March 23, 2020

RMB Watch

Weakness Against USD May Fade

RMB Has Been Rock Solid

Key Updates:

- **CNY has strengthened against most currencies, except against the USD.** CNY was not immune to the USD funding squeeze that happened for much of the past week which spurred most USDAxJ higher. CNH is still relatively resilient vs. other non-USD FX. Its TWI rose 5%ytd. Risk reward ratio suggests that market players should shift focus to the downside for USDCNH from here. With the US now clearly the latest epicenter and stimulus package not as forthcoming as investors would like, the bull-run in the USD may start to fade.
- **1Y LPR and 5Y LPR steadied at 4.05% and 4.75% respectively, in line with our out-of-consensus view.** Apart from liquidity conditions, arguable scope for easing and deleveraging priorities, we think ensuring a strong transmission mechanism is also key, especially for a newly introduced benchmark lending rate, albeit this rate should be reflective of market conditions. The lending rates and concomitantly, 1Y loan prime rate should move in tandem with the policy rates. 5Y LPR may be guided lower as the real estate market remains soft. We anticipate that a softer USD trajectory and a concomitantly less volatile CNY (vs. USD) may be a more conducive environment for rate cuts.
- **What We Watch:**
  1) The announcement of much-delayed economic targets, notably growth target. Will China stick to a V-shape recovery story and keep target at 6% for 2020?
  2) Open Market Operations and MLF. Next MLF Maturity tranche is around 16th Apr and we shall monitor for any other RRR cuts.
  3) Data Releases such as PMI-mfg for Mar on 31st Mar.

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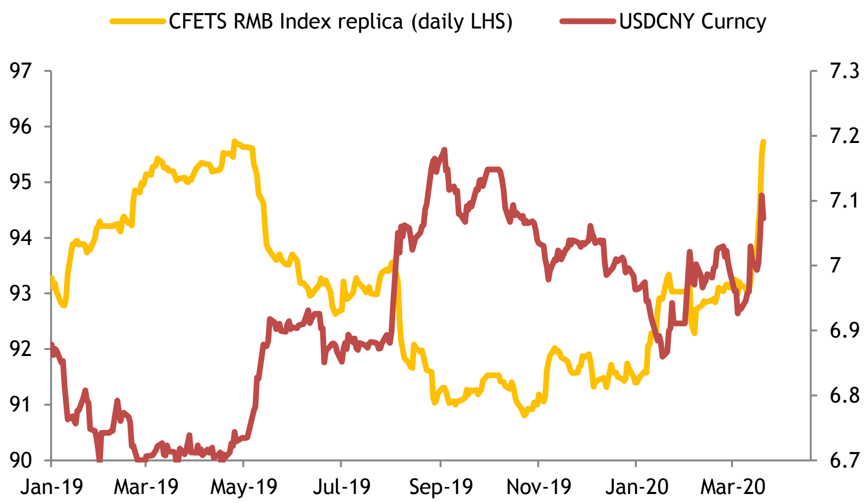
USDCNH Heads Higher, Accompanied by Surge in China's TWI

