Macro | FX Research and Strategy

Global

RMB Watch

Propping Up Growth will Not Do Much for RMB

RMB Gains Could Slow

The USDCNY has drifted lower from its Oct 2018 high. The 3.2% gain in the CNY (between 17 Oct 2018-11 Mar 2019) vs. the USD also boosted the rise in the RMB TWI in the last few months. From a trade-weighted perspective, this is a 50% retracement of the trade war premium since it started earlier last year and taking into account the impact of the tariff on China via business sentiment and damage on export earnings, the monetary policy easing that China still has to undertake, the fiscal support that has come and are being implemented, **we may see an interim peak in the RMB gains against the USD and the trade weighted basket.** The current trajectory of the USDCNY is right in line with our forecast for USDCNH to head towards 6.75 end of this month and perhaps towards 6.65 in six months as USD eases. The recent National People's Congress reminded us that RMB gains are unlikely to continue indefinitely.

Right at the start of the NPC, Premier Li Keqiang reminded in the annual work report that the economy faces downside pressure and has provided a number of fiscal policies, many of which are targeted to support the small and medium enterprises including almost CNY2trn of tax cuts, apart from boosting household consumption. As a result, the annual budget deficit was raised to 2.8% of GDP from 2.6% last year. More RRR cuts were mentioned and even a rate cut is expected, interpreted from reading between the lines of the report. Expectations for PBoC to cut interest rate saw a rebound in China Government Bonds and 10y yield fell to 3.14%. However, PBoC Yi Gang highlighted yesterday (10 Mar) that there is less room to cut RRR currently compared to previous years as China is at a stage of development which requires a certain level of required reserve ratio.

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USDCNH Retraces 40% of its Rally

Source: Bloomberg, Maybank FX Research & Strategy

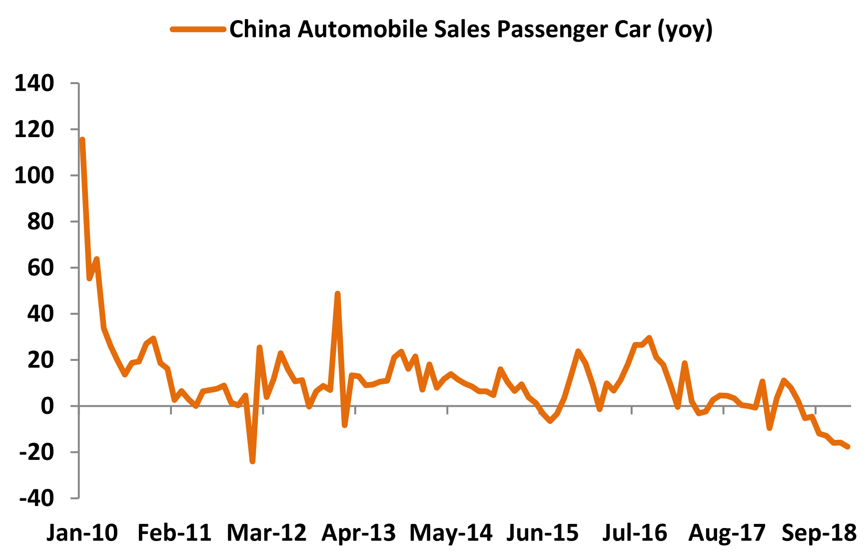
What does the NPC mean for the RMB?

It is quite clear that China is highly concerned about growth this year. Yet, China has reiterated that the government wishes to avoid the debt surge that followed the 2008-09 economic stimulus plan – a RMB4trn stimulus package that was provided to cushion China against the impact of the Global Financial Crisis then. The growth target for 2019 was also adjusted to 6-6.5% from the "around 6% target" that was set for 2018. While this growth target underscores the downside risks to the economy, it is also in line with their aim to get a more sustainable economy. The 3% VAT tax cuts, the targeted RRR cuts for SMEs, more support for elderly healthcare and domestic helper ensures that the benefits from the policies are not largely via the real estate sector this time. There are still mentions of support for R%D on big data and artificial intelligence with budget allotment increased by 13.4% to CNY354.3bn there. This suggests that the goal of the government is to prop up the economy in the near-term, avoid large layoffs while allocating some resources to work towards developing a high technology industrial sector (aka "Made in China 2025"), that could boost potential growth.

