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Global

RMB Watch

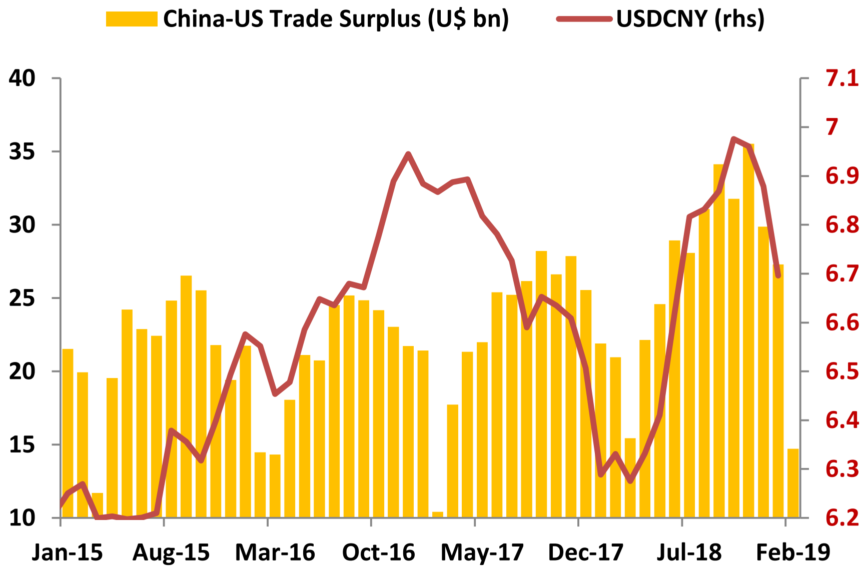
A Preliminary Deal is Close?

RMB Poised For Further Gains

RMB is poised for more gains in the next few weeks as we anticipate that a preliminary deal between the US and China to be possible within Apr/May. Signs of slowdown in the US economy and loss of exports earnings in the past few months are likely to underpin Trump's motivation for a sooner deal. In addition, we see green shoots of recovery from the latest PMI-mfg prints out of China but another targeted RRR cut could still be in the works as purchasing managers from SMEs are still reporting contraction in output. That could still strengthen the RMB as another RRR cut would be viewed as growth positive while our fixed income team looks for CGB yields to have limited downside.

On the US-China trade talks, we view that markets have been cautiously optimistic of the US-China trade talks but a conservatively positive scenario is likely in the price which does not include a significant rollback of tariffs on both nations which we look for. The full/partial removal of 10% tariffs that the US imposed on U$200bn of China's goods could push the USDCNH towards 6.63 and 6.60. In the unlikelier scenario that tariffs are not removed, we anticipate some disappointment and for USDCNH to head back towards 6.75/6.80. Another scenario (best case) is one which includes the removal of all tariffs could see the USDCNH test below the 6.60.

