

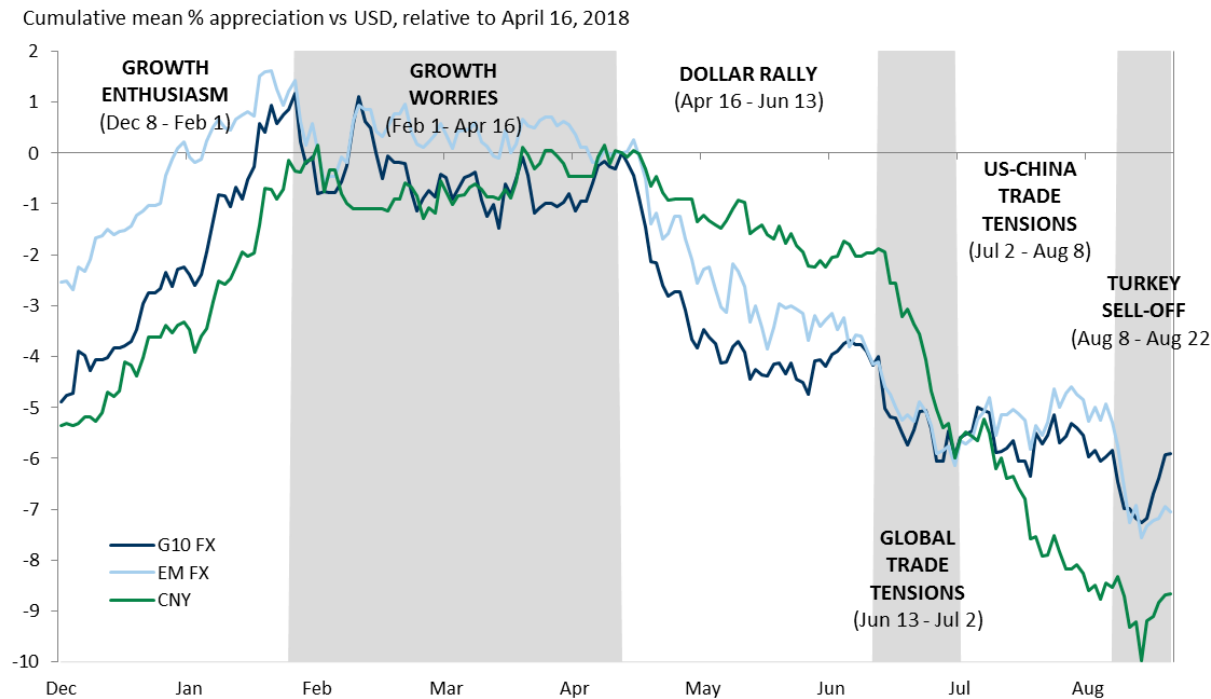
Analysis of foreign exchange developments in China

