

## FX Insight

# Pricing In Yuan Vagaries in ASEAN FX

### Yuan Under Pressure From Multiple Factors

Offshore yuan breached the 7-figure against the USD for the first time this year early this week, weighed by a multitude of factors including weak economic conditions, widening UST-CGB yield differentials as well as lingering geopolitical angst. We do think that bullish seasonality factor of the USD might have amplified the move of the USDCNH a tad but we are wary of attributing too much weight to seasonality this time.

Market action suggests that bearish pressure is building on the yuan with the onshore and offshore discount (or USDCNH-USDCNY premium) widening and the USDCNY fix this morning was a tad lower than estimate, suggesting some signs that the authorities are trying to slow the rate of depreciation of the yuan against the USD. IIF data also suggests that China experienced equity and bonds outflows in Apr.

We are not turning entirely negative on China's growth but a consumption-led recovery in the next half of the year (that could boost imports of goods and services) could weaken its external balance and that is net negative for the yuan. Meanwhile, we look for USD yields to come off into the second half of the year. That could provide some mitigating effect on the rise of the USDCNY and USDCNH. Pair may remain elevated within 6.90-7.20 range between 2Q-3Q 2023. Our forecasts are pencilled in to be around 7.05 for USDCNY.

Along with the forecast changes for yuan, we also adjust our forecast for some of our Asian currencies due to the trade linkages (services and goods) and spill-over sentiment effect. Strategy-wise, we see opportunities to short the CNH against the KRW and AUD.

### Analysts

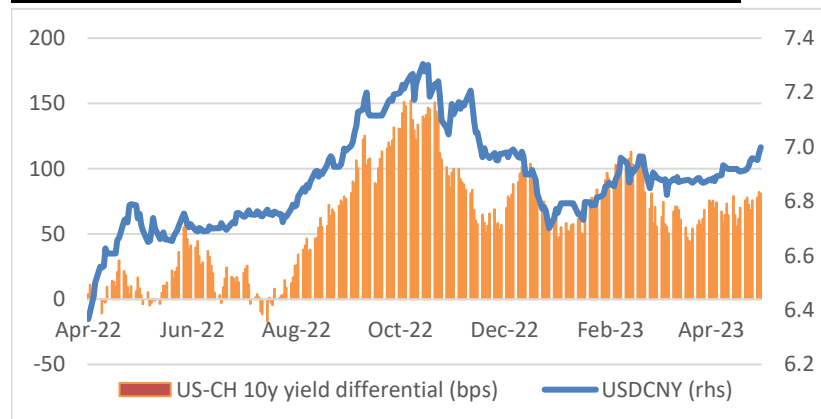
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**Chart1: USDCNY Rises as US-CH 10y yield premium Widens**



Source: Bloomberg, Maybank FX Research & Strategy

## Break of the 7

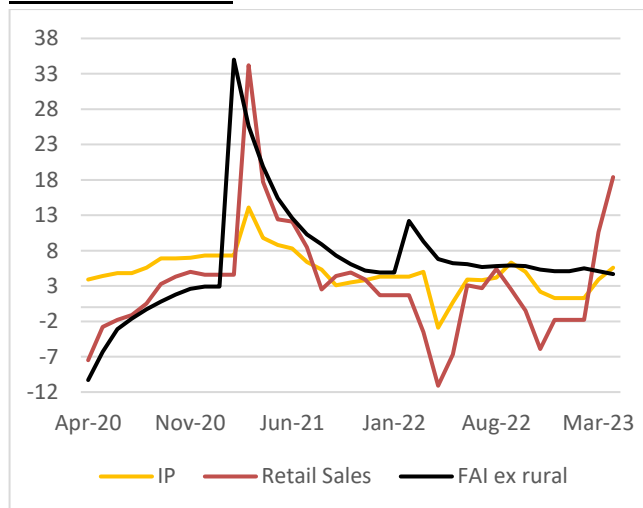
The break of the 7-figure came one day after the release of weaker activity data and in the absence of a recovery in the property sector. New home prices slowed to just 0.32m/m in Apr vs. previous 0.44%. China's activity data for Apr released on Tue (16 Jul) underscores what the credit /inflation/trade data had suggested - that domestic demand is still rather weak. Almost all measures of activity undershot consensus. Industrial production quickened to 5.6%y/y from previous 3.9%, well under the expected 10.9%. Retail sales also accelerated to 18.4%y/y from previous 10.6% (vs. expected 21.9%). Fixed assets ex rural weakened to 4.7%y/y vs. previous 5.1%. Property investment clocked a steeper decline of -6.2%y/y for Jan-Apr vs. -5.8% in 1Q (expected -5.7%).

