Macro | FX Research and Strategy

Global

RMB Watch

China Hardens Its Stance

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Freed From the Level 7

PBoC unleashed the RMB bears when the USDCNY reference rate was fixed at 6.9225, the first time the fixing has breached above the 6.90-level since last Dec. PBoC has been keeping the USDCNY fixing below this level even at the height of the trade-war re-escalation seen in May earlier this year. USDCNH touched a high of 7.1114 as a result, last seen around 7.08. Apart from allowing market forces to drive the RMB, the currency weakness is a policy signal to Trump that China has hardened its stance and the goodwill of limiting the RMB weakness against the USD no longer applies without much "sincerity" shown by the US. It is also in line with our recent change in forecast for USDCNY to 7.00 as we had warned that the RMB *may not shy away from 7 This Time* in our FX Monthly.

This move up came a few days after the DXY index touched a 2-yr high (before coming off recently) and then as Trump had threatened China with 10% tariff on \$300bn of Chinese goods (that were not taxed yet) with effect on 1 Sep with a possibility of the levy being raised even higher. People's Daily commentary said that the latest tariff move has "seriously breached" the truce. Foreign Ministry Spokesperson Hua Chunying had said that China will have to take necessary countermeasures if the US goes ahead with the fresh round of tariffs. Just today, news broke that state-owned companies have been asked to stop purchases of US agricultural products.

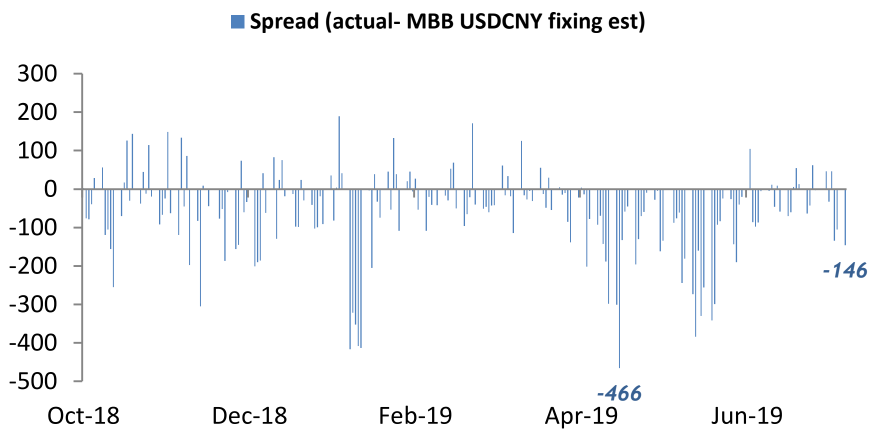
RMB Weakens As US-China Trade Truce is *Breached*

Source: *Bloomberg, Maybank FX Research & Strategy*

Policy Signalling: The fixing is a nod to 7

We note that while the countercyclical adjustment factor is in effect, the gap between our model's estimate at 6.9371 and the actual fixing of 6.9225 is maintained around 146pips (see chart below), similar to what has been observed in the past few trading sessions and has resulted in a fix of above-6.90. Earlier in May this year, the gap between the model estimates of the USDCNY fixing widened to more than 400pips as PBoC seemed more determined to keep the USDCNY fixing below 6.90. So, the latest fixing could be taken as a nod to allow USDCNY to rally past the 7-figure.

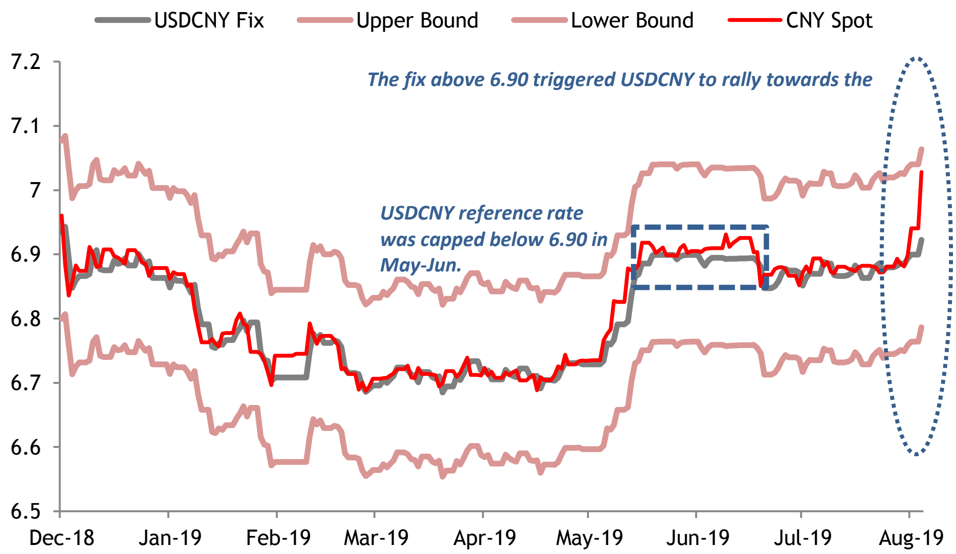
Countercyclical Adjustment Factor is Not Strong



This deliberate move suggests that top policymakers may want to gear up for the next phase of US-China trade war escalation by allowing more yuan weakness to counter the next phase of tariffs.