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September, 2018

CNY: Performance YTD

Outperformance in Q1, stability in Q2, underperformance in Q3



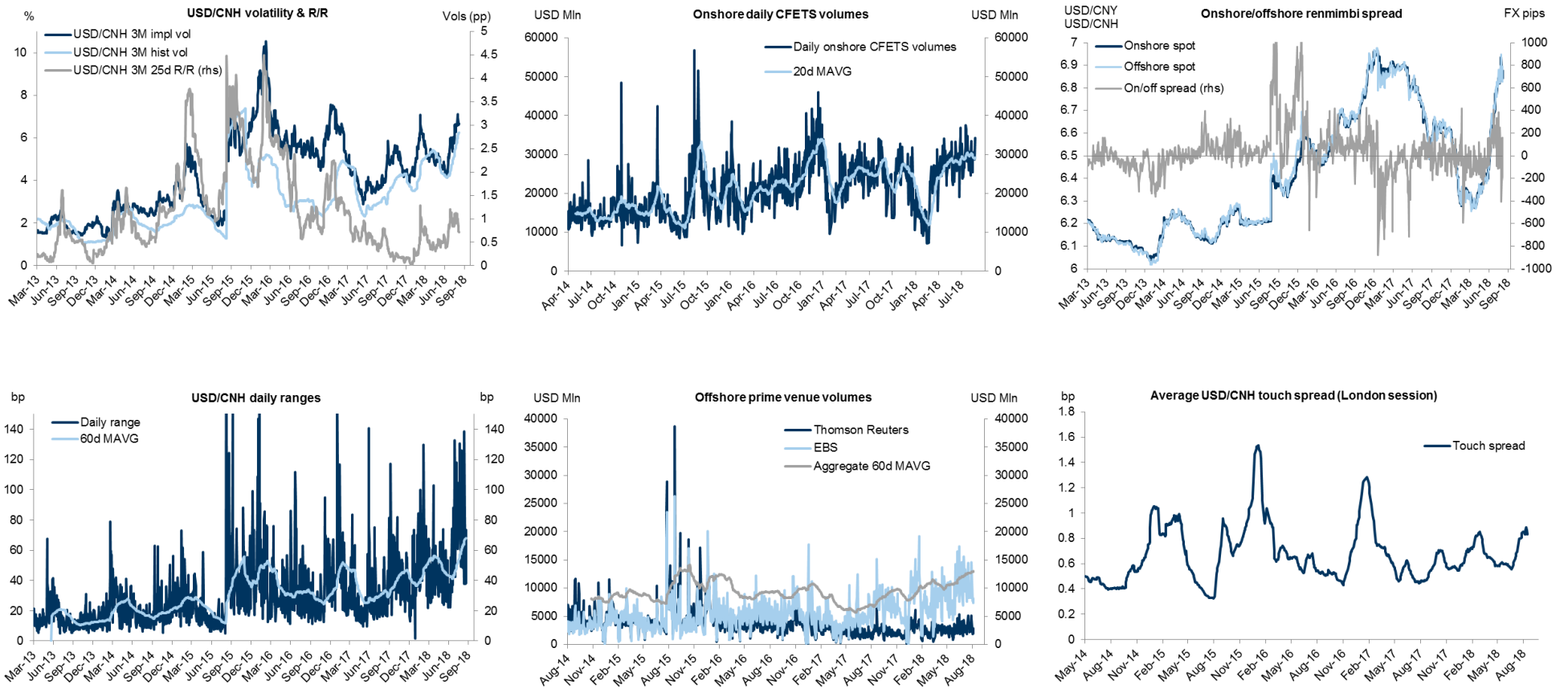
- Equity VAR shock had little impact on the RMB which was a steady outperformer in Q1 and early Q2 helped by strong portfolio inflows
- Renminbi proved to be very resilient in the face of sustained bout of DXY strength in second half of Q2
- Renminbi started to underperform markedly once focus turned towards trade and continued as it became increasingly focussed on bi-lateral China/US trade tensions

