Macro | FX Research & Strategy

Global

RMB Watch

Macro Could Remain Supportive, Watch Other Risks

Fundamentals Underpin but We watch US Elections Risks

Key View:

- USDCNH dropped to close below the 6.70-figure last week. Bias is to the downside as investors continue to expect a macro improvement, especially from the activity numbers due today. Latest IMF projections have been supportive of RMB sentiment along with its carry advantage. Hence, the appreciation bias was not swayed much, even as PBoC injected a little bit of drama with the lowering of risk reserve requirement for FX forward from 20% back to 0%.

- While there are plenty of underpinnings for the RMB, we do watch for risks from the US elections that could inject more volatility. Afterall, the likelihood of a Biden-win is well priced and any significant narrowing of Biden-lead or signs of a Trump-lead on polling day could ease some downside pressure on the USDCNH. In the week ahead, we have the last Presidential Debate on 22nd Oct. The fact that Biden's lead rose to record high after the last Presidential Debate (albeit with concomitant effect of Trump's contraction of the COVID-19 virus) suggests that debates can still have an impact on votes. In addition, USDCNH could also react if sentiment sour a tad more drastically even as it had shown resilience of late.

- As for SGDCNH and MYRCNH, crosses are still bearish bias but MYRCNH seems to have a small chance of rebounding in the near-term. For SGDCNH, next support is seen at 4.9172 before the Mar low at 4.8588. For MYRCNH, rebound could meet resistance around 1.6240 while support is at 1.6074 before 1.5940.

- What We Watch:
  - 20th Oct - 1Y and 5Y LPR (no change expected, MLF unchanged)
  - 22nd Oct - Swift Global Payments CNY, US Presidential Debate
  - 23rd Oct - FX Net settlement - Clients CNY
  - 26 – 29th Oct – China CPC Plenary Session
  - 27th Oct - Industrial Profits (Sep)
  - 31st Oct - Mfg PMI, Non-Mfg PMI (Oct)
  - 2nd Nov - Caixin Mfg, Services PMI (Oct)

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Where Has USDCNH Been?

Bias is still to the downside even though there has been plenty of excitement since the return of onshore from Golden Week break. Two-way action was encouraged when PBoC lowered the 20% reserves required to 0%. However, as we have stated in the note before, this seems to be more like a brake rather than a forced U-turn.

RMB Bulls Still In Charge

USDCNH closed under the 6.70-figure, a second time last week. This pair has been trading within a falling trend channel in spite of some signs that PBoC prefers a less rapid appreciation pace for the RMB. The removal of the rather punitive 20% reserve requirement for FX Forwards was taken as a signal that the central bank desires to slow the pace of is appreciation. The USDCNY fix on 12 Oct was also a tad higher than median estimates polled by Bloomberg **but the rest of the week saw the USDCNY reference rate fixed close to expectations.**

Why Was There A RRR for Derivatives In the First Place?

Quick historical recap:

PBoC first introduced reserves for purchases of all currency derivatives with effect in Oct 2015. This came after the 11 Aug currency devaluation that precipitated a 12% depreciation against the USD thereafter. Reserve ratio set at 20% of nominal value of forwards and swap contracts and fixed at 10% of the nominal value of principals for options.

Roughly 2 years after in Sep 2017, the required reserve was lowered back to zero when depreciation pressure on RMB dissipated.

In Aug 2018, the PBoC raised the foreign exchange risk reserve ratio on currency forwards back to 20% at the height of trade war. That was a period in which CNY was (again) under great depreciation pressure. According to the statement at that time, the new policy is intended to *"prevent macro financial risks and help financial institutions operate in a healthy and stable manner"*. In order words, the pressure on CNY was so great that it was starting to threaten the financial markets stability and the central bank wanted to prevent any systemic risks that could come from other consequences such as capital outflows.

As can be seen, the reserves requirement on derivatives has a history of being imposed when environment becomes threatening for RMB and removed thereafter.

The reversal of the reserve requirement for FX forwards also came in the backdrop of a widening Biden-lead. As we have noted before, a Biden-win may not make US friendlier towards China but rather, less combative similar to Obama's era. A Biden-presidency is unlikely to see a mention of trade war or tariffs at all because Biden is likely to distant himself from Trump. A US administration that chooses dialogue rather than unilateral tariffs is thus perceived as less threatening to RMB.