Underwhelming data releases revived speculations of rate cuts after the 1Y medium-term lending rate and other OMO rates (key 7-day reverse repo) were kept unchanged by PBoC on Mon. This was in contrast to the hawkish Fed comments by various Fed officials this week that drove the UST yields higher. Dismal growth prospect of China at this point could render USDCNY more sensitive to swings in the UST yields.

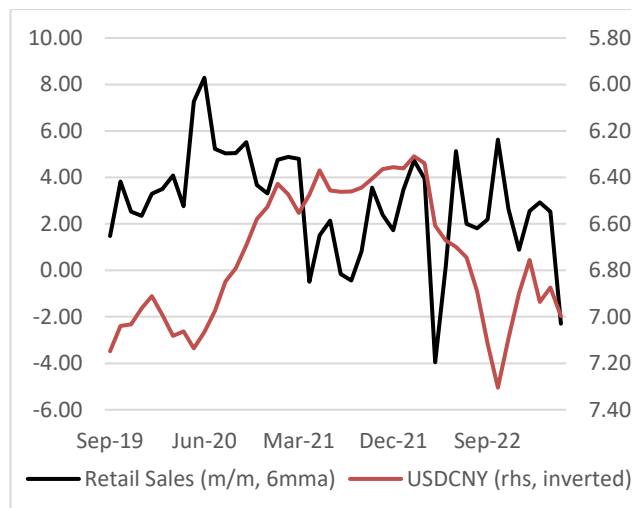
## The Bad

We bear in mind that activity data released was already propped up by the low base effects from Apr last year during the Shanghai lockdown. As such, growth momentum is even more sluggish when we look at the month-on-month figures. While retail sales clocked a growth of 18.4%y/y, retail spending actually slipped -7.5% on the month, well under the average 2.0m/m growth seen for 2022.

**Chart 2: Base Effects Flattered the Year-on-year Activity Momentum in China**



**Chart 3: Retail Sales Actually Slipped in Apr**



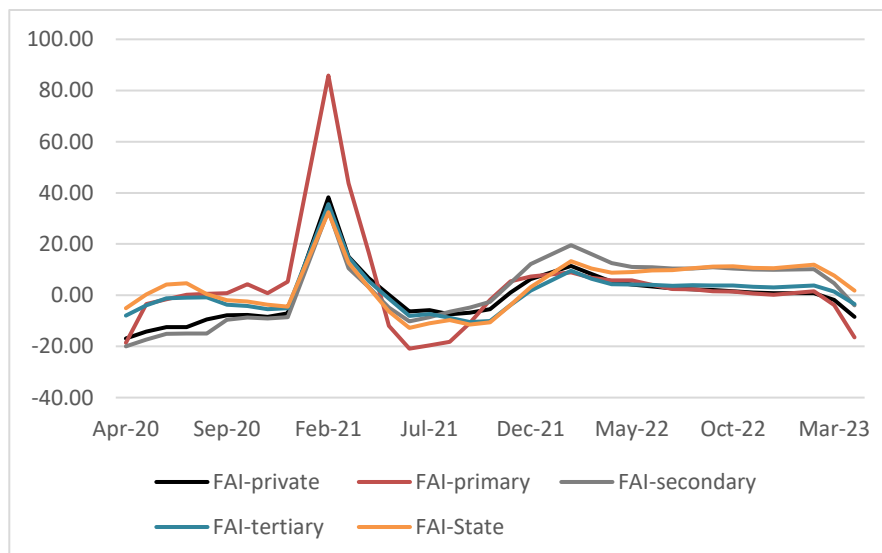
Source: Bloomberg, Macrobond, NBS, Maybank FX Research & Strategy

There was a divergence between spending on services and goods as in line with the Services PMI numbers. Spending on catering/restaurants rose around 1.08m/m in Apr but that of physical goods fell 8.76%. The overall headline was dragged lower as catering/restaurants only account for around 10% of the headline. As much as spending on the services sector could continue to hold up, a lack of recovery in the broader economy and income could eventually weigh on the services sector.