Views represent those of GS Securities Division

Source: Goldman Sachs Global Investment Research (Exhibit), Thomson Reuters

Market state dashboard

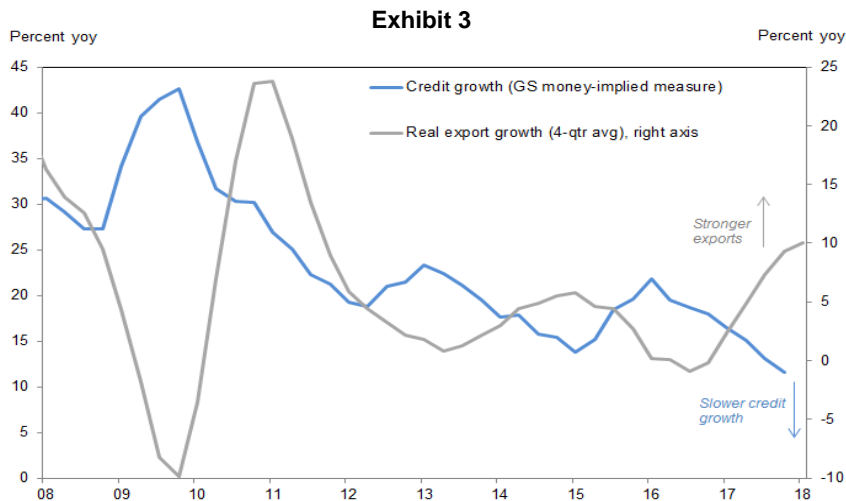
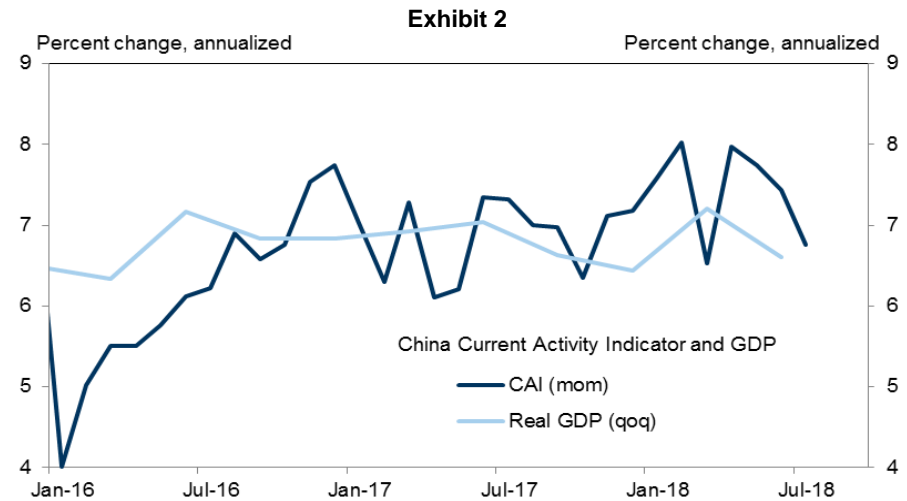
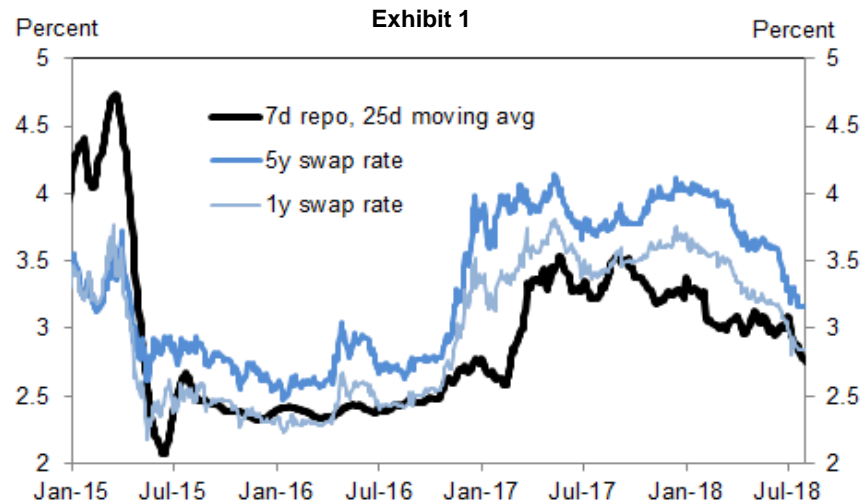
Rising volatility in a maturing market



