

**Macro View****Positive Reevaluation of China Financial Markets under gradual RMB appreciation  
China economic resiliency to higher oil prices**

- China Economic Resiliency to Higher Oil Prices
- China's Growing Presence in Middle Eastern Diplomacy
- Positive Reevaluation of China Financial Markets under Gradual RMB Appreciation

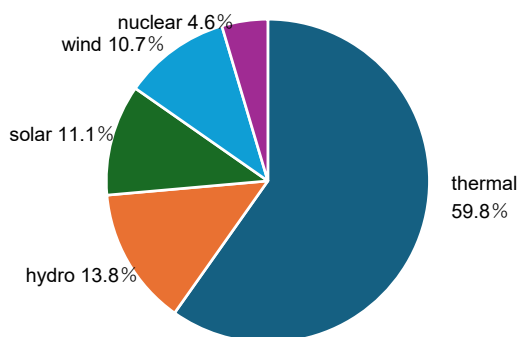
We would like to highlight positive reevaluation of China Financial Markets for three reasons. First, China macro economy holds a resilient structure to higher crude oil prices. In details, China economy does not heavily depend on crude oil thanks to diversification of resources for electricity production. Second, China sophisticated diplomatic policy in Middle East can give more initiative to China government ahead of Sino-US summit meeting, which is scheduled on 14-15 May. We believe that China government can persuade Iran government from a viewpoint of economic support. Third, gradual RMB appreciation can cause more incentive for foreign investors to invest into China financial markets, especially into bond markets. In addition, we can highlight upside potential for high-tech sectors as well as renewal energy sectors in China equity markets.

**China Economic Resiliency to Higher Oil Prices****Low Dependence on Fossil Fuels**

The Chinese economy is resilient to rising crude oil prices. At the breakdown of electricity production in 2025, thermal power generation, which uses fossil fuels, accounted for about 60%, while renewable energy and nuclear power generation, which do not use fossil fuels, accounted for about 40% (Figure 1). The main resource for thermal power generation is coal. China economy can procure more than 95% of coal domestically. If we make RMB denominated price index of crude oil price and coal price on weekly basis, based on 27 February 2026, the day before the US attack on Iran, we observed large gap between oil price index and coal price index. In fact, in the week of April 13th-17th, the Dubai crude oil price index was 144, while the coal price index remained relatively small at 105 (Figure 2). Simultaneously, we should acknowledge that naphtha should be an indispensable material for chemistry sectors.



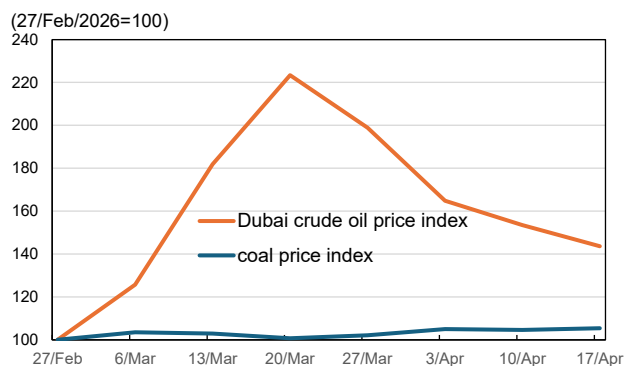
【Figure 1: China Electricity Production】



\*Note: data for 2025

\*Source: SMDAM based on CEIC

【Figure 2: Oil and Coal Price Index in RMB Term】



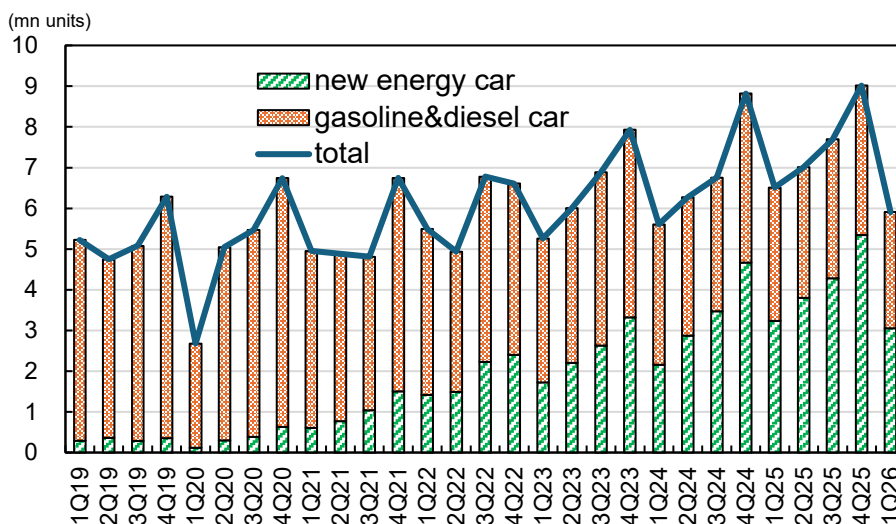
\*Note: on weekly average basis based on the price level on 27 Feb 2026