Eyes Remain on Where PBoC Sets USDCNY Reference Rates

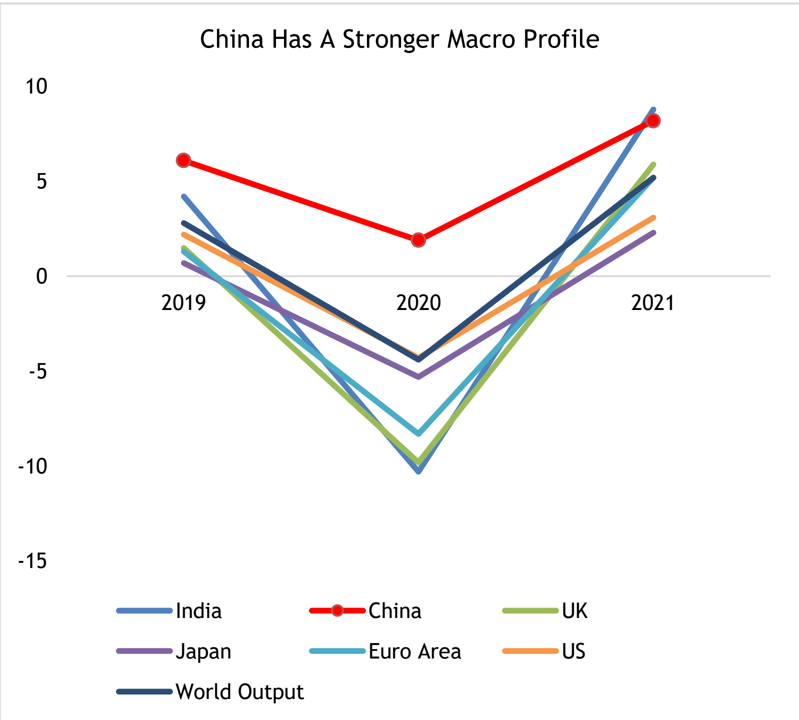
We continue to monitor the daily USDCNY reference rate fixes as market players remain sensitive to its signalling. Thus far, with most of the latest reference rates fixed rather close to estimates, it seems that the PBoC does not want to appear too interventionist. We believe that the greater the perceived guidance, the greater the speculation and volatility. Hence, the central bank prefers to allow market forces to drive the RMB. Recent comments by top officials including PBoC Monetary Policy Dept head Guo Sunfeng alluded the RMB’s strength to recent macro improvement of China. We take this to mean that the currency is deemed rather well aligned with its fundamentals and less need for any action from the central bank.

USDCNY has been hovering around the 6.70-figure for much of last week before mysteriously slipping lower late Fri to close under the key-level. There was no clear trigger for this sudden spurt of appreciation. Asian investors could simply be positioning for a potentially healthy set of activity data due today.

Fundamentals Continue to Underpin

Ahead of Sep data, the IMF had released a set of refreshed forecasts vs. its original projections seen in June. Most of the growth forecasts were revised higher this year to reflect a shallower-than-expected recession but the resurgence of COVID-19 cases delayed re-opening progress (and to some extent reversed) and the IMF downgraded most of the growth numbers, depicting a more uneven and longer recovery. However, China remains one of the few nations to see no change in projections for 2021 along with an upgrade this year, underscoring the likely outperformance of its economy as well as the RMB.

