

FX Insight

RMB - Risks Still To The Upside

RMB Surges

USDCNH has plummeted past the key 6.60-figure last Fri, taking the USDCNY along with it. Offshore spot was last seen around 6.5345. However, this sharp move is not in sync with the rest of USDxJ, or with USD at all. Within the intra-day session for Asia yesterday, CNY has been the top performer in the region with the exception of JPY.

EUR - A Major Driver

While USD has certainly slumped over the past few months, a more significant driver of CNY strength has been the rise of the EUR. We investigated this by using multiple linear regression analysis for two periods this year - (Jan-Apr) and (Jun-Sep4), taking into account four currencies - EUR, JPY, KRW and AUD that hold the most weight in the CFETS RMB index. The EU is China's biggest trading partner, a compelling enough reason for EUR to be a typical strong driver of CNY but the introduction of the countercyclical adjustment factor was a game changer to ensure that CNY strengthen against the basket even as USD weakens. This also means that PBOC could aid in ensuring the CNY does not weaken too much against the EUR.

RMB Still Faces Risk to the Upside

By now, it is clear that PBOC wants a stronger RMB and the central bank is increasingly successful in reversing the market psyche on CNY in this environment of USD weakness, strengthening EUR, tight capital controls and high profile "crack-down" of Dalian Wanda Group's overseas acquisitions that could serve as a warning to other domestic companies looking to acquire global assets. The persistent rise in FX Reserves, whilst largely attributable to valuation effects, has also served to ease concerns on capital outflows. In addition, there are signs of corporates unwinding the USD hedges accumulated in the past few years according to the latest BOP breakdown. On the weekly chart for USDCNH, bearish momentum is still strong for USDCNH. Next support is seen around 6.5090. This pair may be oversold but price action seems determined to press lower. Next support is seen around 6.4432 (200-WMA) before the next at 6.3950. Rebounds to meet resistance at 6.6000.

With Trump still pushing to end KORUS, deterioration in Korea-China's relations that is already weighing on the tourism receipt for South Korea in addition to geopolitical tensions, we see opportunity to load the CNHKRW cross on dips towards 170 for a target of 176 before the next at 180 as CNH continues to be underpinned by proxy-safe haven plays in risk-off events. Stoploss at 168.65.

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RMB Surges

USDCNH has plummeted past the key 6.60-figure last Fri, taking the USDCNY along with it. Offshore spot was seen around 6.5345. However, the sharp move lower is not in sync with the rest of USDxJ, or with USD at all. Within the intra-day session for Asia yesterday, CNY has been the top performer in the region with the exception of JPY. In fact, CNY's strength has surpassed all Asian currencies (vs. the USD) since the start of Jun. That has actually coincided with the introduction of the countercyclical adjustment factor in May.

