

2 May 2014

a weekly chronicle of the Chinese economy

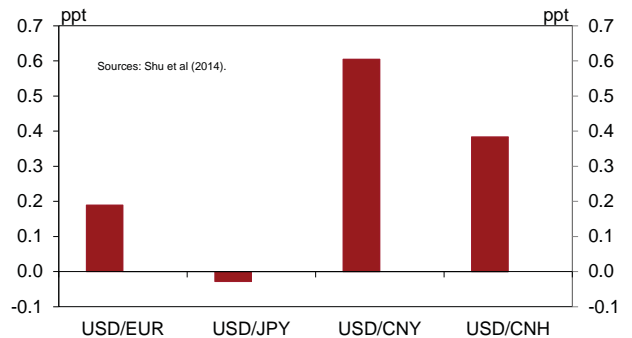
- **Phat Dragon** was drawn to some recent research emanating from the BIS' small but highly accomplished Asian office. The paper, co-authored by the talented Chang Shu (BIS) and the impressive Dong He (HKMA), details empirical estimates of the independent impact of the CNY and CNH exchange rates on regional currency markets. Controlling for the impact of the G3 crosses, they reached the very reasonable conclusions that USD/CNY has the greatest impact in jurisdictions where the local monetary authority manages the exchange change with direct or indirect reference to a basket of trading partners; whereas more flexible regimes are most influenced by developments in CNH. Those sitting in between those extremes tend to be subject to relatively equal independent influence from both markets, with a material combined impact. The MYR comes out as the most China-centric of regional currencies (noting that prospective top contender TWD was not included in the study), with the IDR a distant last. For those still expressing any doubts on the matter, the JPY bloc is dead, and its last sovereign died heirless and without any cryogenic optionality.

- **Phat Dragon** was interested to find that the AUD and NZD, the free floaters who have a zero sum terms of trade relationship with China and are actively traded across all three major timezones, showed themselves susceptible to influence from the CNH, while remaining aloof to trends in the CNY. **Phat Dragon** also notes that trading in the AUD and NZD in the Asian time zone ahead of the Chinese open has no influence on the CNY and CNH opening prices, whereas the performance of KRW in early Asian trade does. That would suggest that those with a CNY fix model that includes the Anzacs might consider dropping them and allocating their combined weights to the KRW.

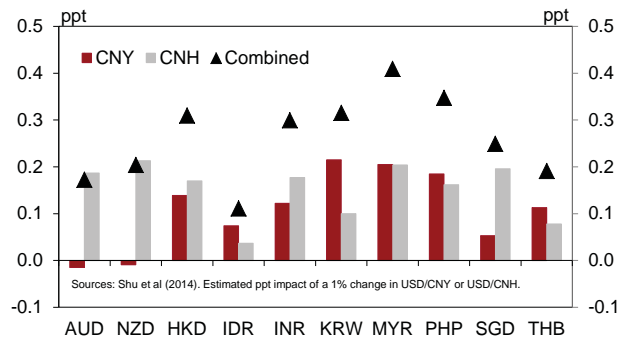
- **Phat Dragon's** ears pricked up midway through the Shanghai-Hong Kong Stock Connect announcement. Such initiatives, and there have been many that preceded it, have tended to be mentally filed away as AIWTPs (Another [impolite word] Trial Program), principally because they tended to be limited by trivial quotas that besides the symbolism involved, made them irrelevant for asset prices and market efficiency. The clear separation between the A share and H share price of dual listed companies is testament to a dearth of arbitrage activity. Shanghai-Hong Kong Stock Connect is cut from a different cloth to its predecessors though. The starting quotas for this program are large: 300bn yuan southbound and 250bn yuan northbound (\$US48bn and \$US40bn respectively). By way of context, **Phat Dragon** notes that the inward quota amounts to 75% of the total granted under the QFII program (46% of QFII plus RQFII), while the outward quota amounts to 52% of QDII allotments. The intensive qualification process associated with the Q-Acronym programs has also apparently been dispensed with, with eligibility for the southbound program a simple assets under management threshold. In sum, **Phat Dragon** sees Shanghai-Hong Kong Stock Connect as a bold step, consistent with accelerating both the financial internationalisation agenda and with reducing bureaucratic oversight of private sector activity.

- **Phat Dragon** is a few days away from having an important announcement to make. No, **Phoxey Dragon** need not be worried. Suffice to say that there remain prominent gaps in China's official data universe, and **Phat Dragon's** dutiful employer is funding a long term project to address one of the larger ones. Intrigued? So you should be.

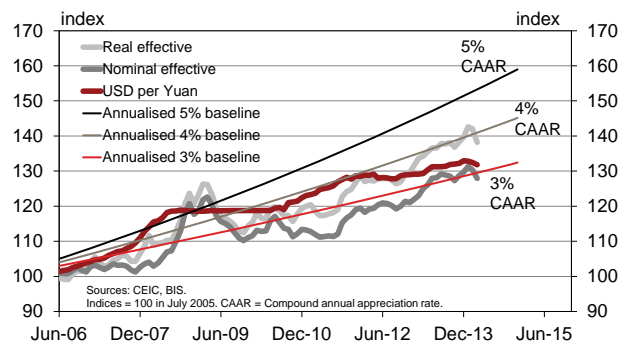
### CNY, CNH & the G3: Asian FX impact



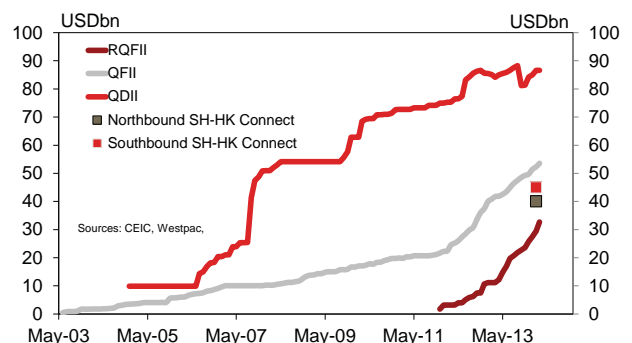
### The CNY & CNH impact in the Asian timezone



### The path of the Chinese exchange rate



### QFII, RQFII, QDII & Shanghai-HK connect



- **Stats of the week: China has two cities in the world's top 10 busiest air systems. The US has 5 of them, with London (#1), Paris (#5) and Tokyo (#3) making ten.**



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