Maybank

FX Flash

RMB - More Room For Market Forces

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Fundamental Underpinnings Would Still Keep RMB on the Strengthening bias in the Medium Term

Banks in China removed the countercyclical adjustment factor (CCAF) from their submissions for the USDCNY reference rate as reported on 27th Oct. This comes at a time where USDCNY has been on the upmove of late amid the uncertainties of the US elections, COVID resurgences as well as the rising speculation that PBoC would do more actions to reverse the RMB rally.

In the past, the CCAF was used as an additional dampener in the USDCNY reference rate formula. The Aug 2015 "one-off devaluation of the RMB" was really due to a FX reform that changes the methodology of the USDCNY reference rate fix. However, the use of the more transparent fixing formula as well as the CFETS RMB index along with other fundamental factors did not result in more calm for the RMB and the countercyclical adjustment was introduced in May 2017 as an additional component for the formula of the USDCNY reference rate to "smooth its volatility". The use of the CCAF was suspended in Jan 2018 and reinstated not long after (Aug 2018) when the US-China trade war came to the fore and the RMB was under intense deprecation pressure again.

Fast forward to 2020, the pandemic has turned the table around for RMB. CNY rose ~7.5% (vs. the USD) from its low in May. Market watchers are now wary of potential actions from PBoC to slow its pace of appreciation. Removing the countercyclical adjustment factor is clearly to give more room for market forces to drive the RMB and a possible opportunity for more weakness in the currency. This is especially timely as markets start to brace for potentially more volatility in the face of the upcoming US elections and strong COVID resurgence in plenty parts of the world. Removing the CCAF at this time could thus potentially weaken the RMB a tad more. We note that USDCNY fix on 28th and 29th came out to be still close to the median estimates polled by Bloomberg - a sign that the central bank does not want to strong-arm the RMB into a bearish reversal. Dropping the CCAF is thus another step to be less interventionist on the FX.

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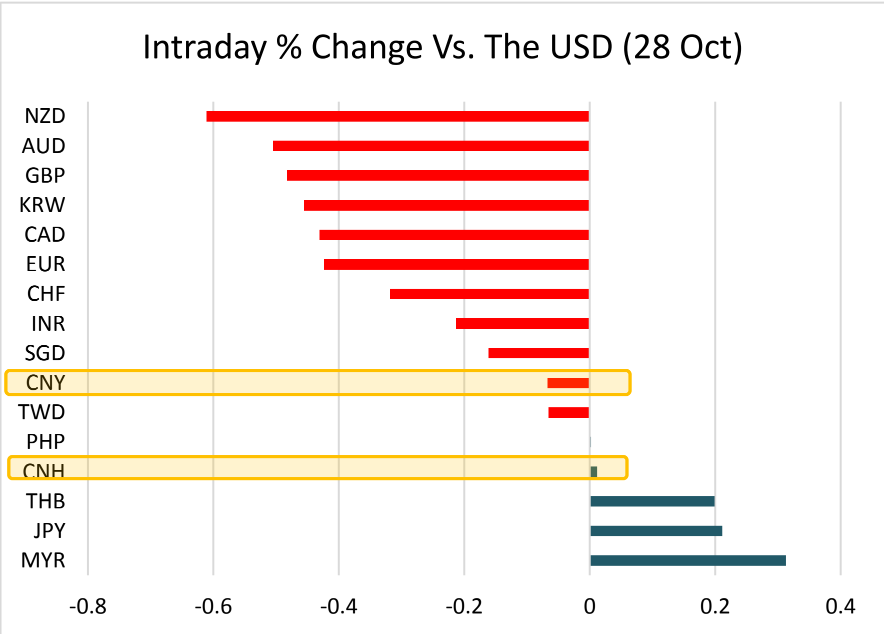
In addition, moves of the USDCNH since has shown that despite the risk-off moves for much of the FX space, the intra-day action of USDCNH and USDCNY were relatively subdued, underscoring the fact that RMB could become a haven of sort as China focuses on "dual circulation" - strengthening its domestic economy, becoming more self-reliant and its well-managed COVID situation has already given the economy that leg-up in recovery vs. the rest of DM as well as Asia.