\*Source: SMDAM based on Bloomberg

## Further Shift to New Energy Engine in Automobile

In China's automotive industry, rapid shift has occurred from gasoline & diesel engine to new energy engine represented by lithium-ion battery. At the breakdown of engine type in passenger vehicle units, the share of new energy car increased to more than 50% in 2Q2025 from 6% in 1Q2019, (Figure 3). We can conclude that total fuel cost for automobile has decreased in line with increasing share of new energy automobile. Even if domestic gasoline prices rise due to higher crude oil prices, electricity tariffs are unlikely to rise significantly, compared with the gasoline prices.

【Figure 3: New Passenger Car Production Units】



\*Note: data from 1Q2019 to 1Q2026

\*Source: SMDAM based on CEIC

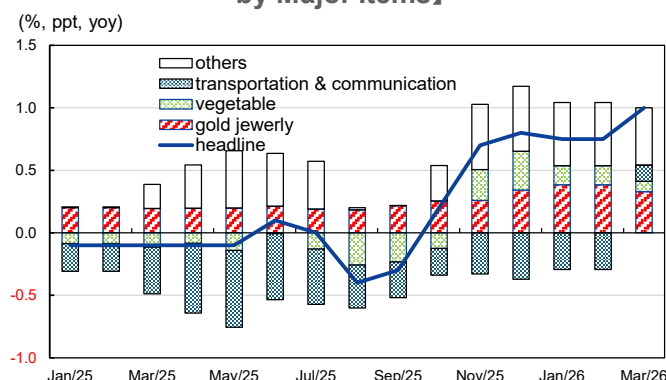
## Limited Upside Risks to CPI Inflation Outlook

We would like to highlight upside risk to CPI inflation outlook. In details, CPI inflation rate should remain at around 1% on a quarterly basis for 2026 for two reasons.

First, there is a negative correlation between crude oil prices and gold prices. Interestingly, higher “gold jewelry” prices could mainly contribute to accelerating CPI headline inflation. CPI inflation came in at +1.0% year-on-year in March, a gradual acceleration from +0.8% in January-February (Figure 4). “Transportation and communication,” whose weight is 14.3% in the CPI basket, accelerated to +0.9% yoy in March, the first positive growth since April 2024. On the other hand, “gold jewelry” decelerated from +77.0% year-on-year in January-February to +65.8% in March. Given a negative correlation between crude oil prices and gold prices (Figure 5), even if the contribution of “Transportation and communication” accelerates, that of “gold jewelry” should decelerate. In other words, upside transportation prices can be offset by downside gold jewelry prices to some extent.

Second, vegetable inflation with 17.0% weight should continuously decelerate due to base effect. In fact, “vegetable” inflation decelerated to +4.9% year-on-year in March from +8.8% in January-February. The yoy contribution of “Vegetable” should turn negative in April, because daily wholesale prices for vegetables have shifted to contraction area since the beginning of April.

【Figure 4: CPI Inflation Contribution  
by Major Items】

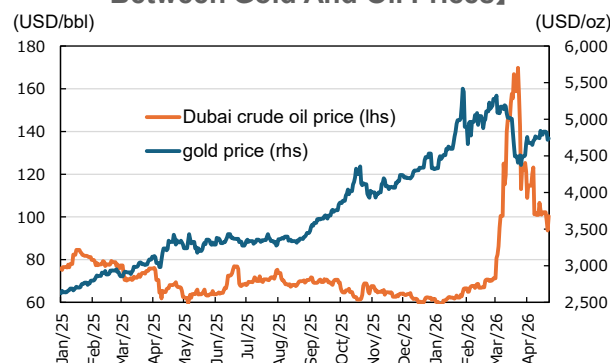


\*Note: data from January 2025 to March 2026, average growth for January-February

\*Note: We assume weight of gold jewelry at 0.5%.

