Maybank

Macro | FX Research and Strategy

Global

FX Insight

The Art of Getting A Quick Deal?

Pushing for a Deal Soon

More details emerged from over the weekend after the US-China trade talks in Washington came to naught. We take the opportunity to fill in more details since our FX Weekly sent out last week that has some of our prelimnary analyses of the trade-war between the US and China thus far. We lay out a few scenarios and trajectories for the USDCNY accordingly.

With a 1-month deadline looming before the tariffs can be applied to the rest of the untaxed China's exports to the US, CNH weakened considerably, lagging only behind the KRW (vs. USD) which typically has a higher beta, no restriction by an onshore trading band, less threat of intervention unlike the RMB. While further upmoves in the USDCNH cannot be ruled out, we are still on the optimistic camp for a trade deal to be reached and the USDCNH rally to be reversed.

Our Base Scenario

Our base scenario still expects a trade deal within the quarter and that includes undoing the tariff hike that came into effect last Fri as well as the partial removal of 2018-imposed tariffs. That could mean a full reversal of the USDCNY rally that we have seen which should bring the USDCNY towards our original forecast at 6.75 (tweaked higher from 6.70) for 2Q taking into account the potential eventual meeting between the US and China at the G20 summit (28-29 Jun).

Our Strategies

Prefer to lean against the USDCNH strength into the latter part of this month as Trump seems to be counting on time as the best motivator in the Art of the deal.

Most Compelling View for a G7 – AUD has been the most sensitive to trade war development but it seems as if short positioning is stretched and AUD bears are finding hard to gain traction. We prefer to long the AUDUSD (spot reference at 0.6972). Stop loss at 0.6900 for a target at 0.7060 before the next at 0.7155. Risk reward ratio is 1: 2.52.

Within the ASEAN space, PHP and THB are still likely to underperform given their idiosyncratic political uncertainties vs. trade-linked currencies such as SGD, KRW, CNH to recover when a deal is reached.

A full blown trade war could see EUR, JPY and USD outperform other EM currencies, especially CNH, TWD, KRW, AUD.

Analysts

Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

SEE PAGE 8 FOR IMPORTANT DISCLOSURES

Pushing for a Deal Soon

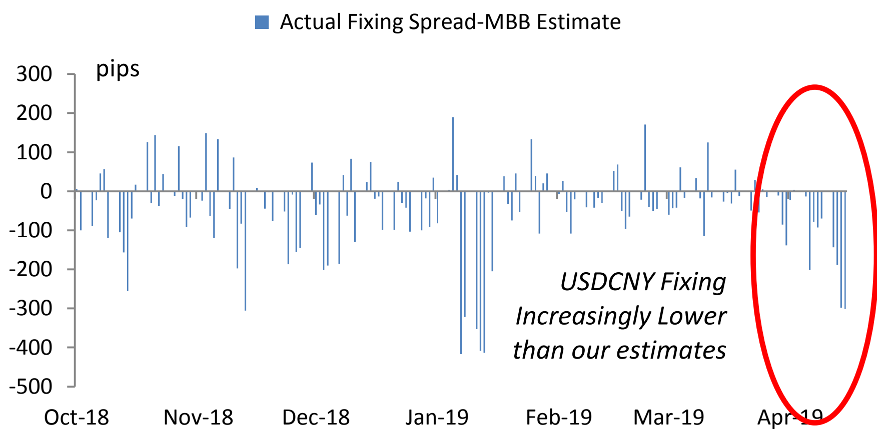
More details emerged from over the weekend after the US-China trade talks in Washington came to naught. We take the opportunity to fill in more details since our FX Weekly sent out last week that has some of our prelimnary analyses of the trade-war between the US and China thus far.

Highlights:

- US raised the 10% tariff on Chinese goods to 25% with effect on 10 May.
- Only US-bound goods that left China's ports on 10 May 12:01pm would subject to the new 25% tariff. Goods in transit are grandfathered the 10%, which suggests an unofficial window of 2-3 weeks for further negotiation before the real impact of the newest tranche of tariff is felt.
- US officials have given China's negotiators 1 month to come to a deal or risk tariffs on the rest of its exports to the US.
- Kudlow mentioned it is likely for Trump to meet Xi during the G20 meeting in Osaka (28-29 Jun).
- China's Ministry of Commerce declared to the press that it would be forced to respond with countermeasures but there has been no update so far. Our Chief Economist, Suhaimi, had stated in their report here that China had practice restraint and may seek to seal a deal by withholding countermeasures for now.

