FX Flash

RMB - The Fix Beckons The Spot

Looking for Clues in the Fix

Insofar, the turns and outcomes of the US-China trade talks have been difficult to predict as we never know if the next move is an escalation or a truce. Just as the break of the 7 came as a policy signal that China would no longer maintain that goodwill of restraining RMB weakness below the 7 by keeping the USDCNY fix below 6.90, we continue to search for clues on the next move from the daily fixing on China's next step and the progress of the discussions that are behind closed doors.

USDCNH was last seen around the 7.15-figure as we write and it trades at a small premium of around 40pips to the USDCNY. The USDCNY fix at 7.0879 today was spot on by our model estimate (also at 7.0879). Our estimate today took into account a CCAF (Countercyclical adjustment factor) that is enhanced substantially, so as to anchor the USDCNY and USDCNH. This is compelling because enhancing the CCAF to such a large extent (shown in the chart below) and keeping the fix at the 7.08-handle for the third consecutive session to suppress RMB weakness may invite speculative bets on the RMB as we have seen in the past (pre Aug 2015 one-off devaluation).

It is generally not sustainable to suppress RMB weakness to this extent over a long period of time and when the CCAF is enhanced to such a huge extent (larger than what was observed during the escalation of the US-China trade war in 2018 and in May 2019). We anticipate that China could be highly motivated to push for some progress at the US-China trade talks that have been ongoing and they seem to be confident of achieving it. We anticipate that the USDCNY spot could move towards the 7.09 (nearer to the USDCNY fix that we have seen so far) in the next week as deviations typically do not last.

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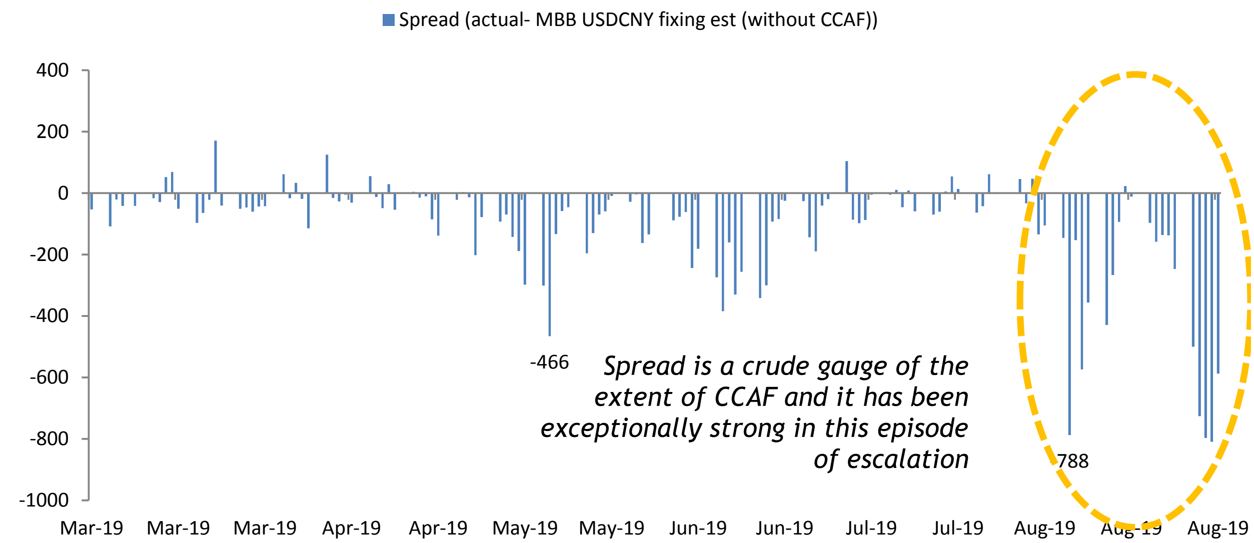
PBoC Continues To Suppress RMB Weakness