## FAI Softens Across All Sectors

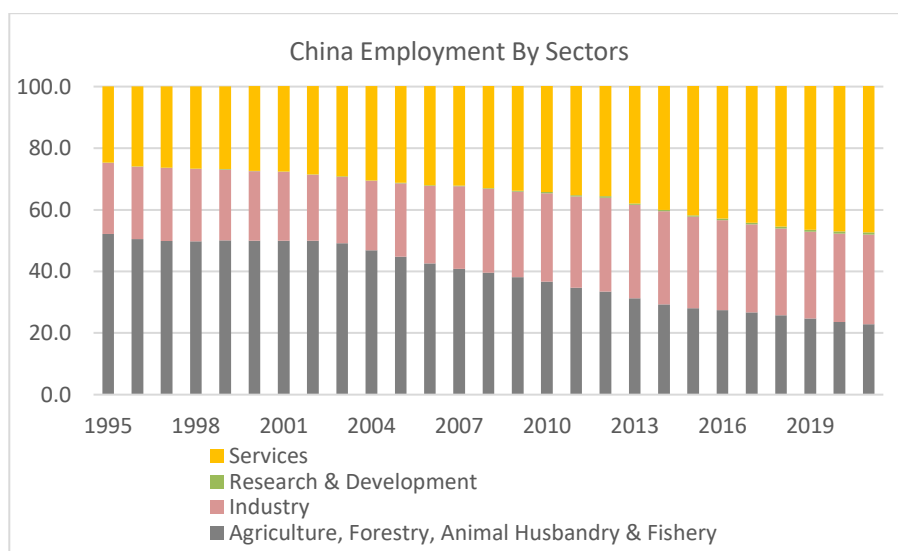
According to the NDRC report today (17 May), CNY378.4bn of fixed asset investments were approved between Jan-Apr and they were mainly in the high-tech, energy and water conservancy industries. Within Apr alone, 14 FAI projects were approved, worth CNY98bn. Yesterday, NBS statement had reiterated that the government is pledged to “create a new pattern of development and comprehensively deepen reform and opening up”. **This could mean that future government investment could remain very sector-specific and targeted.** The breakdown of the FAI released yesterday suggests that private firms have great hesitance in making fixed assets investment while non-private firms still maintained a growth of around 1.9%/y. Lower business confidence would mean hesitant hirers. Companies now remain cost conscious based on earnings report by tech conglomerates.

**Chart 4: Fixed-Asset Investments Soften**



Source: NBS

**Chart 5: The Services Sector is A Major Employer**



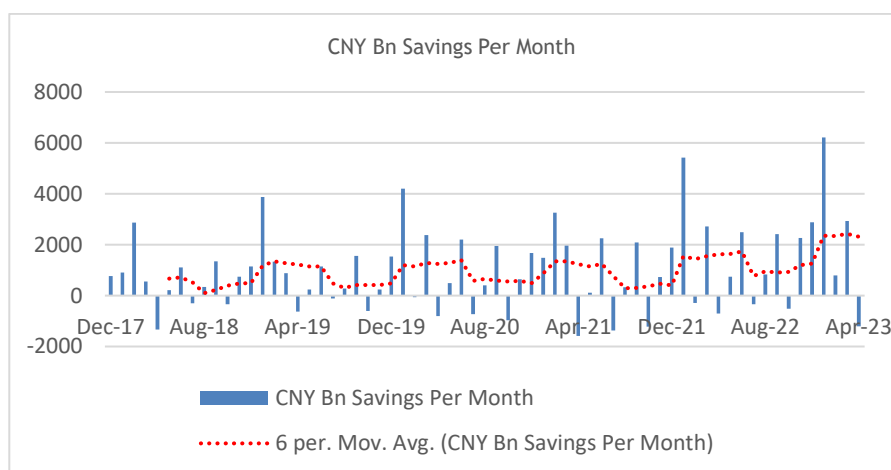
Source: NBS, Maybank FX Research & Strategy

May 18, 2023

### What We Should Also Watch

The silver lining is that the services sector is a major employer. We are cautiously optimistic that the government would act in time to prevent growth momentum from deteriorating further. Looking at the personal deposit levels, there are no signs that Chinese households have started to dip into their savings and that could still mean plenty of spending power should confidence return. **We do not rule out the possibility that Chinese households may take longer than the rest of the world to regain the confidence to spend after re-opening.**

