June 4, 2019

RMB Watch

2019 Trade War Could See Different FX Moves

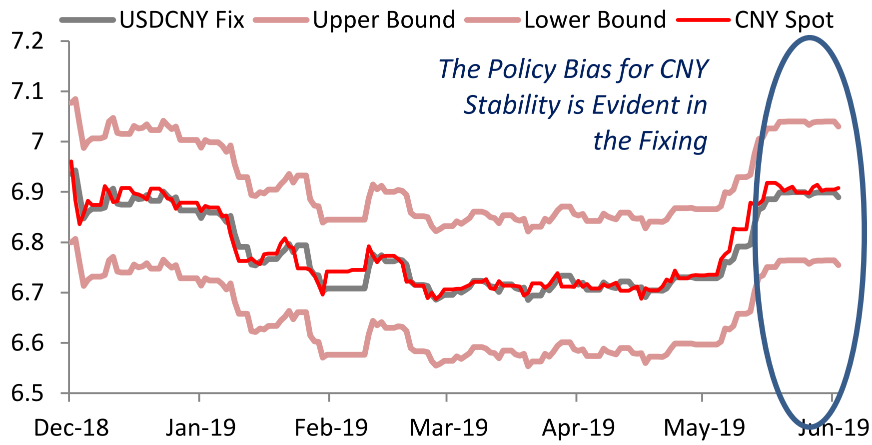
USD May Not Be the Safe-Haven of Choice

China's upcoming list of "unreliable entities", warning of potential restrictions on rare earth shipments, Trump's reiteration that he is serious on imposing tariffs on Mexican exports because of its border crisis triggered a sense of risk-off since last Fri and strengthened the demand for traditional safe havens including US treasuries, gold, the JPY, the CHF but not the USD.

That was clear when the USD slipped broadly across most currencies including the Asian FX. The upside surprise from the Caixin PMI-mfg for May spurred more USDCNH sales and brought the pair from the high of 6.9436 to levels around 6.9260. This comes after a slew of disappointing activity data released for Apr. The PMI-mfg headline came in at 50.2 for May, steady from the Apr print - Markit reported slight improvement in overall operating conditions during May and there was a renewed increase in export sales placed with Chinese goods producers. Respondents mentioned that new product releases and firmer foreign demand underpinned growth. That said, business confidence slid to the lowest level ever, dented by the US-China trade war. We are wary of how the US-China trade tension might have spurred end-users to frontload demand for fear of further escalation and we would not take this expansionary print to mean resilience or optimism. Rather, this print was taken as another excuse for market players to sell the pair.

Recent moves in USDCNH in May have shown that while the US-China trade war headlines have kept the USD elevated, the room for further upside may be limited and that could also slow the USDCNH from making a decisive move towards the key 7-figure. From the policy perspective, USDCNY is anchored as well.

USDCNY Spot Has Been Anchored by The Fix In The Second Half of May



Source: Bloomberg, Maybank FX Research & Strategy

Analysts

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

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

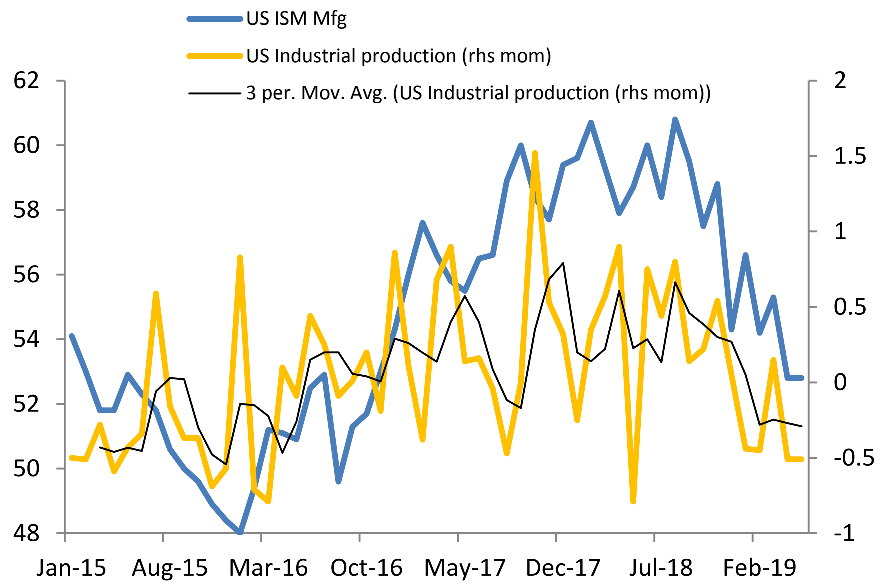
Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Tan Yanxi
(65) 6320 1378
tanyx@maybank.com.sg

