

RMB Watch

Eyes on The Next Round of US-China Talks in Beijing

US Downplays A Deal

Onshore markets in mainland China will be back next week after the Lunar New Year break and while they have been away, the US White House officials have been playing down expectations for a deal in the near-term. The US Treasury Secretary Steven Mnuchin and US trade representative Lighthizer will visit Beijing to negotiate for a deal with China. The last negotiation in Washington DC ended with little concrete details and top Economic Adviser Larry Kudlow most recently told the press that there are still substantial grounds to cover before a deal can be reached. Trump also opined that it is “unlikely” that he will meet China President Xi Jinping within this month. Concerns on the US-China trade negotiations were renewed as market players see less chance of a deal and higher likelihood that the tariff on US\$200bn of China’s goods could be raised from 10% to 25% on 2 Mar if Trump and Xi does not meet within the month. Negotiations in 2018 between lower level US and Chinese officials rarely end with a deal. Breakthroughs like the 90-days temporary trade truce was only announced by Trump.

US Treasury Secretary Steven Mnuchin had repeatedly stressed on monitoring the RMB. We regressed the CNYUSD on China’s exports to the US using monthly data between Jan 2016 to Dec 2018 and found that every 1% appreciation of CNY against the USD would see an approximately -1.1% fall in value of exports to the US. Conversely, using monthly data from the same period, we found that a 1% appreciation of CNY against the USD could cause a 2.6% increase in the value of imports from the US. While that does not mean that China manipulates its currency for export competitiveness and valuation effect could be significant, the RMB weakness in 2018 could be a reason for the surge in China’s trade surplus with the US between Apr-Nov 2018 and a likely issue of contention as trade becomes “more imbalance”.

Analysts

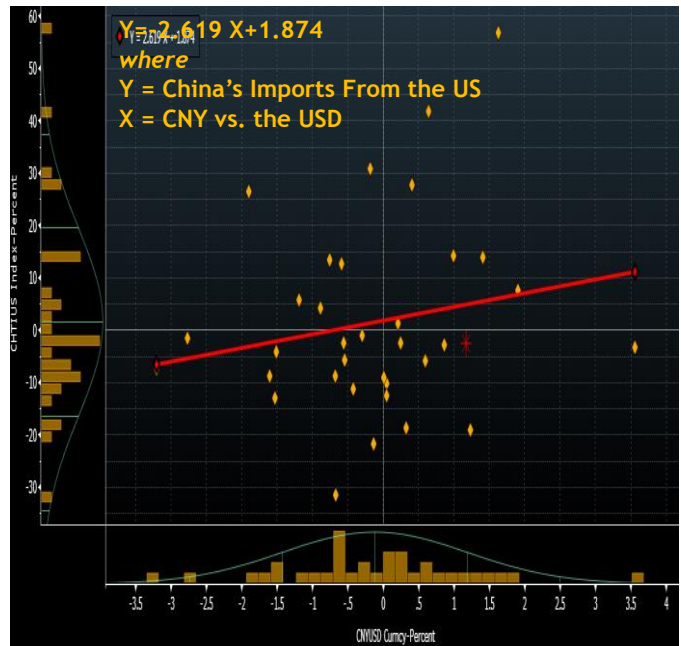
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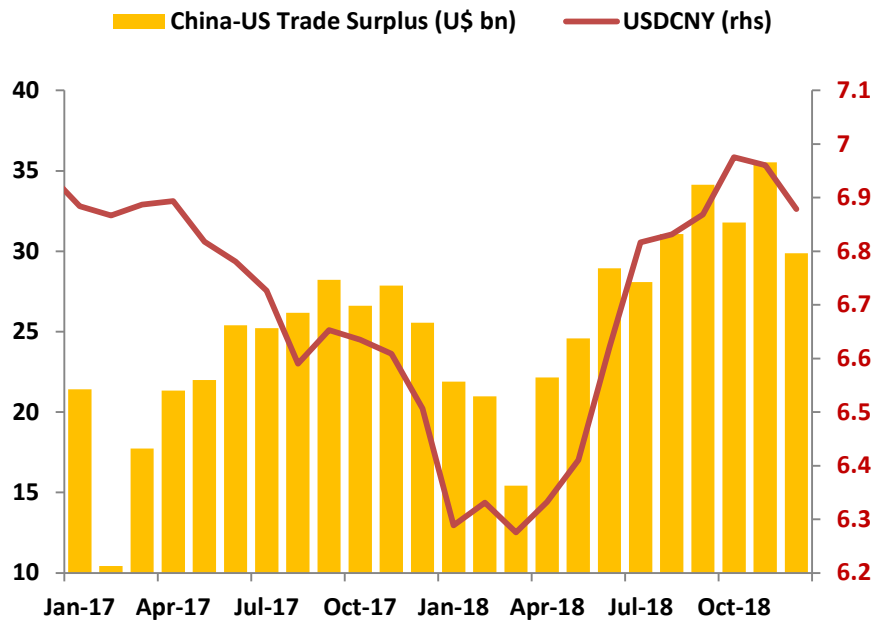
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OLS Analysis: A Cheaper RMB Boosts Exports to the US, Dampens Imports



