

**From:** Richard Kahn <[REDACTED]>  
**To:** "jeffrey E." <jeevacation@gmail.com>  
**Subject:** Fwd: Update in USDCNH  
**Date:** Tue, 11 Aug 2015 14:51:44 +0000

**Inline-Images:** Mail\_Attachment.gif; Mail\_Attachment(1).gif; Mail\_Attachment(2).gif;  
Mail\_Attachment(3).gif; Mail\_Attachment(4).gif; Mail\_Attachment(5).gif;  
Mail\_Attachment(6).gif; Mail\_Attachment(7).gif; Mail\_Attachment(8).gif;  
Mail\_Attachment(9).gif

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not sure daniel understood trade when we were finally at breakeven and he recommended we keep trade on books..

Richard Kahn  
HBRK Associates Inc.

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Begin forwarded message:

**From:** Daniel S [REDACTED]  
**Subject:** Update in USDCNH  
**D** [REDACTED]:17:38 PM EST  
**To:** [jeevacation@gmail.com](mailto:jeevacation@gmail.com)  
**Cc:** Paul Morris <[REDACTED]>, Vahe Stepanian <[REDACTED]>, Stewart Oldfield <[REDACTED]>, [REDACTED]

Classification: Public

Jeffrey,

Rich and I spoke last week on USDCNH, and I wanted to send a recent piece from our research team on this topic. For full disclosure, I personally don't share our research team's recommendation, as USDCNH vol still extremely low and it represents a very cheap out-of-consensus expression of CNH out-performance vs. USD, so don't see the value of crossing bid offer on the transaction. Having said that, our research team advocates closing their USDCNH put spreads as they view "the next phase of FX depreciation will be driven more by China's own worsening fundamentals, namely: 1) slower growth and disinflation, (2) a pick-up in outflows, (3) de-leveraging that increases short-term risks and (4) valuations approaching expensive extremes"

You could unwind you \$75mm USDCNH put struck at 6.16 expiring on 12-Aug-2015 for \$270k bid (Spot ref 6.1310 - the mid would be \$315k - pricing as of noon 11/03/2014)  
You paid \$273k for it.

More details on the research piece below.

Best regards,  
Daniel

Classification: Public

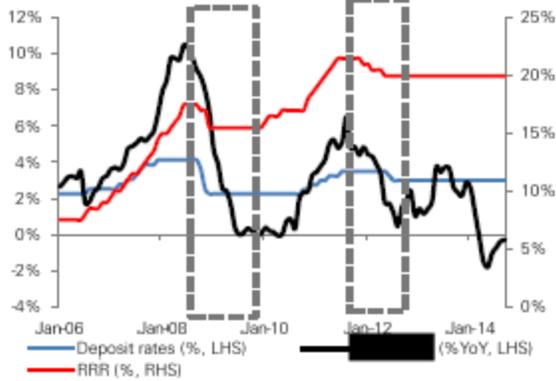
China growth is facing increasing headwinds, with DB Economics downgrading our 2015 growth forecast to 7.0% this week. In this context, **we believe RMB weakness will return to haunt the market in 2015.** This weakness will be different from the early 2014 squeeze, which appeared to be engineered by policy-makers to target speculative capital. The next phase of RMB depreciation will be driven more by China's own worsening fundamentals, namely: **(1) slower growth and disinflation, (2) a pick-up in outflows, (3) deleveraging that increases short-term risks and (4) valuations approaching expensive extremes.** In our view, the resistance from policy-makers to FX weakness will be minimal since it will reflect underlying fundamentals, and authorities should be comfortable with a more market-driven RMB. Moreover, retaining the current policy bias for appreciation would only pull in more 'hot' money flows, which increase systematic risks in China. With this in mind, we are reducing the long CNH exposure in our portfolio by **closing out our USD/CNH put spread.** The slowdown in Chinese growth and RMB weakness is also likely to impact other Asian currencies. We examine four channels of spillover: (1) exports, (2) FDI, (3) financial linkages, and (4) FX policy, and find the KRW, MYR and TWD to be most likely to be affected.

