

RMB Watch

The Underinvested China

China Woos Foreign Investors To its Capital Markets

The latest Caixin PMI-mfg print was well under expectations and underscores the severity of the external headwinds that China faces. In an environment of trade war, slowing growth and narrowing current account surplus, the yuan volatility has risen over the past few years, with the 1W USDCNY at-the-money volatility posting higher yearly averages. Should the USD environment remain unfavourable, we do not rule out further RMB weakness.

As onshore markets are away this week for National Day celebrations, we take the opportunity to delve into China's financial account. Foreign investors have been accumulating local government bonds, NCDs and increasing their direct investment. This is a stark contrast to the yuan depreciation witnessed between the years 2014-2016 when China was liberalizing its capital account to get the RMB into the Special Drawing Rights (SDR) basket of the IMF. The IMF officially included the RMB on 30 Sep 2016.

Analysts

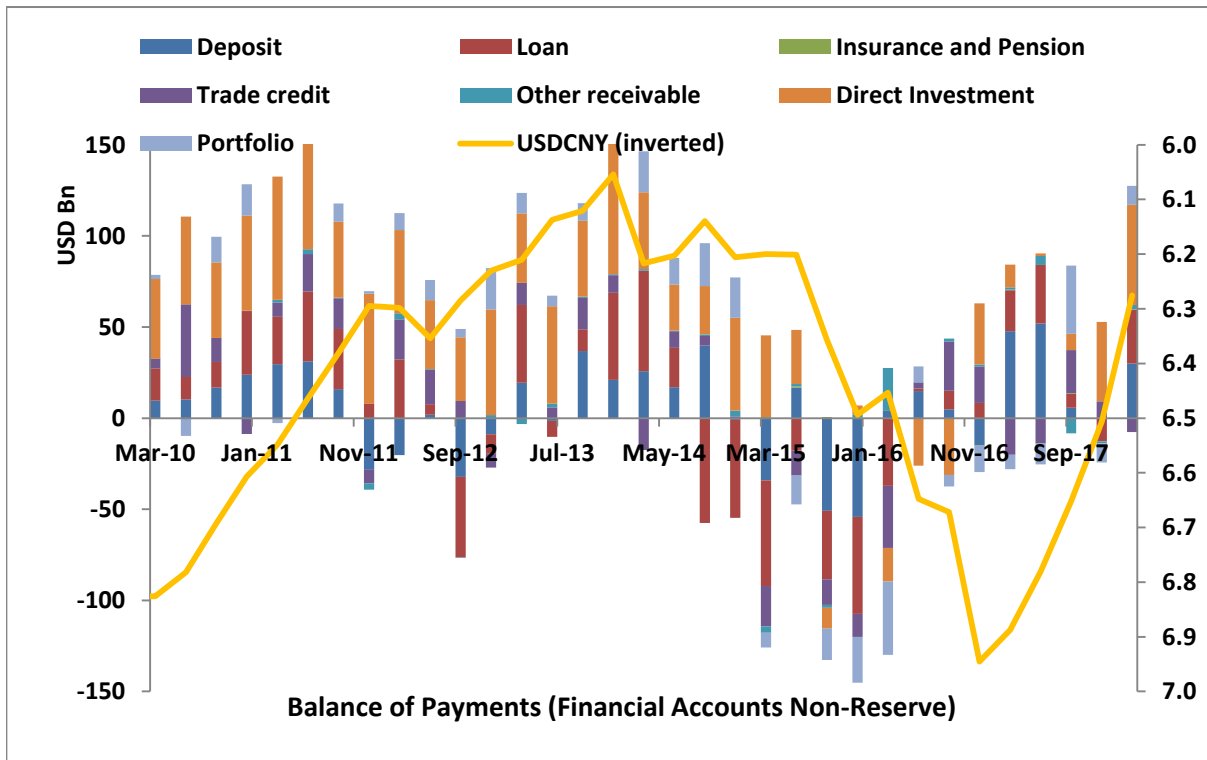
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Chart 1: China has Been Seeing Inflows



Source: CEIC, SAFE, Maybank FX Research & Strategy

Note: Other investment subcomponents in the Balance of Payments Financial Accounts include Deposits, loans, insurance and pension, trade credit and other receivable and data shown here are liabilities. Last Available Data for this breakdown is as of 1Q 2018.

