

Flash Note
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Chinese Yuan rallied, reaching our 2017 target for the CNY. What next?

- **About the onshore & offshore yuan strength:** The [China Securities Journal](#) noted that recent major institutional yuan sellers in the offshore market turned buyers. The institution flagged risk of sharper appreciation (compared to previous bout earlier this year).



- **Reforms: About the “National Deleveraging Campaign”**
 - PBoC macro-prudential approach: PBoC released its latest quarterly report in which the highlights were stronger coordination of financial regulation and modest deleveraging in the economy. The PBoC reiterated that it will seek balance between deleveraging and liquidity stability, stressing that “the impact of previous action has started to appear in the economic data”.
 - Future steps: The PBoC suggested that “market participants should expect continued strong supervision and regulation but should not panic”. “The introduction of new regulations should take into account the market’s tolerance for changes and prevent liquidity risks”. In fact, the PBoC provided breathing space by smoothing deleveraging fever when announcing that “PBoC’s officials see little need to continue driving interbank rates any higher, refraining from increasing borrowing

- rates further". The yield on 10-year government bonds and the Shanghai Composite Index rebounded
- iii. PBoC simplifies focus on two key rates: PBoC announced it will mainly use seven-day reverse-repo operations and the one-year medium term lending facility (MLF) for short and medium term liquidity demand. The bank explained that two rates helps clarify policy intentions on the road to a more market-based toolkit and could prove vital in constructing a yield curve that is understood and trusted by investors.
- **Is this policy is yielding fruit?**
 - i. 25 Shanghai-listed banks cut CNY1.54tn in interbank liabilities in Q1 2017 with the acceleration of the government's deleveraging campaign and the central bank's macro-prudential assessment. Interbank business and off-balance sheet wealth management transactions are expected to fall further.
 - ii. Credit risks are easing: The China Securities Journal cited that default risk in China's bond market has eased amid improvements in the regulatory environment, with new bond default cases falling sharply this year. However, the market still faces pressure in 2017 with more than CNY4tn of bond funding products and more than CNY800bn in corporate bonds due to mature this year.
 - iii. Property developer bond issuance ceased: Bonds issued by real estate developers have largely stopped amid tighter restrictions implemented by regulators.
 - **Financial markets outlook:**
 - iv. Equity (Shenzhen): ATTRACTIVE. Fundamental price 1,979. Exit point at 2,177
 - v. Bonds: ATTRACTIVE. 10Y bond target 2.9% (currently at 3.62% => +9.6% capital appreciation)
 - vi. FX (RMB): CHEAP. USDCNY fundamental target at 6.75-6.8

Regards,

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