Data is Still Weak

Near-term stresses matter. With a trade war still on, ensuring that private consumption expenditure maintains momentum is key as a large domestic market is the alternative for exporters to get their earnings from should the US chooses to leave their tariffs at current levels on their imports from China. At this point, it seems that the combination of trade war and deleveraging efforts last year have hurt consumer confidence. The sales of passenger cars have contracted -17.7%y/y, the steepest fall since Jan 2012. In fact, the print has been in negative print since Jul last year. A persistent decline in the sales of a big ticket item like cars is an indication that the Chinese consumer is less certain of the future. The fall in final consumption expenditure led to the adjustment in the tax threshold for personal income tax last year.

<u>Chart 2: Fall in Passenger Car Sales Suggest Lower Consumer Confidence</u>



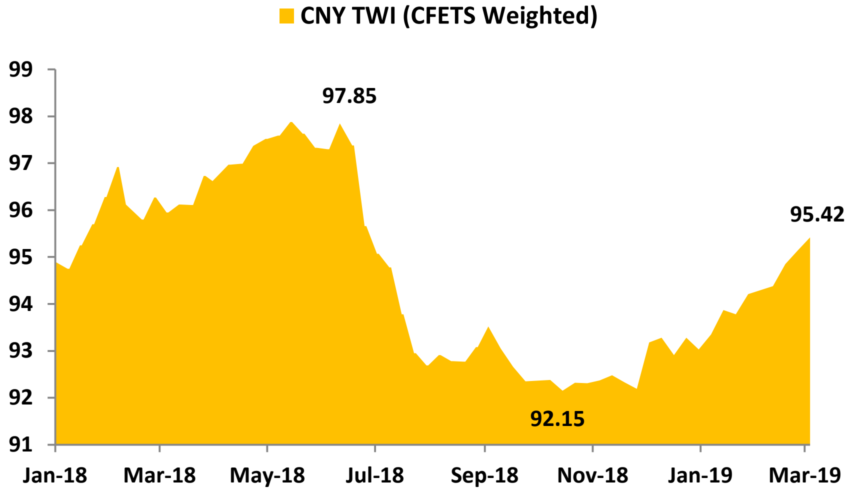
Source: China Automotive Information Net, Maybank FX Research & Strategy

In the meantime, the new export order for PMI-mfg (a sub component of the PMI-mfg print from the National Bureau of Statistics) deteriorated to 45.2 in Feb vs. the previous 46.9. Notwithstanding the fact that this print could be distorted by the Lunar New Year effect, this number is still the worst since the data is available in Jul 2013. This was followed by the most recent trade number - exports shrank 16.6%y/y in Feb vs. the consensus at 6.6%. Imports also fell 0.3%y/y vs. expected 6.2%, underscoring weaker domestic demand. Trade surplus narrowed to just CNY34.5bn from previous CNY271bn.

Credit data for Feb also underwhelmed with aggregate financing at CNY703bn vs. expected CNY1.3trn and new yuan loans at CNY885.8bn, also lower than the expected CNY950bn. The recent string of data all points to **weaker activity momentum, consumption patterns and external demand.**

So, even if there is a structural limit to the scope for PBoC to cut RRR and China does not aim to have a V-shape economic recovery, the nature of the fiscal policy (pro-business, infrastructure but not pro-real estate) could mean that the economic support could be gradual. That in turn suggests that PBoC would have to cut rates at some point should the economy continue to weaken. Further monetary easing in such a scenario is hardly likely to be positive for the RMB.

Chart 3: CNY has Retraced 50% against its Trading Partners



Source: CFETS, Bloomberg, Maybank FX Research & Strategy

The CNY TWI (CFETS) retraced 50% of its fall in 2018 and we anticipate limited upside from here. This is because there is a fair amount of optimism priced already with regards to the US-China trade deal. Risks could thus be tilted towards a sell on fact/or even disappointment at this point. Moving on from a partial deal which is likely to be signed within the next few weeks, focus will be increasingly on the economic performance of China. The current account surplus is slated to narrow if China move to purchase more goods from the US. While that should not be too negative for the RMB in an environment of weak USD as well as a still underinvested financial markets (bonds and equities) amid recent boost in the A-share inclusions to MSCI EM index as well as the Bloomberg Barclays Bond index, weaker growth momentum could still weigh on the CNY as foreign investors decide to hedge against the currency. Against the USD, we anticipate range trade within the 6.60-6.80 range. We do not rule out a move down towards 6.60 should the US-China deal surprise with more commitment from both sides than expected. However, we anticipate the 6.60-support to be strong. Moves thereafter are likely biased to the upside should economic data continue to disappoint.