While China had put in place capital controls to limit capital outflows, the government had been wooing foreign institutional investors to its capital markets via its RMB Qualified Foreign Institutional Investors (RQFII), China Interbank Bond market and Bond connect. As a result, foreign holding of China Treasury bonds jumped from around US\$400bn in 2016 to US\$1trn as of Aug this year. Earlier in Mar, Bloomberg announced that RMB-denominated government and policy bank securities would be added to the Bloomberg Barclays Global Aggregate Index, phased over 20-month starting from Apr 2019.

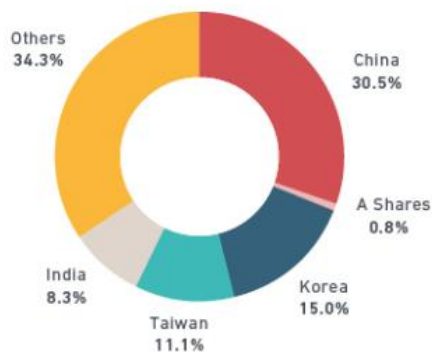
Chart 2: Foreign Holdings of CGB Rise Exponentially



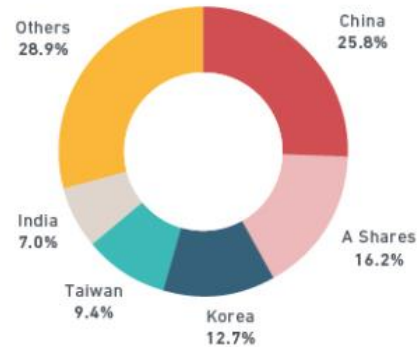
Source: Chinabonds, Bloomberg, Maybank FX Research & Strategy

On the equity front, MSCI had started to include A-shares (shares that are RMB-denominated) in Apr and Aug this year. As of Aug, MSCI had included 5% of China’s A-shares and that constitutes 0.8% of the MSCI EM index. A full inclusion would see the ratio rise to 16.2%. Recently, MSCI had proposed to ramp up the A-shares inclusion to 20% in two stage in 2019 and may even include smaller tech shares.

MSCI EM INDEX WITH 5% CHINA A SHARES



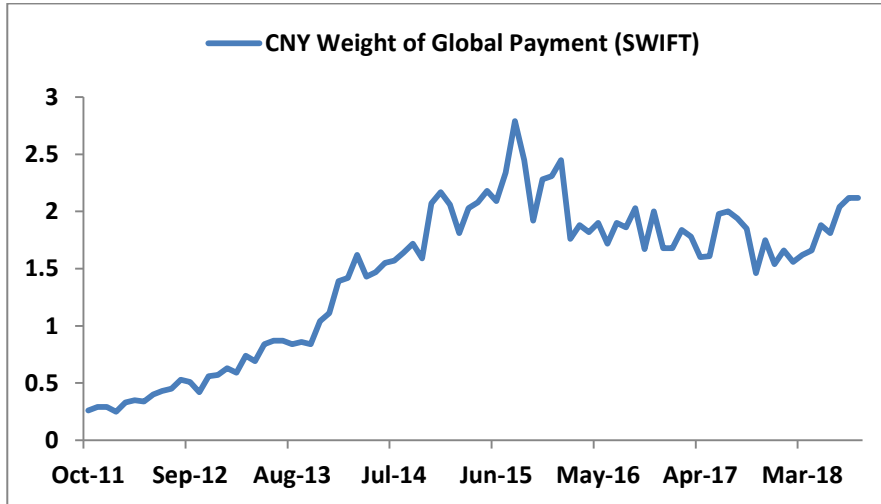
MSCI EM INDEX WITH 100% CHINA A SHARES



Source: MSCI

Elsewhere, FTSE Russell will include Chinese stocks to its Indexes next year. A-shares will make up 5.5% of its FTSE Emerging index. FTSE will also include Chinese government bonds in its “watch list” for potential inclusion into its indexes. That decision could be made in Mar or Sep next year.

With PBoC unlikely to embark rate hike cycles in the foreseeable future, stable money market rates, low but rising foreign participation of the Chinese capital market and further inclusion in store for its bonds and equities could mean greater demand for the RMB in the next few years. In the meantime, the weight of CNY in global payment has been on the increase for much of this year according to SWIFT.



