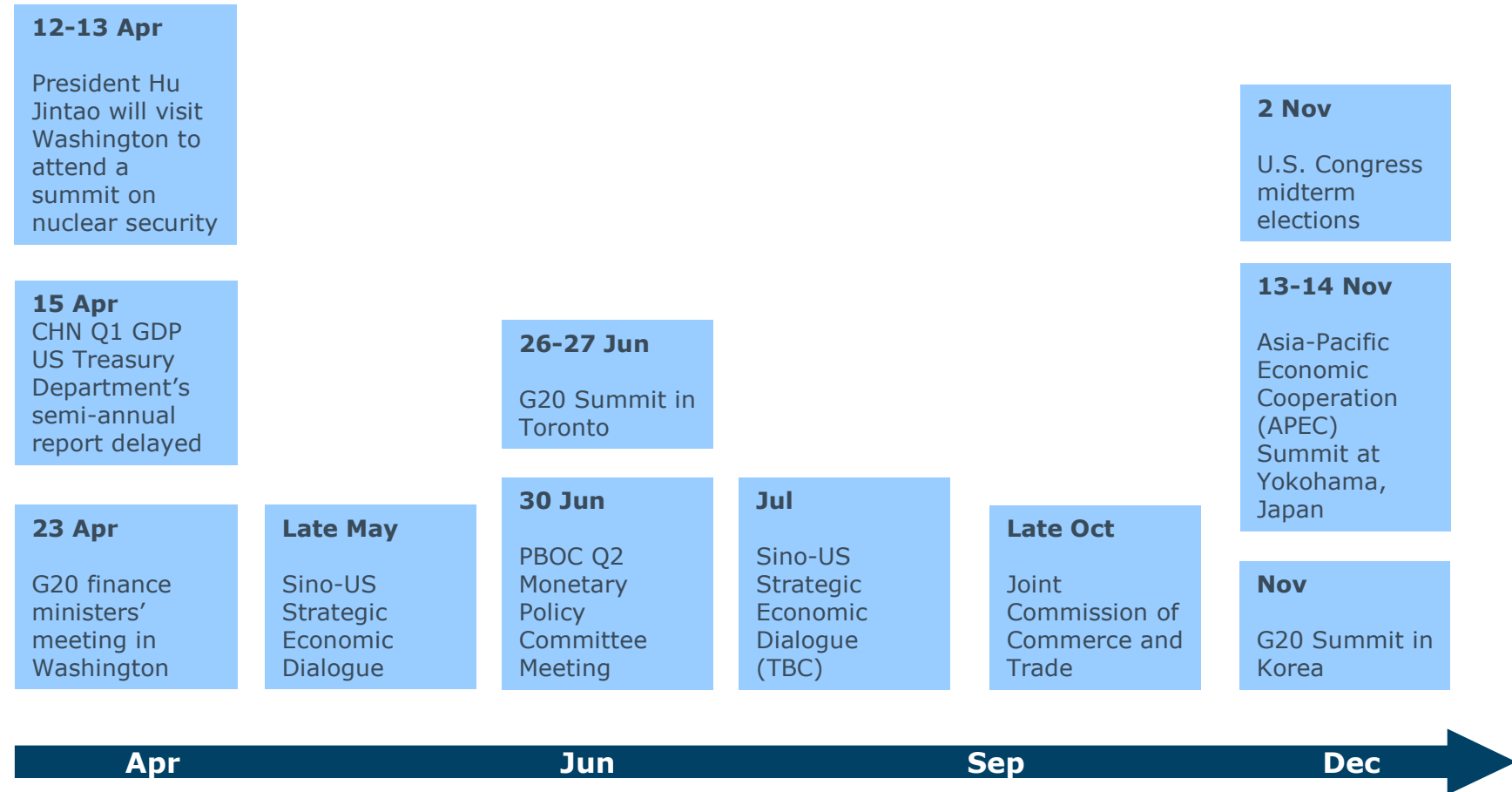
China - Interest Rate Differentials and Foreign Reserve Accumulation