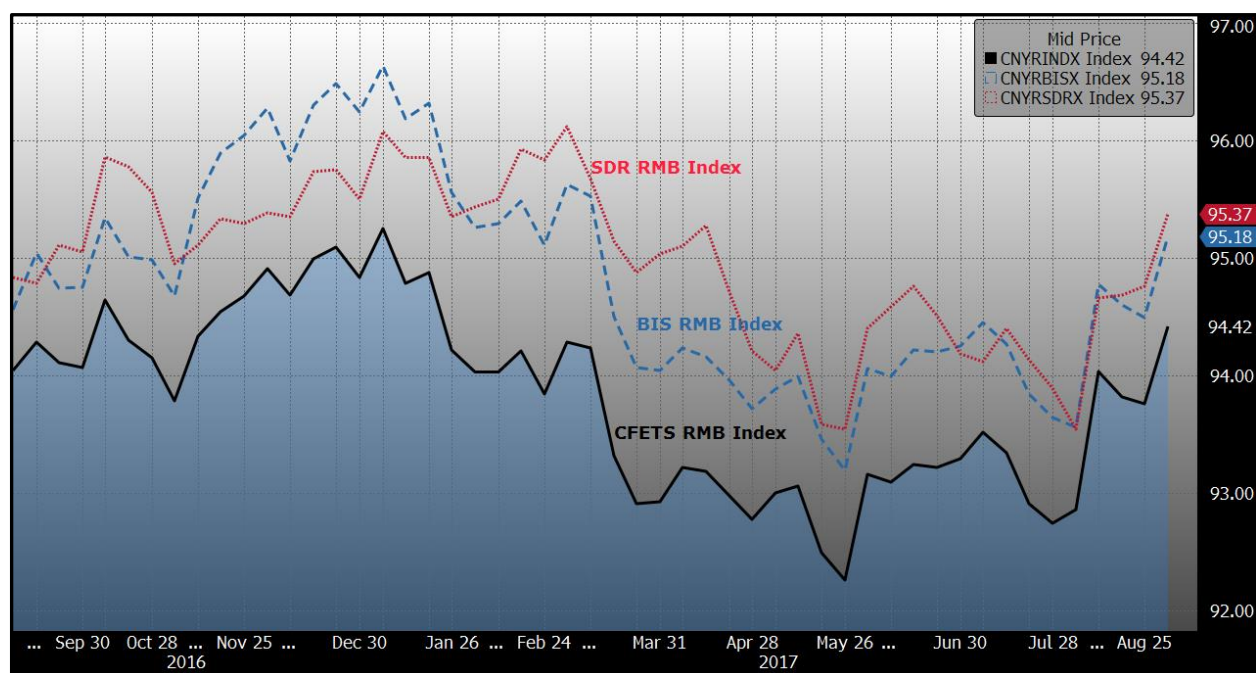
Chart 1: USDCNH Drops



Source: Bloomberg, Maybank FX Research & Strategy

In fact, the CFETS RMB index has rebounded from its low of 92.26 in May to 94.42 as of last Fri (Chart 2) and possibly more today. We also saw a similar rebound in the RMB index based on the BIS basket as well as the SDR basket. In other words, the CNY has managed to strengthen against most other trading partners for the past three months.

Chart 2: RMB Strengthens Against Currency Baskets Since End May



Source: Bloomberg, Maybank FX Research & Strategy

EUR Is A Significant Driver for CNY

While USD has certainly slumped over the past few months, a more significant driver of CNY strength has been the rise of the EUR. We investigated this by using multiple linear regression analysis for two periods this year - (Jan-Apr) and (Jun-Sep4), taking into account four currencies - EUR, JPY, KRW and AUD that hold the most weights in the CFETS RMB index. We excluded May as it is the time that the countercyclical adjustment factor was introduced during which there was also possible FX intervention. The EU is China's biggest trading partner, a compelling enough reason for EUR to be a typical strong driver of CNY but the introduction of the countercyclical adjustment factor was a game changer to ensure that CNY strengthen against the basket even as USD weakens (it was the reverse before May). This also means that PBOC could aid in ensuring the CNY does not weaken too much against the EUR.

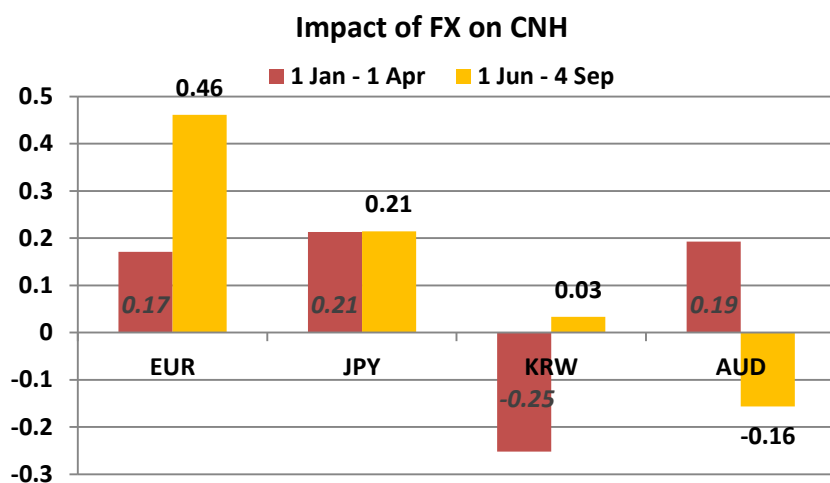
$$\log(\text{CNHUSD}_{\text{Jan-Apr}}) = \log(\text{EURUSD}_{\text{Jan-Apr}}) + \log(\text{JPYUSD}_{\text{Jan-Apr}}) + \log(\text{KRWUSD}_{\text{Jan-Apr}}) + \log(\text{AUDUSD}_{\text{Jan-Apr}})$$