Source: Bloomberg, SWIFT

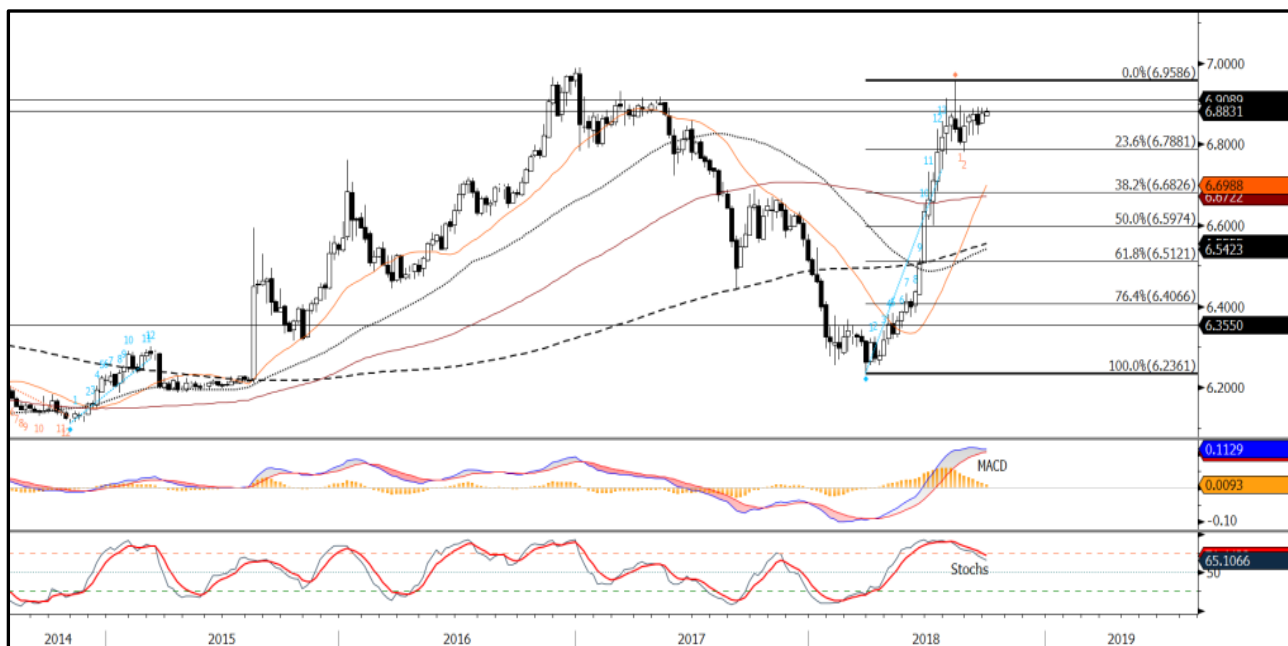
RMB On The Technical Charts

(USDCNH daily) - Pressing The Upper Bound



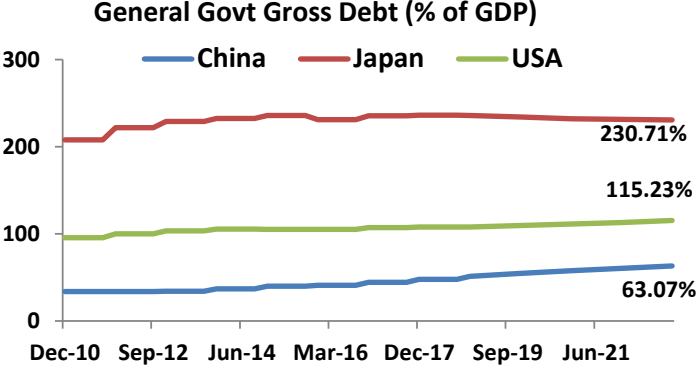
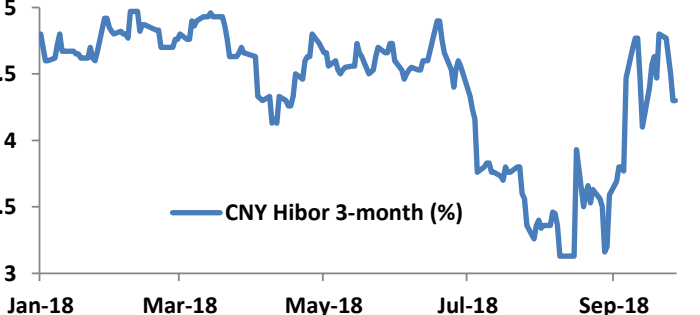
USDCNH has been pressing higher and could test the upper bound of the 6.80-6.90 range. Momentum indicators are fading and moves lower do not compel at this point. We prefer to wait for a break out for further confirmation. Next resistance at 6.96 (recent highs) and support is seen at 6.78 (50-dma). That said, the weekly chart shows bullish momentum is waning. Bulls need stronger cues to be invigorated. Price action suggests sideways trades to dominate though.

