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Global

FX Insight

Familiar Headwinds for the RMB

Our USDCNY Forecast Shifts to 7.25

The most earth-shattering announcement that came out of the Two Sessions thus far is the new national security law for Hong Kong. The inflammatory bill had already triggered more protests in the SAR as some warned that the passage of the bill to mean the death of the "One Country, Two Systems" for Hong Kong. Apart from protests in HK, other repercussions of the bill are from the US. Some US Senators are already proposing sanctions on officials and entities involved in enforcing the new security laws as well as penalize banks that do business with those entities. This series of events certainly ratcheted up the US-China tensions quite a bit and adds to the hostile exchanges that are sovereign challenging in nature after the recent one over Taiwan. USDCNH jumped above the 7.13-figure in response to the news of the new bill and have remained bid since, almost re-testing the recent high of 7.1653 at one point.

Like before, the escalating US-China spats have resulted in a weaker CNY. We look for USDCNY to head towards 7.25 in this leg of upmove, underpinned by the likely scenario of US-China tensions dominating headlines for a while ahead of the US Presidential Election in Nov as well as the fact that the USD is likely to see intermittent support due to a lack of alternative reserve currency amid lingering virus uncertainty. However, trajectory is mild as USD is a weaker King now due to diminished carry advantage. Second, risk sentiment has been resilient and somewhat artificially supported by the policy makers, providing CNY some support. Third, tariff actions are less likely to be used than corporate-targeted actions and few actions are as drastic and damaging on the economy as trade barriers.

In such an environment, shorting the CNH is reasonable and we see weakness against the USD and also on a trade weighted bases, in particular INR and the JPY. Our USDCNY forecast trajectory is adjusted with the view that the most intense of the US-China spat should happen in the next few months before fizzling out towards the Presidential election in Nov.

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NPC in Session

New Security Laws for Hong Kong Declared

The most earthshattering announcement that came out of the Two Sessions thus far is the new national security law for Hong Kong. The potentially inflammatory bill has already triggered protests in the SAR as some warned that the passage of the bill to mean the death of the "One Country, Two Systems" for Hong Kong.

According to sources cited by Hong Kong Free Press, China would add the national security law into Annex 3 (wherein lies the exceptions for National Laws to be applied to Hong Kong) of the city's Basic Law's Article 18 for it to be promulgated by the Hong Kong government and *bypassing the SAR's legislature.* The use of Annex 3 with the intended effect of bypassing the SAR's own legislature could be interpreted as bulldozing Hong Kong's right to its autonomy and violating the "One Country, Two Systems" framework that is meant to be intact until 2047.

The NPC is expected to vote and approve the National Security Law on 28 May and the Standing Committee of the NPC would hold a meeting as early as Jun to draft the laws in more details for Hong Kong to cover secession, foreign interference, terrorism and subversion against the central government.

Apart from potentially triggering protests from pro-democratic Hong Kongers, other repercussions of the bill could be from the US. Some US Senators are already proposing sanctions on officials and entities involved in enforcing the new security laws as well as penalize banks that do business with those entities. This would somewhat follow through with the Hong Kong Human Rights and Democracy Act of 2019 that provides for the US to impose sanctions against China and Hong Kong officials "responsible for human rights abuses in Hong Kong" and requires the US to conduct an annual review to determine whether there are changes in Hong Kong's autonomy (from China) that could justify a change to its unique treatment under various treaties, agreements and US laws.

This series of events certainly ratcheted up the US-China tensions quite a bit and adds to the hostile exchanges that are sovereign challenging in nature after the recent one over Taiwan. China has put out a rather strong-worded warning against the US. China Foreign Minister Wang Yi said at the sidelines of the NPC during his annual news briefing that "It's time for the United States to give up its wishful thinking of changing China and stopping 1.4bn people in their historic march towards modernization". He further warned that the recent assaults on China over the coronavirus and global trade matters "are taking China-US relations hostage and pushing our two countries to the brink of a ***new cold war***". This came after the US Commerce Department's action to restrict Huawei's ability to use US technology and software to manufacture its semiconductor overseas as covered in the RMB Watch.

