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Global

RMB Watch

RMB Bears Hesitate in the Face of Tariff Threats

RMB Bears Not Quite Taken Over Yet

Key View:

- Trump threatened tariffs as the "ultimate punishment for China". If he calls off the trade deal, the US can reinstate tariffs for $112bn of Chinese imports (that took effect on 1st Sep 2019) from 7.5% to original 15%, impose tariffs to almost all of Chinese imports to the US from current 68% (originally set to take effect 15 Dec 2019) or to raise the 25% tariff on $250bn of Chinese imports (meant to happen on 15th Oct 2019).

- However, faced with an unprecedented scale of layoffs, weak consumer and business sentiment and a deeply contracting manufacturing sector based on ISM mfg prints, Trump may find it harder to follow through with his threats unlike the environment in 2018/19. Instead, we see the recent threats as an attempt to shore up his political support.

- USDCNH reacted swiftly last Fri but this pair is back around the 7.13-figure. We eye the USDCNY fix by the PBoC on Wed for its willingness to allow RMB weakness. Key resistance is at 7.1680 for the USDCNH. A failure to breach that could shift focus to the downside.

Data We Watch:

- Caixin Apr China PMI Services, trade for Apr on 7th May,

- BoP current account balance for 1Q

- Aggregate financing, Money supply, new yuan loans for Apr on 10-15th May.

- CPI, PPI on 12th May

- Activity Data for Apr on 15th.

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SEE PAGE 7 FOR IMPORTANT DISCLOSURES

Trump Threatens Tariffs as Punishment for China

A supposed 15-page dossier, documented by Five-Eyes intelligence alliance was leaked to The Saturday Telegraph. The paper suggests that China had lied about human-to-human transmission of the virus, eradicate evidence of it in laboratories, refuse to provide live samples to aid foreign scientists' efforts on a vaccine and allowed millions of people to leave Wuhan after the outbreak before the lockdown on 23 Jan. The Five Eyes is an intelligence alliance that comprise of Australia, Canada, New Zealand, the United Kingdom and the United States.

Armed with evidence that the COVID-19 came from a laboratory in Wuhan (likely to be based on the leaked research paper), Trump threatened to impose more tariffs on China as "the ultimate punishment" and said that the deal would be off if China does not keep up with its purchases.

In the absence of onshore yuan, USDCNH rallied to a high of 7.14 last Fri and charged on to a high of 7.1561 on Mon morning (4th of May) before being pushed under the 7.13-figure by late Asian session. Memories of 2018/19 trade war are still fresh on our minds, along with the concomitant significant weakness in the RMB. Fears of a potential trade war could continue to keep the CNH on the backfoot against the USD.

So What Could Trump Do?

We revisit where Trump and Xi had left off in Jan this year to have a sense of what he may do by using the 2019 trade war script.

The making of the US-China Trade Deal phase 1 took a few months. Within those few months (around Oct 2019 –Jan 2020),

1) the scheduled tariff increase on $250bn of Chinese imports from 25% to 30% that was supposed to take effect on 15 Oct 2019 was cancelled;

2) the plan to impose another 15% on $160bn of Chinese imports on 15th Dec 2019 was also delayed. That was later scrapped on 15th Jan when the phase 1 of the US-china trade deal was inked.

3) Part of the pact also provided for the US to half the tariffs from 15% to 7.5% on an estimated $112bn of Chinese imports that took effect on 1st Sep 2019.

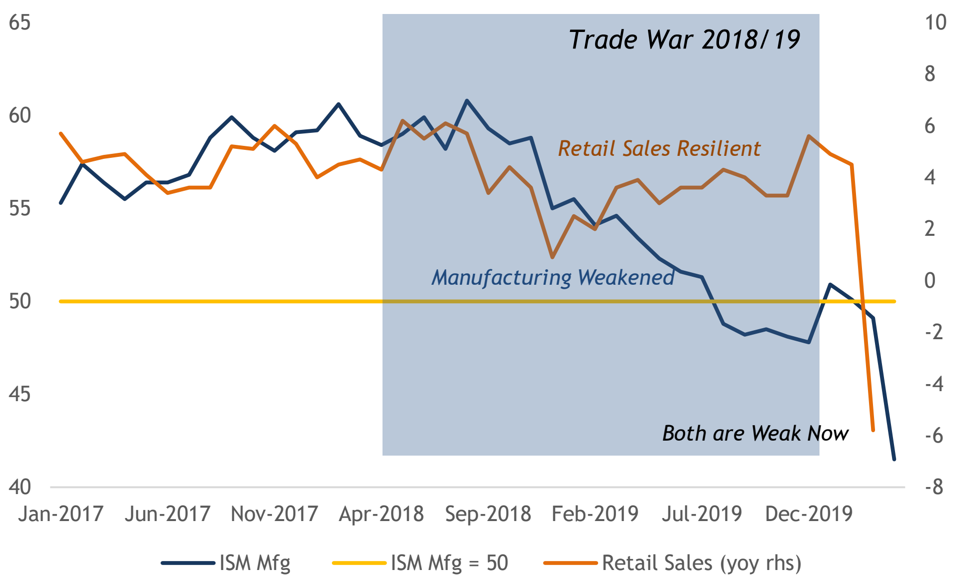
So, based on what was worked on before, Trump could reinstate these three tariff actions that were either scrapped or unwound when the two nations started to work on the deal in the 4Q of 2019.