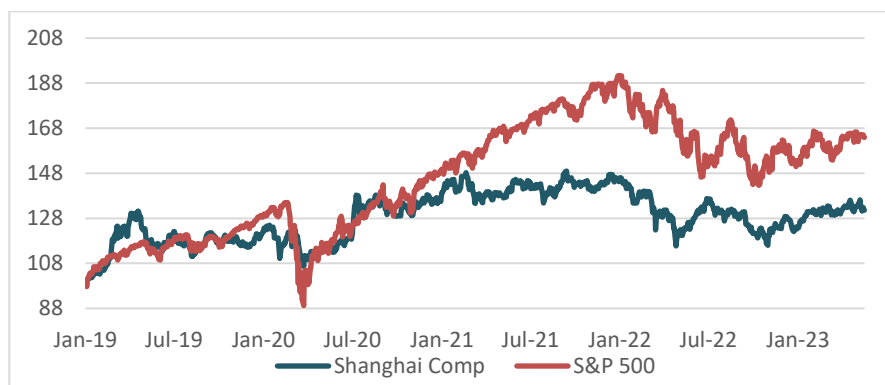
### Chart 6: Chinese Households Sit on Huge Amount of Savings



Source: PBoC

The sharp re-opening play for other countries such as the US cannot be taken as a playbook for China as residents were locked down for a longer amount of time. In the US, we witnessed equities and properties being buoyed by easy monetary policies, creating a positive wealth effect which quickly translated into strong spending upon reopening. For China however, draconian actions on the gaming, payment platforms, private education have stagnated Chinese bourses over the past few years. The property sector was also severely hit by tightened regulations to control the lending to developers. Concomitant default, project delays and zero-covid policy worsened credit conditions and dampened property demand.

### Chart 7: Shanghai Composite Stagnated in Recent Years Vs. to S&P 500



Note: Prices on 1 Jan 2019 are index to 100

Source: Bloomberg

May 18, 2023

As such, Chinese households may take longer to regain that confidence to start spending the amount of savings that was accumulated over the period of hardship and uncertainty. A rise in income would definitely help in that aspect. **While it could be too optimistic to expect strong consumption revival within the year, this high level of savings (CNY130trn) could mean that there is a limit to how much consumption can deteriorate and there is still potential for recovery.**

NBS spokesperson Fu Linghui had said that consumption recovery is still in its infancy and there is still room for improvement in residents' purchasing power and willingness to spend (SMM).

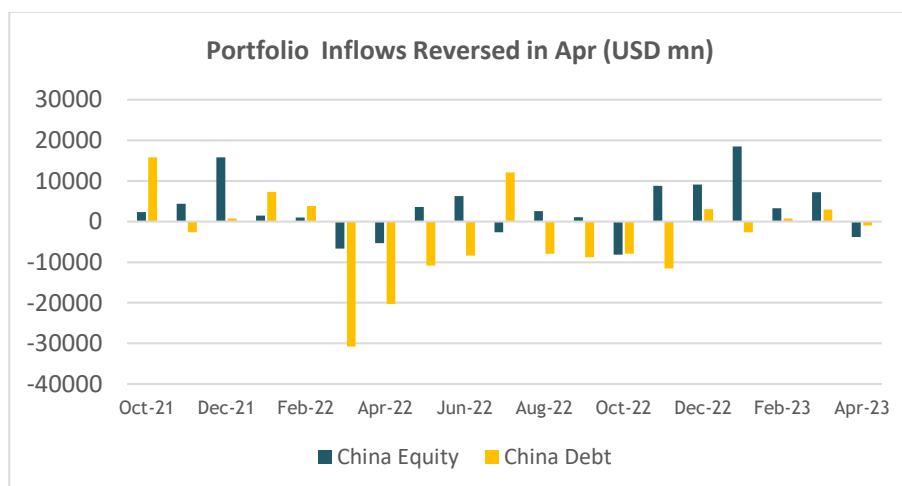
### **Implicit Easing Signals from Monetary Policy Report**

The latest monetary policy report from PBoC saw a pledge to ensure the money supply and credit remain "appropriate". There was also an omission of the key phrase "not flooding the economy with stimulus" for the first time in a few quarters. The central bank also noted that the economy is not in "deflation", Inflation was mild and may gradually rise 2H. This inflation trajectory could mean some room for PBoC to cut policy rates when it deems fit. **Monetary policy easing could be required to provide the broader demand stimulus and we expect the rate cut to come after Fed pauses in order to mitigate impact on the yuan.**

### **Geopolitical Tensions Exacerbate Yuan Weakness**

Eyes probably on G7 meeting to be held this week in Hiroshima and Japan also invited Brazil and Indonesia. Such a decision was reportedly meant to counter China. US envoy to Japan had recently tweeted that the G7 leaders may form some measures to counter China's "economic coercion". With such actions to alienate China, it is hard to believe that anything constructive could come out of recent bilateral dialogues between the US and China (Wang Yi and Jake Sullivan meeting, potential for Secretary of State Blinken visit to China, as well as upcoming Xi-Biden call). The Quad leaders will also have their discussions at the G7 meeting in Japan this weekend in place of a meeting that was cancelled.

