Maybank

FX Insight

RMB - Stable Forever?

FX

Global

Stable RMB, Widening CH-US 10y Spreads

The CNY has been stable against the USD at around 6.90 since the start of the year. This has been largely due to the lack of USD strength in the past 5 months, capital controls and a sharply widened CH-US 10yr yield spreads. Are we looking for RMB to remain stable forever?

CH-US Yield Spread Risk Narrowing

We see a risk of CH-US spread narrowing into the second half of the year. The move might come from both legs. On one hand, we look for growth in China to slow for the rest of the year, as heralded by the softening Apr activity numbers. Potential of slower fiscal spending after a strong start to the year might also reduce the room for PBoC to tighten its monetary policy as it had done so far, putting a ceiling on domestic yields. On the other hand, we see more room for UST yields to go higher at this point as markets underprice Fed balance sheet reduction and markets have almost completely unwound its bets on Trump's admin to push through tax reforms, deregulation plans and infrastructure spending. Any fiscal surprise in the form of realistic plans could generate upside risks for UST rates. That could mean that the CH-US spread could be primed for a reversal.

Downside Risks To RMB

As we look for CH-US yield spread to narrow, we also look for CNY to weaken against the USD. That should bring the USDCNY towards our year-end forecast of 7.04. The performance of CNH against Asians is more mixed. Technically, SGDCNH looks a bit toppish at around the big-5.0 figure while we see a lot more upside for MYRCNH towards 1.63/1.66. *Just in, the latest downgrade by Moody's agency from Aa3 to A1, in line with Fitch and one rung below the S&P's AA- could just be one of the trigger for USDCNY and USDCNH to head higher. USDCNH has already reacted by jumping towards 6.89 from levels around 6.88 before tapering soon after. Moody's cited worsening financial strength, rising debt and slowing economic growth as reasons for the cut in rating. Outlook is stable.*

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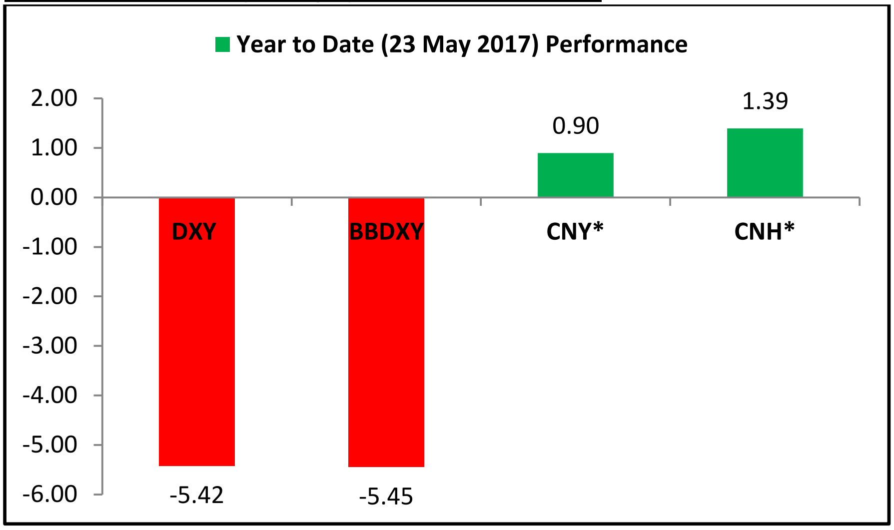
The Stable RMB

The CNY has been stable against the USD at around 6.90 since the start of the year. The key reason for CNY to be able to remain steady against the USD is the lack of strength in the USD. The DXY has already reversed out its post-election gains as we write (24 May) and recorded 5.3% depreciation since the start of the year, a 5.3% depreciation for the Bloomberg's DXY (BBDXY) index (which has a lower a weightage of EUR - around 30% vs the DXY at 60%).

Chart 1: CNY's stability is largely due to USD weakness



Source: Bloomberg, Maybank FX Research
**denotes the currency performance against the USD*

Deleveraging A Priority

Now, deleveraging has been a high priority of the Chinese government since 2015. To make good its words this time, PBOC tightened monetary bias by raising reverse repo rates and MLF rates whilst increasingly relying on MLF as a means of providing liquidity rather than OMO. The aim is to discourage carry trades that enables traders to profit by borrowing at the front end and lending at the longer end. As a result of the initiatives undertaken by the central bank since end of last year, the curve has flattened significantly in the past few months, China bond yields have generally moved higher as well.