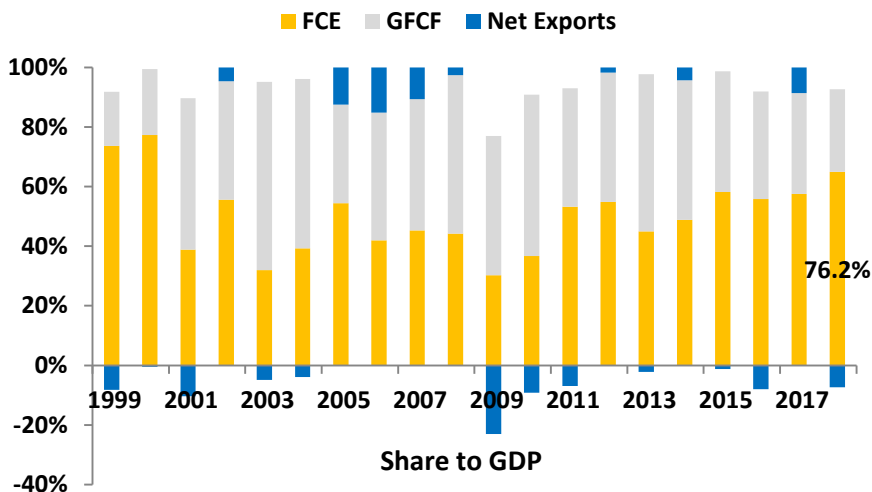
Source: Bloomberg, Maybank FX Research & Strategy

Chart: The Weakness in the RMB (vs. the USD) brought trade imbalances with the US to record high last Nov



Source: Bloomberg, Maybank FX Research & Strategy Estimates

Insofar, the US has asked for “structural changes” to China’s economic and trade policies which includes fresh protections for US intellectual properties, stopping forced technology transfers and curbing subsidies for state industries. They also want China to increase purchases of US agriculture, energy and manufactured products.



In the meantime, China has promised that it will step up purchases of US agriculture and energy goods. The government has also imposed penalties for corporates that infringe on intellectual property laws. These are likely granted more easily than other “deeper” reforms that the US seeks. The structural reforms that US seeks to level the playing field could go against the Communist ideals as China is still to a large extent, a centrally planned economy in which the government directs resources to targeted growth sectors and sets targets (GDP or broader). In fact, the share of final consumption expenditure to GDP reached 76% for 2018, a high not seen since the year 2000. This suggests that as

China's economy matures, the transition to a more domestic demand driven economy is also underway. That offsets the drag from the net exports. So the support that the government gives to the SoEs is paramount to economic stability, employment and unlikely to be shifted away.

Some Risks That RMB Can be Allowed To Float

In order to address the "deeper structural reform" that the US wants, we think that there are some risks that China would allow the RMB to float as that would

1) reduce the likelihood of the US accusing China of currency manipulation and can constitute as a "deep structural reform" that is market-oriented.

