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FX Insight

RMB - Relief For Now, The Gap Remains

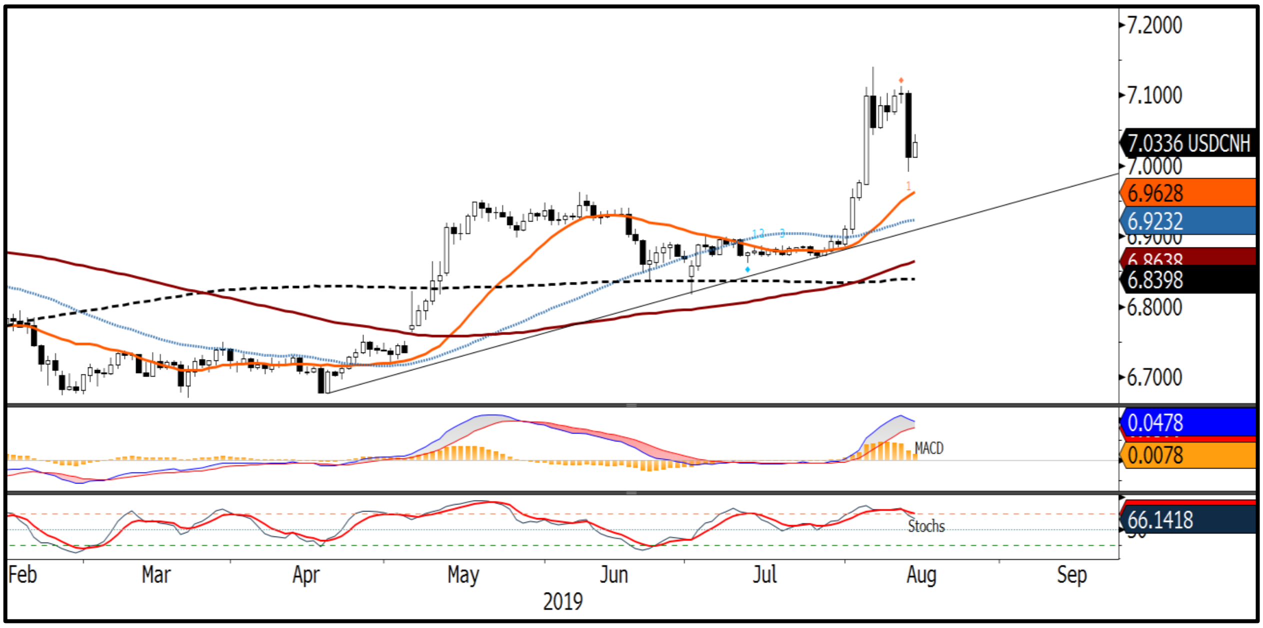
RMB Boosted by Tariff Delays

Overnight, the Office of the US Trade Representative released a statement to exclude “certain products” from the tariff list of products that would be subject to 10% levy on 1st Sep based on “health, safety, national security and other factors”. In addition, as part of USTR’s public comments and hearing process, the tariff should be delayed to 15th Dec for certain articles including “cell phones, laptop computers, video game consoles, certain toys, computer monitors and certain items of footwear and clothing”.

Trump clarified that the tariff delay is meant to avoid an impact on holiday spending. From China’s side, the Ministry of Commerce posted a statement on its website to confirm that there had been a phone conversation between Vice Premier Liu He and USTR Lighthizer and Treasury Secretary Mnuchin on Tuesday and there would be more in two weeks. The statement also included a reiteration of China’s objection to the trade tariffs scheduled to take effect on 1st Sep.

Market responded with a relief rally in crude, equities and most of Asia Pacific ex Japan FX gained against the USD. The USDCNH touched a low of 6.9908. While this provided much relief for markets, the gap between the two nations remains wide. This was a clear modification of their tariff plans rather than a compromise. As such, we still see some near-term upside risks for USDCNY and USDCNH, last seen at 7.0180 and 7.0374 although moves might not be as volatile as what we have seen on 5 Aug 2019.

USDCNH Almost Reversed Out the Move Last Week, Back on the Upmove Now



Source: *Bloomberg, Maybank FX Research & Strategy*

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Wary of Inflation Risks and Christmas Shopping Impact

A (Bloomberg) estimate of $160bn of goods will be subjected to the tariffs on 15th Dec and $110bn will be affected still on 1st Sep. It is apparent that Trump is concerned about the impact that the tariffs would make on retail spending given the reference to "Christmas Shopping" as well as the potential increase in price pressure. US CPI came in firmer at 1.8%y/y for Jul vs. previous 1.6% and the breakdown suggests that the increase was broad-based. Core CPI (ex food and energy) rose to 2.2%y/y from previous 2.1%.