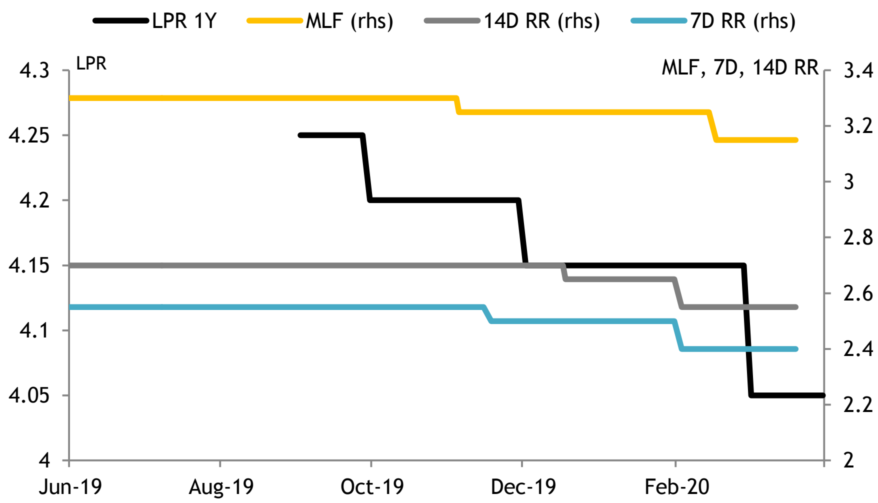


Source: Bloomberg, Maybank FX Research & Strategy

Fed Brings Relief With More USD Swap Lines

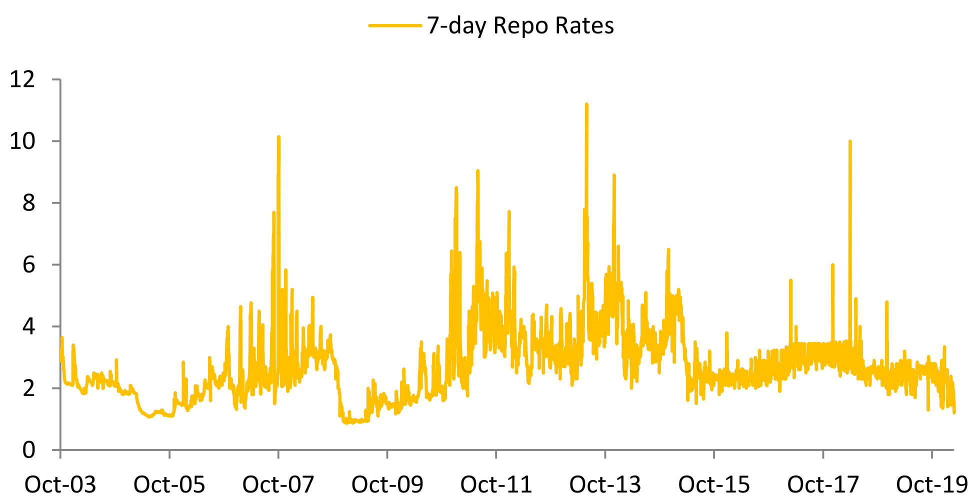
RMB has been resilient against most currencies, with the exception of the USD, bringing to fruition our call for USDCNH to head higher past our month end forecast of 7.08. As we have noted before, CNH was not immune to the USD funding stresses that saw USD strengthen broadly against most other currencies, in tandem with the surge in 10y yield. Fed has been working hard, implementing measures after measures almost every other day and it took the expansion of USD swap facilities to nine other countries (announced 19th Mar) apart from the original five (BoE, BOC, BoJ, ECB and SNB) to calm much of USDAsians including USDCNH today. The swap lines vary in terms of amounts with some up to $30bn and others up to $60bn. Regional sentiment was buoyed today and USDCNH slipped from a high of 7.1653 seen yesterday to sub-7.10 levels as we write. We feel it could still be pre-mature to declare the end of the bull-run for the USD.

LPR Rates Unchanged, In line with Our Contrarion View



Source: Maybank FX Research & Strategy, Bloomberg, PBoC

The LPR for 1Y and 5Y steadied at 4.05% and 4.75% respectively for Mar. This is in line with our expectations stated here, an out of consensus view. In the last RMB Watch on 9 Mar, we noted the lack of OMOs recently as liquidity for onshore seems rather ample. (Just today, 7-day repo rates have descended to recent low of around 1.56%) Hence, we did not look for any cut to the policy tools to guide the loan prime rates lower.



We stand by our view stated on 9 Mar that "A pause in the rate action would probably **send a signal of prudence** that PBoC has been emphasizing even as the monetary policy is supposed to be more "flexible". This could ensure that market players and corporates would not overleverage in anticipation of deep rate cuts. Focus at this point is perhaps on the deposit rate cuts so that net interest margins for banks at home would not deteriorate too much after the lending rates were guided lower."

One can argue that China's debt level is unsustainable and that limits PBoC's scope to ease much more. More importantly, we would like to think that while LPR is meant to be a benchmark lending rate for the 18 banks and should be reflective of market conditions, the transmission mechanism of the policy rates to the real economy via the LPR must be carefully managed, especially for a newly-introduced benchmark rate. As such, we continue to monitor for any policy action via the reverse repo rates (mainly 7D and 14D) as well as the MLF rates. Within Mar, open market operations were scant and there was only 1 medium term facility (MLF) conducted on 16th Mar, and the 1Y MLF rate was unchanged at 3.15%, already a signal for banks to keep their lending rates to their best clients unchanged. 1Y LPR is thus at 4.15%. **The next MLF maturity is on 16th Apr (around CNY200bn) and we expect the next MLF to be conducted then. We can monitor if the PBoC will act to ease rates further then.**

Another condition for PBoC to ease is the stability of CNY against the USD. The central bank might prefer to guide lending rates lower in an environment of stable USDCNY as opposed to an environment of market volatility and surging US rates. This is so that the rate action would not risk inducing more volatility in the FX market.