Chart 1: Trade Surplus Narrows in the Favour of the US



Source: Bloomberg, Maybank FX Research & Strategy

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Hopes of a Deal Revived

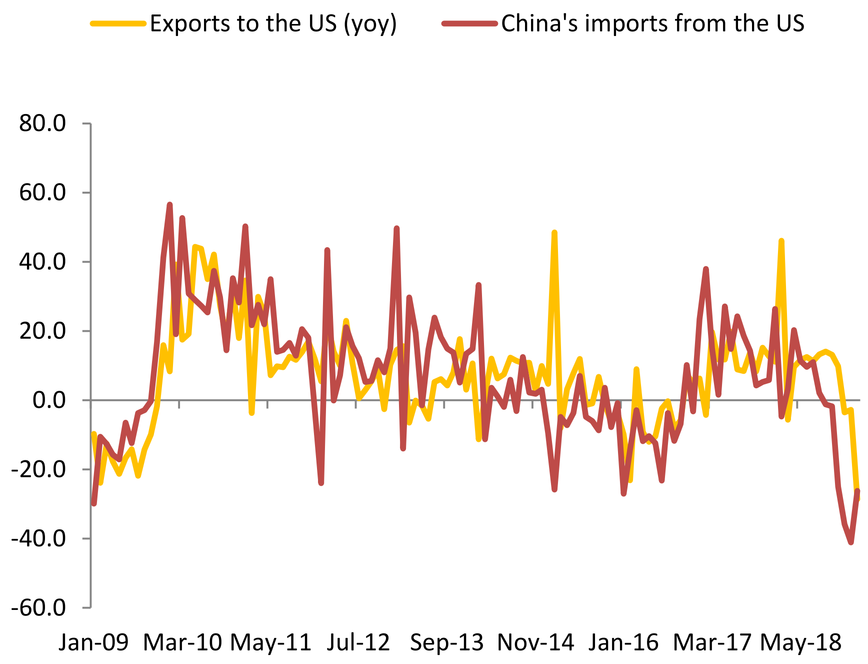
Hopes of a US-China trade deal in the nearer future were lifted this week when FT reported that the US and China have resolved most issues with the exception of the consensus on the what happens should China fail to deliver her end of the bargain and enforcement mechanisms. Sources were also cited by Bloomberg saying that China has now up to 2025 to make good its promise to up its commodity purchase from the US and that the US would be able to have wholly owned enterprises in China. China could risk retaliation if they do not fulfil these “binding pledges”.

In addition, Trump met up with Vice Premier Liu He (4 Apr) and said that “we are rounding the turn” and that “it might take four weeks to put together a framework for the deal and two weeks to get the details on paper”. He also noted that outstanding issues like intellectual property could take more time to iron out. The mention of deadlines like 2025 and the somewhat realistic pledges (as China had promised to increase its purchase of US energy and agricultural produce before) suggest that the two nations are near to a preliminary conclusion worthy of a grand signing ceremony (summit) between the US and China. Although sentiment turned positive on these headlines, the lack of traction in equity and trade-sensitive currencies such as the AUD, NZD, SGD, KRW, TWD and RMB (even with Trump’s meeting with Liu He) suggests that investors are still wary of unexpected and negative turn of events.

Despite White House Economic Advisor’s warning that it can take weeks or months to get a deal, we are of the view that the US cannot wait too long. Our base case scenario is for the US and China to come to a deal within these two months (Apr/May) that includes a rollback of tariffs on both sides and an enforcement mechanism that includes continuing dialogue.

US is Hurting Too

Chart 2: US Export Earnings from China Plunge 30%y/y



Source: NBS, Maybank FX Research & Strategy

Trade balance between the US and China might have improved in the favour of the US for the first two months of the year (as indicated by the chart on the first page). China reported around $15bn of trade surplus with the US for Feb vs. $35bn last Nov. In absolute terms, China seems to be the one taking more damage but that does not mean that trade performance has become better for the US. China's imports from the US fell more than 30%y/y (on average) in the past four months (Nov 2018-Feb 2019). This 30% fall in export earnings is significant for US manufacturers as China is still the third largest export destination for the US. A roll-back in tariffs has to happen in order to provide relief not just for China but also for the US exporters. Total trade shrank to just U$30bn in Feb, a low not seen since 2011 and lowering tariff barrier is likely to boost total trade between the two nations.

In addition, US domestic demand seems to be showing some signs of weakening including weaker retail sales, durable goods and ISM non-mfg data. As such, we anticipate that the deal could come soon and that suggests more RMB strength in the next few weeks.