The few points above underscores how much the US want a deal soon, even as Trump said "no rush".

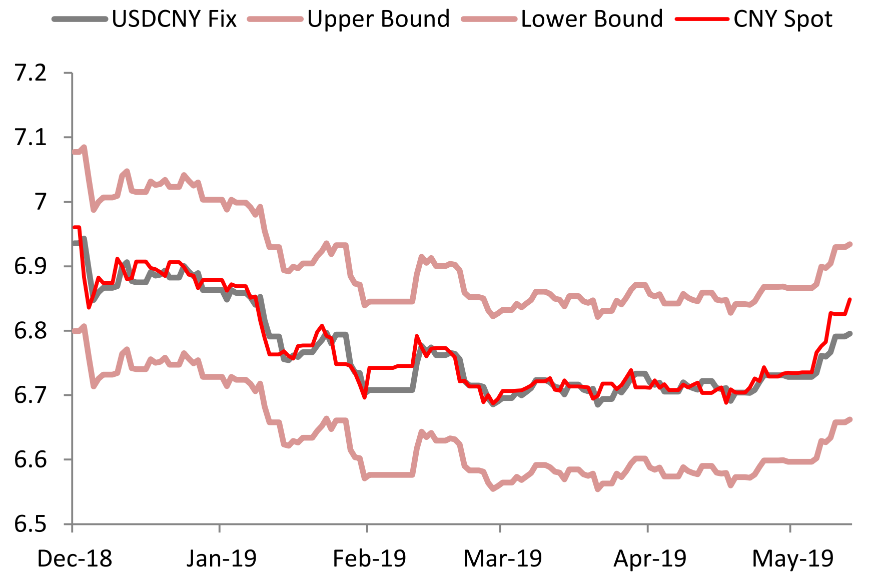
Chart 1: PBoC Acts to Slow CNY Depreciation Via Fixing



Source: Maybank FX Research & Strategy, Bloomberg, CFETS

USDCNH has rallied considerably more than most in the FX space and understandably, as there is increasing expectation for China to weaken its currency to support its external balance should trade war continue to escalate. The USDCNY reference rate was fixed at 6.7954, notably still under the 6.80-figure. The USDCNY fixing has been increasingly lower than our estimates and the widened spread suggests that counter cyclical adjustment factor has been at work to slow the CNY depreciation.

Chart 2: USDCNY is en-route to test the upper bound of the trading band

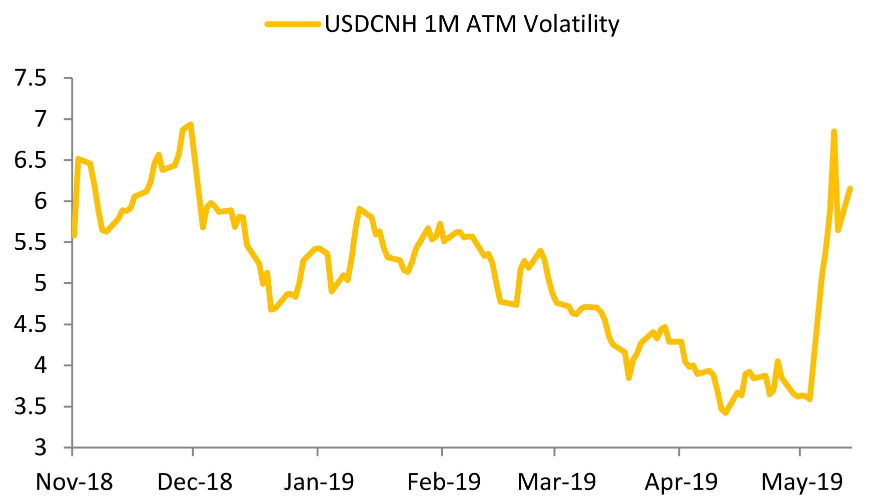


Source: Bloomberg, Maybank FX Research & Strategy

USDCNY is still bound to +/-2% trading band around the daily USDCNY fixing and since the Aug 2015 fixing refresh, the USDCNY spot trades largely closely to the fixing (vice versa) as the USDCNY fixing takes into account the USDCNY close the day before. However, this has changed recently, possibly due to the works of the counter cyclical adjustment factor in the fixing as well as renewed depreciation pressure on the yuan in the short term.

