

Mizuho Brief: CNH Risks

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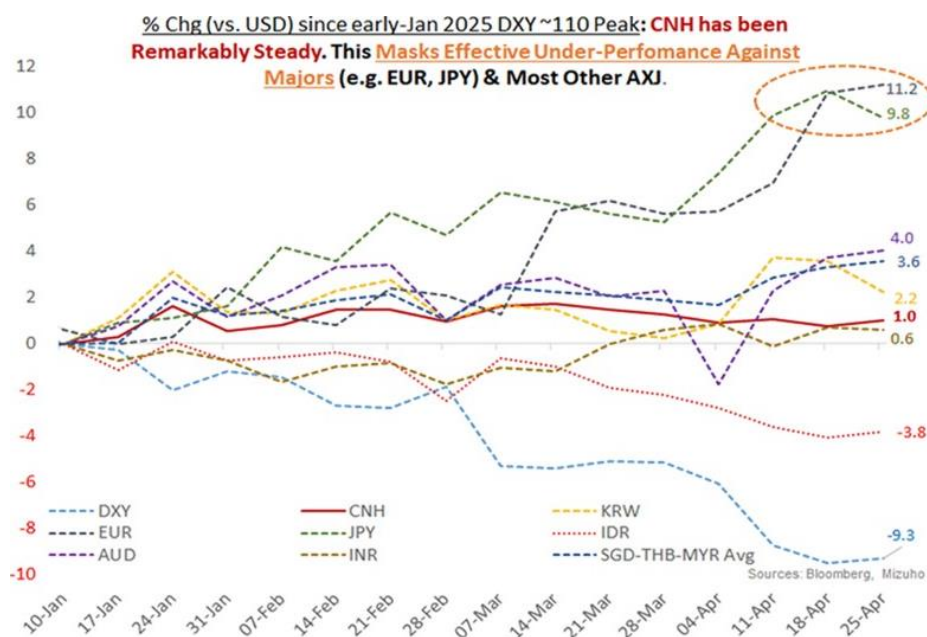
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CNH & the Illusion of Stability

"Reality is an illusion, albeit a persistent one" – Albert Einstein

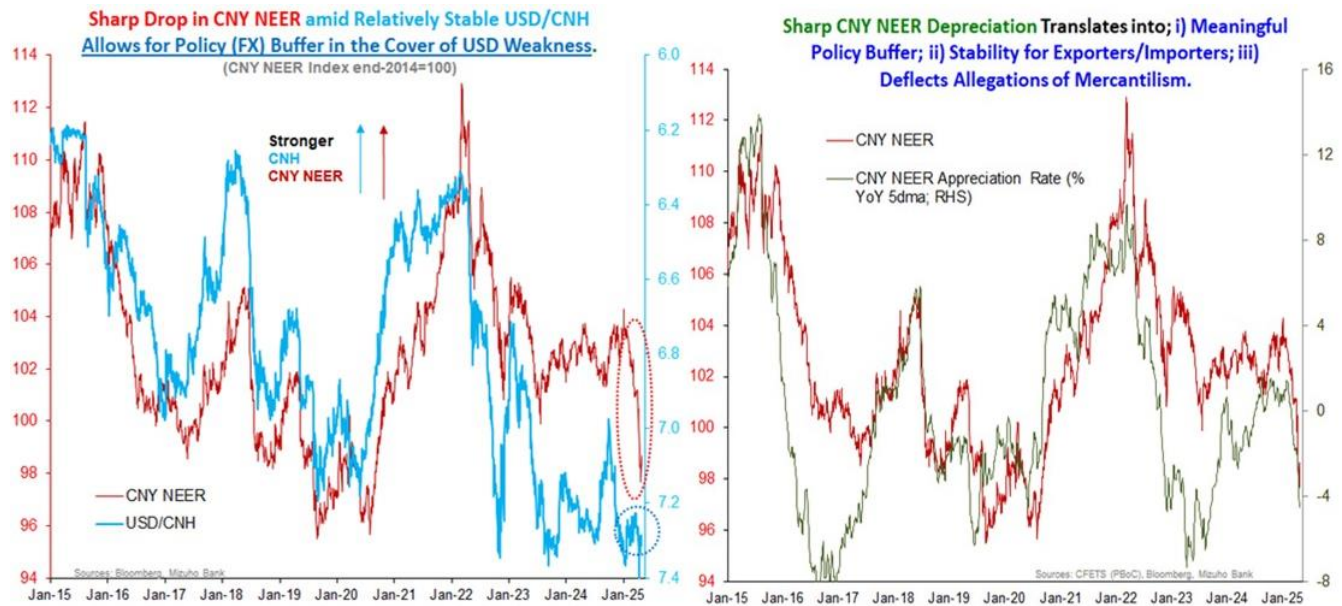
In a Nutshell:

- **CNH stability** (vs. USD) is an **illusion** enabled by a bearish USD wave, whereas the **reality** is sharp drop in **effective** (trade-weighted) **CNH exchange rates**.
- Nonetheless, this is a **useful "illusion"**, **providing the PBoC with sufficient geo-political cover**, as a **relatively softer USD helps deflect potential criticisms of mercantilist policies**.
- Not only does the PBoC enjoy **FX policy buffer** against acute trade turbulence, but it also offers **stability for Chinese exporters/importers** and **builds FX reserves**.
- To be sure, this **FX policy sweet spot** courtesy of USD bears is likely to be **fleeting**.
- **Whereas what's persistent are acute geo-economic risks, and attendant policy trade-offs**, that **feature in the new global order** us being advanced.
- Associated **CNH vulnerabilities** and **wider two-way volatility** are thus merely masked currently and are **liable to resurface** amid elevated threats of US-China antagonism.
- Inevitably, **AXJC** on the hook for spill-over turbulence**, with potentially amplified pressures, as China- and trade-related risks persist amid uncertainty.
- Especially **if the absence of emphatic bearish USD** conspires with **AXJC-CNH correlation rebound** and **exaggerated AXJC gains (vs. CNH)**.