Chart 2: Curve Bear Flattens But Yields Are Higher Across the Board

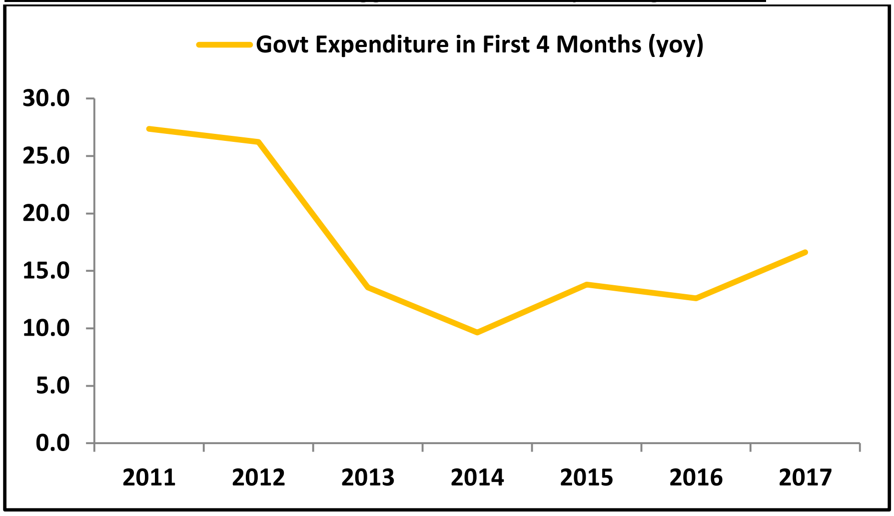
Source: Bloomberg

That has also widened the spread between China's 10yr and that of the UST, lending some support to the CNY.

Tightening Bias To Moderate

With activity numbers showing signs of softening and the autumn National Congress approaching, PBoC's tightening bias may slow. Juggling growth stabilization and deleveraging could become a more challenging task as they start to slow fiscal expenditure. With the National Congress approaching, the Chinese leaders might prefer to ensure growth stability as we near 3Q. Keep in mind that the State Council seems to have been rather aggressive in fiscal spending for the first four months of 2017 compared to the same period in previous years, allowing room for PBoC to tighten in the same period. With growth slowing and a budget deficit target of 3% of GDP to maintain, we suspect that this momentum in fiscal expenditure will not continue for the rest of the year and that could translate to less room for the central bank to tighten monetary policy. That could very well put a lid on China bond yields.

Chart 4: China Has Been More Aggressive In Fiscal Spending This Year



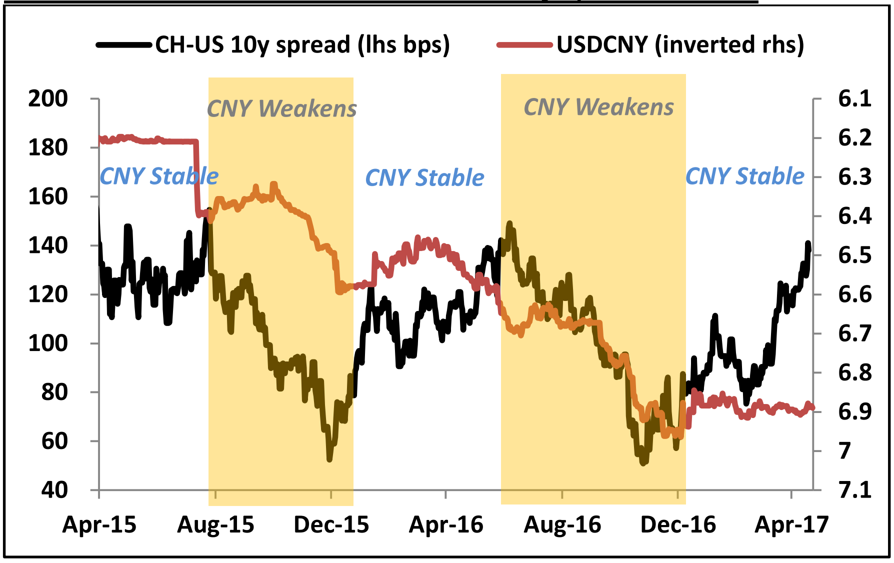
Source: Ministry of Finance, CEIC, Maybank FX Research

Upside Risks to UST Yields

On the other hand, while markets are almost fully priced for the 2 more Fed hikes this year, we see complacency with regards to imminent reduction in the Fed's balance sheet which should have a more direct impact on UST yields. In addition, markets seem to have unwound their bets on Trump's plans for the economy in terms of tax reforms, deregulations and infrastructure spending, not helped the least by the current political furore faced by the White House after Trump fired FBI Director James Comey. That said, markets' positioning at this point suggests that there is certainly more room for rates to move higher rather than lower once the political situation stabilize. The fiscal expectation of Trump is now set so low such that should Trump be able to surprise with any real feasible measures, UST yields might just be able to break higher.

Downside Risks to the RMB
CNY tends to remain stable in times when CH-US 10yr spread widens and weakens when the spread narrows.