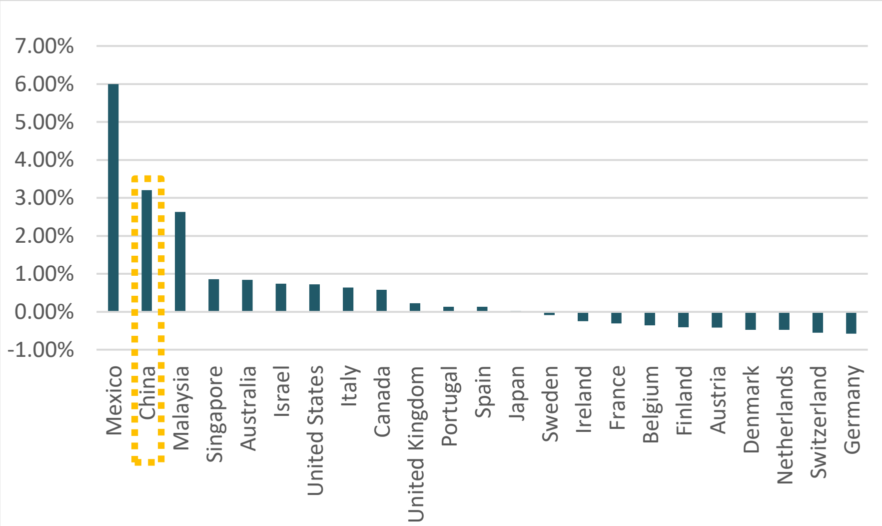
China Is an Outlier For Growth



Source: IMF Oct 2020 World Economic Outlook

Carry Is a Strong Allure for RMB in an otherwise Low Rates World

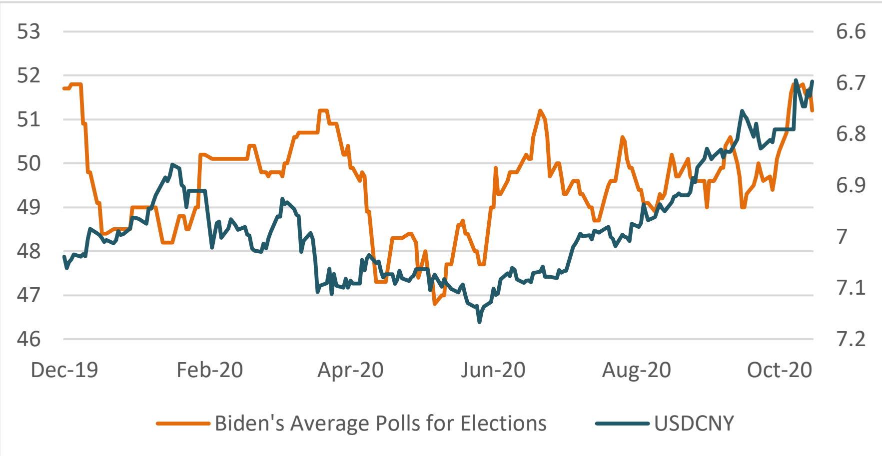
In the medium-term, we hold on to our view that USDCNY remains a sell-on-rally based on its carry allure and now that WGBI is officially including China (pending confirmation in Mar and official inclusion in Oct 2021), expectations that China could see significant passive inflows. With PBoC signalling a clear pause in its rates, the RMB has a carry advantage in a world that has plenty of DMs considering negative interest rate policy. In fact, within the WGBI space, the inclusion of CGB would likely raise the average yield of the index.



CGBs Probably Raise the Average Yield of WGBI

Note: 10y yields of Sovereign Bonds
Source: Bloomberg, Maybank FX Reserves & Strategy