With the USD still rather supported and fresh tariff threats increasing yuan depreciation expectation, allowing the yuan to weaken in this climate shows China's desire for yuan to be market-driven. In addition, the yuan weakness is a policy signal to Trump that China has hardened its stance and the goodwill of limiting the yuan weakness against the USD may no longer applies without much "sincerity" shown by the US.

USDCNY rallies Towards the Upperbound of the Trading Band



Source: Maybank FX Research & Strategy, Bloomberg

Also note that USDCNY is near the upper bound of the +/-2% trading band (chart in previous page), a behaviour that we hardly see since Aug 2015 fixing methodology revamp. We look for signs of intervention to bring the USDCNY lower in the later part of the day. This is particularly so given the fact that PBoC has pledged to keep the RMB "stable". Bringing the USDCNY lower at close would be able to keep the USDCNY reference rate from being fixed too high which could translate into further RMB weakness.

There are two market components to ensuring that the USDCNY is fixed below the 7-figure tomorrow (1) Overnight price actions of trading partners (that are still heavily weighted towards the USD) ; (2) USDCNY close today. The USD has been on a broader down-move because of the strength in the JPY, EUR (risk off moves), GBP and this should work in the favour of the CNY for the fixing tomorrow with regards to the first component of overnight action. However, USDCNY has to be close nearer to the 7.00-figure in order for USDCNY reference rate to have a stronger chance to be fixed below 7.00. Of course, the third component is the countercyclical adjustment factor which can be enhanced, just as what we have seen in May-Jun this year.

We do not rule out further yuan weakness and we eye the USDCNY fixing tomorrow for further policy cues. Regardless, this is in line with our suspicion that RMB may not shy away from 7 this time as we changed our forecast to 7 last week in the FX Monthly.

Should Trump and China really go ahead with imposing more tariffs, PboC is likely to ease monetary conditions and allow further yuan weakness. Pace of yuan weakness may still be slowed by the central bank to ensure that financial markets do not get too unruly.

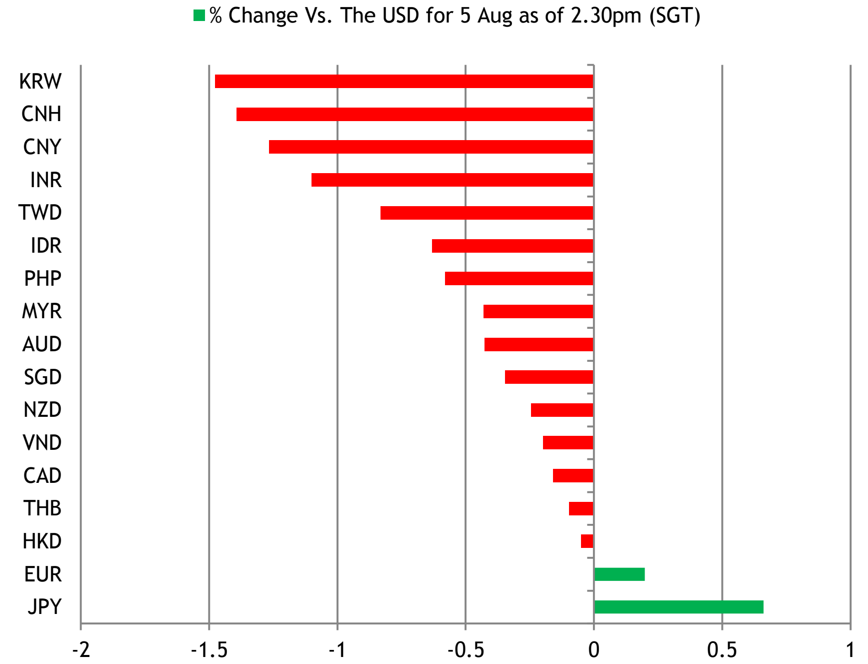
PBoC Follows Up with Comments on Yuan Stability

After the USDCNY reference rate was fixed at 6.9225, PBoC assured that China's economic fundamental is sound and that the central bank is "confident and experienced" enough to keep yuan stable at reasonable and balanced level. The central bank also urged market players not to bet on the trend right now and the two-way moves of the currency are normal. The RMB has been affected by concerns on fresh tariff threats from the US and the breach of the 7 does not mean "it won't come back". This suggests that the central bank is mindful that the yuan depreciation pressure could have repercussion on capital outflow. We do not rule out the possibility of China tightening capital controls such as lowering the limit of individual funds transfer abroad that is supposed to be $50,000 each year. However, tweaks in the financial markets are less likely as those could have serious impact on its goal to get more foreign institutional investors to be invested in its bond market.