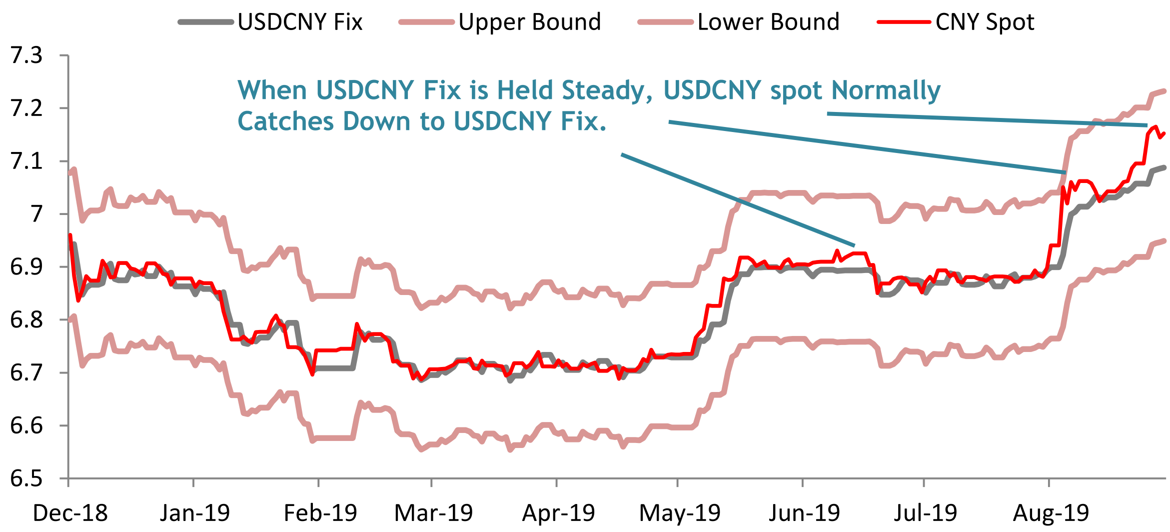


Source: *Bloomberg, Maybank FX Research & Strategy*

Deviation between USDCNY Fix And Spot Do Not Last

Generally, ever since the Aug 2015 one-off devaluation and USDCNY fixing methodology revamp, the USDCNY fix and spot prices do not deviate from each other much as the USDCNY fix is based off the close of the spot price after take into account the performance of other trading partner currencies in overnight action. Hence, typically, USDCNY fix would converge towards the USDCNY spot price. The countercyclical adjustment factor is normally enhanced in an environment of USD strength (or rather general RMB weakness) to slow the weakness in the CNY (that would feed into the CNH). So in an environment of volatility, USDCNY would be allowed to head higher (but still within the 2% trading band) but the combination of the CCAF, issuance of CNH bills and even sometimes intervention in the CNH pool would mean that USDCNY spot would eventually "catch down" with the USDCNY fix.

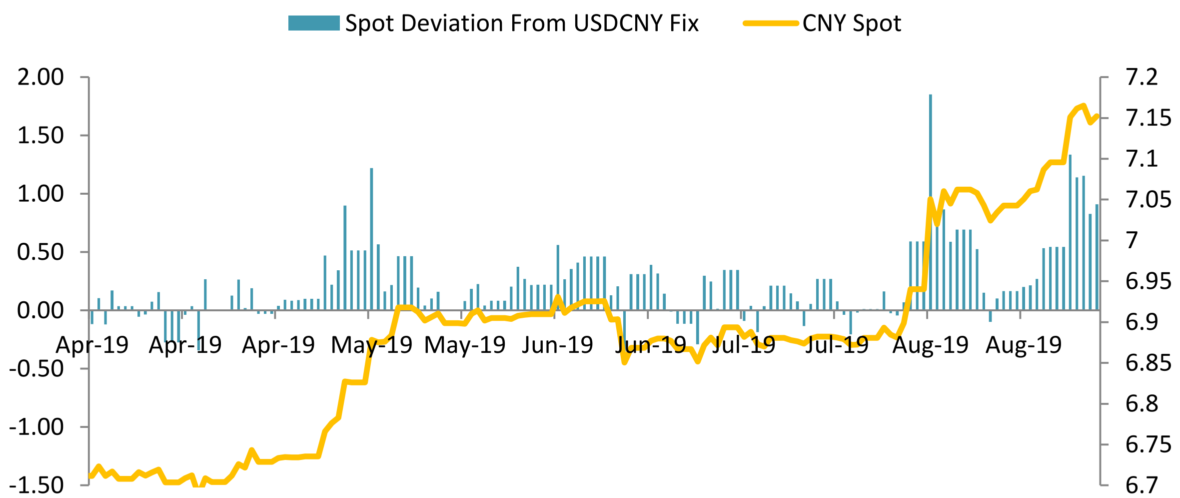
The CNY Spot Should Catch Down towards CNY fix