Markets Are Still Conservative, Leaving Room for Upside

Given the fact that markets are likely to have priced in only a conservative deal, we still expect RMB to strengthen when a deal is announced as we anticipate a trade deal to include some rollback of tariffs and that includes the full or partial of the 10% tariffs that US imposed on $200bn of Chinese imports that markets would not have priced into RMB as well as China to remove the tariffs on $113bn of US imports. This is because China is unlikely to accept a deal without any rollback in tariffs. Our focus on tariffs and not on other aspects of the trade deal is because these have more immediate impact on profit margins, investment and consumption decisions for both countries. A deal like this could possibly bring USDCNH towards the 6.60-figure. We do not expect Washington to roll back the rest of the tariff that was imposed on the U$50bn of Chinese imports easily as that decision was made as a form of compensation for its intellectual property infringement, particularly as intellectual property has been noted to be a contentious issue still. So we anticipate talks to continue on intellectual property infringement. Another aspect of the trade agreement that we anticipate is the potential currency pact that Treasury Secretary Mnuchin has mentioned weeks before. We expect that it should entail an agreement not to have competitive devaluation.

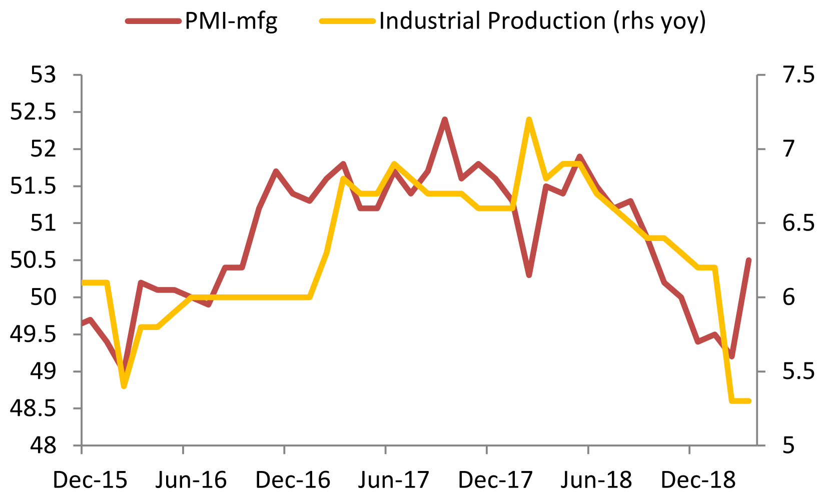
In the unlikelier scenario that no tariffs are rolled back, we anticipate sharp pullbacks in the RMB and other Asian currencies. That could see USDCNH back at the 6.75 or even 6.80. While markets are likely to be conservative in their bets at this point, the move from almost 7 to 6.70 in the past few months were largely due to the fading of trade war risk premiums apart from the fact that USD and US rates have been relatively benign.

An alternative scenario that is not likely to happen is a rollback of all tariffs. We do not anticipate the gains from RMB to be significantly more than our base case scenario.

Another Targeted RRR Cut Likely

While domestic demand in the US seems to have waned, we see another reason for RMB to strengthen as domestic demand in China show green shoots of improving. That said, we expect another targeted RRR Cut for small and medium enterprises just so that activity momentum can gain better traction. That is on the whole positive for the RMB as our Fixed Income Team anticipate limited downsides for rates CGB yields that could add further downside pressure for the currency and prospect of growth stabilization and pick-up in activity momentum to underpin the currency.

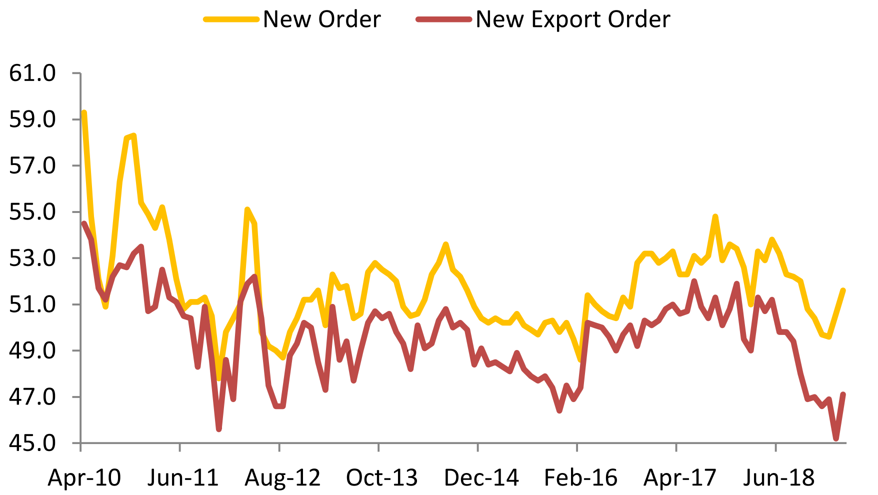
Chart 3: PMI-mfg Suggests A Rebound in Activity