With the 1-month deadline given, it is also not surprising for 1M USDCNH volatility (ATM) to spike recently after drifting lower since Jan.

Chart 3: 1M At-the-Money Vol Spiked for USDCNH



Source: Bloomberg

We like to flesh out the three scenarios painted in our FX Weekly.

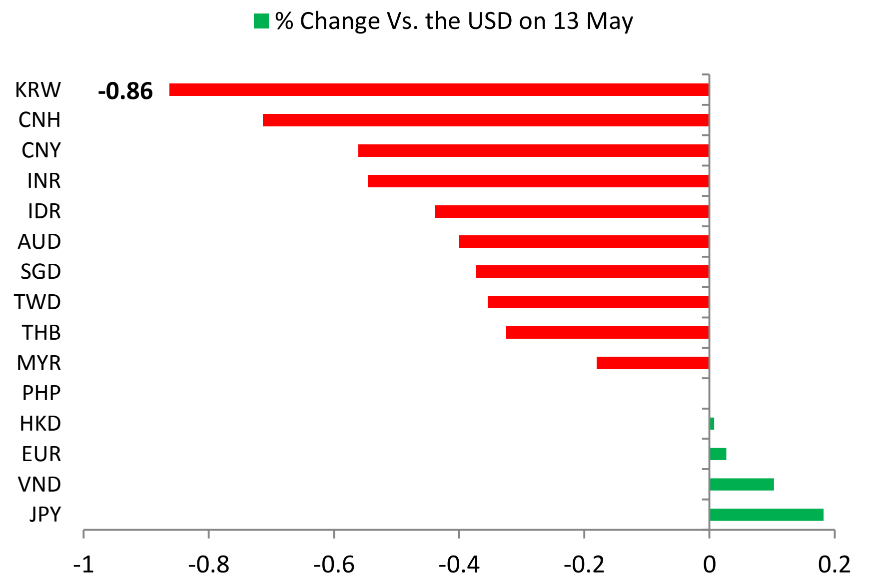
Our (1) base case scenario looks for **retaliatory response from China possibly coming while US-China trade talks continue** with some sort of deal possible at the G20 Summit in Japan (28-29 Jun).

Chart 4: USDCNH Closes in On Resistance at 6.90

So far, USDCNH has spiked to a high of 6.8963 before tapering off to levels around 6.89. This pair could meet resistance at the 6.9073-figure (76.4% Fibonacci retracement of the Oct high to Mar low). This resistance level could hold as long as there are signs of more rounds of negotiations being held. Support is now seen around 6.8620, before the next at 6.8250 (50% fib, 200-dma). Signs of further talks should come soon in light of the 1-month deadline given by the Trump administration.

Insofar, regional currencies were mostly hurt with KRW leading in losses followed by CNH. We continue to expect Asian currencies to weaken, in particular, CNH, CNY, KRW, TWD. AUD seems to be rather resilient for a currency with high beta.

Chart 5: Asian FX React But Not Overreact



Source: Bloomberg

Our base scenario still expects a trade deal within the quarter and that includes undoing the tariff hike that came into effect last Fri as well as the partial removal of 2018-imposed tariffs. That could mean a full reversal of the USDCNY rally that we have seen which should bring the USDCNY towards 6.70. Still, given the potential timeline that seems to have dragged out towards the G20 Summit in 28-29 June, we anticipate the RMB relief rally to be later and thus, we tweak our USDCNY forecast for 2Q towards 6.75 from 6.70 and leave 3Q and 4Q forecast unchanged.

	2Q19	3Q19	4Q19	1Q20
USDCNY	6.75	6.65	6.70	6.68

Strategies Based on Our House View

Prefer to lean against the USDCNH strength into the latter part of this month and buy the AUD on dips. This antipode is the most compelling view for a G7. AUDUSD has been the most sensitive to trade war development but it seems as if short positioning is stretched and AUD bears are finding hard to gain traction. We prefer to long the AUD (spot reference at 0.6972). Stop loss at 0.6900 for a target at 0.7060 before the next at 0.7155. Risk reward ratio is 1: 2.52.