$$\log(\text{CNHUSD}_{\text{Jun-4 Sep}}) = \log(\text{EURUSD}_{\text{Jun-4 Sep}}) + \log(\text{JPYUSD}_{\text{Jun-4 Sep}}) + \log(\text{KRWUSD}_{\text{Jun-4 Sep}}) + \log(\text{AUDUSD}_{\text{Jun-4 Sep}})$$

All variables were determined to be statistically significant.

According to Chart 3 below, the impact of EUR on CNH has more than doubled in the period of Jun-Sep4 compared to its impact taken in the first four months of the year. For every 1% appreciation in EUR against the USD, CNY is expected to appreciate 0.46% between Jun-Sep compared to just 0.17% in the first four months of the year. On the other hand, impact of JPY remains roughly the same. Interestingly, the impacts of KRW and AUD have decreased and changed. It is also worth noting that the R-squared for the Jun-Sep4 model is 0.84 vs. 0.43 for Jan-Apr model, suggesting that changes in EUR, JPY, KRW and AUD can better explain the changes in CNY in the months since Jun compared to their moves in Jan-Apr.

Chart 3: Impact of EUR on CNH has Risen Significantly Since Jun

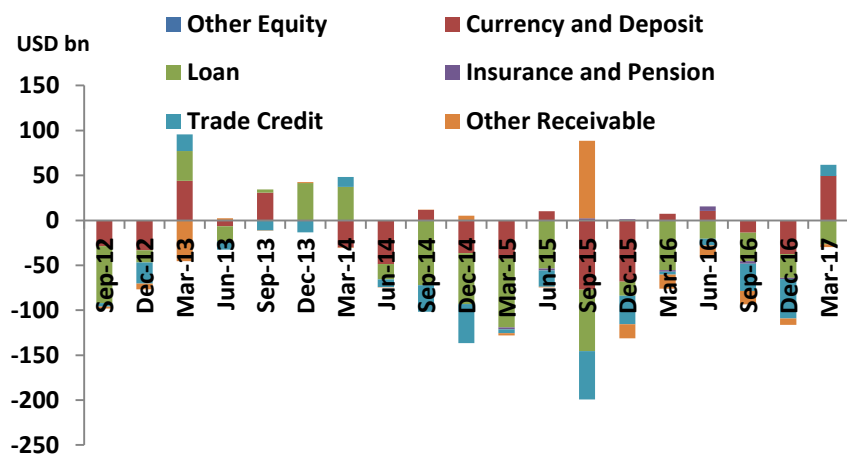


Source: Maybank FX Research & Strategy, Bloomberg, Eview

Separately, with JPY as a barometer of risk sentiment, the role of JPY as a stabilizer of RMB in times of risk aversion cannot be underestimated. By now, it is also clear that PBOC wants a stronger RMB and the central bank is increasingly successful in reversing the market psyche on CNY in this environment of USD weakness, strengthening EUR, tight capital controls and

high profile “crack-down” of Dalian Wanda Group’s overseas acquisitions that could serve as a warning to other domestic companies looking to acquire global assets. The persistent rise in FX Reserves, whilst largely attributable to valuation effects, has also served to ease concerns on capital outflows. In addition, there are signs of corporates unwinding the USD hedges accumulated in the past few years according to the latest BOP data (chart 4 on the next page) that shows a net inflow of corporate FX deposit and trade credit. In fact, former PBOC adviser Yu Yongding opined that this environment is ideal to “complete the exchange rate reform” and free float the CNY. Putting together all these factors, risks to the CNY and CNH are to the upside and widening the yuan trading band is unlikely to cause much volatility unlike what was observed in the past episodes of band widening.