Travel Bans

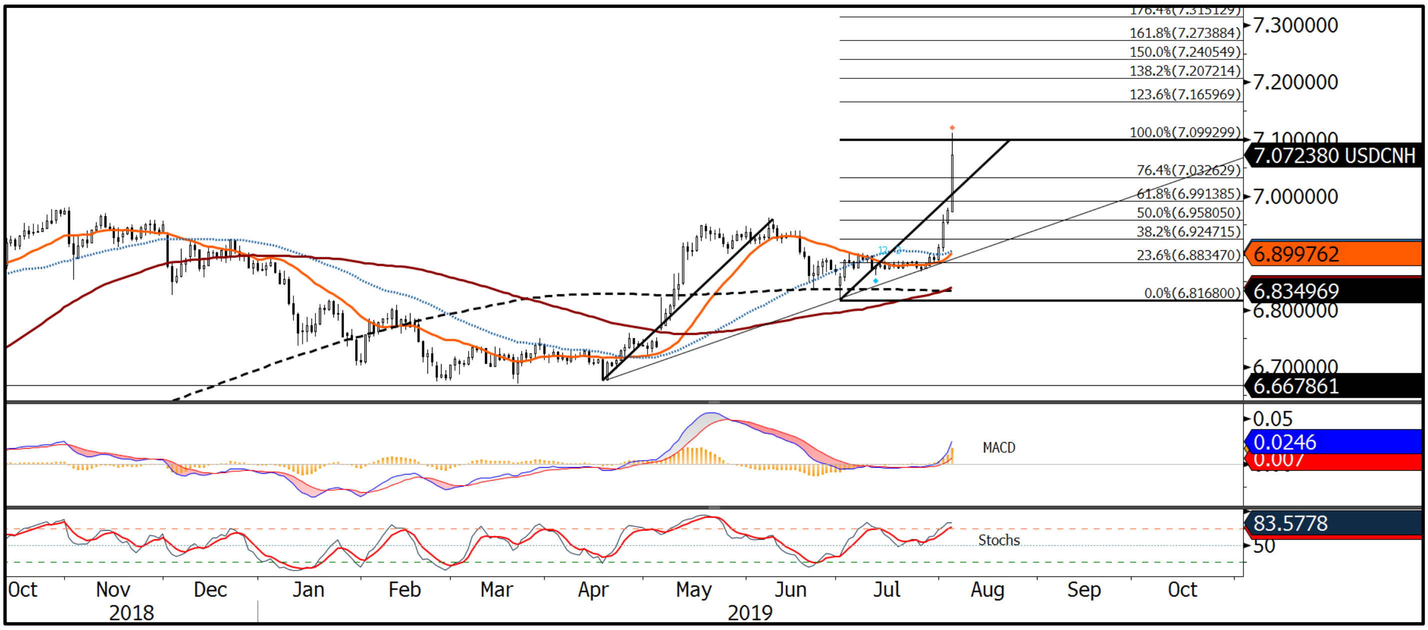
We recall that China has recently prohibited individuals from visiting Taiwan. Apart from the fact that the incumbent President Tsai seems to have some conflict with Beijing and the President election is a few months away, this latest move also gels with some speculation that China could limit its current account deterioration. This also has the effect of ensuring that household spending are not "leaked" and instead support the merchants at home in a more hostile global environment.