2) The current external environment is somewhat ideal for PBoC to do so:

FX Volatility has eased and that typically suggest that the current environment is more favourable for EM currencies. That is underpinned by somewhat stable crude price that is conducive for growth and non-threatening to inflation. The Fed has also signalled a pause in their tightening cycle, reducing expectations for global rates to head much higher and concomitantly easing pressure on EM currencies (including RMB). As such, the USD is no longer threatening as well, thereby also reducing expectations for CNY to depreciate against the USD. This can be seen in the USDCNH 12M forward points that remained around 100pips after its collapse last year.

As growth outlooks are being downgraded by central banks around the world, major central banks and regional central banks have also become more cautious and dovish. Policy normalization in the non-US DM world is also less likely to be aggressive. Slower rises in global rates could provide the environment for PBoC to float the RMB as risks of a downward spiral in the RMB is much less now, compared to what we have seen in the past few years.

3) China still has ammunition to combat a slowdown:

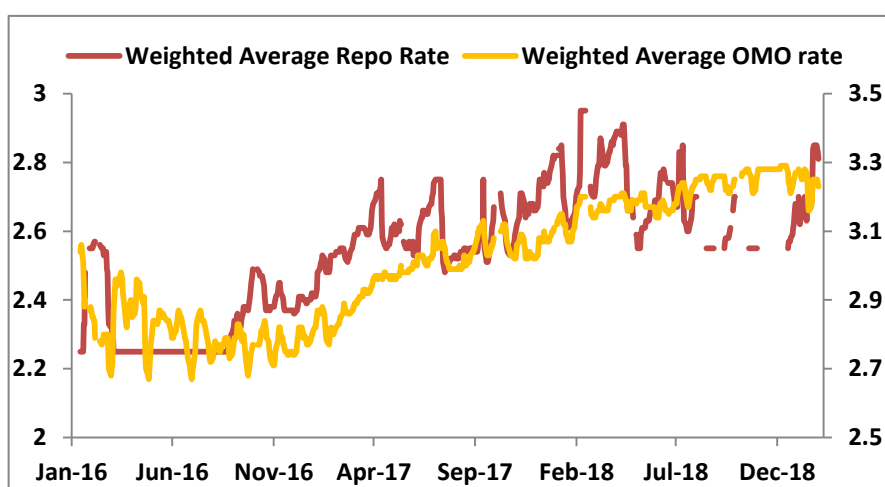
Floating the currency in any environment could cause significant volatility, even in the best of times. With the RRR still relatively high and debt accumulation somewhat slowed, the government seems to have sufficient monetary and fiscal tools to combat further deceleration in the economy. The recent tax cuts and RRR cuts were well received by market and has boosted the RMB as well as the equity markets in this year so far is also testament to the faith in the government. That should also in turn buffer the CNY against excessive depreciation pressure.

Upcoming Events to Watch in The Next Two Weeks

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|------------|--|
| Mid- Feb | - US-China Trade Talks in Beijing |
| 10 -15 Feb | - Aggregate Financing, New yuan loans, Money Supply M2 (Jan) |
| 11 Feb | - Foreign Reserves for Jan |
| 14 Feb | - Trade for Jan |
| 15 Feb | - Inflation for Jan, 4Q BOP |
| 22 Feb | - New Home Prices |