\*Source: SMDAM based on CEIC

【Figure 5: Negative Correlation  
Between Gold And Oil Prices】



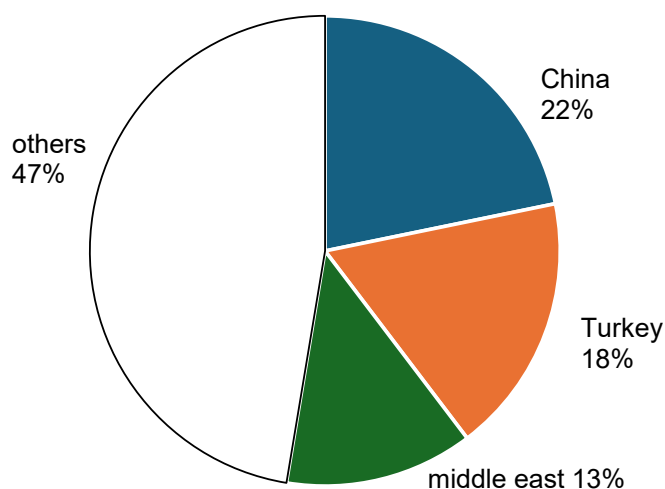
\*Note: data from 1 January 2025 to 22 April 2026

\*Source: SMDAM based on Bloomberg

China government has actively joined Middle Eastern diplomacy and has built friendly relations with gulf oil economies inclusive of Iran. At Iran's exports by destination for 2025, the share to China was the largest at 22%, significantly exceeding the 13% for that to all Middle Eastern countries (Figure 6). The Chinese economy is indispensable to the Iranian economy.

Diplomatic relationship between Iran and Saudi Arabia had worsened mainly due to differences in religious principles. However, on March 10, 2023, both governments announced an agreement to normalize diplomatic relations through the mediation of the China government. Following the US attack on Iran, Iran retaliated against Saudi Arabia with attacks. On March 21, 2026, the Saudi Arabian government designated five military attachés at the Iranian embassy to Saudi Arabia as persona non grata (undesirable persons) and ordered them to leave within 24 hours. Although relationship between Iran and Saudi Arabia has got worsened again, they have not reached a complete breaking-off of diplomatic relations.

**[Figure 6: Iran Exports Share By Destinations]**



\*Note: data for 2025  
\*Source: SMDAM based on CEIC

### China Calls for Easing Tension in Middle East Through Dialogue and Requests Iran To Keep Safe Navigation in the Strait of Hormuz

After the US attack on Iran on 28 February, the Chinese government called on the US and Iran to immediately cease fire and terminate the war, while simultaneously requesting that Saudi Arabia and other Middle Eastern governments to de-escalate the situation through dialogue.

The Chinese government emphasized the protection of Iran's sovereignty and requested that Iran ensure safe navigation in the Strait of Hormuz, acting as a spokesperson for ASEAN and other countries which depend on crude oil in Middle East. The Chinese government has succeeded in enlarging diplomatic presence demonstrating a desire for international peace.

At the G20 Finance Ministers and Central Bank Governors Meeting held in Washington, D.C. on April 16, Treasury Secretary Bessent called for strengthened financial sanctions against Iran and warned potential secondary sanctions against two Chinese banks, which are expected to deal with Iran. Under the anti-Iran circumstances, China government has expressed opposition to comprehensive sanctions against Iran. Due to the strong opposition by China government, G 20 members had not reached a joint statement. For Iran, which is under pressure from strengthened sanctions, China's pro-Iranian diplomatic stance has turned more important for Iran to survive.

### **The Shadow Mediator Between the US and Iran**

On 8 April, Pakistani Prime Minister Sharif announced that Iran and US had agreed to a two-week ceasefire, just one hour before the US deadline for destroying Iran. Interestingly, on the same date of the cease war announcement for a fortnight period, President Trump stated in an interview with AFP that he believed China had persuaded Iran to reach the cease war agreement with US. We can conclude that China government would like to hold incentive to leverage the situation in Middle East to negotiate with US at any kind of important meetings.

We can recall that conflicting relationship between Pakistan and Afghanistan suggests a proxy war between US and China, because China and US have taken aggressive approach to Afghanistan and Pakistan, respectively.

