Macro | FX Research and Strategy

Global

RMB Watch

Trade War Premium Fades

USDCNH Drifts Lower as trade war premium fades

The effect of the trade war has been best observed by the moves of the more speculative USDCNH and the trade war premium has been fading. The conclusion of the mid-level trade talks on Wed had spurred the USDCNH lower beyond through the 6.80-level threshold. The USTR mentioned about China's pledge to purchase a significant amount of agriculture, energy and manufacturing and even hinted of some framework to enforce pledges. From China's Ministry of Commerce, apart from comments that the trade talks were "broad, deep, detailed", official comments thus far lack concrete specifics. Disappointment, if any, was rather brief as "no negative news" is eventually regarded as "good news". We hold the view that as long as the two nations continue their negotiations, the trade war premium that has propelled USDCNH towards the big-7 at one point would continue to fade. We see more chances of progress in the form of a compromise or an extension of the 90-day truce rather than a complete breakdown in talks this year for the following reasons.

1) The US economy shows signs of slowing growth momentum and China's economy is also under pressure. Both sides are thus motivated to get a deal.

2) Trump is eager to call this a success as the US government remains in a partial shut-down and the Democrats are unwilling to allow Congress to fund his wall.

3) There are enough low hanging fruits (China to purchase more US goods, framework for better intellectual property protection) for both sides to come to an agreement while leaving the thornier issues for future discussions.

The USTR stated that the delegates will report back to receive guidance on the next steps". Recent hints of a rate pause by recent Fed speakers also created a broad USD weakness environment that accentuates the USDCNH decline.

