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LONDON

The Chinese renminbi is set to appreciate substantially in the coming decade

- The currency is currently 50% undervalued compared to the US dollar
- It could appreciate by around 5% per annum against the US dollar over the next decade
- Appreciation will help to rebalance global economic activity

Stefan Hofrichter, Senior Strategist at RCM, a company of Allianz Global Investors, comments on the substantial appreciation of the Chinese renminbi:

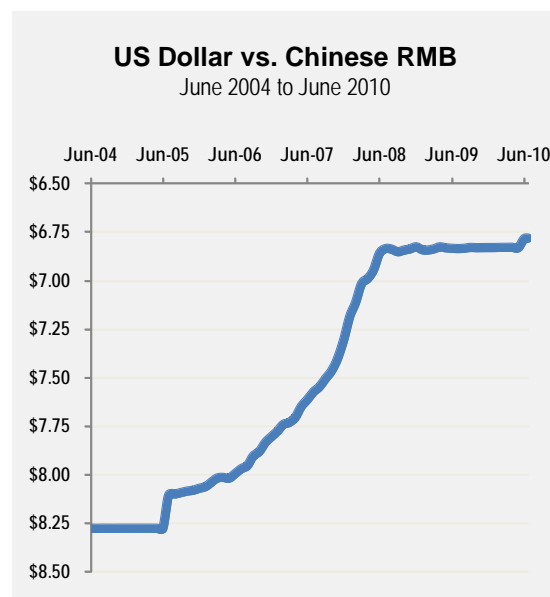
“The US is repeatedly demanding an appreciation of the Chinese renminbi (RMB). While it is difficult to anticipate the timing of a nominal appreciation of the Chinese currency, as this is actually a decision to be taken by Chinese policy makers, we have a strong view that the RMB will appreciate substantially in real terms over the coming decade. An appreciation in real terms takes place either via nominal appreciation or via higher inflation relative to its trading partners.

“According to The Economist’s Big-Mac index, which estimates purchasing power parity based on a single product—the Big Mac—the RMB is currently roughly 50% undervalued compared to the US dollar (but less so compared to other developed currencies). Most other emerging market currencies are undervalued too, albeit less so than the RMB, on average around 20%. Over the last five years, the RMB has indeed appreciated against the US dollar by around 25%. This is the so-called Balassa–Samuelson effect at work. This theory explains, why, based on higher productivity growth from a lower level and wage growth rates compared to developed economies, emerging market currencies tend to be structurally undervalued and appreciate in real terms against developed markets’ currencies.

The outlook for the RMB going forward

“Let’s assume that the RMB undervaluation converges to the average undervaluation of other emerging market currencies. By additionally applying a quantitative estimate for future real appreciation based on estimated growth differentials and assuming Chinese real growth to be around 6% higher than US growth growing forward, we come to the conclusion that the RMB could indeed appreciate by around 5% per annum (more than 60% cumulatively) against the US dollar over the next decade.

“This may sound a lot in the first place, but it fully matches the development of the Japanese yen post 1960, i.e. 15 years after Japan



began to rebuild its economy. Up until the mid 1990s, the yen appreciated against the US dollar by almost 300%. Until the mid- to late-1970s, the real appreciation primarily took place via a widening inflation differential, thereafter only via nominal appreciation. Since 1994, i.e. 15 years after China decided to modernize its economy, the RMB has appreciated by less than the yen in a comparable period of time. If indeed the RMB managed to appreciate by 5% in real terms over coming next decade, the cumulative appreciation would merely equal that of the yen between 1960 and 1985. Hence, this estimate is indeed realistic.

The implications of a RMB appreciation in real terms

“For China, it implies a trade-off between nominal appreciation and rising inflation. If the nominal exchange rate remains unchanged, we would expect inflation to pick up substantially. Indeed, strong money growth in China is consistent with inflation rising to a high single digit number later this year already. Ultimately, the RMB will also have to appreciate in nominal terms. However, timing this decision is extremely difficult as it is actually a political decision to be taken by Chinese policy makers. We believe it is most likely that China will opt for a gradual increase of RMB flexibility rather than for a one-off appreciation. Otherwise, the risk of huge speculative inflows would be too high. For the global economy, a RMB appreciation in real terms would likely help to rebalance economic activity, as it would induce less current account surplus in China at the benefit of stronger domestic demand—exactly what we believe is needed.”

- Ends -

For more information:

Emma Taylor, Head of Media Relations UK, RCM, Phone 020 7065 1526 Email Emma.Taylor@uk.rcm.com

Amy Butler, Lansons Communications, Phone 020 7566 9709 Email Amyb@lansons.com

Anna Moulds, Lansons Communications, Phone 020 7294 3681 Email Annam@lansons.com

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Awards

- RCM Highly Commended for Equities Manager of the Year, at the European Pensions awards 2010.
- RCM named winner of Active North American Equity at Pensions & Investment Provider awards 2009. RCM US Large Cap Select Growth is managed by Scott Migliori, CIO for US Equities, RCM.
- RCM named No.1 leading fund management firm for SRI Research by Thomson Reuters Extel 2009.

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- Global CIO of RCM, Andreas Utermann, named CIO of the Year by Funds Europe magazine 2008.
- Winner of European Investment Trust of the Year by Investment Week magazine, 2008, for the RCM-managed Charter European Trust.
- Allianz RCM Global EcoTrends Fund named winner Best Climate Change Investment fund 2008, by Holden & Partners/ Incisive Media.

About RCM (all data source RCM as at 31/03/10)

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