China - Housing Price and Interest Rate



What will be the timing for revaluation? Key events to watch



Our Forecasts

	2010				2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	<i>11.6</i>	<i>10.0</i>	<i>9.5</i>	<i>9.0</i>	9.0	9.5	9.7	9.8	9.9	9.9	10.0	10.1
Interest Rates												
1-yr Lending Rate	5.31	5.58	5.85	6.12	6.12	6.39	6.66	-	-	-	-	-
3-month SHIBOR	1.94	1.9	2	2.1	2.3	2.5	2.5	-	-	-	-	-
FX Rates												
USD/CNY	6.83	6.74	6.66	6.57	6.49	6.45	6.40	6.34	6.27	6.21	6.15	6.09
AUD/CNY	6.27	6.40	6.39	6.18	5.97	5.81	5.63	5.45	5.33	5.15	4.92	4.75
EUR/CNY	9.20	9.23	9.06	8.74	8.44	8.26	8.06	7.86	7.65	7.45	7.50	7.55
GBP/CNY	10.34	10.38	10.26	10.05	9.93	9.80	9.73	9.50	9.60	9.63	9.53	9.49

Note: The italic numbers are ANZ's forecast; other are actual figures.



PART 2 –
HEDGING USD/CNY IN THE
ONSHORE VS OFFSHORE MARKETS

by Jeannette Chan,
Asian Markets, Corporate Sales Europe



Onshore vs Offshore Hedging in USD/CNY

Market Liquidity & Pricing Indications

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Average daily amounts (USD equivalent) executed in local market hours during normal market conditions.

Onshore

Offshore*

	USD 8 – 10bn	
Spot FX	Only licensed entities in China can trade CNY onshore, with designated foreign exchange banks. General corporations registered in China are not permitted to buy/sell foreign currency offshore	N.A. (CNY cannot be settled outside China)
FX Forwards	Deliverable Forwards: USD 1 - 2bn (1 week to 2 years)	Non-Deliverable Forwards: USD 1.5 - 2bn (1 week to 2 years)
FX Forward Indications (implied appreciation %) 13 April 2010, Spot ref 6.8260	USD/CNY Forward 3mth: 6.8108 (0.19%) 6mth: 6.7908 (0.49%) 12mth: 6.7308 (1.37%)	USD/CNY NDF 3mth NDF: 6.7650 (0.86%) 6mth NDF: 6.7210 (1.51%) 12mth NDF: 6.6350 (2.77%)
FX Options	Not available	Non-Deliverable Options NDO: USD 50 - 100m (1 month to 2 years)
Currency Swaps	Interbank market only	Non-Deliverable Swaps NDS: USD 30 - 50m (1 – 5 years)
CNY Interest Rate Swaps	IRS: USD 10 - 30m equiv (1 to 5 years)	Non-Deliverable Interest Rate Swaps: USD 10 - 30m (1 to 3 years)

* Forwards, Options and Currency Swaps are traded offshore on a non-deliverable basis

USD/CNY Reference Fixing Rate: the official spot rate set by the State Administration of Foreign Exchange of the People's Republic of China, on Reuters Page SAEC at 9.15 AM (Shanghai time)



Onshore vs Offshore Hedging in USD/CNY

Booking Requirements

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For All FX Transactions	<u>Onshore</u>	<u>Offshore</u>
Booking Entity:	Onshore entity ('Local Subsidiary')	Offshore entity ('Parent Company')
ANZ Branch:	ANZ Shanghai, Beijing, or Guangzhou Branch	ANZ Melbourne
Booking Requirements:	CNY, FCY account required. Credit Facility. Dealing mandate, ISDA (more than 12mths)	Credit Facility. ISDA Master Agreement
Central Bank approval:	Usually required for capital account transactions (e.g., capital injection, direct investment, loans, securities and equity investment)	Not required
Documentation Requirements:	<p>All FCY/CNY FX deals must be supported by related trade documents which evidence hedging purposes. (note: less documentation will be required if the company is selling FCY for current account items)</p> <p><u>For pre-payment, on Trade Date</u></p> <p>Original Foreign Exchange Instruction/TT Application, Sales Contract or Invoice</p> <p><u>For payment on delivery, on Settlement Date</u></p> <p>Original Foreign Exchange Instruction/TT Application, Sales Contract or Invoice, Original Custom Declaration Form, China E-Port IC Card</p>	No underlying commercial documents required

FCY: foreign currency



Onshore vs Offshore Hedging in USD/CNY

Summary

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Which market is more favourable for you?

Onshore

SHORT CNY, LONG USD

"manufacturing in China for overseas export"

- > Buying from China
- > CNY payments for raw materials, building, projects

**CHEAPER TO HEDGE IN
THE DELIVERABLE
FORWARD MARKET
ONSHORE**

Offshore

LONG CNY, SHORT USD

"importing materials from overseas for domestic sales in China"

- > Selling in China
- > CNY receivables
- > future CNY dividends

**LOCK-IN HIGHER
IMPLIED APPRECIATION
IN THE OFFSHORE NDF
MARKET**

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