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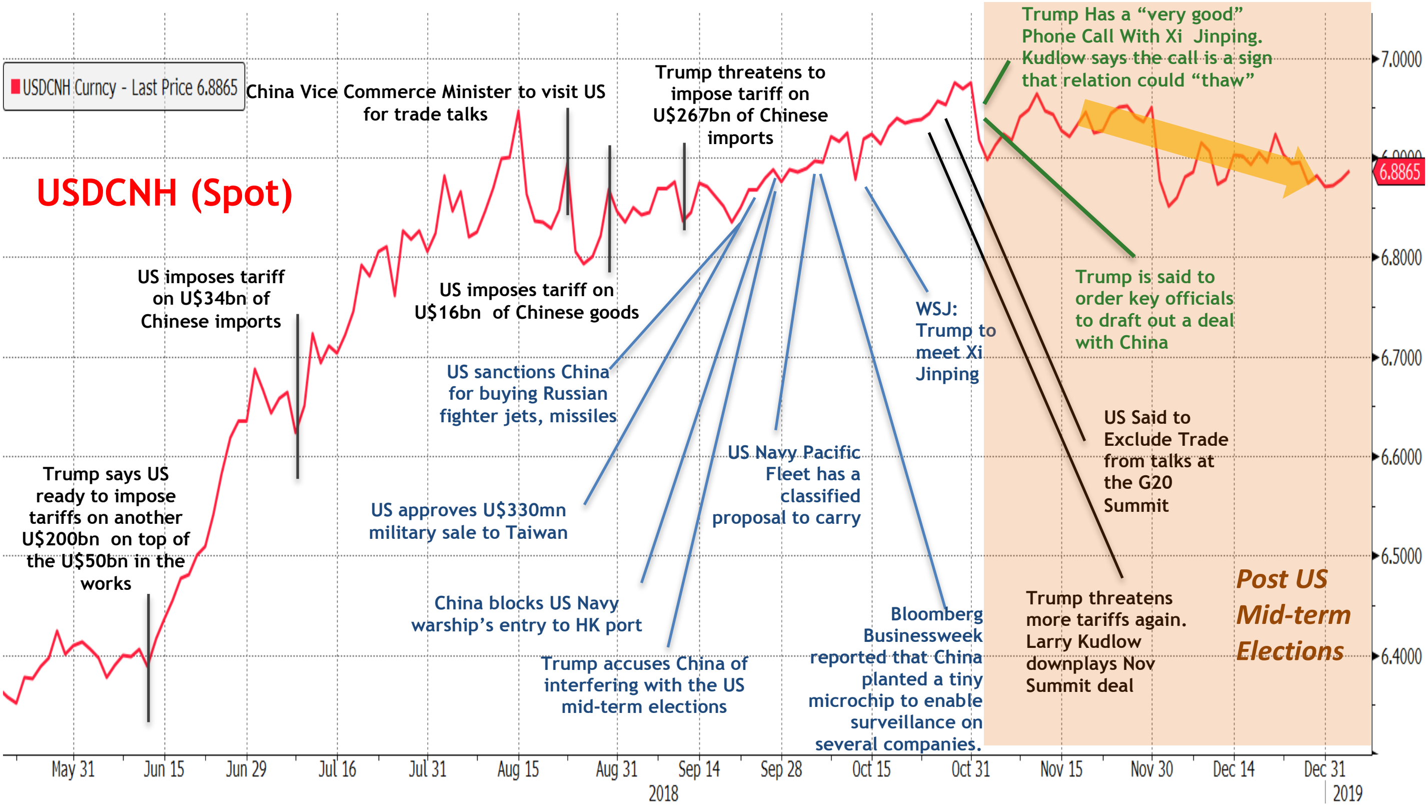
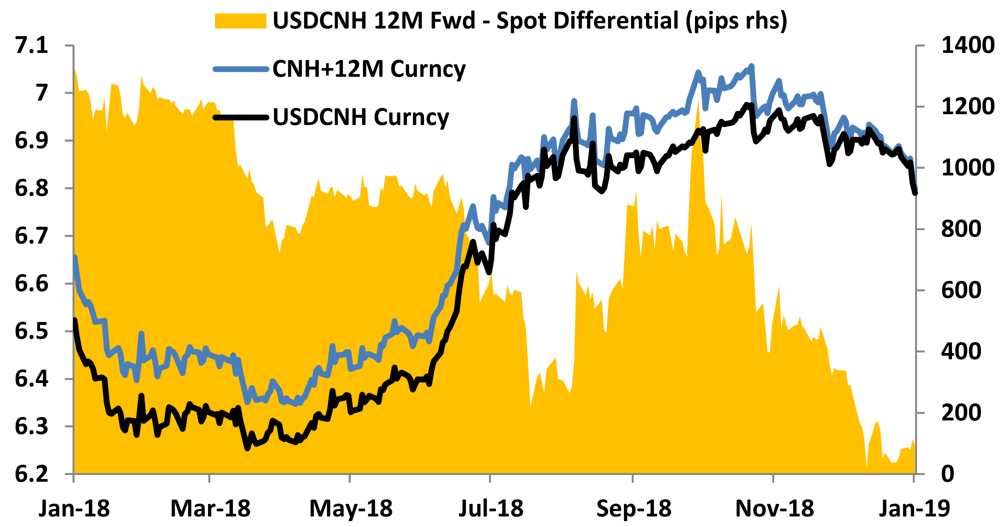
Chart: USDCNH Declines as Trade War Premium Fades



Source: Bloomberg, Maybank FX Research & Strategy

However, even before the trade talks come to a conclusion, there were signs that the RMB is no longer under as much depreciation pressure as before. The 12M USDCNH forward has collapsed since mid-Dec and remained close to spot levels. The USDCNH premium has eroded to just 100 pips from the 5-year average of around 1400pips. This could suggest that USDCNH spot has been primed for more downside since then. A sense of urgency from China's policymakers to boost growth with corporate tax cut, increasing the fiscal deficit target for the year, broad RRR action and more targeted monetary tool to support SMEs decrease the depreciation expectations of the RMB, especially in the more speculative CNH.

