



FRANKLIN TEMPLETON
INVESTMENTS

China Increases the Flexibility of the Renminbi

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OVERVIEW

- On 19 June 2010, China's central bank announced it would increase the flexibility of the renminbi.
- We believe the currency's potential appreciation is likely to be very gradual.
- The move does not dramatically change our overall outlook on Chinese stocks.

FLASH INFO

TEMPLETON EMERGING MARKETS GROUP

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For approximately two years, China has effectively pegged the value of its currency, the renminbi, to the value of the U.S. dollar. In 2005, it briefly allowed a controlled appreciation of the currency, but it ended that policy with the emergence of the global economic crisis.

On Saturday, 19 June 2010, China's central bank, the People's Bank of China (PBOC), announced that it would increase the flexibility of the renminbi. In its statement, the PBOC cited the "recovery and upturn of the Chinese economy," the country's "enhanced economic stability" and the PBOC's desire to "proceed further with reform" of its exchange rate regime as reasons for the change in policy.

In reaction to the announcement, equity markets in Asia and Europe closed higher on Monday, while U.S. markets were somewhat mixed. However, we think the potential change in the value of the currency is not likely to be either fast or dramatic. Judging from past experience, we believe that the Chinese authorities may be prepared to see a gentle appreciation in the coming weeks and months, but they are not likely to allow any large jumps in the value of the renminbi because they are afraid of the consequences of such volatility.

Indeed, the PBOC also stated that, with its balance of payments nearing equilibrium, the "basis for large-scale appreciation" of the renminbi exchange rate did not exist. It also made clear its intention to maintain the exchange rate at a "basically stable" level.

As bottom-up equity investors, we focus on individual companies when evaluating investment opportunities. However, it is also important for us to understand how a company is positioned within its sector and country or region, and as such, our outlook on currencies forms part of our broader assessment of a company's operating environment.

Since we expect China's exchange rate change to be gradual, this move does not dramatically change our overall outlook on Chinese stocks. We are still able to selectively find what we believe are some attractive stocks on an individual basis, with companies in sectors related to commodities and consumer products and services seeming to offer more interesting opportunities at this time.

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