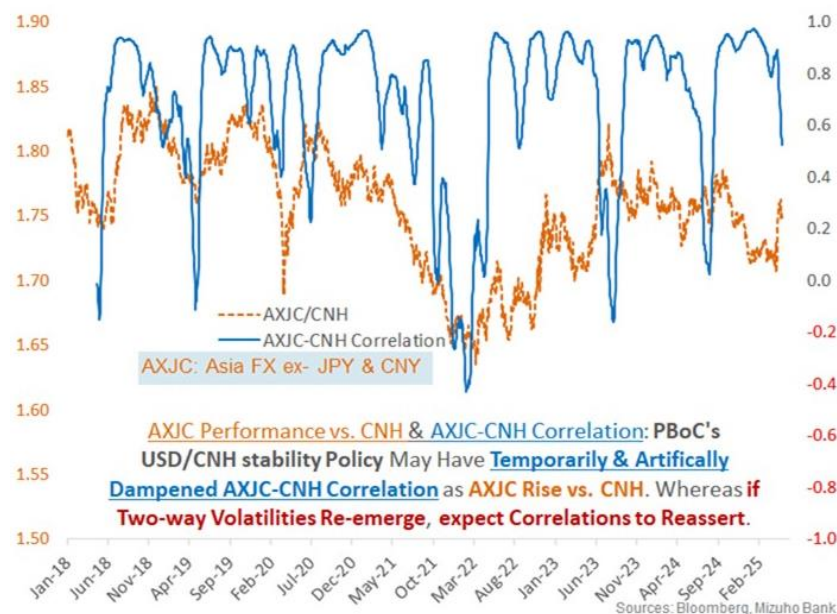




- Remarkably Stable (USD/CNH): Ironically, in the midst of acute tariff turbulence that has been trained on China, **CNH (vis-à-vis the USD) has been remarkably stable***.
- Merely an Illusion (Masking Broader Under-performance): But that **stability is merely an illusion**, that masks broader, significant CNH under-performance of the vs. JPY, EUR and other AXJ (See Charts above).
- Albeit a Highly useful one (for Beijing): Nonetheless, this **illusion of CNH stability** masking effective weakness is **highly useful in the context of conflicting risks amid heightened trade conflict/tariff uncertainties**.
- Weak USD Cover Affords Critical Policy/Geopolitical Buffer: Point being, the **cover of a sharply weaker USD** (that is down 9-10% since mid-Jan highs) **allows the PBoC to extend low-cost policy buffer** whilst **mitigating geo-political blowback risks**.
- Effective Currency Cushion: First and foremost, the **reality** is that a **stable USD/CNH against a bearish USD** delivers a **considerably softer effective (trade-weighted) CNH exchange rate** to help buffer against trade/tariffs headwinds.
- Deflects Allegations of Mercantilist (FX) Policies: Crucially, this may be **achieved at minimal geo-political cost** as **CNH stability vs. (a weakening) USD** helps **deflects potential US allegations of mercantilist PBoC (FX) policies**.
- Mitigates FX Uncertainty for Trade: What's more, **stable USD/CNY rates alleviate the burden of managing outsized FX risks** for **Chinese exporters/importers** already hobbled by acute trade uncertainties.
- Building FX Buffer: Finally, the PBoC has the **benefit of potentially building FX reserves**. Specifically, as **maintaining a stable CNH (vis-à-vis USD) amid broad-based the Greenback** typically entails **accumulating FX (USD) reserves**.



- FX Policy “Sweet Spot” Compliments of (Weak) USD: Hence, the **silver lining** is that the **PBoC** has the **benefit of a window of (FX) policy “sweet spot” compliments of USD woes**, dulling trade-offs otherwise associated with policy stimulus.
- But “Gift of Cover” Likely Fleeting: Nonetheless, the **“gift” of bearish USD cover** is **unlikely to endure**, as **exaggerated one-way bearish USD forces** on **under-accounted tariff blows-back shocks** and associated **US exceptionalism erosion peter out**.
- Unlike the Feature of Acute Geo-Economic Threat: Whereas what’s **persistent** are the **complex and acute geo-economic threats** likely to **feature in the “new order”**.
- “Two-Way” Volatility Risks May Build Again: Necessarily, it is **just a matter of time** before **CNH stability is upended, as “two-way”, potentially out-sized, volatility resurface**. Especially as sharp, underlying, policy trade-offs reassert more forcefully.



- [Attendant AXJC** Volatility Risks](#): Inevitably, such an **outburst of CNH volatility** is likely to entail **AXJC spillover** as **AXJC-CNH correlations are likely to remain high**
- [Given Temporarily Suppressed Correlations](#). In fact, potential CNY-triggered AXJ turbulence may be amplified **if AXJC-CNH correlations, temporarily suppressed** amid the PBoC's current policy of USD/CNH stability, **reverts higher**.
- [& Exaggerated AXJC \(vs. CNH\) Gains](#): What's more, **artificially inflated*** AXJC/CNH gains** *given the soft USD peg of the CNH*, warn of **potentially accentuated downside pressures for AXJ should "risk off" re-emerge without the benefit of a bearish USD cover**.

* Looking past a fleeting step up in volatility (and CNH weakness) on retaliation headlines in the second week of April.

** AXJC refers to Asia currencies excluding JPY and CNH.

*** From the PBoC's USD/CNH stability that indirectly suppresses CNH gains with a soft "USD peg"

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