USDCNH jumped above the 7.13-figure late last week in response to the news of the new bill and have remained bid since, almost testing the year high with a print of 7.1643. We continue to see potential for further moves higher with the almost inevitable sanctions from the US.

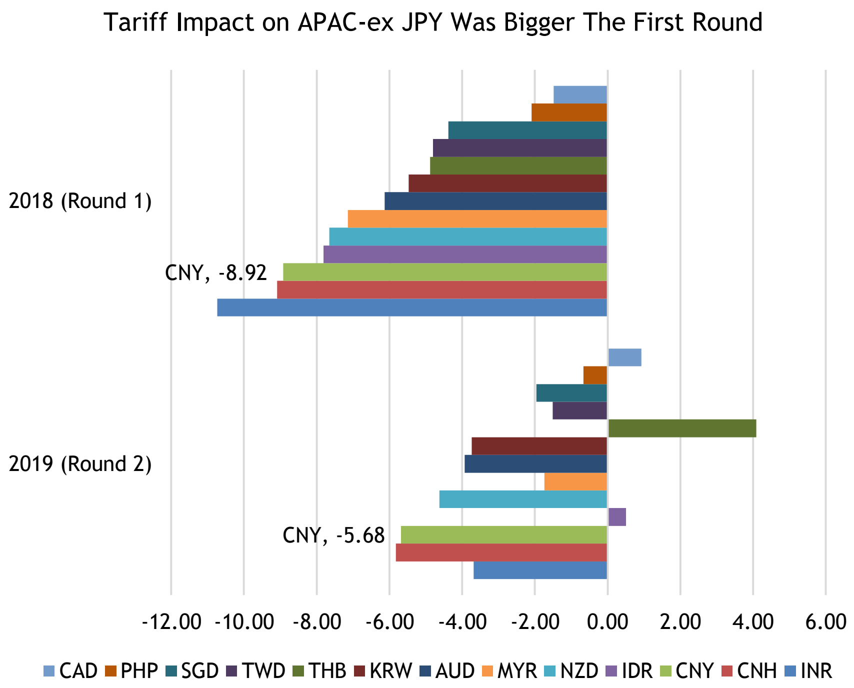
Familiar Uncertainties Return to the Fore, Yet Different This Time

USDCNY and USDCNH are likely to remain on the upmove in the near-term as some familiar uncertainties return to the fore.

Earlier this week, in another action against China, the Senate also passed a proposal to delist Chinese companies from US stock exchanges if they are unable to comply with the US financial disclosure standards. In response to that, House Speaker Nancy Pelosi said that the House would review the measure but stopped short of mentioning a vote.

Like before, the escalating US-China spats have resulted in a weaker CNY. CNY is likely to remain under pressure and we look for USDCNY to head towards 7.25 in this leg of upmove. The northbound trajectory would be underpinned by the likely scenario of US-China tensions continuing well towards the US Presidential Election in Nov as well as the fact that the USD is likely to see intermittent support due to a lack of alternative reserve currency amid lingering virus uncertainty that could keep the USDCNY and USDCNH biased to the upside.

Non-USD FX was Less Hurt in the Second Round of Tariffs in 2019, Subsequent Impact Should Also be Smaller



Source: Bloomberg, Maybank FX Research & Strategy

While the move to 7.25 would exceed the 2019 high for USDCNY, the extent of decline would be mild compared to the 5.7% depreciation seen (from peak to trough vs. the USD) during the last tariff action in 2019, notwithstanding the weakness dealt by the global crash in Mar. We also note that the impact of the last tariff action on non-USD FX was smaller than the first round in 2019. This round of escalation is likely to see an even smaller impact due to a few factors.