Source: Maybank FX Research & Strategy Estimates, Bloomberg

Since yesterday, there has been some nascent signs of positive talks but market players show signs of reservation. We think that a positive development from the US-China trade discussion is not yet in the price and the USDCNY and USDCNH may even test the 7.10 in the next week.

Spot Deviation from the USDCNY Fix Show Signs of Narrowing Already



Source: Maybank FX Research & Strategy Estimates, Bloomberg

Is Trump Motivated Enough for A Deal or at least a delay of the tariff?

We like to reiterate the possibility that the upcoming tariff could be delayed as we had noted in our FX Weekly dated 16 Aug 2019.

The timing of the re-escalation on Trump's part is so close after the Fed's decision to execute a half-hearted insurance cut that we suspect a ploy to force the Fed's hand. The recent delay in tariffs suggests that he recognizes the costs of his tariff action in terms of fanning inflation risk as well as hurting retail sales at home. As such, while we do not recognize the tariff delay to be any compromise on the part of the US or any signs of easing tension, we see potential for Trump to soften his stance with a delay in the tariff slated to take effect on 1st Sep, as a window of opportunity for the Fed to deliver its next cut then (mid of Sep). This scenario is likely not priced at all.

Technical Outlook: Bearish Divergence

There are quite a number of reasons for USDCNY to remain stable, not least of all China's 70th Founding Anniversary on 1st Oct and RMB is normally kept rather stable ahead of important events and few are as important as its own 70th National Day. So we have been of the view that 7.20 should cap the USDCNY for Sep. However, our observations of the USDCNY fix and recent comments on "removing tariffs" by China's MOFCOM spokesperson Gao suggests that progress might be even more significant this time and we look for a potential test of the 7.10. On the daily chart below for USDCNH, we spot a bearish divergence of the USDCNH spot with the MACD forest which typically precedes a downmove, coinciding with the recent hopeful rhetoric. We look for a move below support at 7.1418 and perhaps even towards the next support at 7.0772.

USDCNH Spots A Bearish Divergence

Source: Bloomberg, Maybank FX Research & Strategy

	US	China	Our View
Sep 2019	**1st Sep: US Tariff on China** Estimated $112bn of Chinese imports (untaxed) will be taxed at 15%. 18th Sep: FOMC Minutes. Fed to cut 25bps	**1st Sep: China Tariff on US:** More Tariffs on $75bn of US Goods split between 1st Sep and 15th Dec. 5% more tariff on soybeans and crude oil starting on 1st Sep.	*Tariffs are Widely Expected To Be Imposed. We see risks of these tariffs being delayed or previous ones being rolled back.*
Oct 2019	**1st: Oct: US tariff on China:** Existing 25% tariffs on some $250bn imports from China would rise to 30% on 1st Oct.	*Potential RRR Cut and MLF Rate Cut in 4Q*	
Dec 2019	**15th Dec: US tariff on China:** Estimated $160bn of Chinese imports (untaxed so far) will be taxed at 15%.	**15th Dec: China tariff on US:** More Tariffs on $75bn of US Goods split between 1st Sep and 15th Dec. The suspended extra 25% duty on US cars will resume on 15th Dec, with another 10% for some vehicles, taking total tariffs on US origin cars to be as high as 50%.	

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