What do we say to the number 7? Not so easy.

However, in a period of persistent USD strength, it is not sustainable for PBoC to keep CNY stable. That was demonstrated in the Aug 2015 devaluation episode that resulted in a lot of volatility. However, it would be useful to see how different 2019 is from 2018 to gauge whether FX moves would be the same.

US ISM Mfg and Industrial Production Have Been on a Downtrend



Much of the 2018 trade war was dominated by the USD strength that took the USDCNY higher from 6.25 to 6.98. That was a time when the US was embarking on expansionary fiscal policy (tax cuts), Fed was still on a rate hiking cycle and CFETS RMB index was at a high. 2019 presents a different environment for Trade War Version 2.0. We do not see the FX moves to be the identical to 2018 as the US starts to feel the ramification of Trade War 2018 and then as it embarks on further trade-related actions that could likely be to its own detriment (at least in the short-run) which could also fuel expectations of Fed to cut policy rates. Concomitantly there is also the argument of why people would want to hold on the USD when the cost of USD funding is high relative to other currencies at this point in time. These factors should limit the USD DXY upside.

With that in consideration, while we see USDCNH as a continued expression of tensions with the US, the cross above the 7-figure may not be easy even as USDCNH starts Trade War Version 2.0 from a higher level.

In addition, the policy signals from top officials in China have been rather clear..

1) CBIRC Guo Shuqing warned repeatedly against shorting the RMB;

2) PBoC quarterly reports indicate a pledge to keep the exchange rate steady;

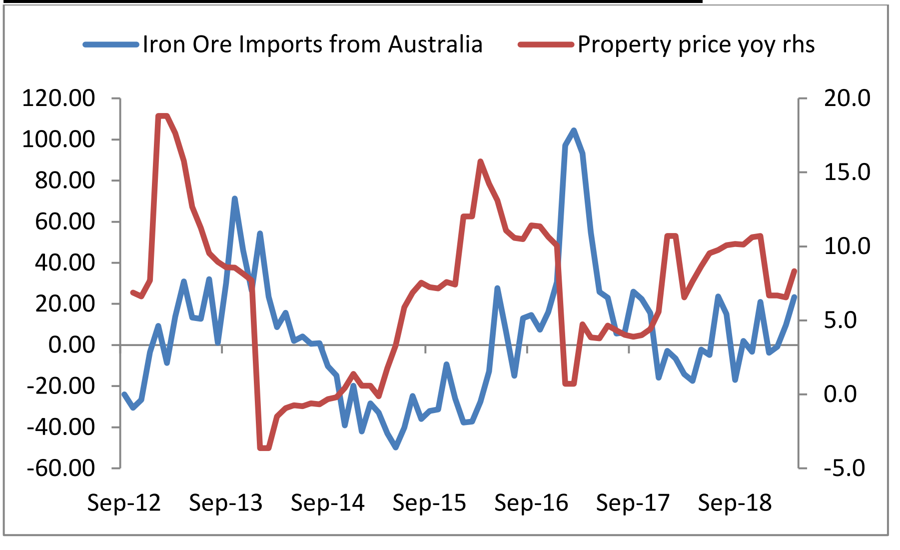
3) PBoC to issue more yuan bills in Hong Kong, possibly to keep the cost of shorting the CNH expensive. 3M CNH Hibor had shot up towards 4% before coming off more recently to 3.44%.

4) The increasing spread between our USDCNY fixing estimates and the actual spreads in the periods of USD upmove and trade war headlines suggest the presence of the countercyclical adjustment factor.