(USDCNH Weekly) - Bullish Momentum Wanes



Source: Bloomberg, Maybank FX Research & Strategy

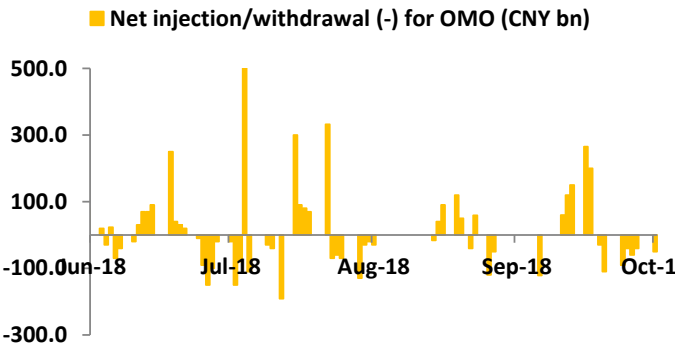
Keeping Track

| <u>Date</u> | <u>Events/Data Headlines</u> | <u>More Details, Impact and Views</u> | <u>Relevant Charts (if any)</u> | | | | | | | | | | | | |
|-------------|--|--|---|---------|-----------|--------|--------|--------|---------|--------|---------|--------|------|--------|------|
| 19 Sep | <p><u>Government Debt Can Rise</u></p> <p>National Institution for Finance & Development Vice Director Zhang Zhaojing said the government can use the large amount of assets as collateral for government debt.</p> | <p>The NIFD reported that the end 2Q leverage ratio in the real economy rose to 242.7% from 242.1% at end-2017; household leverage ratio rose 2 ppts to 51%.</p> | <p>General Govt Gross Debt (% of GDP)</p>  <table border="1"> <caption>General Govt Gross Debt (% of GDP)</caption> <thead> <tr> <th>Country</th> <th>Value (%)</th> </tr> </thead> <tbody> <tr> <td>China</td> <td>63.07%</td> </tr> <tr> <td>Japan</td> <td>230.71%</td> </tr> <tr> <td>USA</td> <td>115.23%</td> </tr> </tbody> </table> | Country | Value (%) | China | 63.07% | Japan | 230.71% | USA | 115.23% | | | | |
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| USA | 115.23% | | | | | | | | | | | | | | |
| 21 Sep | <p>PBoC signed memorandum with HKMA to facilitate its bill issuance in Hong Kong.</p> | <p>This PBoC bill sale was interpreted to be supportive of CNH. HKMA stated that it is meant to enrich spectrum of yuan financial products with high credit ratings, improve the yield curve of RMB bonds and support development of the offshore yuan business in Hong Kong. CNH Hibor spiked to 4.80%.</p> |  <table border="1"> <caption>CNY Hibor 3-month (%)</caption> <thead> <tr> <th>Period</th> <th>Rate (%)</th> </tr> </thead> <tbody> <tr> <td>Jan-18</td> <td>~4.8</td> </tr> <tr> <td>Mar-18</td> <td>~4.8</td> </tr> <tr> <td>May-18</td> <td>~4.8</td> </tr> <tr> <td>Jul-18</td> <td>~4.8</td> </tr> <tr> <td>Sep-18</td> <td>~4.8</td> </tr> </tbody> </table> | Period | Rate (%) | Jan-18 | ~4.8 | Mar-18 | ~4.8 | May-18 | ~4.8 | Jul-18 | ~4.8 | Sep-18 | ~4.8 |
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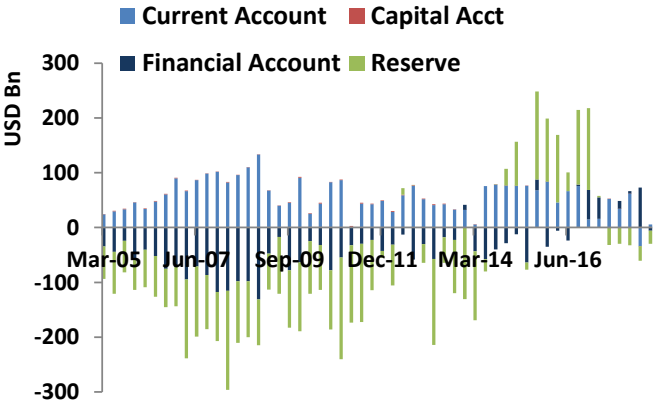
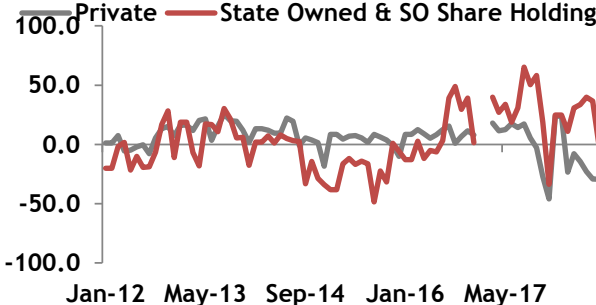
*News Sources from Xinhua, Bloomberg, China Daily, China Securities Journal, China Business News, People's Daily; Data from CEIC, Bloomberg, NBS, SAFE, PBoC