Source: NBS, Maybank FX Research & Strategy

The PMI-mfg print releases for Mar exceeded the consensus which was already looking for an improvement. The PMI-mfg came in to be 50.5 from the National Bureau of Statistics vs. the previous at 49.2 (consensus at 49.6). Looking beyond the headline, PMI-mfg for small and medium enterprises still printed in contractionary region at 49.3 (vs. prev. 45.3) and 49.9 (vs. prev. 46.9) respectively. PMI-mfg for large enterprises actually deteriorated to 51.1 from previous 51.5. This suggests that the boost to the headline actually came from the stronger production reported by purchasing managers in the SMEs which is encouraging. New order was also reported to have expanded for SMEs while that of large enterprises seemed to have slowed. In contrast, the new export order remained in contraction for all enterprises. In other words, domestic demand in China seems to be picking up while external demand still remains a tad lacklustre.

Chart 4: New Order Back In Expansion While New Export Order Still Contracts

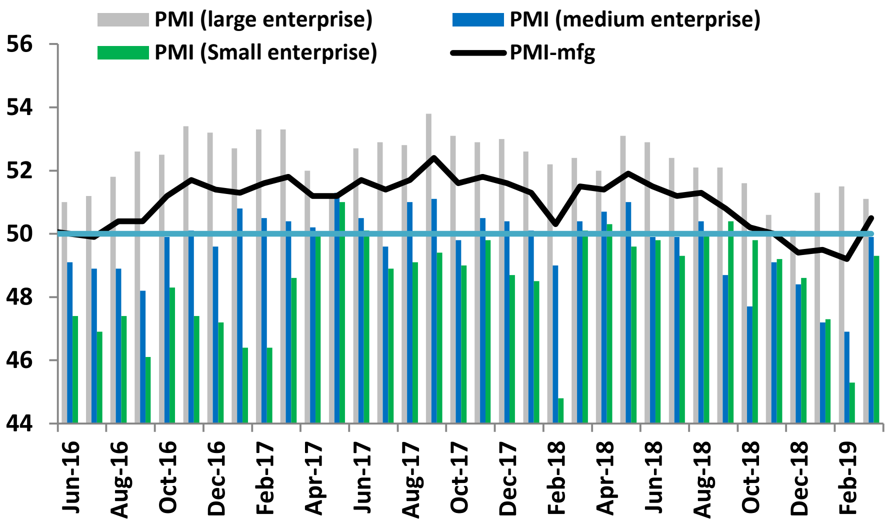


Source: NBS, Maybank FX Research & Strategy

More recently, a PBoC adviser Sheng Songcheng said the central bank should not make a decision (on RRR) until after China releases its 1Q economic result. Industrial profits and industrial production have been lacklustre for the first two months of the year and eyes are on whether the rebound in PMI-mfg really translates into stronger activity numbers as Mar PMI-mfg numbers tend to rebound from weaker prints in Feb. Activity prints for Mar will be released on 17 Apr.