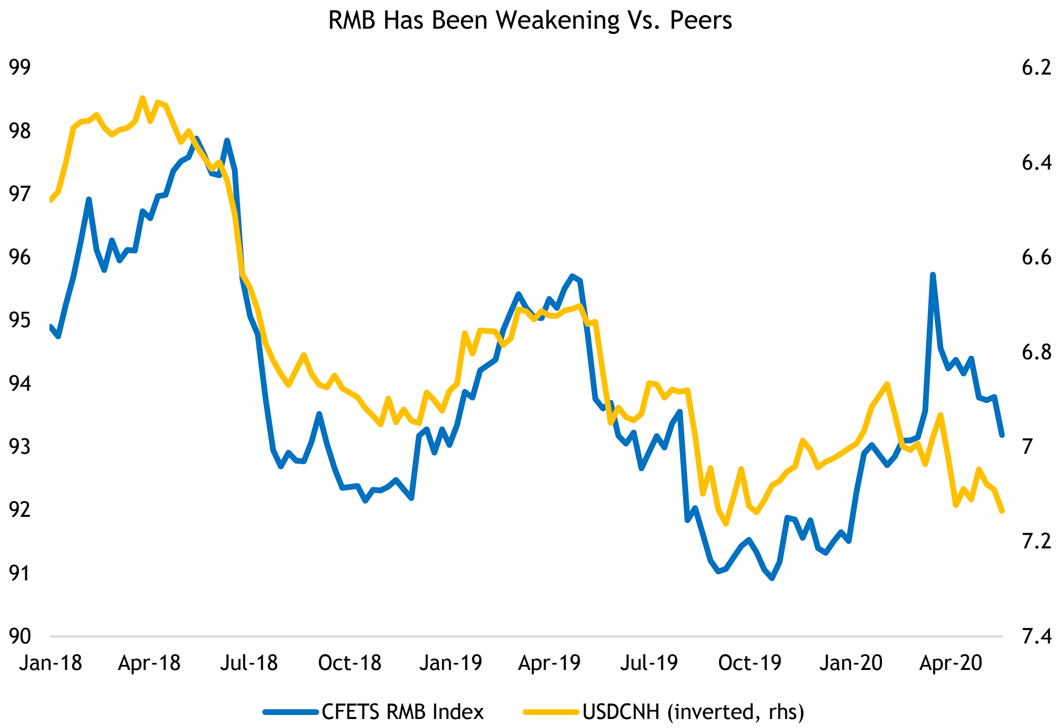
- **USD a Weaker King.** There are a number of factors that chip away at the strength of the USD. We are in a more benign US rates environment as the Fed has wiped out all carry advantage of the USD with the aggressive monetary easing tools, undermining the demand for USD for yield gains. In addition, the massive fiscal spending is likely to widen US' current account deficit and worsen its fiscal deficit ratio. The greenback tends to weaken when the twin deficit ratio increases.

- **Sentiments Supported by Governments/Central Banks.** Market players remained vested in risk assets, taking advantage of the low volatility backdrop, due to hopes of vaccine breakthroughs and developments along with the earlier-than-expected reopening of economies that could mean at the very least, tepid recovery. Sentiment is also all the more supported by central banks' commitment to ensure ample liquidity, normal functioning of financial market, keeping a lid on safe haven demand of the USD.

- **Corporate Actions Are Less Damaging to the Economy.** Third, more specific to the US-China tensions this time round is the fact that economic impact of tariff actions is likely significantly wider and more damaging relative to corporate actions, notwithstanding the outcome of the 5G race. However, as we have covered in RMB Watch dated 17 May, the corporates (Huawei, Cisco, Boeing, Qualcomm and Apple) named by both US and China have been already impacted in varying extents by the trade war for the past two years. The firms are likely to have been making adjustments to limit the impact on their supply chains. Correspondingly, the impact on CNY would be smaller in this round of escalation. We retain the view that tariff actions would inflict far too much damage on both economies (already weakened by the Covid-19 pandemic) and are unlikely to be undertaken this year and are likely to be postponed to 2021 or beyond.

The USDCNY trajectory would be milder compared to previous years. Nonetheless, further weakness could manifest. While we remain cautiously optimistic over pandemic situation and the potential recovery of the world economy, we still see a potential for a more material pullback in equities on more news of a second wave of infection potentially gaining traction, slower than expected re-starting of economies and the possibility of a dearth in good news from vaccine developments that could shift focus to more risk-off headlines such as more US sanctions on China followed by more in-kind retaliation along with potential delisting of certain Chinese corporates. A move higher towards 7.25 could be propelled by such factors and RMB could be hurt more disproportionately vs. others.