Scenario 1B)

There is an alternative scenario which we label 1b where we envisage a preliminary deal with the Trump's administration undoing this latest tariff hike but leaving the other 2018-imposed tariffs intact. Accompanying that decision is their commitment to further rounds of negotiations (back to square 1). In that case, we could see a partial retracement of the USDCNY but we would reflect the delay in a real deal (that includes the removal of 2018 tariffs) in the USDCNY forecast.

	2Q19	3Q19	4Q19	1Q20
USDCNY	6.80	6.75	6.80	6.77

Scenario 2

We see some risk of scenario (2) that could see another 25% tariff on $325 bn of Chinese goods. This could come within a month, as indicated by the Trump administration. We anticipate the likelihood of this to become more apparent closer to deadline (around 10th June). In that case, pressure on the CNY could become more persistent. Beyond the resistant level at 6.9073, this USDCNH could head towards the next at 6.9455 and then at 6.9805.

	2Q19	3Q19	4Q19	1Q20
USDCNY	6.90	6.80	6.80	6.77

Scenario 3

(3) The worst case scenario will be a case of outright no-deal. Even as they want a quick deal, recent developments suggest risks that Trump may hold on to the false notion that "tariffs" is good for the US economy and go for an "all or nothing" scenario have increased. A full-blown trade war and a breakdown on issues of trust and impasse on non-tariff factors (IP, tech transfer). That could increase the risk of a recession and change the trajectory of our USDAxJ forecasts to the upside.

	2Q19	3Q19	4Q19	1Q20
USDCNY	6.95	7.05	7.10	7.15

Our economic team has shared that a full-blown trade war will have knock-on effects on global financial, currency market as well as domestic demand especially investment. Estimates by the ASEAN Macroeconomic Research Office (AMRO, Fig 5) showed a full-blown US-China trade war will shave average -0.6ppt and -0.3ppt off China and US real GDP growth in 2019-2020. Regional economies hardest hit by a full-blown US-China trade war are Hong Kong (-0.86ppt) and Singapore (-0.65ppt), followed by South Korea (-0.37ppt), Malaysia (-0.24ppt), Thailand (-0.19ppt), Vietnam (-0.14ppt), Indonesia (-0.12ppt), Philippines (-0.10ppt) and Japan (-0.06ppt). ASEAN's total exports are all currently in negative territory, except for Vietnam (Fig 6).

Currency Impact In the Region

We hold our view that in the near-term, trade-linked FX including CNH, KRW could continue to trade on the backfoot while EUR, JPY and USD could remain supported. For the ASEAN currencies:

USDSGD – Initial kneejerk reaction to trade disruption is a sell-off in the SGD given the reliance of the economy on trade. We could see the SGD NEER drift lower but still above the mid-point of the policy band. Currently, the SGD NEER is 1.20% above the mid-point. Further upmoves though could be a slow grind given the quasi-safe haven nature of the SGD as the only Asian country with a triple-A rating, large current account surplus and not-insignificant foreign reserves. Near-term moves by the USDSGD toward 1.37-38 levels cannot be ruled out. A trade deal though could see the USDSGD slide back below the 1.35-levels.

USDMYR - The MYR has been exhibiting more resilience than its regional peers although it is unlikely to buck the USDAXJ trend. Last seen around 4.1665, the USDMYR pair may face resistance around 4.1672 (76.4% Fibonacci retracement of the Dec-Apr fall) before the next at 4.1850 and then 4.20. A deal between the US and China could bring this pair back towards the 4.1460 support, before 4.1378 (21-dma).

USDIDR – The impact on the IDR is likely via the sentiment channel. A risk-off environment could see foreign investors shift away from emerging market assets, including Indonesia, back towards less-risky assets. This together with slowing Chinese demand, which is likely to impact demand for raw material and slow exports, puts downward pressure on the IDR. Still, optimism over a Jokowi second term and his retention of Sri Mulyani as his key economic advisor (once officially confirmed on 22 May) should mitigate some of this downward pressure on the IDR in the near term. USDIDR could hover around 14500-14600 in the near term.