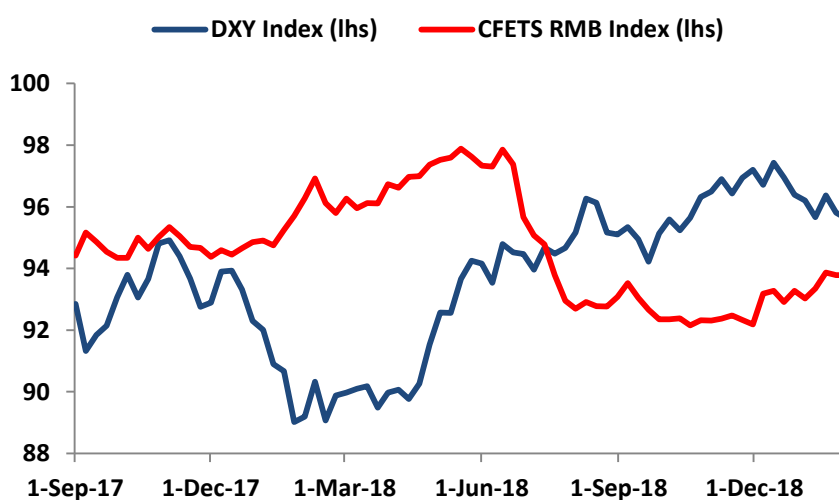
Charts We Monitor

Chart 1: Rates Stabilized But Elevated



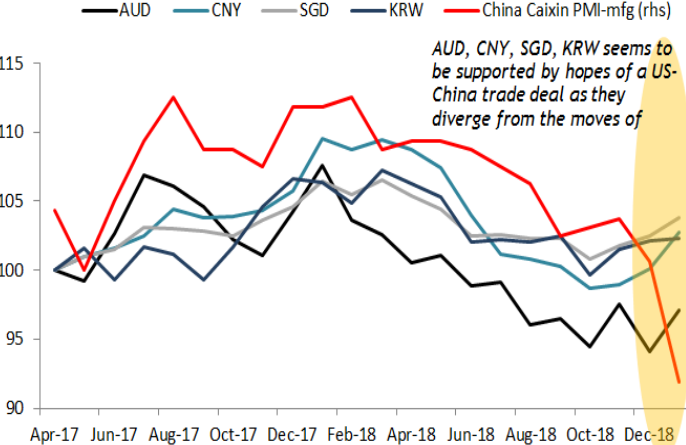
Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Strengthens Against Trading Partners Of Late



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> |
|-------------|--|---|---|
| 31 Jan | <p><u>PMI mfg Weakens Further</u></p> <p>Jan Markit PMI-mfg for Taiwan came in this morning at 47.5 vs. previous 47.7, South Korea at 48.3 vs. previous 49.8 and China's at 48.3 vs. previous 49.7.</p> | <p>Plenty of RMB-sensitive currencies reacted including the AUD, NZD, SGD and KRW. While these currencies have certainly reacted negatively, we see a limit in their bearish moves as more negative risks are in the price compared to positive ones. In addition, the possibility of a trade deal, Fed's signal of a potential pause in rate tightening and further economic stimulus has been keeping AUD, SGD and KRW supported on dips and resilient to worsening China data. The divergence between the currency performance and China's Caixin PMI-mfg is not expected to persist and with factors looking more optimistic (growth being a priority for China, US-China both motivated for a trade deal), we anticipate that the AUD, CNY, SGD and KRW could still see some gains beyond the recent pullback.</p> |  <p><i>AUD, CNY, SGD, KRW seems to be supported by hopes of a US-China trade deal as they diverge from the moves of</i></p> <p>Source: Bloomberg, Maybank FX Research & Strategy Note: AUD, CNY, SGD, KRW moves are measured against the USD, indexed to their respective prices as of end A</p> |
| 3 Feb | <p><u>Tax benefits for unemployed to start business</u></p> <p>Those registered as needy, jobless for more than half a year, on subsistence allowances or recent graduates from higher educational institutions can have CNY12000 deducted from their families' annual share of taxes over three years.</p> | <p>Provincial-level governments to raise tax relief by a max of 20%. Companies who hire "the needy" and paid social insurances for them can also enjoy tax deduction of CNY6000 per person a year for three years. This is another expansionary fiscal policy to boost disposable income as well as household spending.</p> | |

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|-------------|---|---|---------------------------------|
| 5 Feb | <p><u>China Differs with the USTR</u></p> <p>Ministry of Commerce posted a statement on its website, stating that it has "earnestly" fulfilled its commitment since its entry to the WTO and increased the transparency of its trade policies.</p> | <p>This is in response to the US report by the Office of the US Trade Representative which called for a more aggressive and unilateral action against China to address its trade abuses. China's response to the US remains rather dignified and non-aggressive. This suggests that China is unlikely to accede to all of US requests but will show some form of compromise and goodwill.</p> | |

**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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