### **Chart 8: Portfolio Flows Turned Negative as Investors Lose Faith in Re-Opening and US-China tensions continue to Simmer**



Source: IIF

## External Balance Could Deteriorate

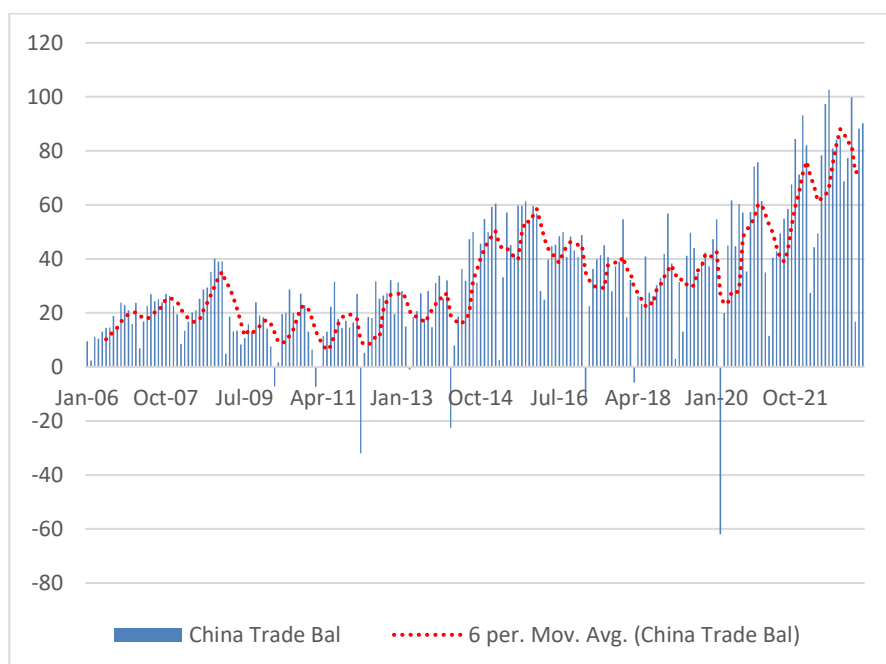
We have been more cautious on yuan's performance for 2023 as we had looked for China's trade balance to deteriorate. That has not happened thus far as weak domestic demand capped import bills. So even as exports growth had slowed in line with global growth slowdown, China's trade balance remained rather healthy thus far. We still look for consumption to potentially recover in the second half of the year, which will increase import bills and weaken its external balance. On net, that should be negative for the yuan.