USDPHP – Like its IDR counterpart, the PHP also faces downside pressure from via the sentiment channel on market concerns over trade disruptions. The search for less risky assets amid risk-off sentiments could see a sell-off in emerging market assets, including the Philippines. Meanwhile, the mid-term elections on 13 May could see President Duterte's ruling coalition retain its majority in both the houses of Congress. This though does not necessarily translate into a strong PHP, possibly on concerns over a lack of new policy initiatives to drive the economy further as well as the lack of policy continuity since Duterte's presidency is term-limited. We could thus see PHP weakness intensify in the near term consequently with a move by the USDPHP towards the 52.640-levels possible.

USDTHB – The THB has been able to avoid much of the downward pressure from Sino-US trade war concerns as focus was on the formation of the next Thai government after the 24 Mar general elections. The election results suggest either a pro-military government led by the Palang Pracharath Party or a more neutral coalition not associated with either the pro-military or anti-military camps fronted by the Bhum Jai Thai Party. Either case suggests a fractious government made up of numerous smaller parties that is likely to be unstable and short-lived, supportive of the USDTHB higher towards the end of 2019. Aside from political uncertainty, also keeping the USTHB supported around the 31.600-32.00 region in the next three-six months will be the Sino-US trade dispute given its relatively large reliance on trade.

DISCLAIMER

This report is for information purposes only and under no circumstances is it to be considered or intended as an offer to sell or a solicitation of an offer to buy the securities or financial instruments referred to herein, or an offer or solicitation to any person to enter into any transaction or adopt any investment strategy. Investors should note that income from such securities or financial instruments, if any, may fluctuate and that each security's or financial instrument's price or value may rise or fall. Accordingly, investors may receive back less than originally invested. Past performance is not necessarily a guide to future performance. This report is not intended to provide personal investment advice and does not take into account the specific investment objectives, the financial situation and the particular needs of persons who may receive or read this report. Investors should therefore seek financial, legal and other advice regarding the appropriateness of investing in any securities and/or financial instruments or the investment strategies discussed or recommended in this report.

The information contained herein has been obtained from sources believed to be reliable but such sources have not been independently verified by Malayan Banking Berhad and/or its affiliates and related corporations (collectively, "Maybank") and consequently no representation is made as to the accuracy or completeness of this report by Maybank and it should not be relied upon as such. Accordingly, no liability can be accepted for any direct, indirect or consequential losses or damages that may arise from the use or reliance of this report. Maybank and its officers, directors, associates, connected parties and/or employees may from time to time have positions or be materially interested in the securities and/or financial instruments referred to herein and may further act as market maker or have assumed an underwriting commitment or deal with such securities and/or financial instruments and may also perform or seek to perform investment banking, advisory and other services for or relating to those companies whose securities are mentioned in this report. Any information or opinions or recommendations contained herein are subject to change at any time, without prior notice.

This report may contain forward looking statements which are often but not always identified by the use of words such as "anticipate", "believe", "estimate", "intend", "plan", "expect", "forecast", "predict" and "project" and statements that an event or result "may", "will", "can", "should", "could" or "might" occur or be achieved and other similar expressions. Such forward looking statements are based on assumptions made and information currently available to us and are subject to certain risks and uncertainties that could cause the actual results to differ materially from those expressed in any forward looking statements. Readers are cautioned not to place undue relevance on these forward looking statements. Maybank expressly disclaims any obligation to update or revise any such forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

This report is prepared for the use of Maybank's clients and may not be reproduced, altered in any way, transmitted to, copied or distributed to any other party in whole or in part in any form or manner without the prior express written consent of Maybank. Maybank accepts no liability whatsoever for the actions of third parties in this respect.

This report is not directed to or intended for distribution to or use by any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation.

Published by:

Maybank

Malayan Banking Berhad
(Incorporated in Malaysia)

Saktiandi Supaat	Christopher Wong	Fiona Lim	Leslie Tang
Head, FX Research	Senior FX Strategist	Senior FX Strategist	Senior FX Strategist
saktiandi@maybank.com.sg	wongkl@maybank.com.sg	Fionalim@maybank.com.sg	leslietang@maybank.com.sg
(+65) 63201379	(+65) 63201347	(+65) 63201374	(+65) 63201378