RRR Cut Still Likely To Help SMEs

Chart 5: PMI-mfg for SMEs are Still Under 50, Suggesting Contraction



Source: NBS, Maybank FX Research & Strategy

Despite the stronger PMI-mfg headline, the fact that purchasing managers from medium sized enterprises still see a fall in production could mean that risks are still tilted towards another targeted RRR cut in the absence of price pressures so that momentum can gain better traction in the SMEs.

USDCNH (Daily) – Downside Bias

USDCNH edged lower in a falling trend channel, last seen around 6.7040. Prices have been hovering and testing the upper bound of the trend channel and we see plenty more room downside according to the price action. Support is seen at 6.63 before the 6.60-figure. For CNYSGD, risks are to the upside in this rising trend channel.

CNYSGD (Daily) – Rising trend channel Still Intact

Source: Bloomberg, Maybank FX Research

Upcoming Events to Watch in The Next Two Weeks

7 Apr - Foreign Reserves for Mar

10 - 15 Apr - Money Supply, New Yuan Loans, Aggregate Financing Mar

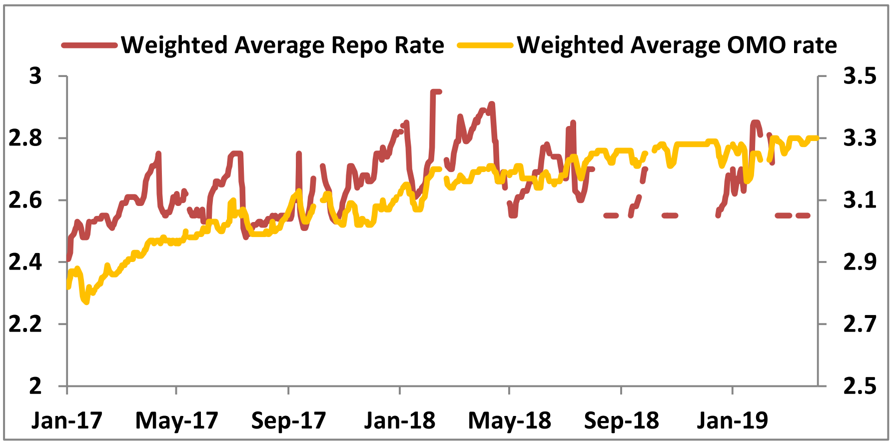
11 Apr - CPI, PPI (Mar)

12 Apr - Trade Data (Mar)

16 Apr - New Home prices (Mar)

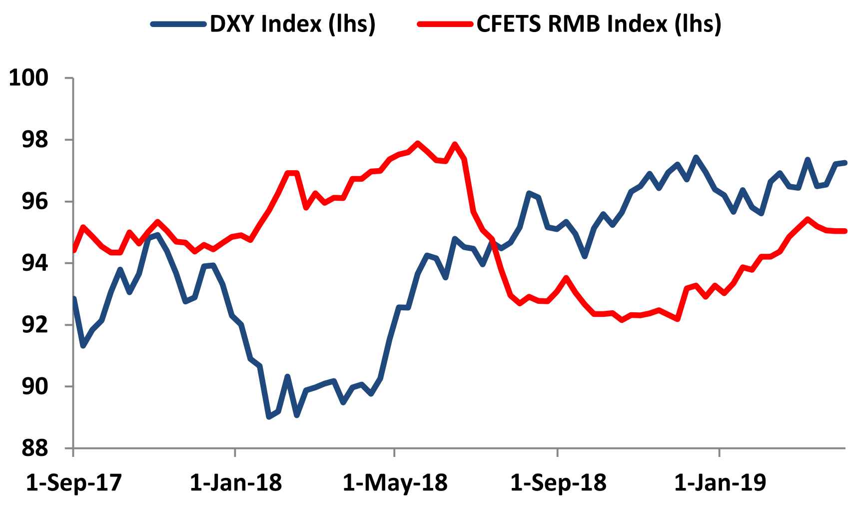
Charts We Monitor

Chart 1: Repo Rates Remain In Range



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Came Off More Recently VS. its Trading Partners



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