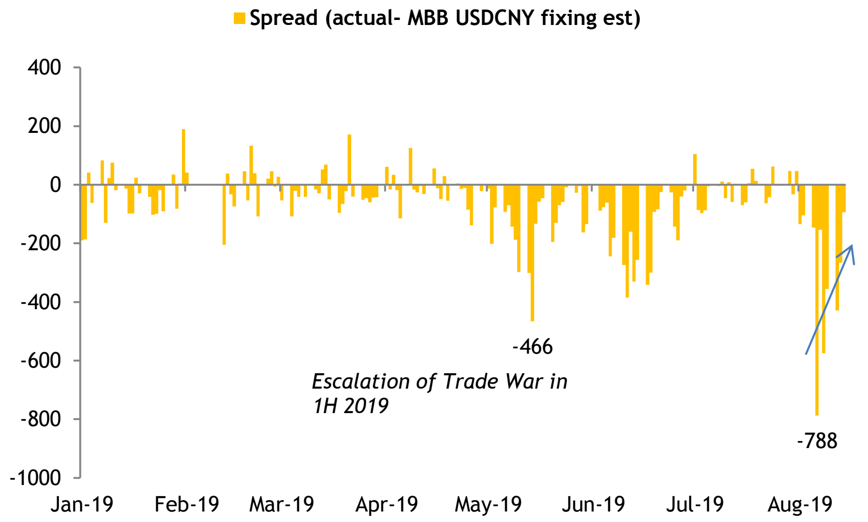
No Compromise, Only Modification of Tariff Plans

The latest development appears to us that the US-China tensions did not ease and there was no compromise reached yet even though there was a mention of a phone call between the high level officials. The US had simply modified their tariff plans so as to reduce the impact of the tariffs on their consumers and merchants. Much of the tariffs may still take effect, albeit in phases. However, this also allows more time for negotiations.

USDCNY Fix Yesterday Was Telling

The USDCNY daily fix (aka the reference rate) yesterday was telling. We noted in our GM Daily yesterday (13th Aug) that the countercyclical adjustment factor was smaller for the fix and that from the policy signalling perspective, PBoC might allow market forces to dictate the direction of the fix as well as the yuan.

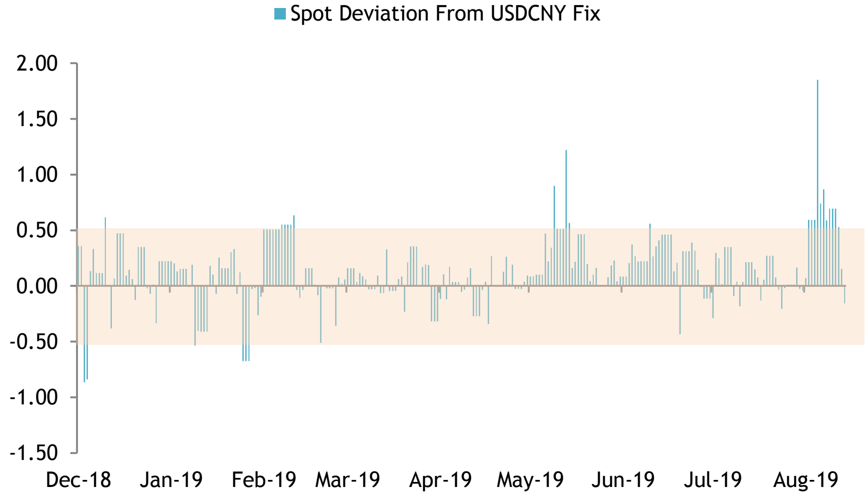
Possible Sign of Confidence as Spread between actual and projected USDCNY fix narrows



Source: Maybank FX Research and Strategy Estimates, Bloomberg, CFETS

On hindsight, the smaller countercyclical adjustment factor could also be taken as a *sign of confidence* in the yuan, and even hint of a positive development for the US-China talks. In addition, USDCNY has started to trade at less than 0.5% above the USDCNY reference rate (Chart in next page) and that convergence is a sign that market players have taken the cue from PBoC that further yuan weakness is unlikely in the near-term and depreciation pressure on the yuan is alleviated. Yuan bears should be alert when these "stars are aligned".