Source: Bloomberg, Thomson Reuters, EBS, Goldman Sachs Securities Division

Macro developments and policy response

Clear monetary response to slowing growth. Fiscal response might be next



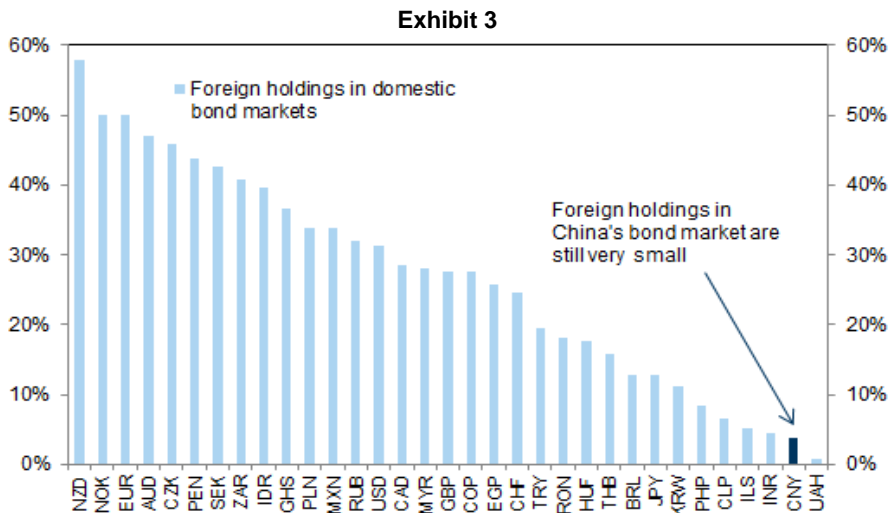
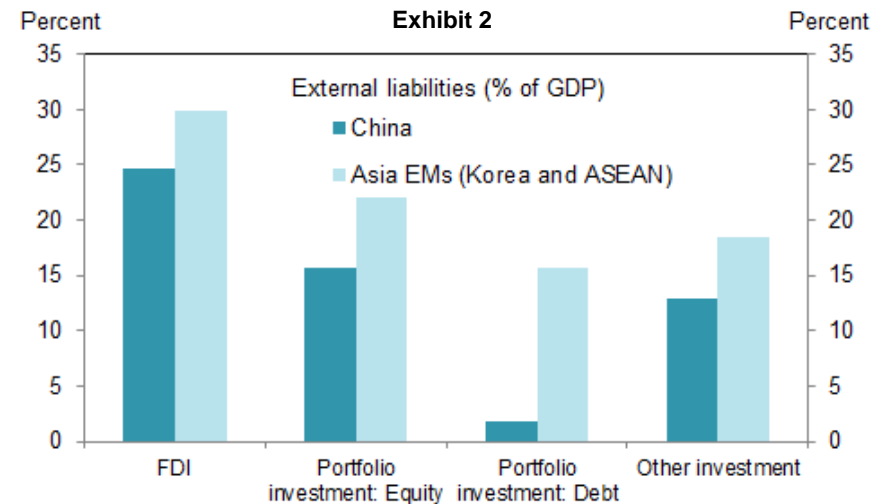
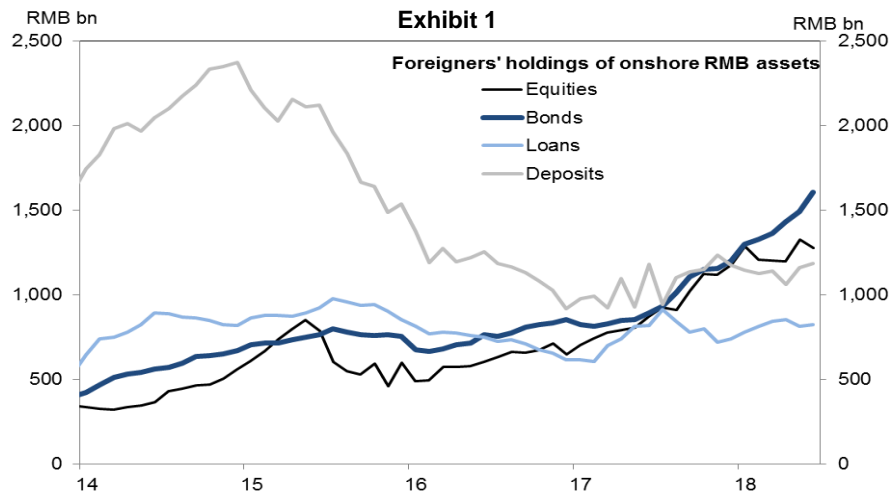
- PBOC has been dovish in rates since early 2018 (Exhibit 1)
- Growth has been stable so far (Exhibit 2), but showing signs of rolling over
- Strong exports did not just boost growth, but also helped contain leverage. Market has perceived financial stability (Exhibit 3)

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Source: Reuters, CEIC, Goldman Sachs Global Investment Research (Exhibit 1, 2 and 3)