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| 24 Sep | <p data-bbox="302 213 577 308"><u>China Release a White Paper on the Trade War</u></p> <p data-bbox="302 325 533 451">This comes after China cancelled trade talks on 22 Sep.</p> | <p data-bbox="613 213 1077 244">Xinhua highlighted six main points:</p> <ol data-bbox="658 261 1218 1034" style="list-style-type: none"> <li data-bbox="658 261 1218 355">1) the gap in trade in goods alone is not a good indicator of China-U.S. trade and economic relations; <li data-bbox="658 373 1218 499">2) the discussion of fair trade should not be detached from the principle of mutual benefit of the World Trade Organization (WTO); <li data-bbox="658 517 1218 611">3) the accusation that China forces technology transfer is against the spirit of contract; <li data-bbox="658 628 1218 722">4) China's huge efforts and achievements with regard to IPR protection should not be dismissed; <li data-bbox="658 740 1218 930">5) the Chinese government's encouragement to Chinese business to go global should not be distorted as a government attempt to acquire advanced technologies through commercial mergers and acquisitions; <li data-bbox="658 948 1218 1034">6) China's subsidy policy complies with WTO rules and should not be attacked. | |

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| 25 Sep | <p>Up to the US</p> <p>Vice Commerce Minister Wang Shouwen said it is up to the US to decide when to resume trade talks</p> | <p>China clearly does not want to talk so soon after the US imposed the recent tranche of tariffs on Chinese goods. However, this latest comment basically threw the ball back to the US' court. This gels with the earlier rumours that China is hesitant to negotiate before the US mid-term elections and underscores how unwilling China is to initiate trade war escalation. China could continue to react but not overreact and with 1st Jan 2019 the next date to look out for, focus might just drift away from here for a while. In the meantime, China plans to enhance cooperation with the EU, Japan and Russia.</p> | | | | | | | | | | | | | |
| 25 Sep | <p>Overseas FI should have paid in capital of at least CNY10bn to sell bonds in China's interbank bond market</p> | <p>Non-financial firms must adhere to the rules by the National Association of Financial market Institutional Investors. Foreign bond issuers are allowed to use non-China accounting standards.</p> | | | | | | | | | | | | | |
| 26 Sep | <p>Looser Liquidity</p> <p>PBoC-run press stated that liquidity could be loose towards end of Sep.</p> | <p>The first half of the month saw substantial liquidity injection but since 19 Sep, PBoC has been making liquidity withdrawal though net amount decreased towards the end of the month.</p> |  <p>■ Net injection/withdrawal (-) for OMO (CNY bn)</p> <table border="1"> <caption>Approximate data from the OMO Net Injection/Withdrawal chart</caption> <thead> <tr> <th>Month</th> <th>Net Injection/Withdrawal (CNY bn)</th> </tr> </thead> <tbody> <tr><td>Jun-18</td><td>-50</td></tr> <tr><td>Jul-18</td><td>500</td></tr> <tr><td>Aug-18</td><td>100</td></tr> <tr><td>Sep-18</td><td>100</td></tr> <tr><td>Oct-18</td><td>-50</td></tr> </tbody> </table> | Month | Net Injection/Withdrawal (CNY bn) | Jun-18 | -50 | Jul-18 | 500 | Aug-18 | 100 | Sep-18 | 100 | Oct-18 | -50 |
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|--------|--|---|---|
| 27 Sep | <p><u>China and US Should Cooperate</u></p> <p>Minister of Industry and Information Miao Wei urged the US and China to cooperate.</p> | <p>The Minister said it is a misunderstanding that China will replace US in 10 industries in 10 years, pointing out a 30-year gap between China and the US in terms of technology and manufacturing capability.</p> | |
| 28 Sep | <p><u>Current Account Back in Surplus</u></p> <p>China recorded a current account surplus of U\$5.3bn for 2Q</p> | <p>While current account has swung back into surplus for 2Q, the level is well under 2017 average of U\$41bn.</p> |  |
| 29 Sep | <p><u>More Tax Cuts</u></p> <p>Premier Li Keqiang pledged to lower taxes, administrative fees and red tape to provide further support to the real economy</p> | <p>Li urged for speedy efforts to build a market-oriented, legalized and internationalized” business environment. Both private and SOEs are “important components” of the economy. These remarks came after China released slower industrial profits for Aug. Profits for private companies have slipped for the 8th consecutive months and the most recent slide is the steepest yet.</p> |  |