Eye Biden's Lead and US Presidential Debate for Volatility



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

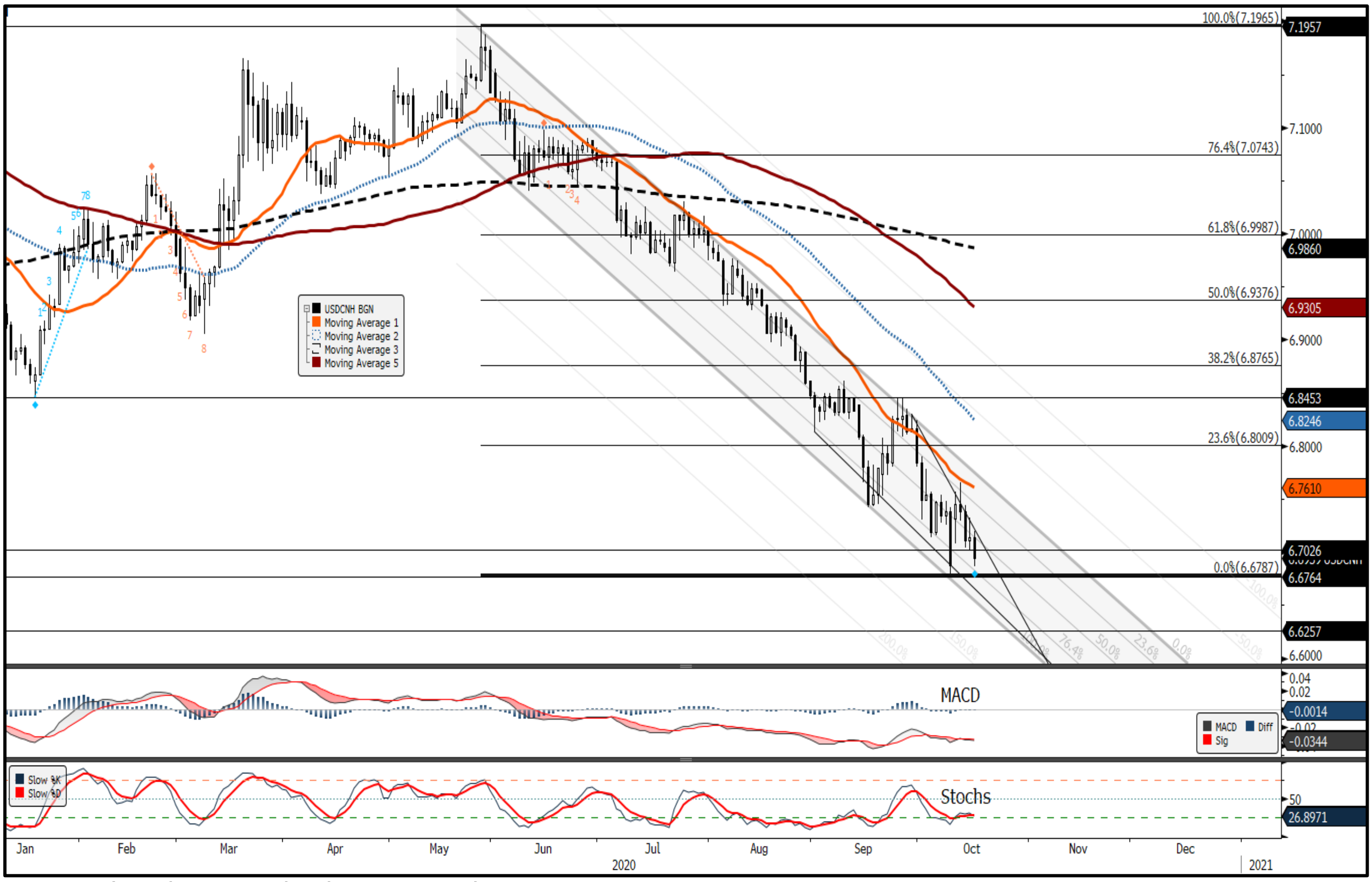
Where there are plenty of underpinnings for the RMB, we do watch for risks from the US elections that could keep the USDCNH on a 2-way action. Afterall, the likelihood of a Biden-win is well priced and any significant narrowing of Biden-lead or signs of a Trump-lead on polling day could ease some downside pressure on the USDCNH. In the week ahead, we have the last Presidential Debate on 22nd Oct. The fact that Biden's lead rose to record high after the last Presidential Debate (albeit with concomitant effect of Trump's contraction of the COVID-19 virus) suggests that debates can still have an impact on votes.

USDCNH might have displayed some resilience to the rise in COVID-19 cases that threaten the world. Afterall, China's strong COVID-19 management has enabled a faster economy vs. the rest of the world. However, should risk sentiment sour a tad more drastically, the rise in the USD might still lift the pairing. Other events that we watch include US-China tensions with China's recent threat that China may detain Americans after the FBI arrested three Chinese for hiding their membership in the People's Liberation Army; China's NPC standing Committee to restrict sensitive exports to protect national security – the law that has prevented the easy sales of TikTok; the People's Liberation Army had been conducting military drills, sparking speculation of a potential invasion of Taiwan.