**Chart 9: Exports Growth Has Been on the Decline Already Along with Global Slowdown**

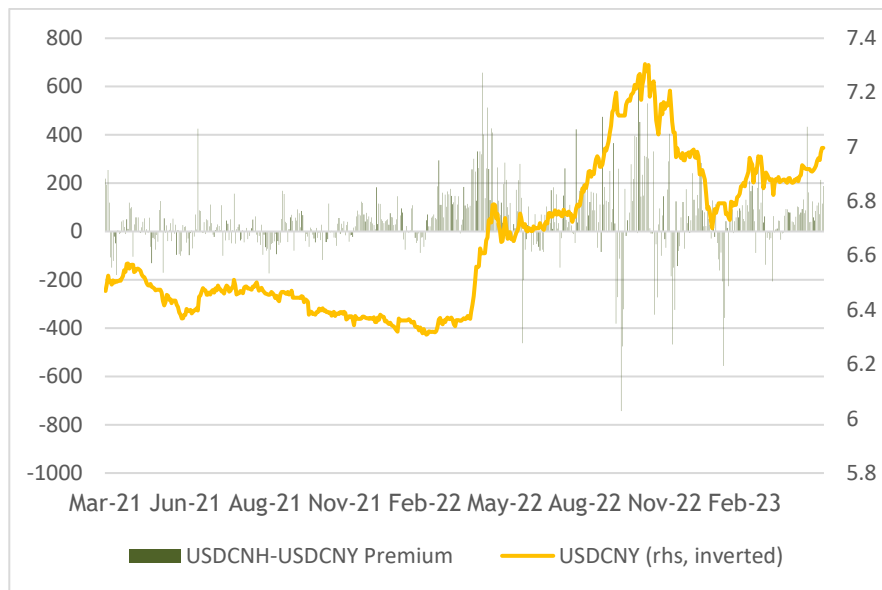


Source: OECD CLI, Bloomberg, Maybank FX Research & Strategy

**Chart 10: Trade Surplus Could Be Vulnerable**

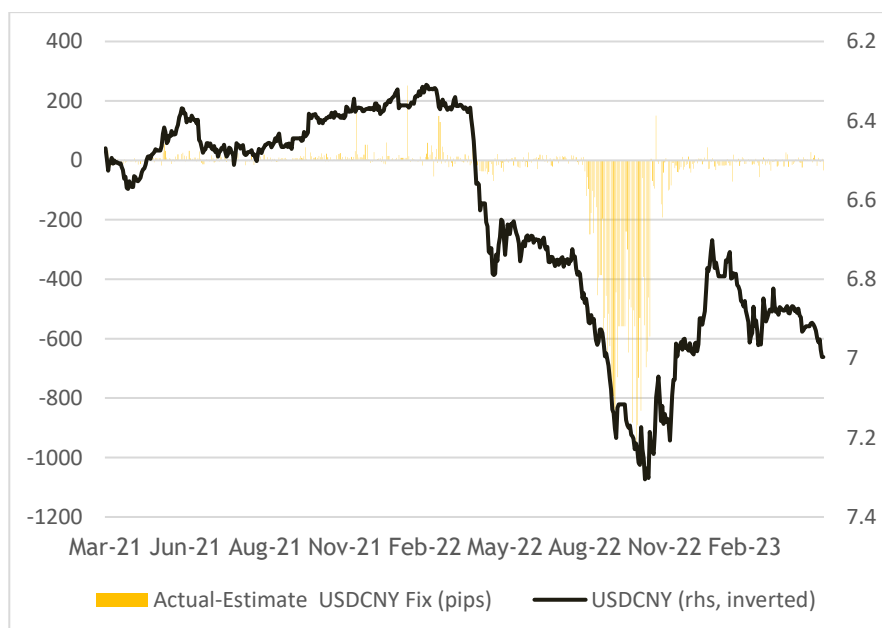


Sentiment-wise, the USDCNH-USDCNY premium has been widening, a reflection of rising bearishness on the yuan.

**Chart 10: USDCNH-USDCNY Spread Widens**

Source: Bloomberg, Maybank FX Research

However, PBoC is not that concerned. Recall that PBoC Governor Yi Gang had said that the level 7 is no longer a psychological level and that China has “largely ended currency intervention”. That said, the central bank “reserve the right” to intervene still, according to his speech at the Peterson institute for International Economics in Washington on 15 Apr. This morning (18 Jun), the USDCNY reference rate was fixed at 6.9967, around 34pips below estimates. This is still within 1 standard deviation but we detect some effort to slow the pace of the USDCNY rise.

**Chart 11: Policy Signal from Fixing is Still Mild**

Source: Bloomberg, Maybank FX Research & Strategy

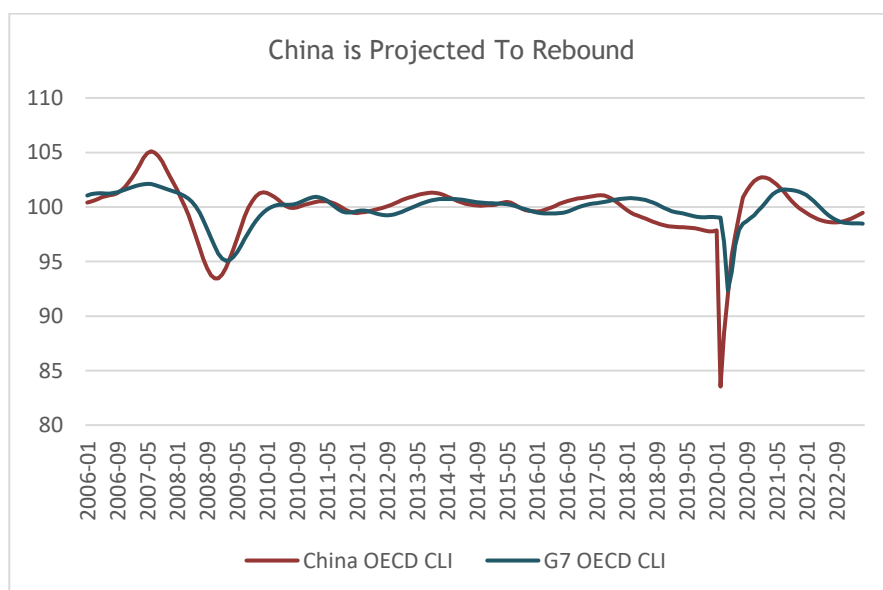
### Could this be a Repeat of 2022, 2018 or 2015?