Chart 4: BOP Breakdown Shows Net Inflow of Corporate FX Deposit, Trade Credit



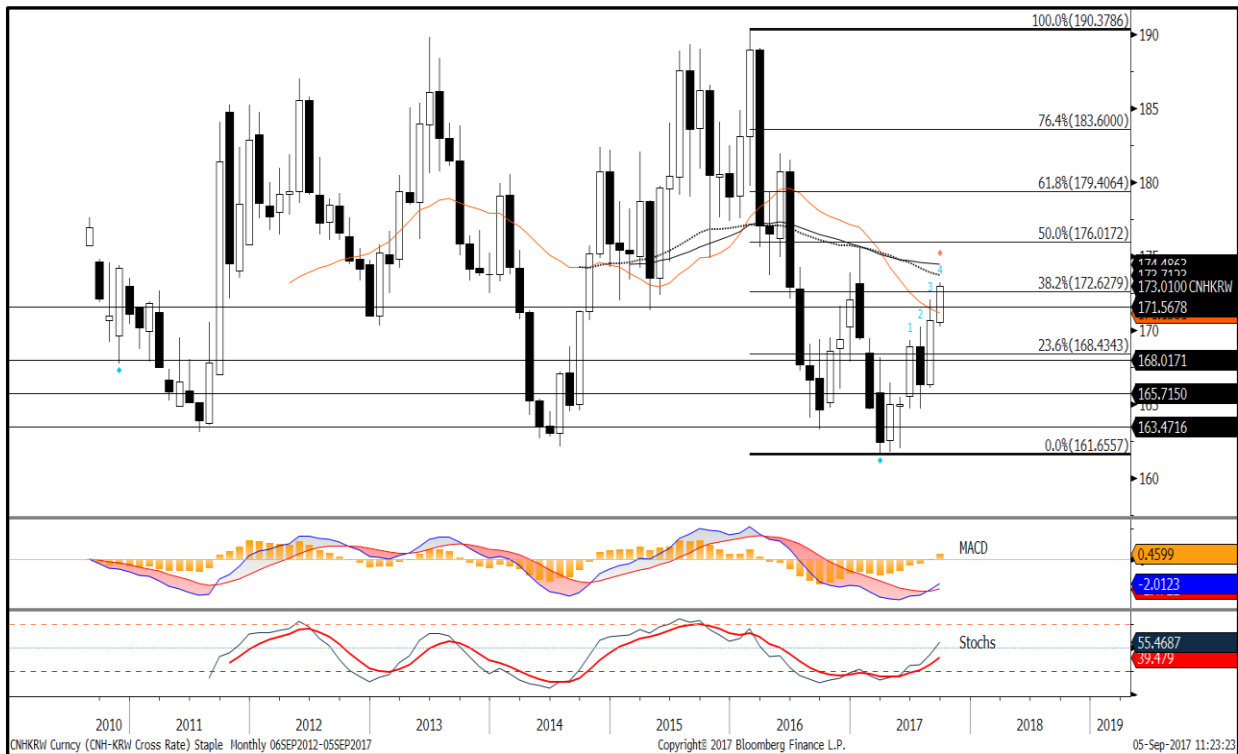
Source: Maybank FX Research & Strategy, CEIC

Chart 5 (Weekly USDCNH): Still Bearish



It is dangerous to catch a falling knife and bearish momentum is still strong for USDCNH. Next support is seen around 6.5090. This pair may be oversold but price action seems determined to press lower. Next support is seen around 6.4432 (200-WMA) before the next at 6.3950. Rebounds to meet resistance at 6.6000.

Chart 6 (Weekly CNHKRW): On the Uptrend



Barring potential retracements that are flagged on the daily chart, the bullish momentum on the monthly chart is compelling. This cross seems to remain on a broad uptrend with an arguable triple bottom formed in 2011, 2014 and 2017. With Trump still pushing to end KORUS, deterioration in Korea-China's relations that is already weighing on the tourism receipt for South Korea in addition to geopolitical tensions, we see opportunity to load the CNHKRW cross on dips towards 170 for a target of 176 before the next at 180 as CNH continues to be underpinned by proxy-safe haven plays in risk-off events. Stoploss at 168.65.

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