USDCNH – Falling Wedge

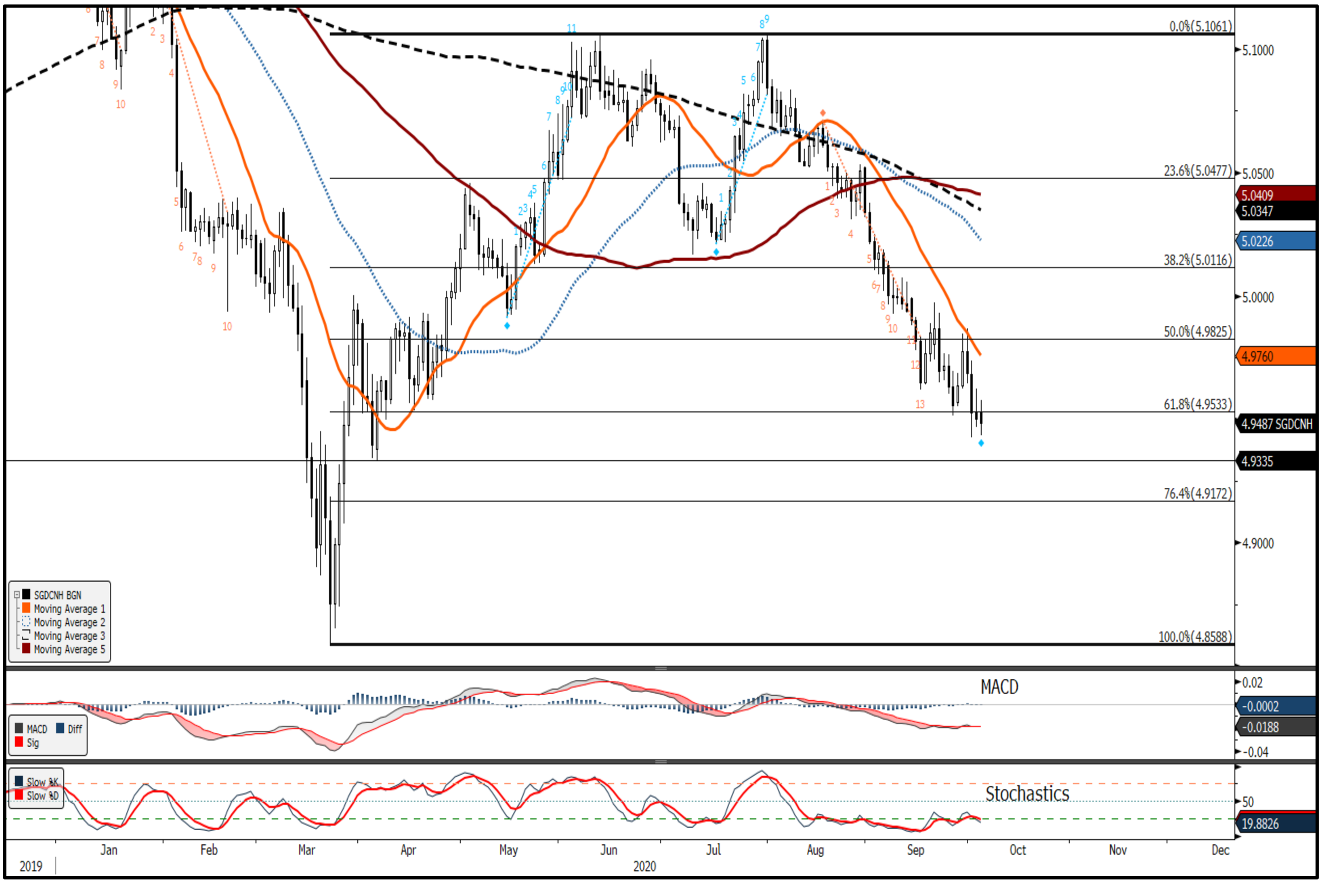
The USDCNH has been on a decline and was last seen around 6.6940. This pair remains well within the trend channel formed since Jun but we see a potential falling wedge forming. If we look at momentum indicators, MACD and stochastics on the weekly and monthly chart are still incredibly bearish and rightfully so. However, given that external environment could get a little more uncertain, we see a risk of a rebound towards 6.7610 (marked by the 21-dma). Beyond that, next resistance is seen at 6.8250 (50-dma). However, a clean break of the 6.6760-level (Oct low) could mean a extension towards 6.6257.