There is justification for China to keep its currency stable. 1) Perhaps to prevent further aggravation from the US. 2) To prevent speculators from building depreciation bets against the CNY. 3) The RMB has depreciated quite a bit from the trade-weighted perspective and further depreciation could send a signal that the policy preference is for RMB weakness.

Inevitably, China is likely to increase fiscal stimulus via infrastructure expansion. The iron ore imports from Australia seemed to have bottomed because of that. This time, it is not led as much by the property sector. We do not expect a strong pick-up in activity but rather, we hope for stabilization that could merit less depreciation pressure on the RMB into the end of the year.

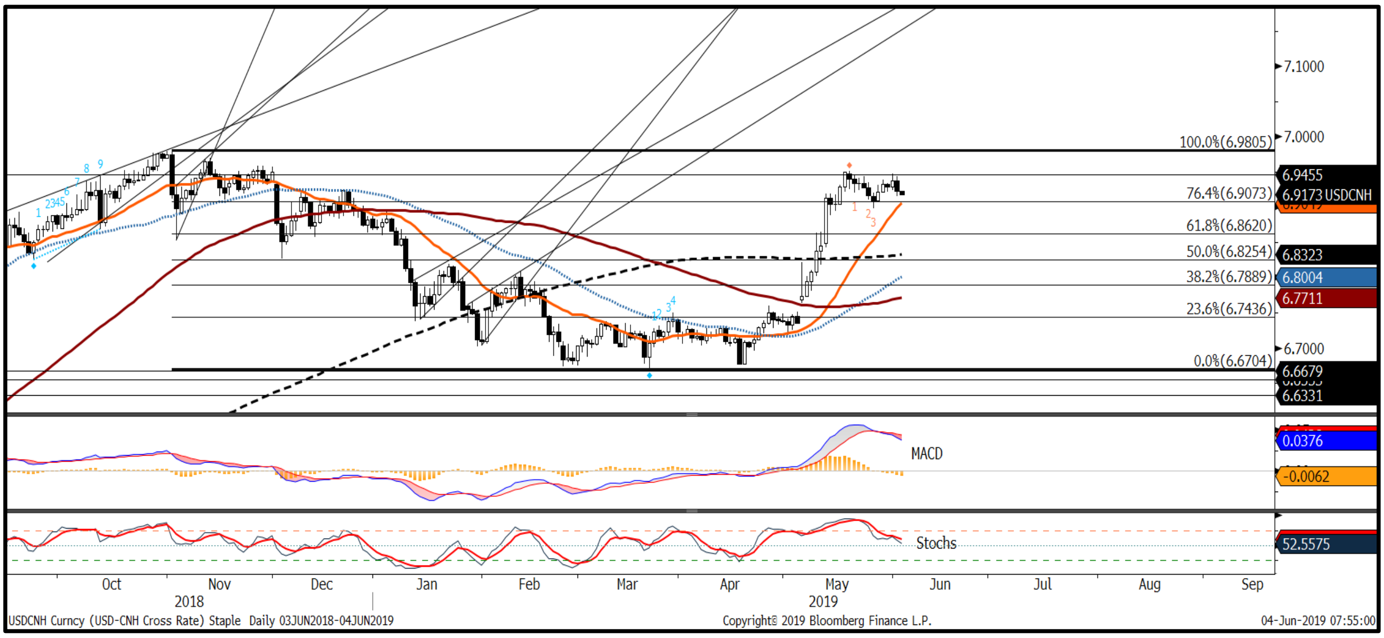
Iron Ore Imports from Australia Seem to Have Bottomed



Our forecasts below indicates a protracted period of tensions between the US and China which could keep the USD supported against the CNY and CNH. However, further USD might needs greater boost from its own economic data.

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USDCNY	6.98	6.98	6.95	6.92
USDCNH	6.98	6.98	6.95	6.92

<u>**USDCNH (Daily) – Turning Lower**</u>



The USDCNH failed to break above the 6.95-figure and seems poised to have formed a double top formation, a bearish reversal formation that could see this pair break the 6.90-figure. Momentum is increasingly bearish for this pair. Below, CNYSGD break below the diagonal support level and was last seen around 0.1983. That brings to mind the triple top formed over 2017 and 2018 that we have noted in our first RMB watch of the year. This is a bearish set up and we hold our target price at around the 0.19-figure. Look to sell this cross on rally towards 0.20. Stoploss at 0.2080.