Chart: The USDCNH forward Premium Collapsed since Dec



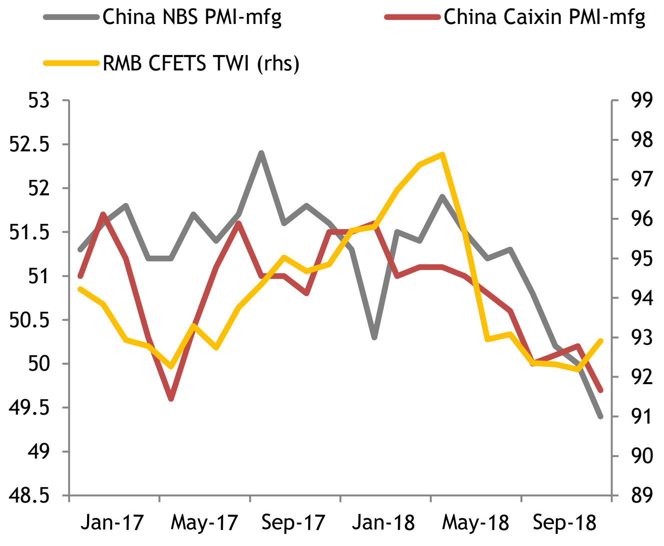
Source: Bloomberg, Maybank FX Research & Strategy

Technical charts suggest that USDCNH could head much lower at the break of the support at 6.8050. Next support level is seen around 6.7170, marked by the 200-dma, which lies pretty close to the 38.2% Fibonacci retracement of the Mar-Oct rally at around 6.6960. A decisive break there could open the way towards 6.60 (50%). Weekly momentum is increasingly bearish. We await more details from the US on the next step of negotiations.

Chart (Daily): Clean Break of the 6.80 opens the way towards 6.7170

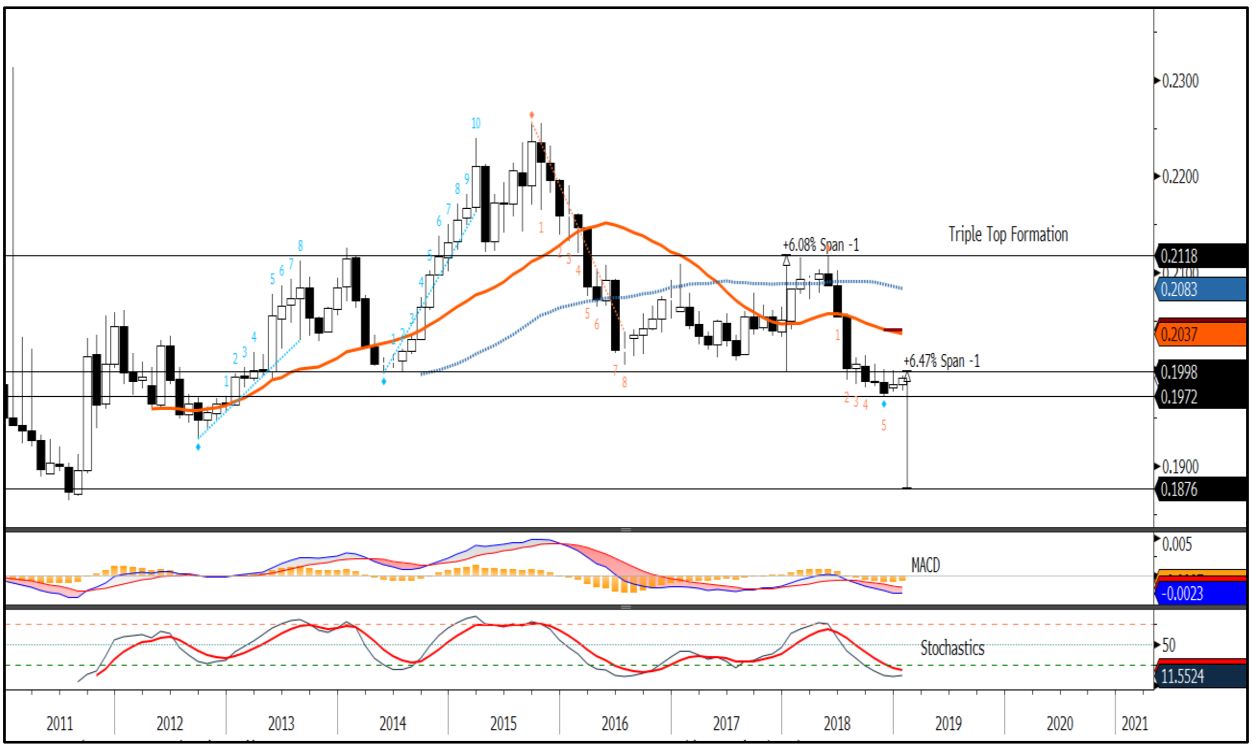
In episodes where US-China trade talks are in focus, we anticipate USDCNH to come off rather sharply. However, for much of 2019, CNH recovery is unlikely to race ahead of regional peers given the fact that costs of funding are likely to be kept low to ease credit conditions for small and micro enterprises. Economic stability is what policymakers are after and not sharp economic recovery. Even a positive trade outcome with the US would mean room for China to continue with its deleveraging endeavours which would in turn, continue to crimp on growth. With current account surplus swinging around zero, the CNY is also less buffered against negative pressure. Hence, barring nearer-term recovery, expect CNH to underperform other currencies including IDR, SGD and even INR in the medium term (refer to chart on the next page).