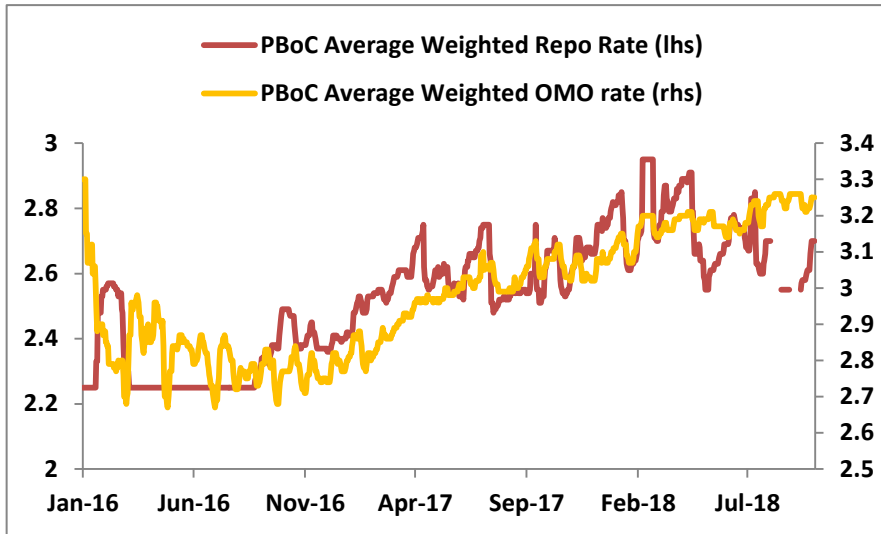
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Upcoming Events to Watch in The Next Two Weeks

- 7 Oct - Foreign Reserves (Sep)
- 8 Oct - Caixin PMI Services, FDI for Sep
- 10-15 Oct - Aggregate Financing, New yuan loans (Sep)
- 12 Oct - Trade (Sep)

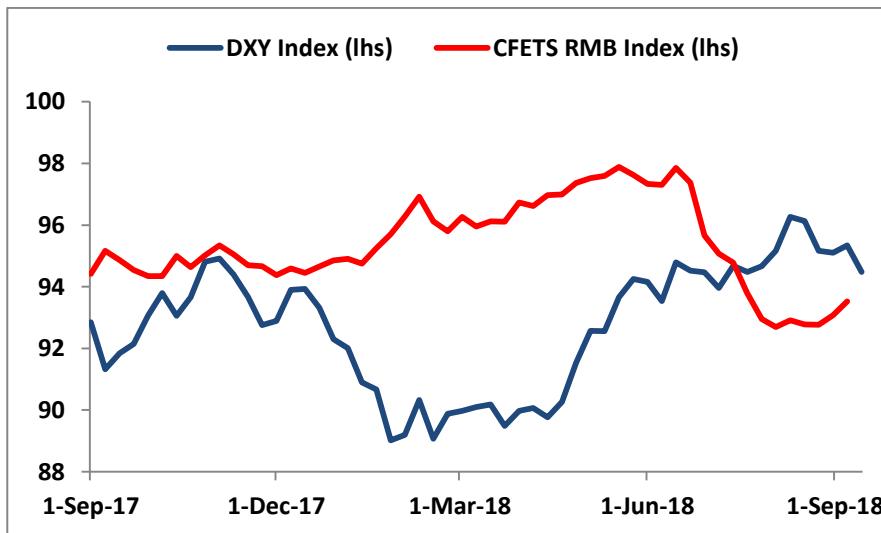
Charts We Monitor

Chart 1: Repo Rates and OMO Rates Are Rather Supported



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: CFETS RMB Index Converges With the DXY Index



Source: Bloomberg, Maybank FX Research & Strategy

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