Link: [23\\_0900b8c088c00869.pdf](#)

Figure 3: The Chinese authorities have been loosening monetary policy, particularly in the past few months

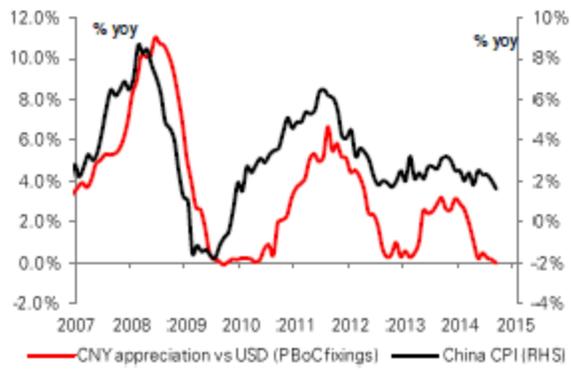
Dates	Measures announced
8-Apr-14	CDB was granted about 100 billion yuan in loans to shantytown rebuilding projects
16-Apr-14	The State Council announces a 50bps RRR cut for county-level rural commercial and cooperative banks
21-Mar-14	The PBOC announced an increase in lending to micro and small-sized enterprises (MSEs), arranging 50 billion yuan re-lending quota specially for loans to MSEs.
6-May-14	The PBoC lent RMB100bn to some of small banks and rural credit unions via its re-lending facility.
21-May-14	China allows local governments to independently issue bonds. 10 local governments to sell bonds on their own credit
22-May-14	The PBoC lent 300 billion yuan to the China Development Bank for re-lending to reconstruction projects of shanty towns
30-May-14	Targetted RRR cut for financial institutions with loans to SME and agricultural sectors
6-Jun-14	The PBoC lent 100 billion yuan to some small- and medium-sized banks to allow them to re-lend the cash to agricultural projects
9-Jun-14	PBoC announces it will cut the RRR by 50bp for many small banks, effective 16 June
12-Jun-14	The PBoC announced a string of credit measure to exporters
30-Jun-14	CBRC's tweak loan-to-deposit ratios to support growth
7-Jul-14	The People's Bank of China started a 100 billion yuan (\$16 billion) quota for relending for agriculture and small businesses.
20-Jul-14	PBOC offers CDB a RMB1tm credit line for Shantytown developments
31-Jul-14	PBoC cuts its 14-day repo operation today by 10bp to 3.7%.
8-Aug-14	PBoC announces that it will increase its rediscount facility quota by RMB12bn for some of its branches to support the financing of the agricultural sector and small and micro enterprises
27-Aug-14	PBoC sets aside another 20bn yuan for a relending program
16-Sep-14	Local press reported PBOC carried out Standing Lending Facility (SLF) operation, providing 500 billion liquidity to five major banks.
18-Sep-14	PBoC cuts its 14-day repo operation today by 20bp to 3.5%.
30-Sep-14	The PBOC and the CBRC jointly announced measures to loosen mortgage policy and encourage banks to support shantytown projects and better-quality developers.
14-Oct-14	PBoC cuts its 14-day repo operation today by 10bp to 3.4%.
17-Oct-14	PBoC announced it will inject RMB200bn into Joint-Stock banks

**Figure 4: RMB policy normally moves in sync with monetary policy**



Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 5: Ongoing RMB strengthening could add to the disinflationary environment China is facing**



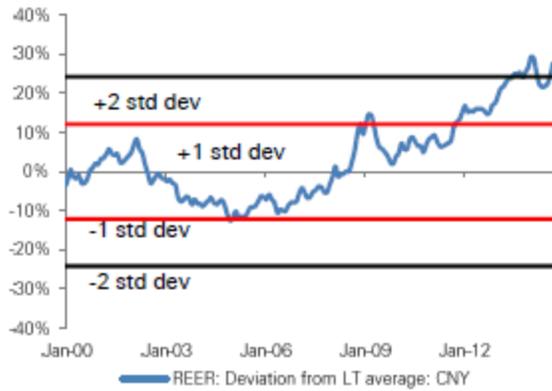
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 6: RMB could again shift towards being more market-driven, particularly since fundamentals no longer support a strong RMB**