However, China government simultaneously has tried to mediate between Pakistan and Afghanistan through shuttle diplomacy with special envoys. A series of China diplomatic actions can maintain confidence to China government from Pakistan government. In fact, before the ceasefire announcement, Pakistani Deputy Prime Minister and Foreign Minister Dhar met with Foreign Minister Wang Yi in Beijing on 31 March, suggesting that the Chinese government should play an important role in mediating between Iran and US to cooperate with Pakistan.

China government has actively pursued diplomacy to de-escalate the tension in the Middle East, including requesting Iran to negotiate a ceasefire and to ensure safe navigation in the Strait of Hormuz. China government can hold leading initiative at the Sino-US summit meeting, which is scheduled on 14 and 15 May 2026, if China diplomatic efforts can cause continuous ceasefire between US and Iran.

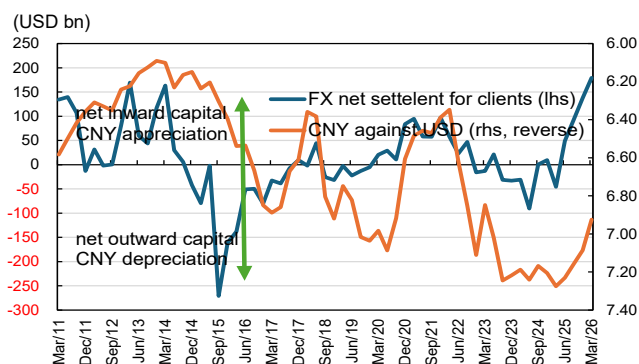
## Gradual Yuan Appreciation To Induce Capital Inflows and To Leave Room for Rate Cut

### Gradual Yuan Appreciation

On a quarterly average basis, the yuan's exchange rate against the US dollar has been gradually rising since January-March 2025 (Figure 7). Looking at net foreign exchange settlement for customer accounts, the pace of capital inflows accelerated in 2025, reflecting widening current account surplus led by trade account surplus. Diversification of export destination has caused a main reason for large sized trade account surplus via solid exports momentum (Figure 8).

We expect the People's Bank of China to set the yuan reference rate in the direction of a gradual yuan appreciation, which can be interpreted as accepting a gradual yuan appreciation. At least until the US midterm elections in November 2026, it can be interpreted that the Chinese government is trying to demonstrate a conciliatory stance towards the US by guiding the yuan to appreciate in order to correct the US-China trade imbalance.

【Figure 7: Banks' Net Settlement of  
FX for Clients' Accounts】

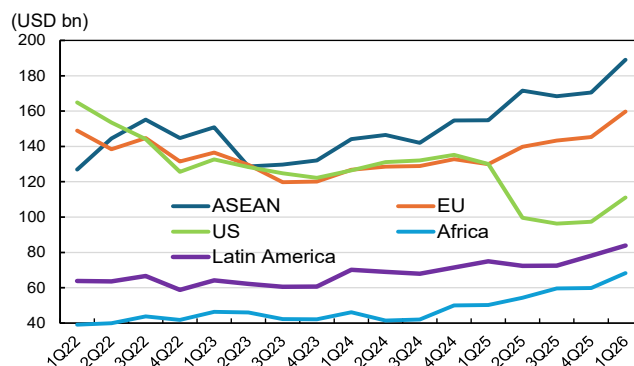


\*Note: data from 1Q 2011 to 1Q 2026

\*Note: Net purchase (sell) of CNY by clients from banks means net capital inflow (outflow)