Apart from the US tariffs, Trump administration had considered limiting US investors' portfolio flows into China as a retaliatory action last year. Elsewhere, given the COVID-19 pandemic and National Emergency Act invoked, Trump can also tap on the International Emergency Economic Powers Act to block transactions and freeze assets. This could potentially enable the US to renege on its interest payments to China for its UST holdings without being recognized as a default.

But, Can the US Withstand Another Trade War?

Trump launched the trade war in 2018 when jobless rate has just slipped under the 4.0%-level (around a two-decade low) and growth was being bolstered to full steam by tax reforms. The tariffs then mainly targeted intermediate goods and thus, the impact was felt more acutely in the manufacturing sector while the US consumer remained a pillar of the economy.

US Manufacturing Was Hurt by Trade War but Consumption was Resilient



Source: US Census Bureau, Bloomberg, Maybank FX Research & Strategy

With manufacturing already weakened by the earlier phases of trade war, ISM Mfg is now in deep contraction from COVID-19. The environment is now vastly different as the global economy was severely hurt by Covid-19. Most of the tariffs scrapped in 4Q 2019 would have affected consumer and capital goods. It is thus difficult to imagine how the Trump administration would inflict more pain on the economy at a time where the US has already witnessed a massive scale of layoffs (>20mn) amid the shutdowns of non-essential businesses across the country. Concerns about current and future income sank consumer sentiment. The University of Michigan final sentiment index for Apr slumped 17.3 to 2011-low of 71.8. A tariff action on Chinese imports of consumer and capital goods could worsen the already weak household spending and capex.

Possible Scenario of All Bark and No Bite

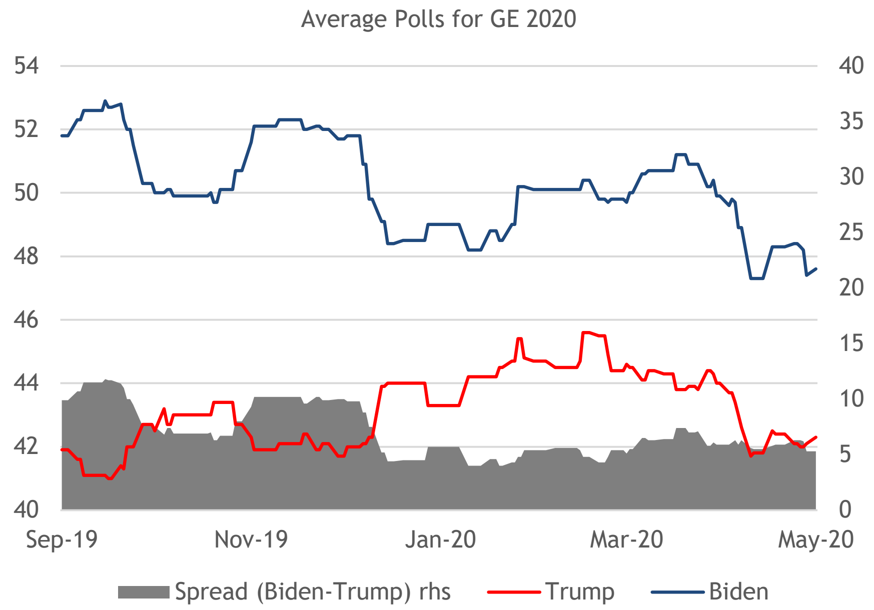
From the economic perspective, it is hard to be convinced that Trump would go ahead with more tariffs on China – the major economy that is ahead of the rest of the world in terms of Covid-19 normalization. China may also boost the recovery of other countries as more starts to jumpstart their economies from variants of shutdown/lockdowns. A curtailment of its recovery would also affect the pace of recovery in other parts of the world and we are still in a fragile phase of re-opening where coordination rather than conflict is more constructive in virus containment.

Trump had a few tweets around the time of fresh tariff threats.

“Fake Polling, just like 2016 (but worse!)” – 30 Apr 2020.

He seems to be referring to the polls statistics tabulated by *Real Clear Politics* on the General Election that showed a 5.3point advantage that presumptive Democratic Presidential Nominee Joe Biden have over him.