Weakness in the CNY Un-anchors AxJ FX



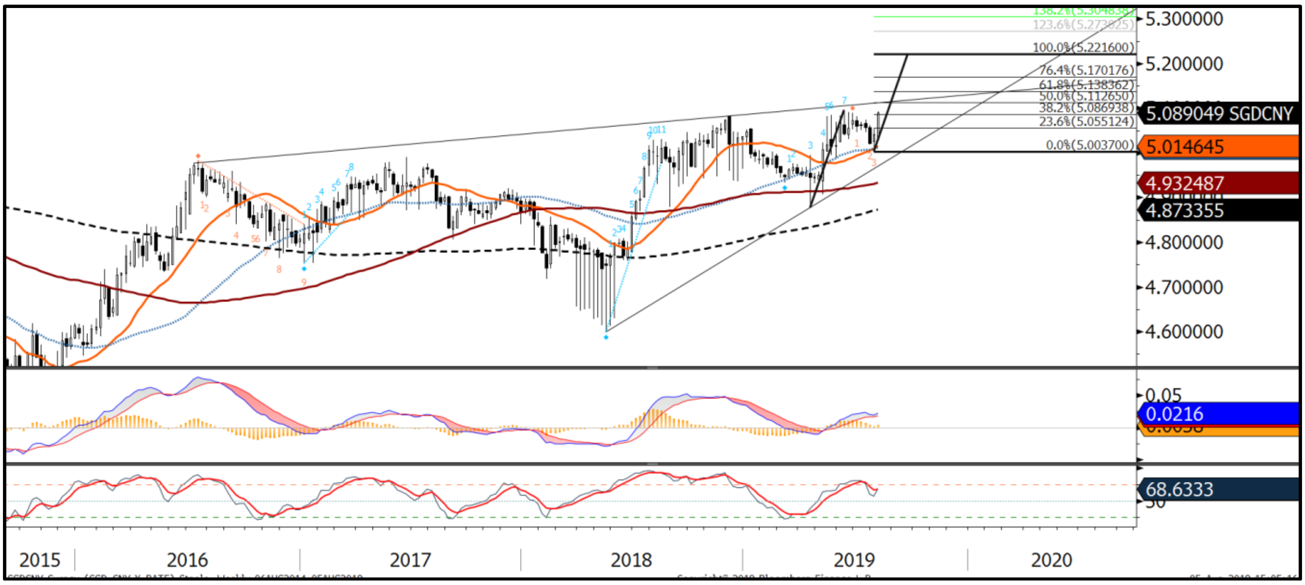
Most Asian ex Japan FX weakened alongside CNY against the USD in Asian session today and we see potential for these currencies to overshoot our 3Q forecast in the near-term. That said, bear in mind that the US-China trade war development is fluid and could turn around anytime, just like what we have seen in May. Hence, while we see potential for further RMB weakness, we would like to monitor the price action and USDCNY for further policy signals and any developments out of the US-China trade spat.

USDCNH [Daily] – Bullish bias intact



USDCNH gains bullish momentum on the daily chart and was last seen around 7.0715. This pair may find resistance at 7.099 before the next at 7.1660 and then at 7.20. Support at 7.03.

SGDCNY [Weekly] – Next resistance at 5.11 before 5.14



SGDCNY has regained bullish momentum after today's move and next resistance is seen at 5.11. Last seen around 5.0730. This cross may continue to head higher towards the next resistance at 5.11 since momentum on daily, weekly, monthly chart is still bullish. Support at 5.055.

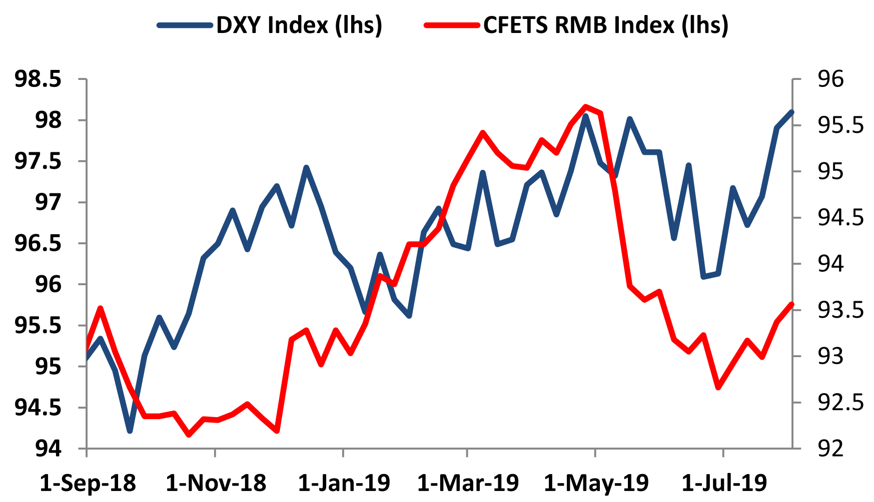
MYRCNY [Weekly] – Need a break of 1.69 for further bullish extension

MYRCNY is en-route to the 2018 high of 1.69 and a break there has to happen for further bullish extension. Or else, this cross risks a double top and a bearish pullback. Last seen at 1.6830. Stochastics on the weekly chart suggest that conditions are overbought. The 1.69 level happens to be the 50% Fibonacci retracement of the 2014-2015 decline and the next resistance is seen at 1.7530. Support at 1.65.

Upcoming Events to Watch in The Next Two Weeks

7 Aug	- Foreign Reserves
8 Aug	- Trade Data
9 Aug	- CPI, PPI
9 Aug	- BoP Current Account Balance
9-15 Aug	- Money Supply M2, New Yuan Loans, Aggregate Financing
16 Aug	- Urban FAI, Industrial production, retail sales
17 Aug	- New Home Prices
19 Aug	- FX Net Settlement on Behalf of Clients

CNY TWI Moves in Tandem with DXY More Recently



Source: Bloomberg, Maybank FX Research & Strategy

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