Chart 4: CNY Tends to Weaken as CH-US 10y Spread Narrows

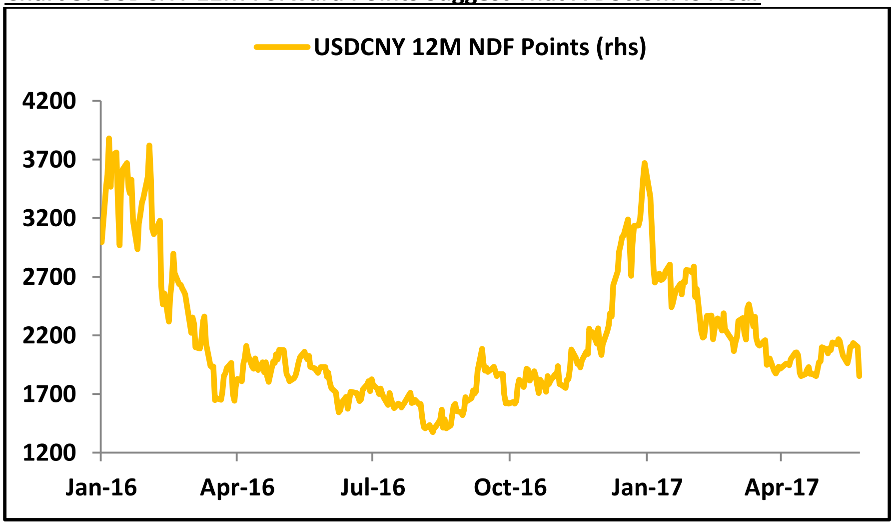


Source: Bloomberg, Maybank FX Research

At this point, we see risks of the CH-US 10y spread narrowing after widening for a good five months. This is based on our view that we see less room for domestic bond yields to go a lot higher and upside risks to the UST yields. As such, the CH-US 10y spread which is already reaching 2016 high, is unlikely to widen a lot more. Rather, there is an increasing risk that it could reverse lower and that could bring about the next leg of CNY weakness towards our year end forecast of 7.04.

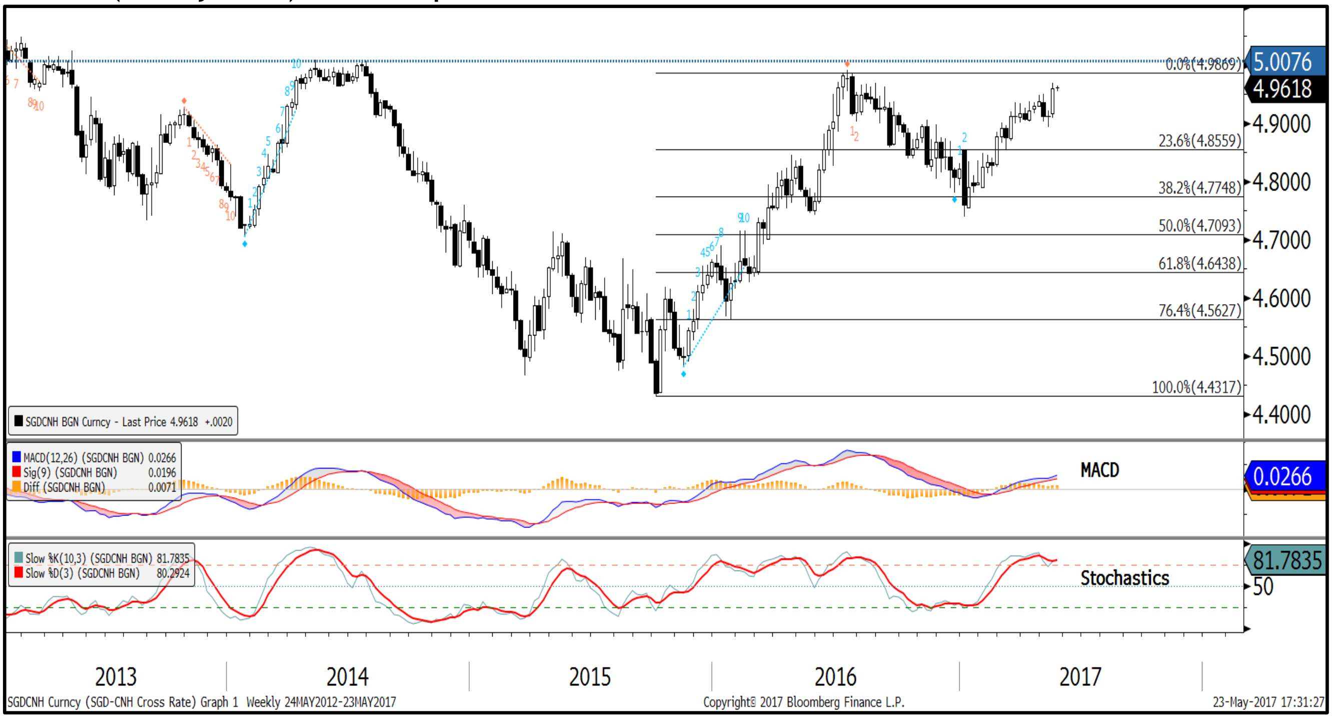
Forecast	2Q 2017	3Q 2017	4Q 2017	1Q 2018
USDCNY	6.95	7.01	7.04	7.04
USDCNH	6.95	7.02	7.05	7.04