Targeted RRR Cut Takes Effect on 16th Mar, More Should Come

Even as rates were not eased this month and open market operations were not provided much, **China decided to provide liquidity in a more structural approach - by lowering targeted RRR rate last Fri.** The targeted RRR cut took effect on Mon (16th Mar). The RRR was lowered by (0.5 to 1ppt) to banks under inclusive finance scheme and an additional 1ppt for joint stock banks. The central bank also said that CNY550bn was released to the banking system because of the fall in RRR. The required reserve ratio is now at 11% for large banks and 9% for joint stock commercial banks.

Just today, PBoC adviser told Shanghai Securities News that the central bank still has "relatively large" room to lower banks' reserve requirement to stabilize the Chinese economy and it can conduct more open market operations. He added that it takes time for RRR cut to be transmitted to the LPR which does suggest that PBoC is still on easing mode and the OMOs and 1Y MLF may also be eased in tandem as China continues to get its production level to normalize and its banks to lend.

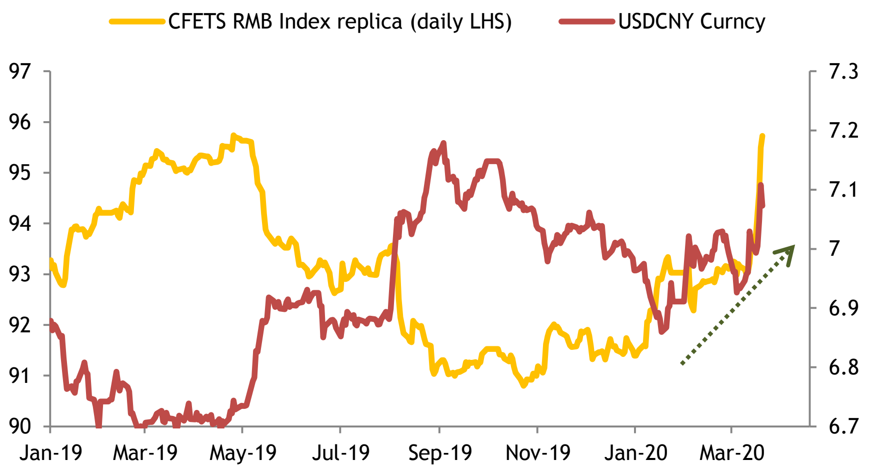
Eyes are also on the much-delayed economic targets for 2020. The Two Sessions were postponed from 5 Mar this year indefinitely due to the COVID-19 outbreak. There had been plenty of expectations for China to lower the growth target from 6%.

We also look for signs of recovery such as the PMI-mfg prints out of China for Mar.

What Drives the RMB Now?

The currency is displaying a lot of resilience against other currencies even as the CNY weaken against the USD. This is basically due to the fact that China seems to have successfully contained the coronavirus and it is on its way to recovery, in contrast to economies in other parts of the world that are still in the stage of suppression and lockdowns. In addition, PBoC has been allowing the USDCNY reference rate to be fixed higher, in tandem with market expectations.

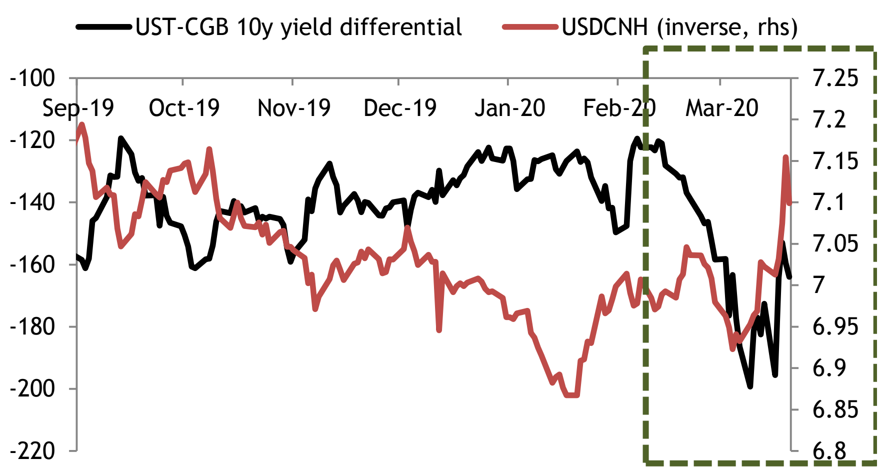
CNY strengthened in tandem with the USD, Behaving like a Safe Haven