USDCNH (Daily Chart) – Risk of A Rebound, Downtrend Still Firmly Intact



Source: Bloomberg, Maybank FX Research & Strategy

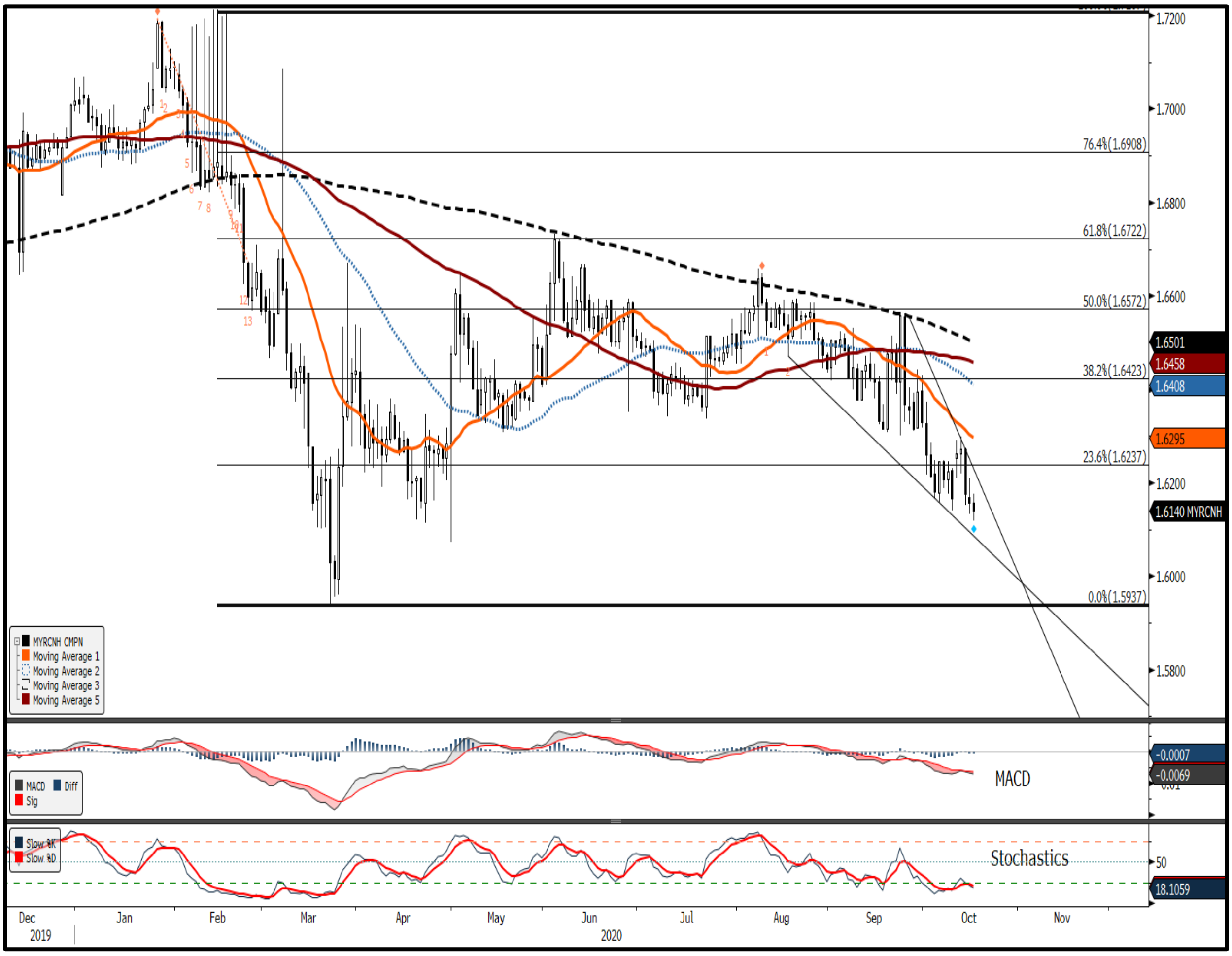
SGDCNH (Daily) – Bearish Bias



Source: Bloomberg

SGDCNH was firmly on the downmove, last seen around 4.9290. Based on the price action, there does not seem to be any sign of respite for the cross. Next support is seen at 4.9172 before the Mar low at 4.8588. Unexpected rebounds to meet resistance around 4.9580 (21-dma, also the 61.8% Fibonacci retracement of the Mar- Jun rally).

MYRCNH – Bearish but Wary of Rebounds



Source: Bloomberg

This MYRCNH falling wedge extends and this cross remained under pressure. MYRCNH last printed 1.6140 and could decline further towards 1.6070 before key support at the year low of 1.5937. Bearish momentum is intact and stochastics also point south. While we remain bearish on this cross, we are wary of short-term rebound in light of the falling wedge price pattern. Resistance is seen around 1.6240 (23.6% fibo retracement of the Feb-Mar fall) before the 1.6295 (21-dma).

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