We bear in mind that there are distinct differences between the macro environment now and what the yuan faced in 2015, 2018 and 2022. First, the Fed hiked aggressively in 2022 and there was enormous uncertainty on monetary policy. In 2015, Fed was only at the start of its hiking cycle and the UST yields ran ahead of the central bank, resulting in significant USD strength as well. In addition, USDCNY was kept steady at 6.20-level for a period of time before the one-off devaluation by PBoC via a reform of the USDCNY fixing model. That resulted in a lot of pent-up pressure on the yuan and along with the introduction of the CFETS basket, spurred significant FX volatility and uncertainties in anticipation of further FX reforms and devaluations between 2015-2016.

In 2018, Fed was well into its most aggressive stage of its hiking cycle in 2018 and US and China's trade war also created a lot of downside pressure on the yuan then.

Right now, the Fed is now near the end of its tightening cycle and we see more downside risks to US interest rates on net. Correspondingly, we expect USD to weaken a tad more into 2H. In addition, based on the OECD composite leading indicators (CLI), China could be at the cusp of a cyclical recovery. The CLI for China is based on few components namely output of chemical fertilizer, manufactured crude steel, overseas order of industrial enterprises, construction, motor vehicles and Shanghai Stock Exchange turnover and the amplitude adjusted index normally precedes turning points of business cycles with a 6-9 months lead. Based on the OECD leading indicator which bottomed out in Aug 2022, China should bottom within this quarter. In addition, tensions between the US-China are likely to remain on a slow simmer rather than a fiery fight in 2018. We see current weakness in the yuan as a coincidence of multiple pressure factors at this point.

### Chart 12: Despite the current dismal activity numbers, there are other tentative signs of Cyclical Recovery



Source: OECD



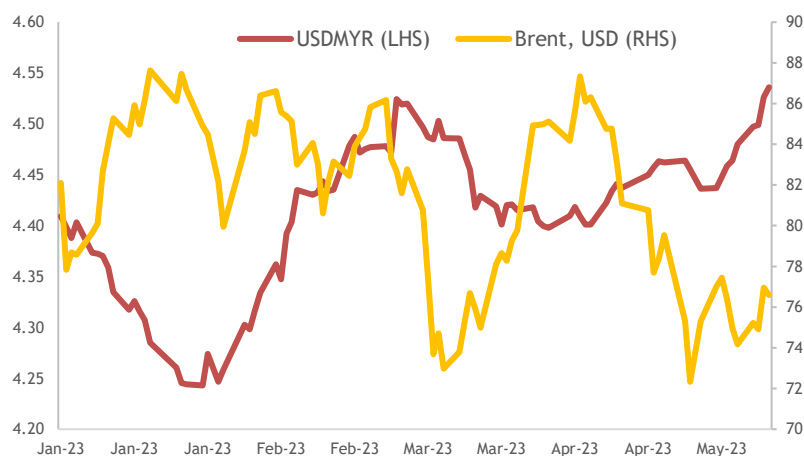
We adjust our USDCNY forecast higher to take into account the lack of recovery thus far, lingering geopolitical tensions that could crimp on yuan gains. Risks are skewed to the upside in the near-term but we are not looking for an unruly depreciation of the yuan. In fact, there is a chance for USDCNY and USDCNH to trade within the 6.90-7.20 range, given opposing forces of potential USD weakness towards the second half of the year as US growth slows further, UST yields fall that could keep the USDCNH moves on a leash. Any signs of stronger recovery for China would also start to slow net portfolio outflows.