Source: Bloomberg, Maybank FX Research & Strategy

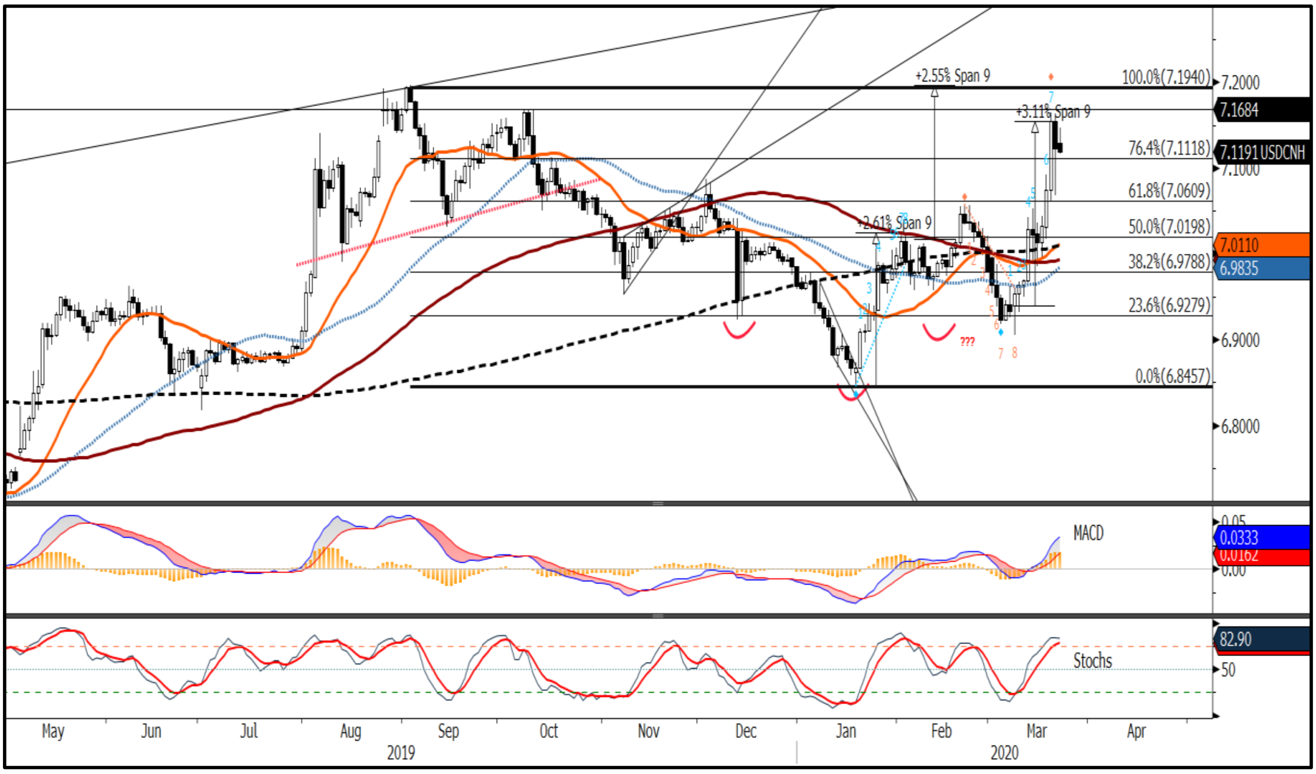
On top of that, the CNY retains a relatively decent carry appeal against the rising USD. This, we have noted before in our previous RMB Watch. While the USDCNH does not always have a strong correlation with the USD-CGB 10y yield differential, recent moves suggest that yield differential matters more now. Surge in US rates narrowed the negative yield differentials of the UST vs. the CGB and lifted the USDCNH. As US rates stabilize, so has the depreciation on the CNY.