RMB Underperformance May Extend



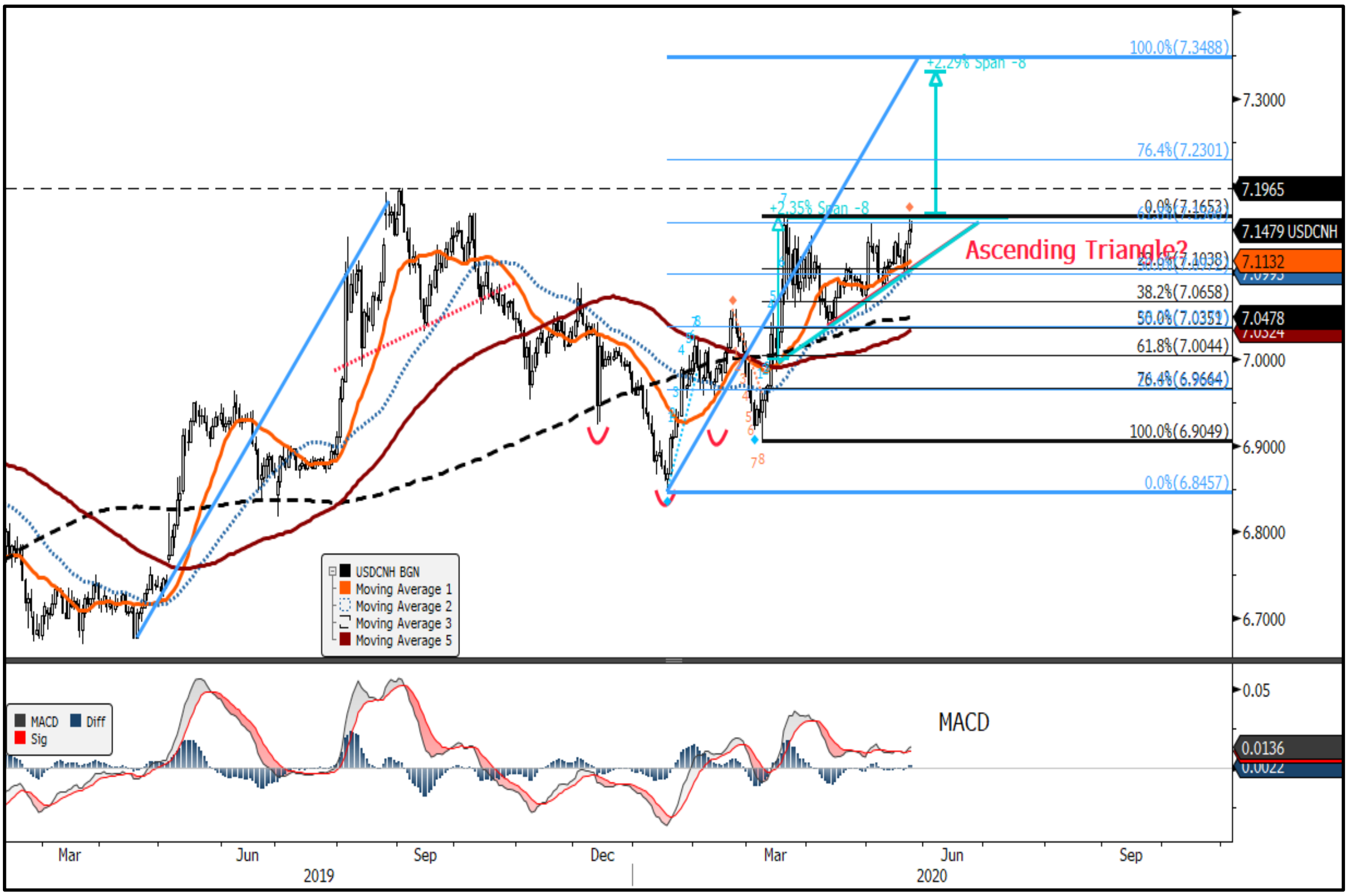
Source: CFETS, Bloomberg, Maybank FX Research & Strategy
Note: CFETS RMB index is a trade weighted index introduced on 11 Dec 2015. The 24 weights for CFETS RMB index are calculated by international trade weights with adjustments of re-export trade factors.

In forming our forecast trajectory for USDCNY, we expect the most intense period of escalation to be within the next few months before tapering off into the end of the year as the Trump administration becomes more occupied with the presidential election.