### Other FX Forecasts Revision

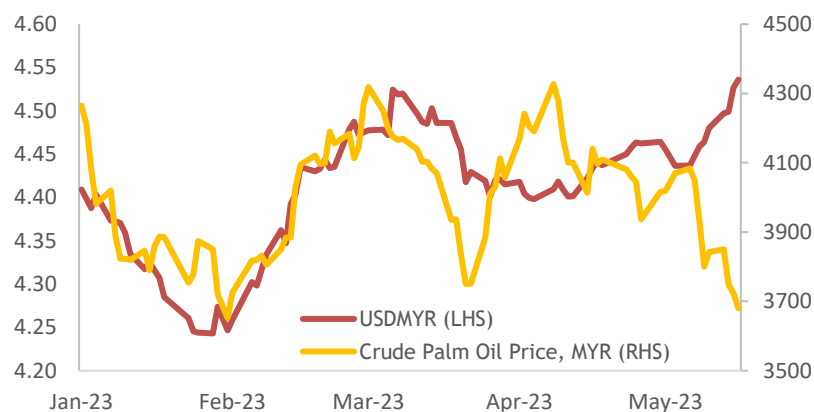
We revise our USDSGD forecasts higher to reflect the slower than expected pace of China's reopening effects and close linkages between the SGD and the CNY. Our earlier bearish USD-Asia core view remains intact, albeit implied to be at a slower pace with our forecast revision. Trade linkages between Singapore and China remain strong, as China was Singapore's largest trading partner with S\$175b of merchandise trade in 2022. In addition, SGD and CNY remained inextricably linked as we think the Yuan is one of the major components of the SGDNEER basket. We also see that movements in the CNY typically drag the SGD along in the same direction, and as such we revise our USDSGD forecasts alongside our higher USDCNY forecasts.

Concurrently, we are also revising our USDPHP, USDTHB and USDIDR forecasts upwards. However, the USDIDR forecast is seeing less of a change given that the IDR has actually been proving relatively resilient compared to many of its ASEAN peers. This has been likely due to the stronger appeal of the Indonesian Government Bonds (especially among the high yielders) given the country's resilient trade surplus and disciplined fiscal management. As for the USDTHB, the adjustments for it reflect the risk of weaker Chinese economic conditions weighing in on tourism inflows. Expectations of improved tourism inflow is seen as a driver to support the THB this year. Meanwhile, the USDPHP sees some slight adjustments as markets have already factored in a high level of weakness for the currency.

Meanwhile, we are substantially raising our USDMYR forecast due to the weaknesses in China's economy and other external factors. Weakness in China's economy can risk weighing on the MYR given the large trade exposure Malaysia has to China. In 2022 alone, trade between Malaysia and China stood at an astounding RM487.13bn or 17.1% of Malaysia's total global trade. This in fact also marked a 15.6 % increase from the previous year. Additionally, beyond just China, weaknesses in commodity prices (such as crude oil and crude palm oil) in light of increasing global economic concerns have likely affected sentiment towards the MYR in recent times. The holding up of broad USD strength is also likely to weigh on the MYR. However, we also note the risk that the MYR can face substantial gains should the global situation instead pan out more favourably.

**Chart 13: USDMYR and Brent Oil Price**

Source: Bloomberg, Maybank FX Research & Strategy

**Chart 14: USDMYR and Crude Palm Oil Price**

Source: Bloomberg, Maybank FX Research & Strategy

## Refreshed Forecasts

Forecast	2Q 2023	3Q 2023	4Q 2023	1Q 2024
USDCNY	7.05 (6.75)	7.05 (6.70)	6.95 (6.65)	6.95 (6.60)
USDCNH	7.08 (6.75)	7.08 (6.70)	6.95 (6.65)	6.95 (6.60)
USDSGD	1.3300 (1.3150)	1.3150 (1.3000)	1.3050 (1.2950)	1.3050 (1.2950)
USDMYR	4.4500 (4.3000)	4.4000 (4.2000)	4.2500 (4.1000)	4.200 (4.1000)
USDTHB	34.00 (33.50)	33.25 (33.00)	32.50 (32.25)	32.00 (31.50)

**Strategies - Prefer to Short CNH against AUD, KRW**

**Chart 15: CNHAUD Weekly: Turning bearish**

Source: Bloomberg

CNHAUD could head lower towards the 0.2122 and then towards 0.2100 (Fibonacci retracements). Momentum indicators are turning bearish with stochastics turning lower from overbought conditions. Moves have been choppy within the 0.2130-0.2160 range. We look to short the CNHAUD at reference of 0.2150 towards first target of 0.2122 and then at 0.2104, 0.2093. This is inherently due to the fact that AUD could continue to benefit from China's modest recovery, a potential ramp-up in infrastructure projects that will increase demand for its resources. Stop-loss at 0.2172 (above 23.6% Fibonacci retracement of the Jan-mar rally). Risk-reward ratio at 1:2.1.

**Chart 16: CNHKRW Daily: Short CNHKRW as Rising Trend Channel is Violated**

Source: Bloomberg

CNHKRW has violated its rising trend channel and was last seen around 189.76. We prefer to short this cross towards 190.10 for the target at

188.10 (target1) and then the next at 185.23 (target 2). Stop-loss around 192.01. Risk reward ratio at 1:2.5%.

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