Chart: Slowing Growth Momentum to Leave RMB the Laggard Among Other Trading Peers



Source: Bloomberg, NBS, Markit, Maybank FX Research & Strategy

Chart (Monthly): Triple Top Target Price is around 0.19



Trade Idea:

Beyond the near-term which could see some recovery due to the somewhat positive outcome of the US-China trade war, we anticipate that CNH could still weaken against the SGD for much of this year. **The triple top formed over 2017 and 2018 is a bearish set up with a target price at around the 0.19-figure. Look to sell this cross on rally towards 0.20. Stoploss at 0.2080.**

Keeping Track

Key Events/Data Headlines	More Details, Impact and *Views*
Manufacturing Weakens Caixin PMI-mfg came in at 49.7 vs. previous at 50.2. Earlier, NBS also released PMI-mfg at 49.4 vs. previous 50.0.	NBS PMI-mfg came in at 49.4 vs. the expected 50.0. Caixin PMI-mfg came in at 49.7 vs. the previous 50.2. Deterioration was more than expected and broad-based, affecting large, medium and small corporates.
Credit Support for SMEs PBoC created the targeted medium-term lending facility to encourage credit support for small, medium and private enterprises on 19th Dec.	It was later announced that this TMLF would be offered in late Jan (this month end). PBoC wants to provide a "long term source of stable funding to financial institution"s that lends to SMEs. This is in line with what President Xi has pledged earlier in the days to protect China's private businesses. Funds from the facility can be used for three years, and the operating rate will be 3.15% for now, 15bps below the current 1Y MLF rate (at 3.30%). PBoC also raised the relending and rediscounting amount by CNY100bn to support small, micro and private enterprises.
Central Economic Work Conference (19-21 Dec) China is now more focus on growth	Apart from the TMLF that was announced recently, the top policy makers reiterated that growth would be bolstered by monetary and fiscal support in 2019 including substantial cuts to taxes and fees. Monetary policy will remain "prudent". The word "neutral" was excluded in the statement.
Broad RRR Cut PBoC announced a 100bps RRR Cut	4 Jan saw PBoC announced its first broad RRR cut since Mar 2016. The RRR cut will take effect in two tranches - 50bps on 15th Jan and then another 50bps on 25th Jan. The central bank officers said that the RRR cut was timed ahead of Lunar New Year seasonal demands. The CNY1.5trn of liquidity is also meant to cater for the CNY1.22trn of MLF maturities in that would not be rolled over. Along with targeted MLFs and targeted RRR cut, a net CNY800bn will be unleashed. Policy stimulus came after the PMI-mfg data indicated further deceleration in the manufacturing sector.
Tax Cuts for SMEs China announced a U$29 annual tax cuts for SMEs for the next three years.	This comes after the officials raised the fiscal deficit target for 2019 to 2.8% of GDP from 2.6% in 2018. These have been rather widely expected after the top officials have already pledged to do tax cuts and support private enterprises, especially the small and medium ones. Nonetheless, the fiscal bolsters have likely contributed to the risk-on sentiments recently and Asian FX including CNH and CNY which have strengthened as a result. That said, officials seem rather clear in avoiding those big stimulus package that was seen in 2009.