Chart 5: USDCNY 12M Forward Points Suggest That A Bottom Is Near



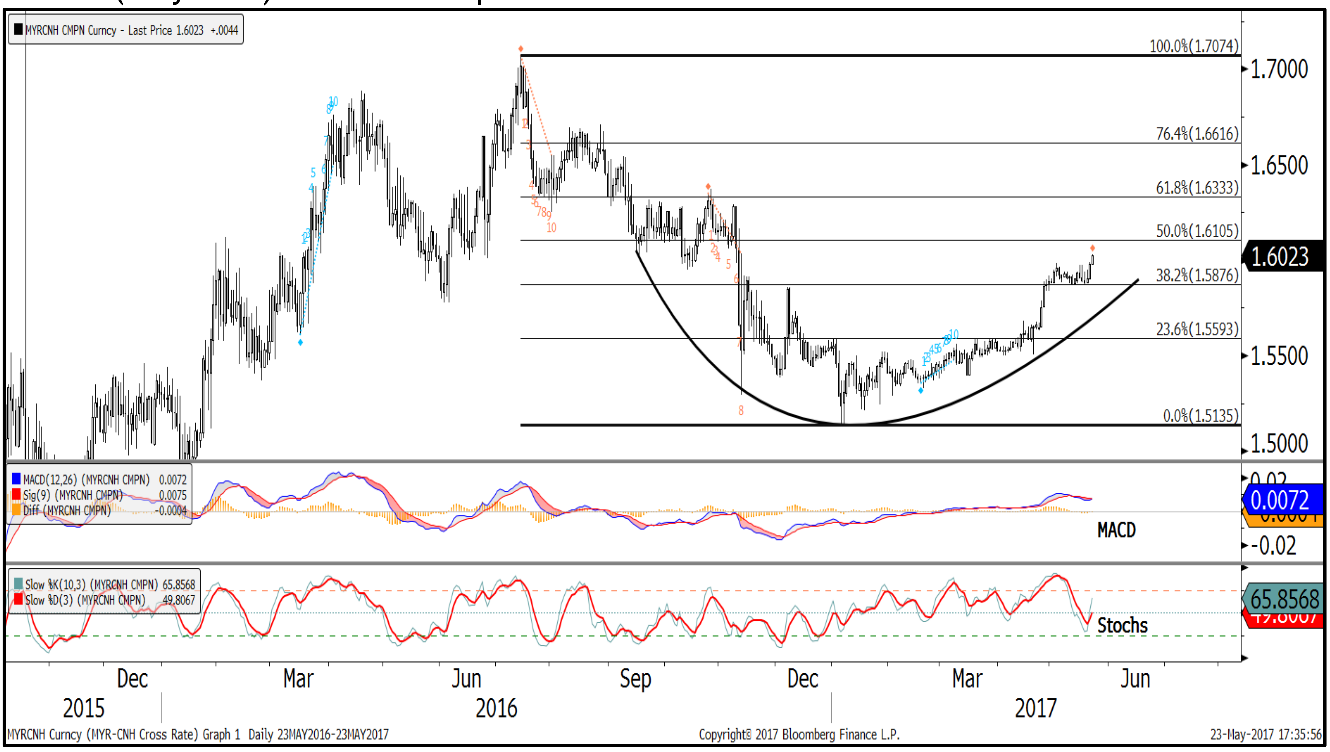
Source: Bloomberg, Maybank FX Research

SGDCNH (Weekly Chart) - Sell on Upticks



SGDCNH has been bid for a while and trend is still bullish at this point. However, this cross risks reversing towards the 5.00-figure, especially if the USD starts to turn higher. Stochs are overbought and bullish momentum is weakening. Support is seen around 4.8560 (23.6% fibonacci retracement of the 2015-2017 rally). Strong resistance is seen at 5.00, failing to break that could be form triple top.

MYRCNH (Daily Chart) - Risks To The Upside



MYRCNH seems to have a lot more upside to go, last seen around 1.6030 with a reliable support at 1.5880 (38.2% Fibonacci retracement of the 2016-2017 sell off). Next resistance at 1.61 (50%) is seen before the next at 1.6330/1.66.

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