GF Macro Views

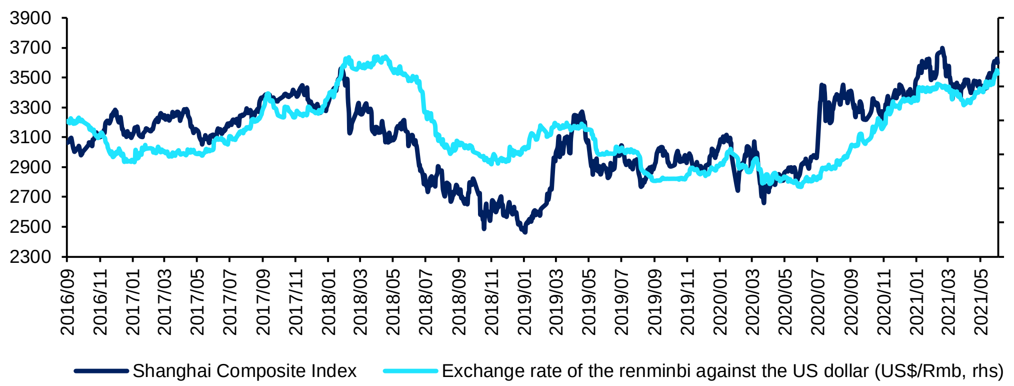
Weekly views from GF Securities' macro research team

Renminbi movements and the capital markets

Short-term renminbi appreciation is highly correlated with strengthening stock and bond markets in China, yet the uptrend may reverse given potential changes in fundamentals and policies The exchange rate is usually influenced by interest rate spreads, purchasing power parity and risk premium, and the latter two factors have led to the recent renminbi appreciation. The strengthening of the renminbi has come with a surge in northbound flows through the Mainland-Hong Kong Stock Connect and the increased amount of bonds held by foreign institutions; a weaker US dollar index since the COVID-19 pandemic has also underpinned the trend. Yet the dollar index may rebound as the fiscal deficit ratio in the US may shrink marginally, real interest rates could rebound and risk appetite may weaken. The PBoC raised the required reserve ratio for foreign currency deposits recently to reverse market expectations of renminbi appreciation. We thus caution the short-term risk of a correction in the exchange rate of the renminbi.

Guo Lei, June 2, 2021

Shanghai Composite Index and the exchange rate of the renminbi against the US dollar



Source: Wind, GF Securities Development & Research Center

A look at historical Fed tightening cycles

An overheated economy and crises coming to an end are two triggers for monetary tightening by the Fed; a tapering timetable may be provided in the next two months The nine rounds of monetary tightening by the Fed since 1960 show that an overheated economy is often a trigger for the Fed to tighten monetary conditions. Factors outside the Fed's monetary policy framework can also influence the central bank's stance, such as external economic crises, stagflation and the outbreak of a pandemic. The constraints of the pandemic on the US economy may be removed in July, when the US economy could become overheated and the US government will no longer provide pandemic-relief stimulus, making it less necessary for the Fed to lower bond issuance costs. As such, this could be an appropriate time for tapering. We suggest watching whether Jerome Powell, the Fed Chair, will provide an exact timetable for tapering over the next two months, and how the Fed's tightening policies will affect the US dollar index, US Treasury yield, global liquidity and market expectations.

Zhang Jingjing, Wang Shen, June 4, 2021

Nine rounds of monetary tightening by the Fed

Time	Target	Before (%)	After (%)
July 1963	Discount rate	3.00	3.50
January 1973	Discount rate	4.50	4.77
March 1977	Federal funds rate	4.25 - 5.25	4.50 - 5.25
March 1983	Federal funds target rate	8.50	8.63
January 1987	Federal funds target rate	5.88	6.00
February 1994	Federal funds target rate	3.00	3.25
June 1999	Federal funds target rate	4.75	5.00
June 2004	Federal funds target rate	1.00	1.25
December 2013	Initiating tapering and cutting monthly QE by US$10bn		

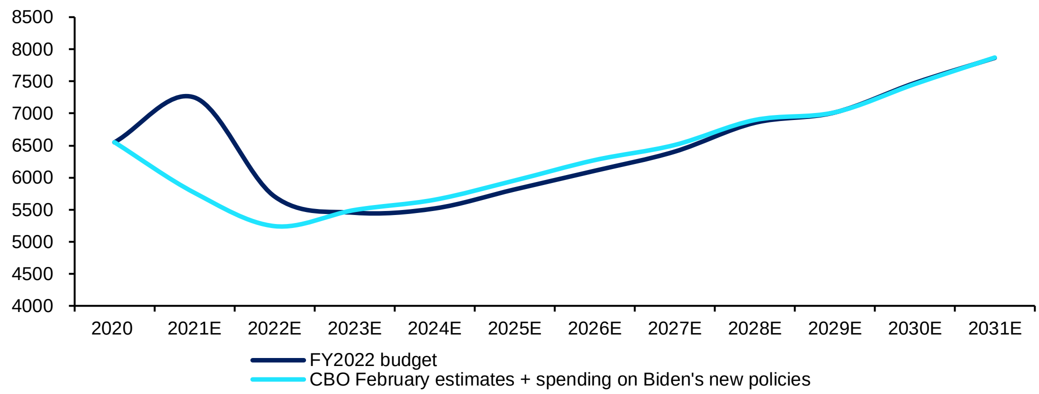
Source: Wind, GF Securities Development & Research Center

Watch the timeline for tax hikes

Infrastructure and tax hike policies could be implemented in 4Q21; QE tapering and tax hikes may lead to corrections in US stocks The American Jobs Plan and the American Families Plan have been included in the budget plan for FY2022, demonstrating the Biden administration's determination to roll out new policies. Yet, the Democratic party has stuck to bundling infrastructure policies with tax hikes, while the Republicans have tried to separate the infrastructure plan from the policy mix. Although the Democrats can revise the budget resolutions for FY2021, the Biden administration does not want to ignore the conflicts between the two parties. As such, the policy mix of infrastructure and tax hikes may be bundled with the budget plan for FY2022 and be implemented as soon as in CY4Q21. After the new policies are implemented, the US deficit ratio and the US government leverage ratio may decline. We thus expect the ten-year US Treasury yield to rise over the long term, yet we suggest watching the impact of QE tapering and tax hikes on US stocks.

Zhang Jingjing, May 31, 2021

FY2022 for fiscal spending budget vs. fiscal spending estimated by CBO estimates in February 2021 (US$ bn)



Source: OMB, CBO, GF Securities Development & Research Center

Compiled and summarized by: Cai Juntao (email: caijuntao@gf.com.cn)