Source: Xinhua, Bloomberg, China Daily, NBS, Markit, Maybank FX Research & Strategy

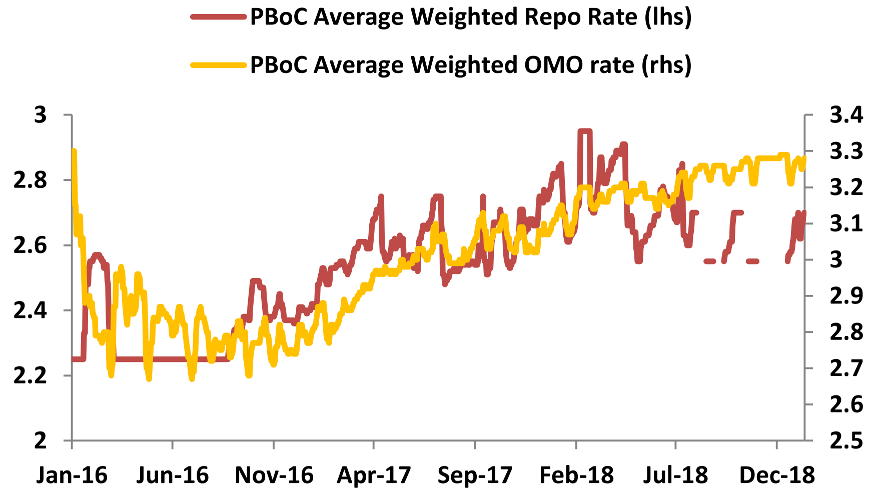
Note: For this publication, we selected key events that happened since the last publication on 10 Dec 2018. Trade war development is in the main story.

Upcoming Events to Watch in The Next Two Weeks

11 - 15 Jan	- Money Supply M2, Aggregate financing, new yuan loans
14 Jan	- Trade Data
16 Jan	- New home price
17-25 Jan	- FX Net Settlement
21 Jan	- Retail sales, industrial production, FAI (urban), 4Q GDP

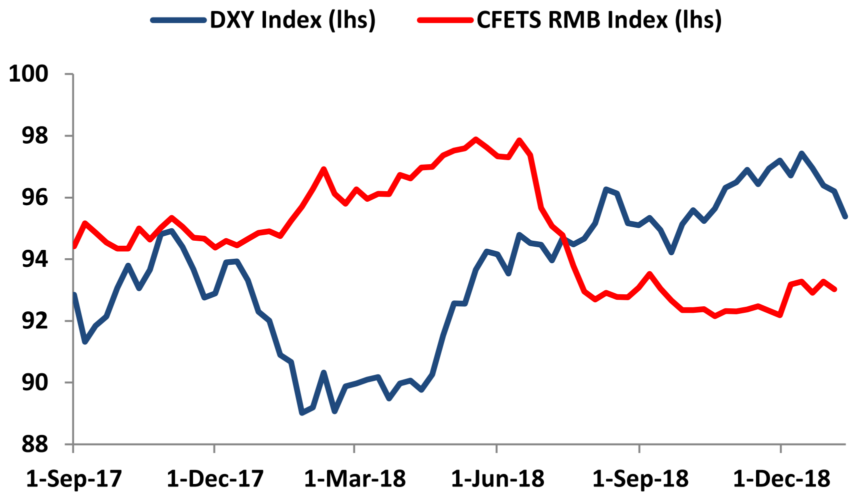
Charts We Monitor

Chart 1: Rates Are Elevated But Plateaued



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Steadies Against Trading Partners As USD Depreciates



Source: Bloomberg, Maybank FX Research & Strategy

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