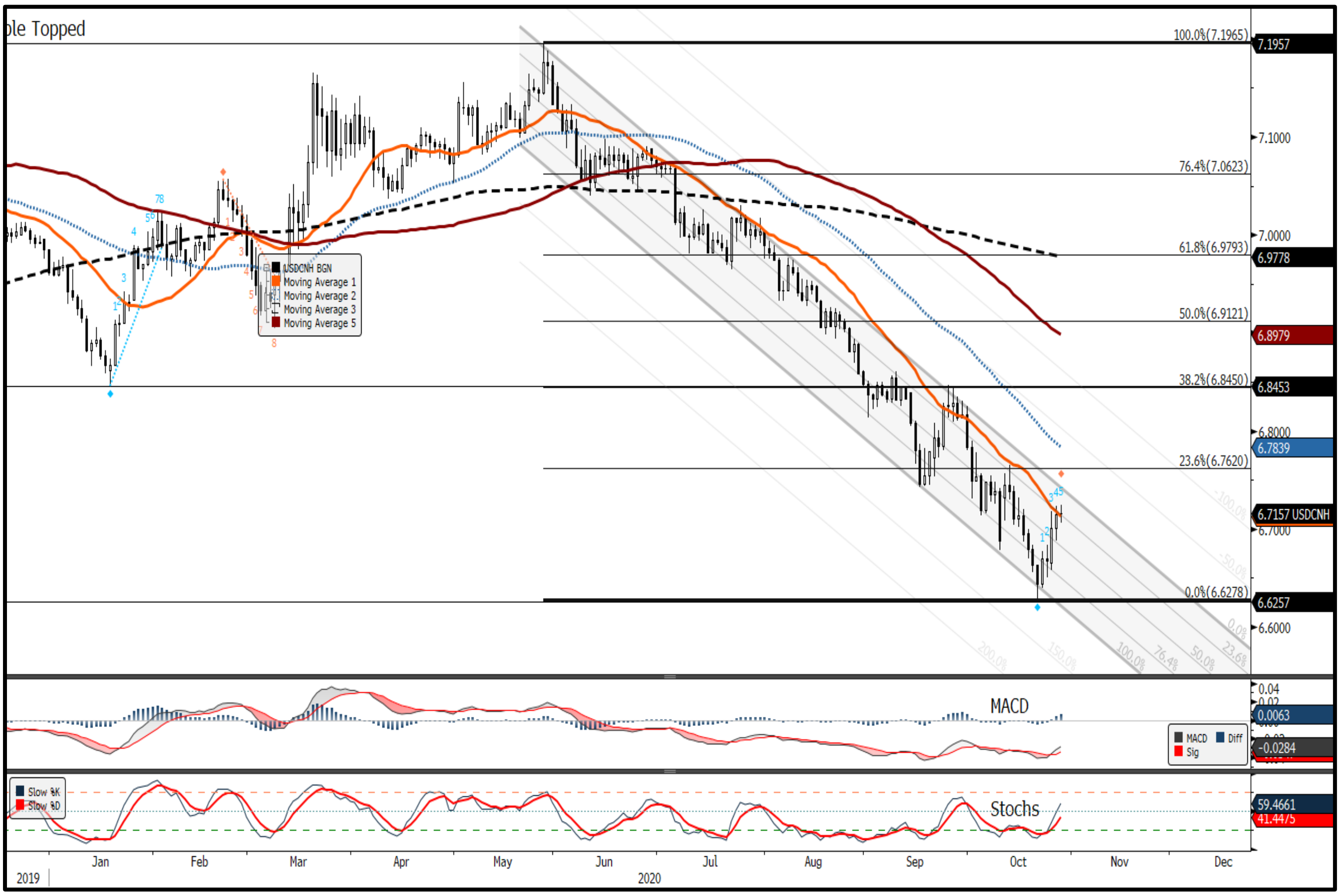
This removal of countercyclical adjustment factor, along with the ramp up of QDII quota and the reduction of RRR on its FX forwards are incremental moves to allow market forces to drive the RMB. Barring some near-term volatility, market forces will still eventually take the cue from its fundamental underpinnings and that points to likely further strength for RMB. That could mean better entry levels to short the USDCNH as we maintain our bearish view on the pair.

RMB Remains Rather Subdued Today in the Face of Volatility



Source: Bloomberg, Maybank FX Research & Strategy
Note: Prices were taken as of 6.45pm (SGT) 28th Oct 2020.

USDCNH (Daily) – Still Within Falling Trend Channel



Despite the recent upmove, USDCNH is still within the falling trend channel. The pair does have some key levels to watch including the 21-dma at 6.7130 (21-dma). Momentum indicators at this point are pretty bullish and there is a risk that the falling trend channel can be violated. Key resistance is around 6.7620 (23.6% Fibonacci retracement of the May-Oct fall) before the 50-dma at 6.7840. Support is at recent low at 6.6278 before the 6.60.

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