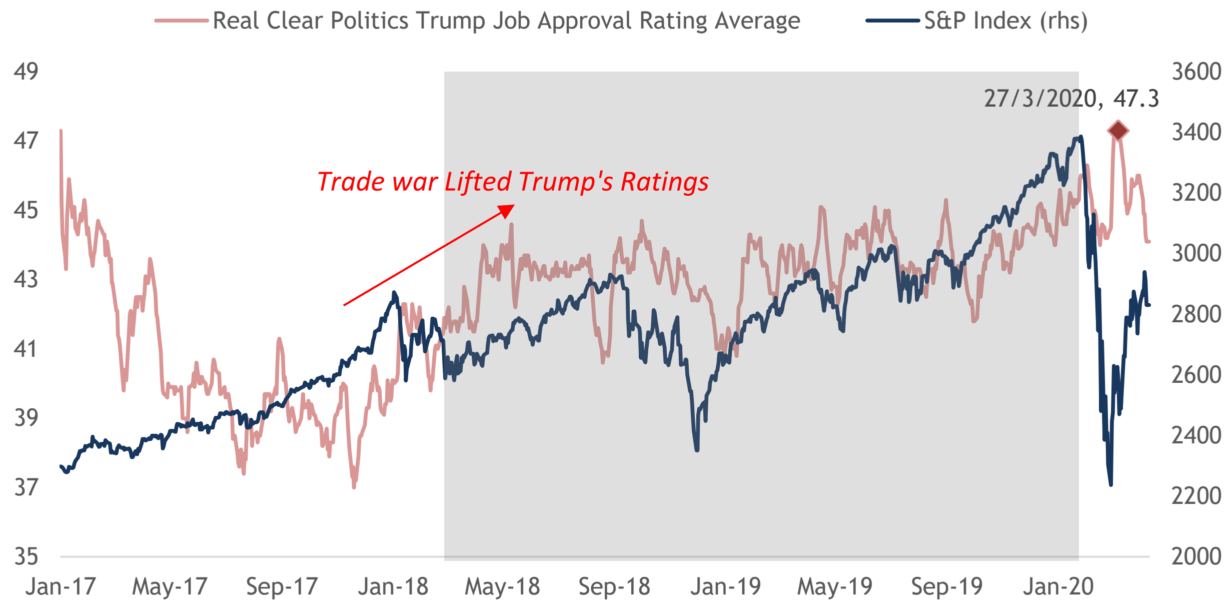
Joe Biden Has A Higher Poll Rating for GE2020



Source: Real Clear Politics, Bloomberg, Maybank FX Research & Strategy

Trump’s job approval rating had also slipped from its Mar highs as death tolls from Covid-19 rose at home. Poll results typically vary as the recent release by Gallup showed a surge in the approval ratings for Trump, which was a sharp rebound to 49% vs the dismal print of 43.0 in the previous release (a fortnight ago).

Trump’s Trade War Lifted his Ratings in 2018



Source: Real Clear Politics, Bloomberg, Maybank FX Research & Strategy

Regardless of the swings of the approval ratings and where it sits at this point, **Trump had benefitted from a trade war that he launched which kept his ratings rather steady for 2018-2019 as shown in the chart above.** His approval rating had fallen for much of 2017 into 2018. Into the rest of the year, there is a real chance that he may want to proclaim another trade war as a way to boost his rating in view of the upcoming election but severe economic data could keep him from following through unlike 2018-19.

More Calls for Probe May Soften China's Defensive Stance and Stem Conflicts

As we have mentioned in our previous RMB Watch dated 20 Apr, UK, Australia and US were urging for independent probes in the origination/causes of the coronavirus and we saw risks of a revival of the trade war then. Insofar, China has denied allegations that the country has intended for the virus to spread beyond the borders. In reaction to calls by Australia for an independent probe into the causes of the coronavirus, Chinese officials have accused Australia of "cooperating with the US in its propaganda war against China". China's ambassador to Australia also warned of boycotts by Chinese citizens in terms of tourism, education and even Australian goods.