Forecast	2Q 2020	3Q 2020	4Q 2020	1Q 2021
USDCNY	7.22 (7.05)	7.25 (7.03)	7.23 (7.03)	7.18 (7.03)
USDCNH	7.23 (7.05)	7.27 (7.03)	7.23 (7.03)	7.18 (7.03)

Technical Biases for the RMB and its Crosses

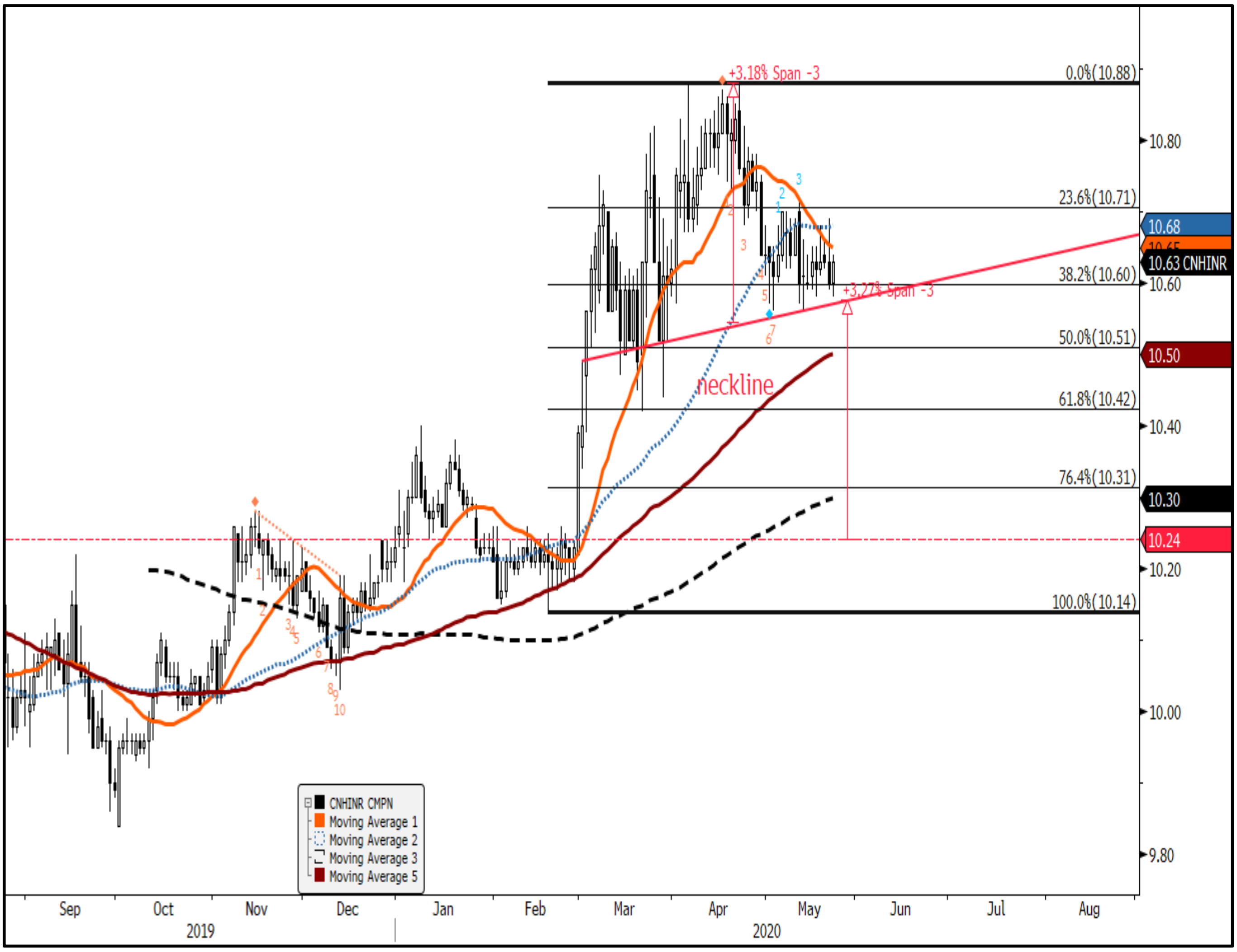
USDCNH – Will it Repeat The Trajectory of 2019?