<u>**CNYSGD (Daily) – Stochs Show Signs of Turning**</u>

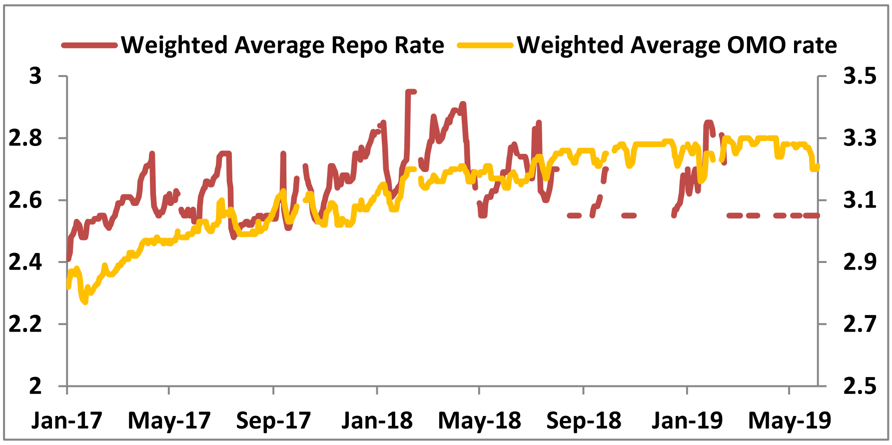
Source: Bloomberg, Maybank FX Research

Upcoming Events to Watch in The Next Two Weeks

5 Jun	- Caixin China PMI Composites
7 Jun	- Foreign Reserves
9-15 Jun	- Aggregate financing, New Yuan Loans, Money Supply M2
10 Jun	- Trade data
12 Jun	- CPI, PPI for May
14 Jun	- Urban FAI, Industrial Production and Retail Sales

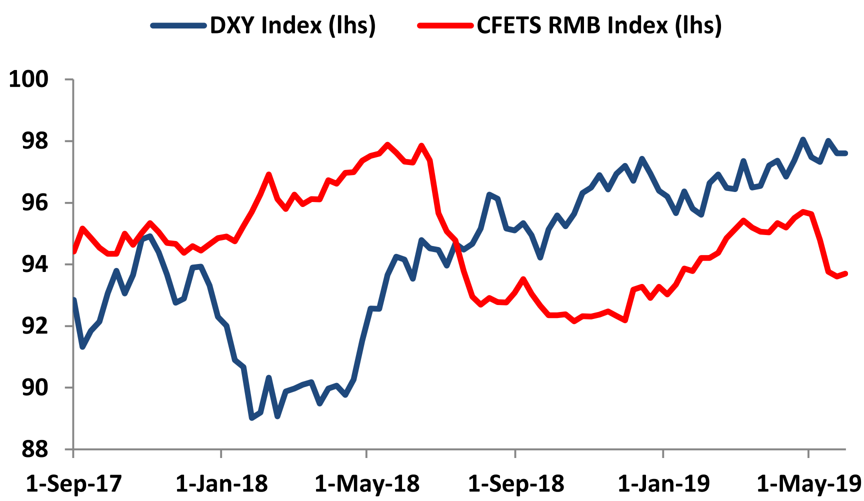
Charts We Monitor

Chart 1: Repo Rates Are Capped



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Weakens TWI-wise While DXY Strengthens



Source: Bloomberg, Maybank FX Research & Strategy

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Malayan Banking Berhad
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Saktiandi Supaat	Fiona Lim	Leslie Tang	Christopher Wong
Head, FX Research	Senior FX Analyst	Senior FX Analyst	Senior FX Analyst
saktiandi@maybank.com.sg	Fionalim@maybank.com.sg	leslietang@maybank.com.sg	Wongkl@maybank.com.sg
(+65) 63201379	(+65) 63201374	(+65) 63201378	(+65) 63201377