\*Source: SMDAM based on CEIC and Bloomberg

【Figure 8: Exports By Destinations】

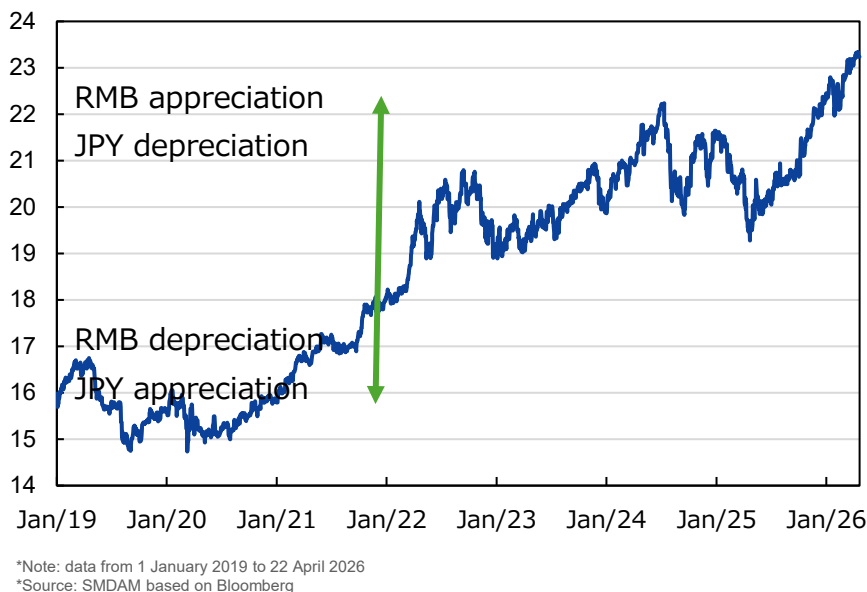


\*Note: data from 1Q 2022 to 1Q 2026, seasonally adjusted basis calculated by SMDAM

\*Source: SMDAM based on CEIC

Given the expected gradual appreciation of the yuan as well as the limited risk to CPI inflation outlook, there should remain room for PBOC to cut policy interest rate for the rest of 2026. As the yuan is expected to continue its appreciation trend against the Japanese yen (Figure 9), yuan-denominated bonds can give more chance of capital gain to Japanese investors.

**【Figure 9: JPY Rate Against CNY】**



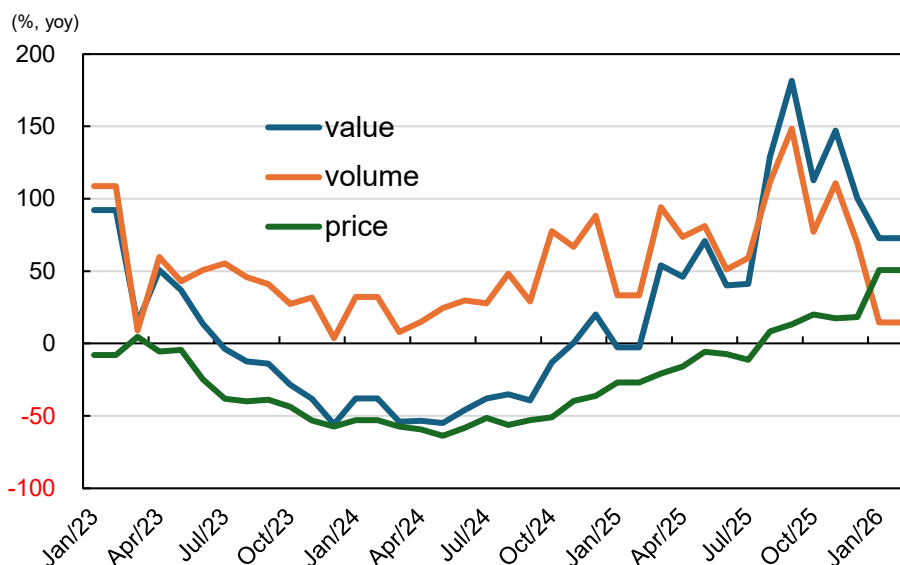
### Attention High Tech Sectors As Well As Renewable Energy Sectors in Equity Markets

As mentioned above, China's economic structure is resilient to high oil prices. As global investors acknowledge this kind of advantage of China economy, they should give more attention to gap between undervalued China equity markets and overvalued US equity markets.

By sector-wise, we would like to highlight existing upside momentum of high-tech sectors as well as potential upside momentum of renewable energy sectors. In fact, real GDP growth came in at 5.0% yoy in 1Q26, higher than consensus, accelerating from 4.5% in 4Q25, mainly due to solid high-tech momentum.

Furthermore, higher crude oil prices triggered by the US attack on Iran have given good chances to reevaluate renewable energy sectors to many people. We expect demand for solar panels, in which Chinese manufacturers hold an overwhelming market share, to increase. Looking at solar panel exports from China, export price growth has entered into accelerating phase due to anti-involution policy, which aims to curb excessive production and investment and avoid excessive price-cutting competition) (Figure 10). Going forward, more demand for solar panel cell can induce further upside export prices.

【Figure 10: Solar Panel Cell Exports】



\*Note: data from January 2023 to February 2026, average growth for January-February  
\*Source: SMDAM based on CEIC

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