Ownership and positioning

Foreign portfolio inflow to continue growing in importance



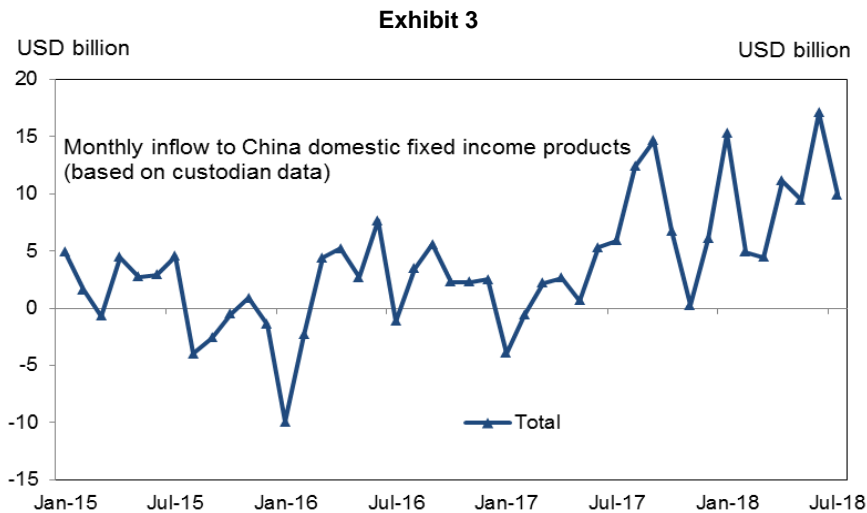
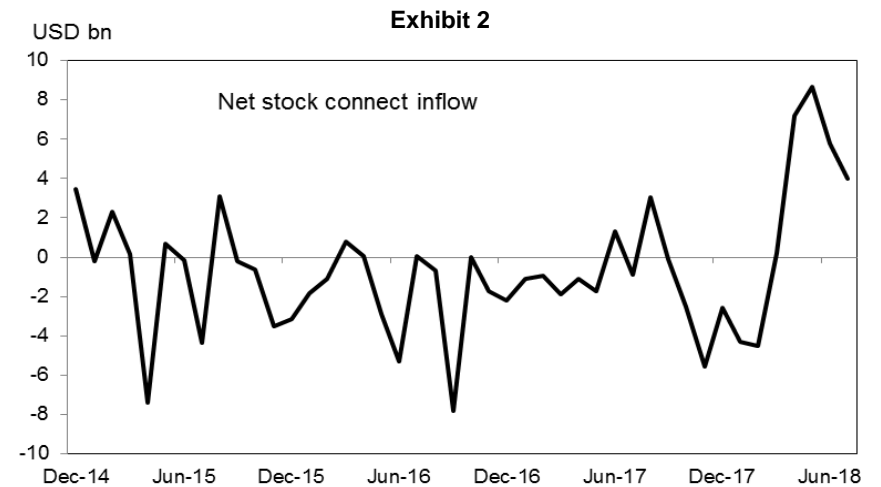
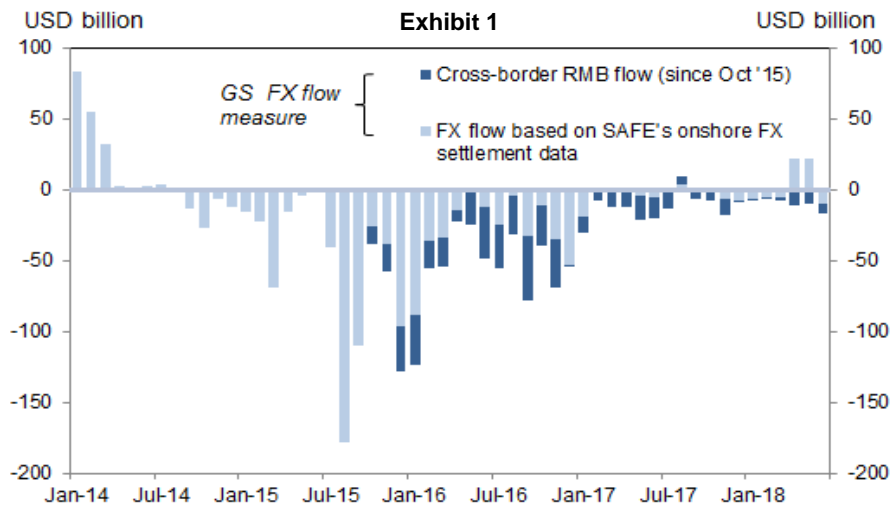
- Foreign ownership of local assets is trending higher lead by bond ownership as access channels are opened up (Exhibit 1)
- FI portfolio inflows into China have lagged FDI and equity inflows domestically and in the rest of the region (Exhibit 2)
- Current levels of foreign ownership of local Chinese fixed income remain very subdued by global standards (Exhibit 3)

Views represent those of GS Securities Division

Source: PBOC, CEIC, China Central Depository & Clearing Co, Shanghai Clearing House, IMF, Haver Analytics, Goldman Sachs Global Investment Research (Exhibit 1, 2 and 3)