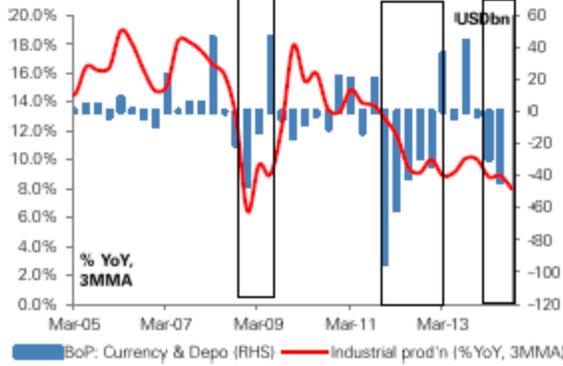
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 7: From a valuation perspective, the RMB is looking expensive**



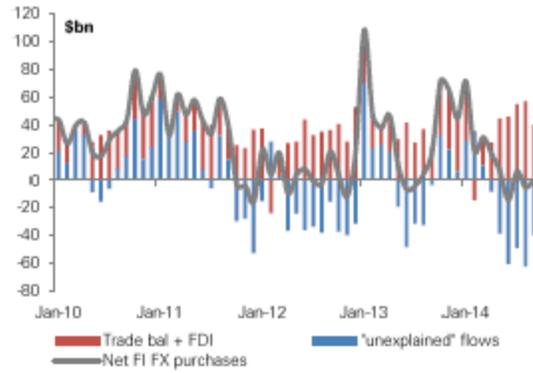
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 8: China tends to experience capital outflows when the domestic economy slows**



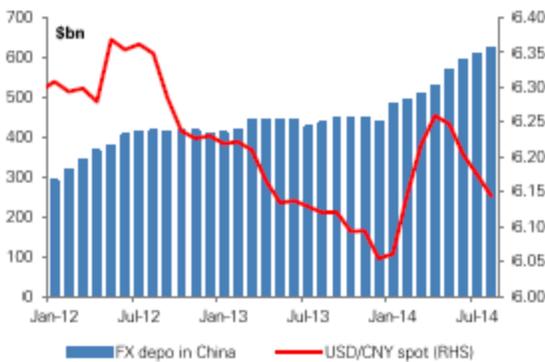
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 9: Recent weakening in growth and RMB has resulted in flows into China becoming more balanced**



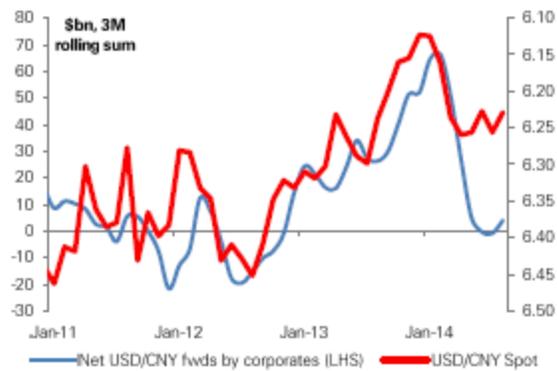
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 10: Corporates are actively rebuilding their USD balance sheets....**



Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 11: ...and actively hedging more of their FX risks**



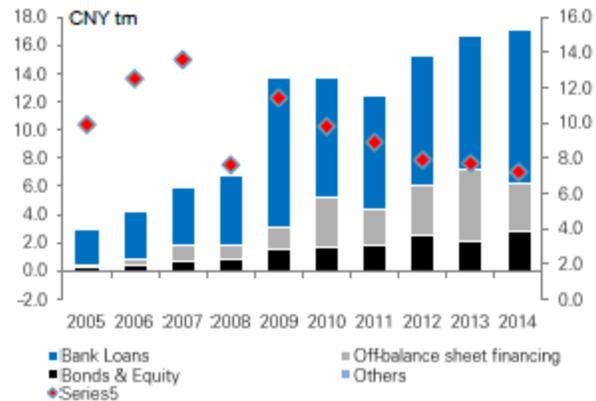
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 12: Increasingly, 7.5% growth target is not achievable in the absence of stimuli**