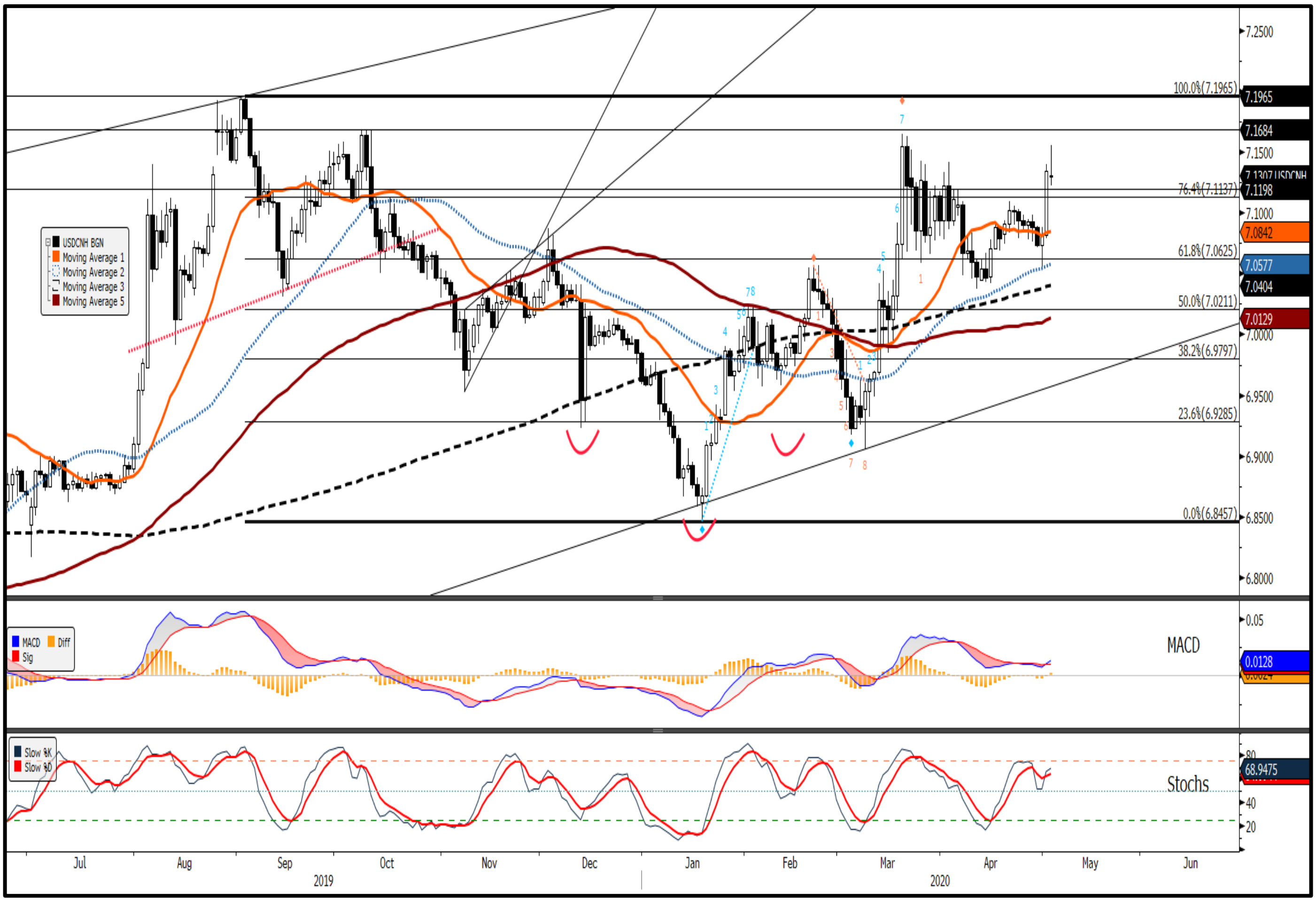
More nations are asking for an investigation including some European nations such as Sweden and even EU Chief Ursula von der Leyen. If China can change its response from a defensive stance to a more open, collaborative one, the geopolitical tension could ease.

Back to the RMB

Trump's determination to fault China for its lack of transparency could mean further deterioration in US-China relations. As such, some risk premium in the RMB could still be sustained. However, the uncertainty of how this could unfold is significant and we look for other clues such as the USDCNY fix.

The daily USDCNY Fix is always a good gauge on how willing the central bank allows the currency to weaken. USDCNH made a U-turn from today and ended as a doji, suggesting that bearish forces on the CNH could be curbed by an anticipation of the PBoC fix on Wed. A weak countercyclical adjustment factor would inherently be China's green light for more weakness in the currency. This would in turn suggest that a near-term resolution to the conflict is not likely and the central bank would allow market drivers to drive the RMB lower as opposed to propping up the RMB for an indefinite period that would see depreciation pressures on the currency to accumulate unsustainably. USDCNH moves insofar seem to suggest that market players expect China to prop up the RMB. PBoC tends to prefer some stability in the RMB when the central bank eases monetary policy.

USDCNH – Double Topped?



Eyes are on the key resistance at the 7.1680. The doji formed for today also suggests that the bulls have not gained the upper hand yet. The failure to break the 7.1680 resistance could mean a probable double top, a bearish price set-up. Break there could open the way towards 7.1965. Support is seen around 7.1137 (76.4% Fibonacci retracement of the Aug-Jan fall) before the next at 7.0625 (61.8% fibo, 50-dma). Momentum is mild.

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