Source: Bloomberg

The trajectory can be repeated but this time with the help of Covid-19. The escalation of the US-Sino tensions could probably lift the USDCNH by another 2.3% based on the bullish ascending triangle with the strong resistance at recent highs of around 7.1650. A breakout there could propel the pair to around 7.33. Thereafter, this pair may be drawn towards the 76.4% Fibonacci level at 7.23. The apex of the triangle is still sometime away in late Jun so the break-out of the triangle may not be certain. In addition, a failure to break above the 7.1650 could be a triple top for the USDCNH. We eye the 50-dma as a support at around 7.1020 as a violation of the ascending triangle. Before that happens, interim support around 7.1040 (23.6% Fibonacci retracement of the Mar rally) before the next at 7.0660 (38.2%). 7.10 happens to be near to the 21-dma, 50-dma (not shown) is a key area of support for USDCNH.

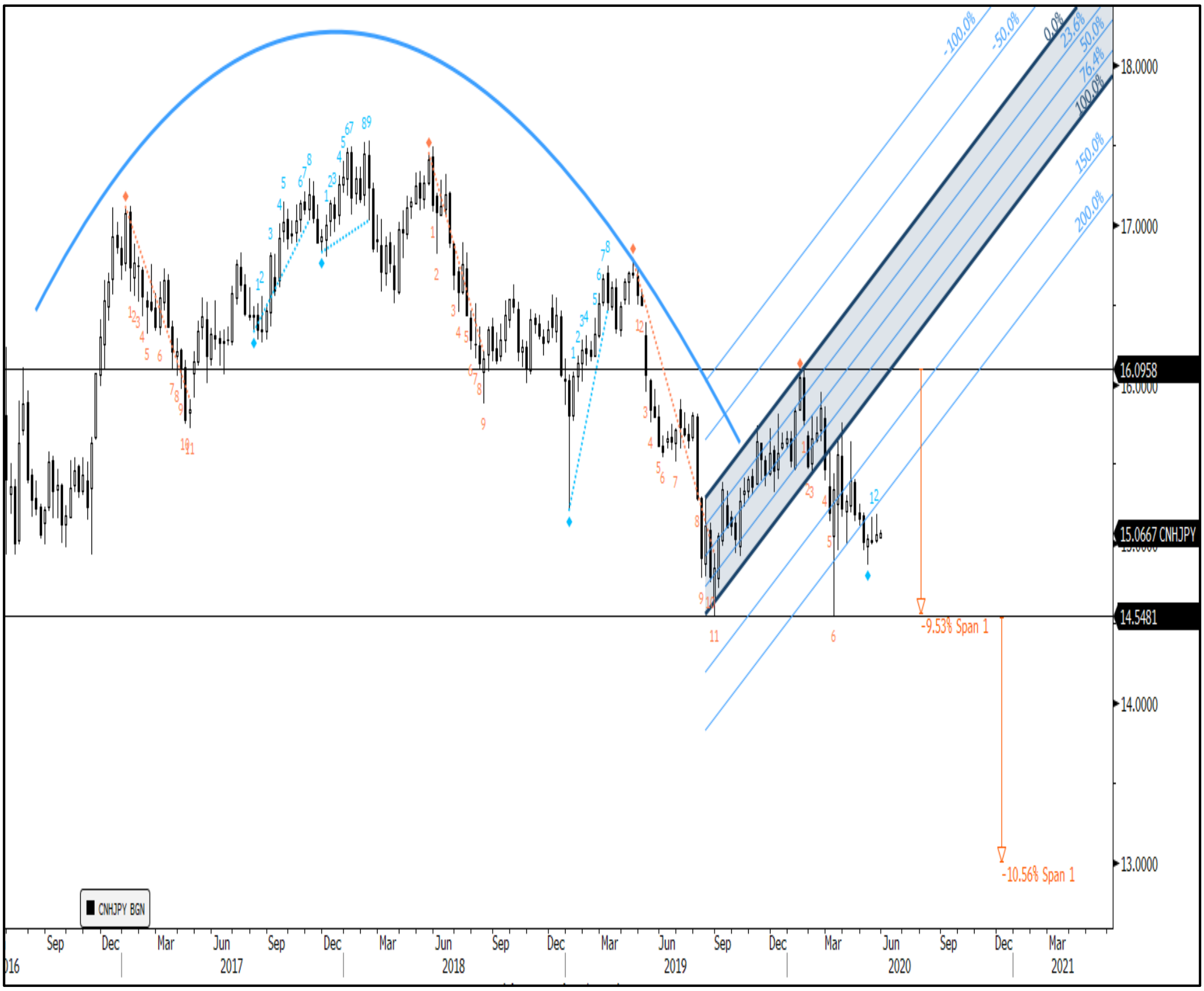
CNHINR (Daily) – Potential Head and Shoulders Formation