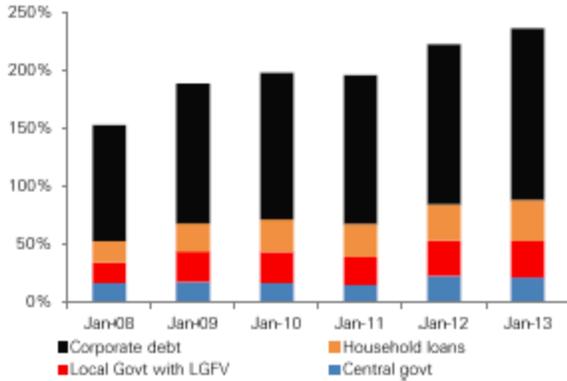
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 13: More credit required for every incremental bit of GDP growth**



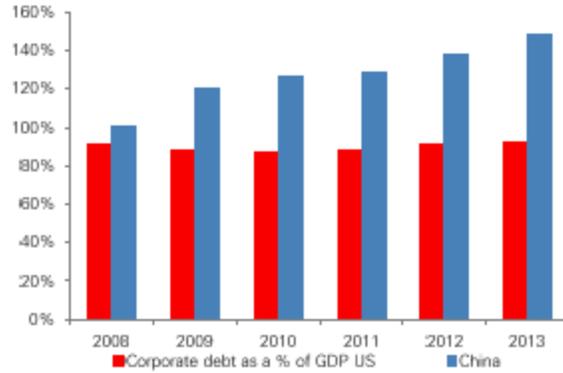
Source: Deutsche Bank, CEIC, Bloomberg Finance LP

**Figure 14: China's overall debt level is rising dramatically, particularly corporate debt, which stands at 150% of GDP**



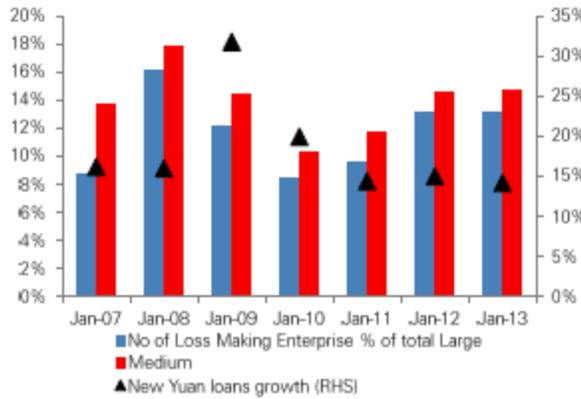
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

**Figure 15: China's corporate debt has been rising faster than that of the US over the past few years**



Source: Deutsche Bank, CIBC, Bloomberg Finance LP

**Figure 18: Rising risk of loss-making enterprises and possible default if credit growth slows further**



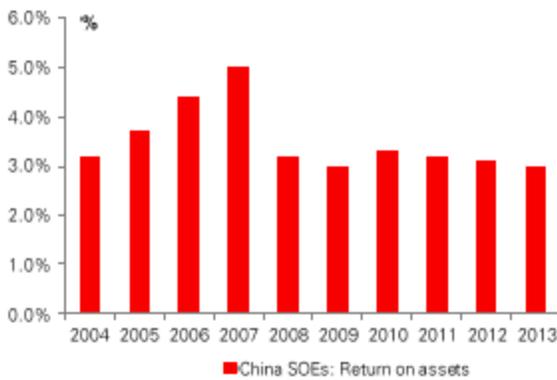
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

**Figure 19: Industrial profitability is at risk of declining as IP slows**



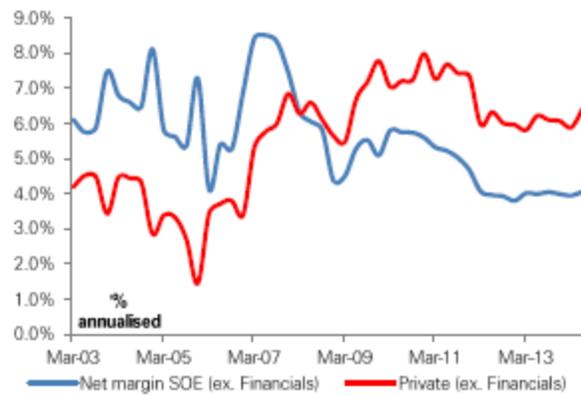
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