USDCNH Might be More Affected by Yield Differentials Than Before



Source: Maybank FX Research & Strategy, Bloomberg

USDCNH (Daily) – Bullish Move Plays Out



Source: Bloomberg

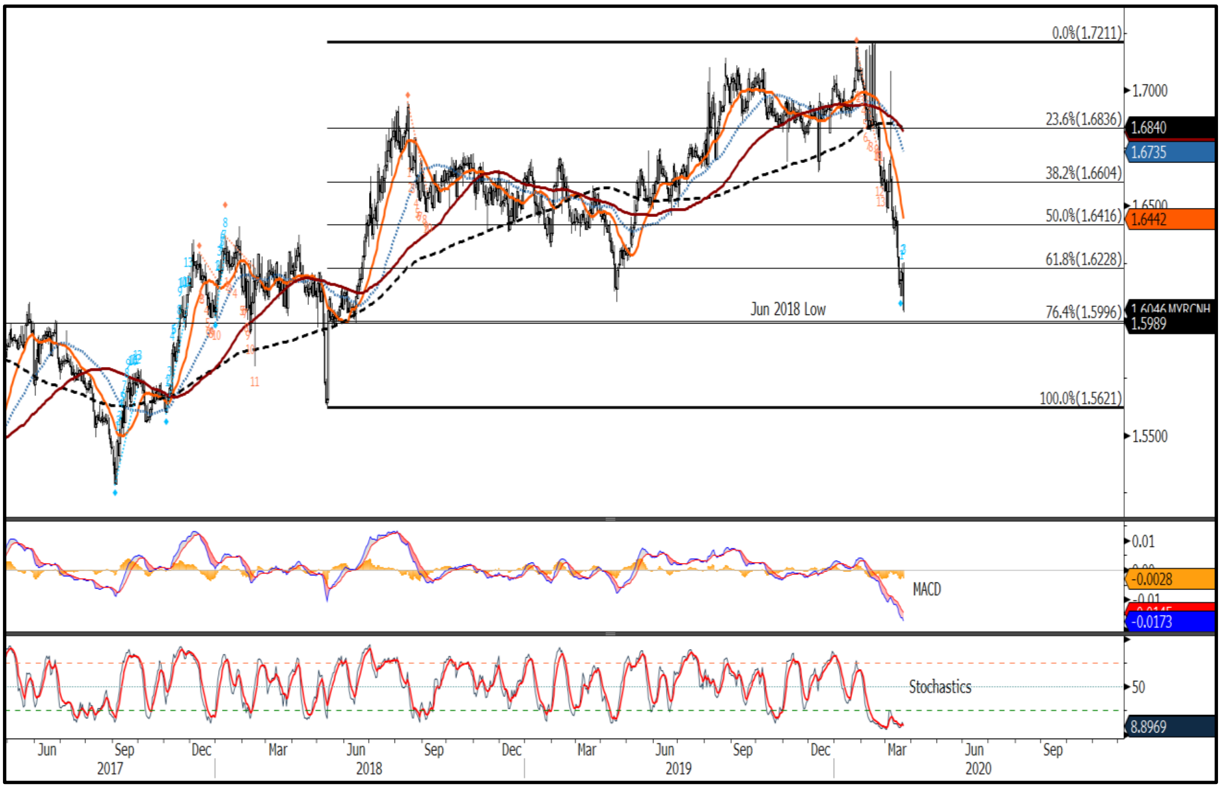
As warned in the last issue of RMB Watch, we were seeing some signs of turning for the USDCNH on 9th Mar. Since then, USDCNH has risen around 3%. The bearish price action is rather aggressive in the more recent sessions and stochastics show signs of turning from overbought condition. Support around 7.11 is back in focus and the next is seen around 7.06/02. Risk reward ratio suggests that anyone who wants to bet on this pair should shift focus to the downside. This is especially in light of the surge in the cases in the US with Worldometer reporting more than 33K cases at last sight. With US now clearly the latest epicenter and stimulus package not as forthcoming as investors would like, the bull-run in the USD may start to fade. For the USDCNH, momentum is still bullish, but waning.

SGDCNH - Downside Bias Still, but Bullish divergence

Source: Bloomberg

SGDCNH unfortunately slipped even more over the past two weeks, contrary to our expectations. We do see signs of bullish divergence with the MACD forest (the most recent trough of the MACD forest was higher while the recent low of SGDCNH). Bias is to the downside for now, based on the momentum indicators. That said, we do not rule out rebound towards the 4.9565 resistance before the next resistance at the 5-figure. Support at recent low of 4.8867 before the next at 4.8330 (76.4% fibo retracement of the 2018-2019 rally)

MYRCNH - Bullish Divergence Here Too



Source: Bloomberg

This cross remains biased to the downside at this point. There is also sign of a bullish divergence of MACD forest and Stochastics with the price action but price action this morning suggests that bias is still to the downside. Strong support at 1.6000 (Jun 2018 low and 76.4% Fibonacci retracement of the 2018-2020 rally). Beyond this level, 1.5630 is another support level (2018 low). Rebounds to meet resistance at 1.6360 before 1.6520.

Upcoming Events to Watch in The Next Fortnight

27th Mar	- Industrial Profits (Feb)
27th Mar	- BOP Current Account Balance (4Q)
31st Mar	- Mfg, Non-Mfg and Composite PMI (Mar)
4th Apr	- CPI and PPI (Mar)

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