CNHINR seems poised for a bearish reversal move as recent price action seems to be forming a potential head and shoulders formation. Last seen around 10.63, neckline slopes upward (less compelling than a downward sloping one). The head and shoulders may not be perfect but given the resilience of the sentiment and likely subdued oil prices, INR may have catch up with the rest of the EM FX that has already gained in a low rate environment where investors could be hungry for yield gains.

With the 40bps cut to policy rate (repo and reverse repo rate) on 22nd May, RBI pledges even more easing to support the economy and the easing trajectory for domestic rates should be positive for domestic bonds and to some extent INR. There are still fundamental reasons for INR's underperformance so far as India remains a country that has not flattened its COVID-19 epidemic curve. Dr. Laxmainarayan, the director of the US-based Centre for Disease Dynamics, Economics and Policy told Outlook India that the peak is likely in early Jul. Back on the CNHINR chart, we see potential for CNHINR to fall. 21-dma has cut the 50-dma and poised to head towards the 100-dma, another bearish signal. Strong support at 10.50. **We prefer to short at 10.55 for a target of 10.30 (200-dma, 76.4% Fibonacci retracement) before 10.24 (complete head and shoulders). Stoploss at 10.68.**

CNHJPY (Weekly) - Inverted Cup and Handle



CNHJPY was another key trade for 2018-2019 trade war escalations. An inverted cup and handle seems to have formed over the past few years. The handle had a false break in Mar when equities crashed in light of the worsening pandemic situation that triggered lockdowns of economies across the world. A clean break of the 14.55 could open the way towards 13.00.

Other Less Exciting Announcements from annual Work Reports

- Numerical growth target would be abandoned for 2020.
- CPI Target for 2020 is lifted to 3.5% from the usual 3.0% limit, underscoring emphasis on growth stimulus.
- Fiscal deficit ratio target is raised from 2.8% of GDP for 2019 to 3.6% for 2020.
- Aims to add more than 9 million new urban jobs vs. 11 mn in 2019. Surveyed urban unemployment rate target to be around 6% vs. 5.5% in 2019.

- Monetary policy to remain prudent but the State Council vows settings to be more flexible and appropriate
  - To maintain ample liquidity via RRR and interest rate cuts as well as re-lending
  - “Renovate monetary policy tools” to support economy
  - Guide money supply higher
- Fiscal policy to be more proactive
  - Further cut taxes and fees by another CNY500bn. Extend existing programs/policies due to expire by Jun to end of 2020.
  - Bond Issuance
    - Issue CNY 1trn of anti-virus government bonds.
    - A cap of CNY 3.75trn of special local government bonds for this year, up from CNY2.15trn.
    - Support financial institutions with issuance of CNY300bn of bonds to finance the lending to small businesses.

The package of promised stimulus failed to excite Chinese stocks which were already spooked by rising US-China tensions in light of the most recent aggravation by upcoming national security laws to be enacted for Hong Kong.

As we have noted in our RMB Watch dated 18 May 2020, weakening fiscal positions in the past generally coincide with a downtrend of the CNY. This time, we do not think there is any difference. The reiteration by the Chinese government that houses are meant to be lived in and not for speculation serves as a reminder that unlike the 2009 episode of fiscal stimulus, the property market will not be such a big beneficiary this time. That said, what is similar to 2009 is the use of infrastructure to boost demand as the target for local government special bonds were raised.

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