**Figure 16: SOEs' RoA has not picked up, despite rising debt level**



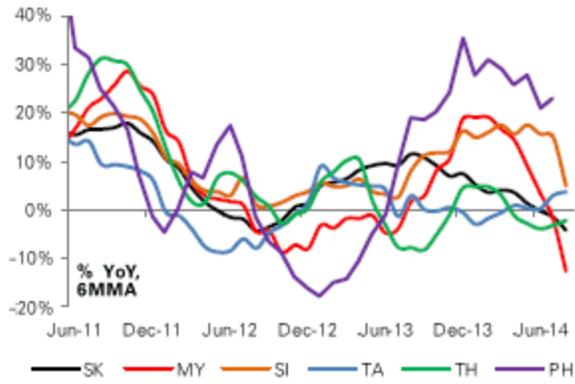
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

**Figure 17: In fact, net profit margin has been low despite easy funding compared with private enterprises in China**



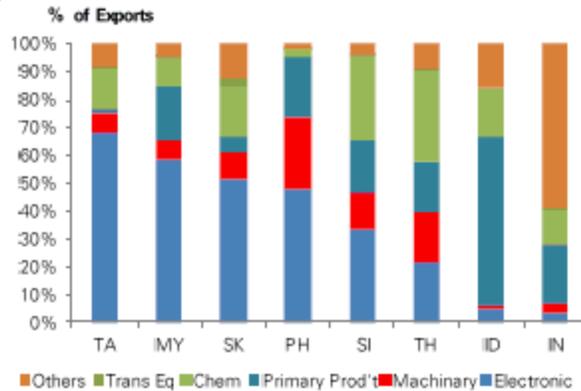
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

Figure 22: Asia exports to China have slowed notably



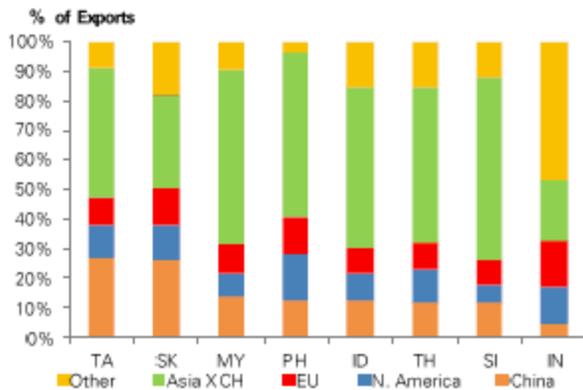
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

Figure 23: Taiwan, Malaysia and Korea are the most exposed to China's slowdown, given that the majority of their products are electronics



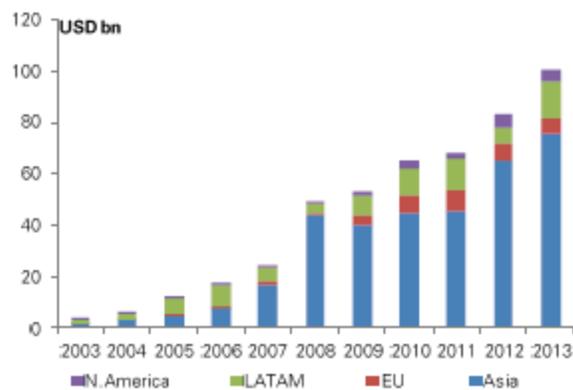
Source: Deutsche Bank, CIBC, Bloomberg Finance LP

Figure 24: Taiwan and Korea are the most exposed to China



Source: Deutsche Bank, CIBC, Bloomberg Finance LP

Figure 25: Chinese investment into Asia is the largest relative to other regions



Source: Deutsche Bank, CIBC, Bloomberg Finance LP

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