

RENMINBI REDUX

Last week, comments by senior government officials in China strengthened our conviction for a stronger RMB and we believe investors should be positioned to take advantage of this. Both Premier Wen Jiabao and the PBOC Governor Zhou Xiaochuan have recently talked about using the currency as another tool with which to fight inflation. Since 2009, the PBOC has raised reserve requirements 10 times (500 bp) and hiked policy rates 4 times (100 bp) but inflation has remained undeterred in its rise from 2% to 5.4%. A stronger currency would help curb some of the inflation imported from other countries: according to [REDACTED]. Morgan's Greater China Economics team, every 1% of appreciation lowers headline inflation by about 10-12 bp per year.

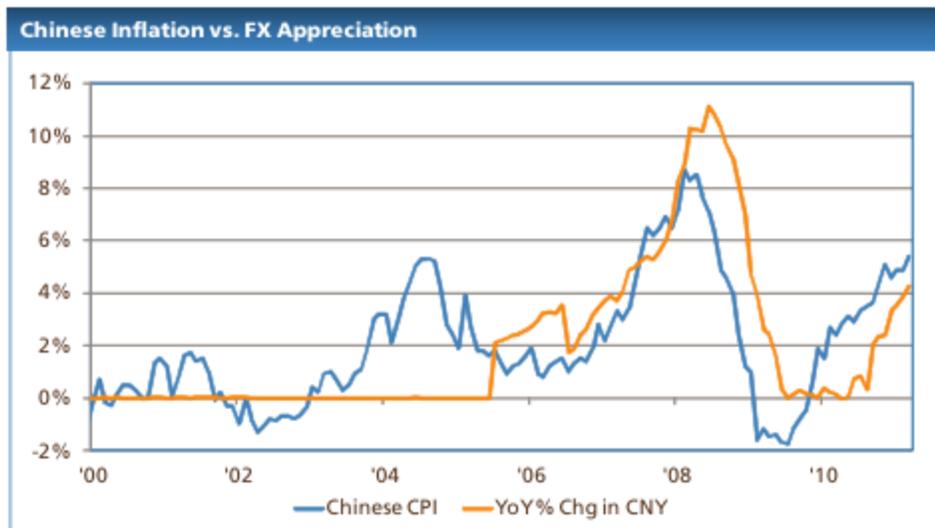
As inflation continues to grind higher and expectations of stabilization or moderation get pushed out, we believe there is more pressure to pull on all the inflation levers including the currency which could allow for faster RMB appreciation than previously expected. We are not calling for a one-time revaluation of the RMB as has been speculated in the press but in the face of high and rising inflation, we believe the overall risks for the currency are to the upside.

Risks:

- Inflation stabilizes or moderates earlier than expected.
- Government currency intervention.

Implementation:

- Please call your [REDACTED]. Morgan representative for options on trading the RMB.



Source: China Economic Information Network, Bloomberg. Data as of 3/31/11.

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