Flows

Capital account to take up slack of declining c/a surplus

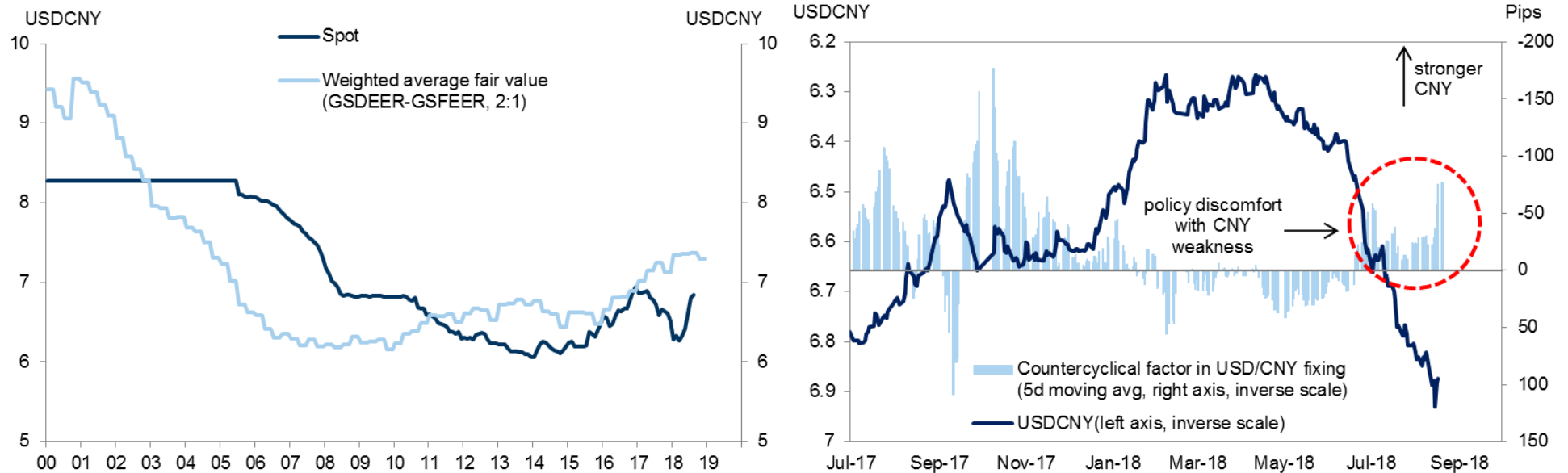


- Successive measures since 2015 have prevented excessive capital flight (Exhibit 1)
 - Steady net equity inflows observed since the end of last year (Exhibit 2)
 - Inflows into local fixed income market continue to grow in importance (Exhibit 3)
- Views represent those of GS Securities Division*

Source: SAFE, China Customs, PBOC, CEIC, China Central Depository & Clearing Co, Shanghai Clearing House, Goldman Sachs Global Investment Research (Exhibit 1, 2 and 3)

Valuations

Mild over valuation, but policy response appears symmetrical



- GS valuation models detect a small over valuation in renminbi based on current levels
- Despite official abandonment of the counter-cyclical factor, policy response clearly pushed against excessive currency strength earlier in the year and against currency weakness in recent weeks
- Recent official resumption of counter-cyclical factor should provide policy makers with greater flexibility and influence in standing against short term aberrations

Views represent those of GS Securities Division

Source: Bloomberg, Goldman Sachs, Goldman Sachs Global Investment Research (Exhibits)

China macro forecasts

	2015	2016	2017	2018	2019
				GS forecasts	
GDP yoy, %	6.9	6.7	6.9	6.6	6.1
CPI yoy, %	1.4	2	1.6	2.3	2.3
Current account, % of GDP	2.8	1.8	1.4	1.3	1.4
7-day repo rate, % (year-end)	2.4	2.6	3.1	2.3	2.5
USD/CNY (year-end)	6.45	6.92	6.59	6.90	6.40

- Forecasts assumes EUR/USD @ 1.1700 y/e 2018 and @ 1.2500 y/e 2019
- Forecasts imply a mild underperformance in CNH over the rest of this year, but a mild outperformance over the course of 2019
- Growth to continue its downwards trajectory while inflation and c/a should stabilise around current levels

Views represent those of GS Securities Division

Source: Goldman Sachs Global Investment Research

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