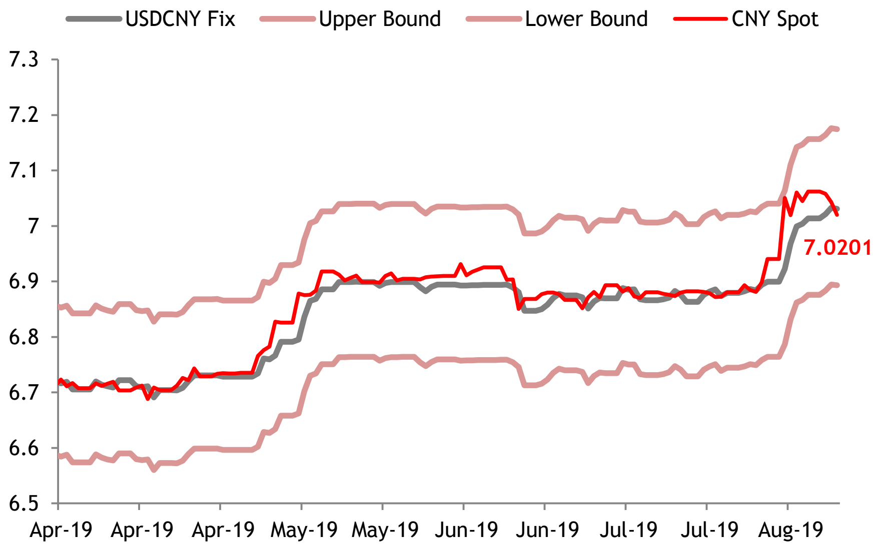
USDCNY spot reverts to trade close to the USDCNY reference rate (shaded +/-0.5% of fix)



Source: Bloomberg, Maybank FX Research & Strategy

5th of Aug saw PBoC fixed the USDCNY reference rate above 6.90 for the first time (at 6.9225) since last Dec. As a result, USDCNY closed at 1.85% above the fix for the day. The daily trading band that USDCNY spot is allowed to trade in is +/-2% around the fix. Deviation of 1% and above only happens at the height of trade-war escalation. USDCNY now trades below the fix (shown in the chart below).

USDCNY Spot now trades below the USDCNY Fix (7.0312)



Source: Bloomberg, Maybank FX Research & Strategy

We think that the volatile move seen on 5 Aug may not repeat so soon as the authorities are not keen to see more volatility in the yuan and the psychologically key level 7 has been breached. PBoC Yi Gang has assured that the currency will remain strong in the medium term. The recent move lower in the USDCNH and USDCNY seems to be a case in point - that there could be two-way moves that renders the CNY generally stable in the medium term. Moving forward however, USDCNY could retain an upside bias in the next six months as fundamentals remain soft, monetary stimulus may not be as forthcoming as what we have imagined given the inflation environment and external headwinds like US-China trade tensions remain. We see our year-end forecast to 6.95-7.05 for USDCNY with one RRR cut expected this year given the recent dismal activity and credit numbers.

We also view the allowance for USDCNY to break above 7 as an indication that China has hardened its stance and the goodwill of keeping the USDCNY below 7 is now removed. There are whispers of officials sticking to their plan to visit Washington in Sep for the next face-to-face trade discussions but Chinese negotiators do not seem to have a lot of optimism on progress there. As such, the gap between the two sides of negotiators did not narrow and that leads us to put out three scenarios that we envisage that could unfold in the next six months.

Plausible Outcomes in the next six Months	Probability	Implication for USDCNY
Lines of Communication between the US and China are kept open. Trade talks remain protracted with risk of escalation (short of no-deal), in the near term with potential of a deal at the turn of the year. No Tariffs Removed.	Base Case (60%)	USDCNY to head towards 6.95-7.05 into the end of the year.
US and China come to an interim agreement with partial rollback of tariffs.	Best Case (15%)	USDCNY to slip towards 6.70 by the end of the year.
US and China have a complete breakdown in negotiations. The 10% tariffs that are scheduled to take effect on 1st Sep and 15th Dec could be raised to 25%. More limitations imposed on technology companies from China.	Worst Case (25%)	USDCNY to head towards 7.30.

FX Technical Outlook: USDCNH [Daily] - Retracements For Now, 1-2 Week View

Support is seen around the 7.0050-level and momentum indicators suggest that this pair could consolidate within the 7.00-7.08 range for now. Resistance is seen around 7.0372 before 7.0772. Resistance beyond the recent high of 7.1418 is seen around 7.2064.

Source: Maybank FX Research & Strategy, Bloomberg

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