NPC 2019

Economic Targets

- GDP Target is lowered to 6 - 6.5% in 2019 from "around 6.5%" set for 2018.
- CPI target is maintained at 3%.
- Money supply (which includes cash in circulation and deposits, and total social financing this year) would be in line with nominal GDP growth.

Monetary Policy Guidance

- More targeted RRR cuts for Small and Medium Enterprises.
- Premier Li says to “improve the formation mechanism” of the RMB exchange rate and keep currency basically stable at reasonable levels
- NDRC said that China will increase the yuan exchange rate flexibility and strengthen regulations on cross-border capital flows in 2019; also to ensure equity, bond and currency markets stability.
- PBoC Yi Gang says that the central bank will keep credit growth in line with the pace of nominal GDP and promised to better support small firms (reiterating Li Keqiang's government work report).

Fiscal Priorities

- A 3% VAT cut (16% to 13%) for manufacturing companies
- A 1% VAT cut (10% to 9%) for transport and construction sectors
- China to increase its defence expenditure by 7.5% to CNY1.19trn, a slower increase compared to 8.1% in 2018.
- Local government bond issuance quota set at CNY3.08 trn this year, special bond issuance quota for local government is CNY2.15trn vs. CNY1.35trn last year.

Other Reforms

- A Foreign investment draft Bill could be passed as early as this week that would allow investors to expect a more transparent and predictable environment. They can enjoy the same treatment as Chinese companies. Spokesman for the NPC said this was drafted to address concerns on intellectual property protection and technology transfer.
- The "Negative List" of industries that foreign investors cannot access will be shortened. More measures to be implemented to open up agriculture, mining, manufacturing and service industries to allow wholly foreign-owned firms to operate in more sectors.
- A draft property tax in China is "steadily advancing" and it will be submitted for review when conditions are right.
- Economic zones like the Guangdong-Hong Kong-Macau GBA, Yangtze economic belt and a new pilot free trade zone on Hainan island are a key part of China's future development
- Expenditure on water and soil clean-up will increase by 45.3% and 42.9% to CNY30bn and CNY5bn respectively. Spending on air pollution will increase by 25% to CNY25bn.

News Sources: Bloomberg, Reuters, CNA

USDCNH (Daily) – Sideways, Moving Averages Compression

USDCNH is back within the 6.70-6.80 range, now biased to the upside. The break below the 6.6960-level was brief and this pair drifted northbound thereafter. Momentum indicators are mild bullish. We anticipate some two-way trade within 6.60-6.80 range as we see a compression of the moving averages. We take profit for our trade initiated on the 25 Jan issue of RMB Watch.

CNYSGD (Daily) - Rising trend channel

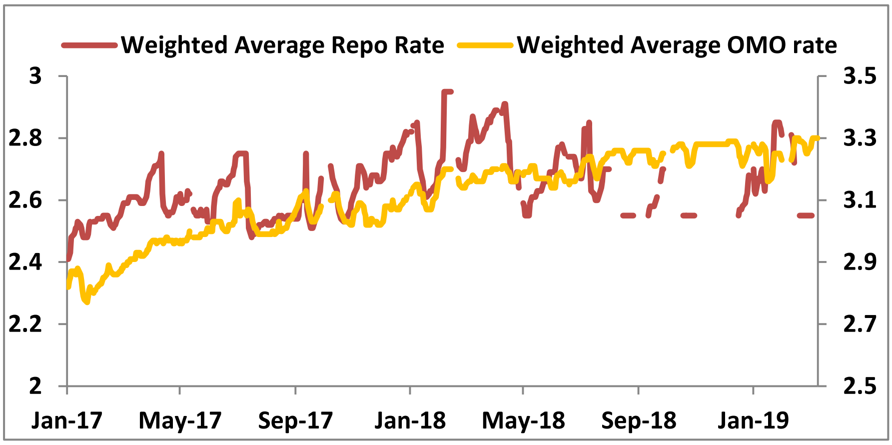
Source: Bloomberg, Maybank FX Research

Upcoming Events to Watch in The Next Two Weeks

11 - 18 Mar	- FDI (Feb)
14 Mar	- Urban FAI, IP, Retail sales, property investment (Feb)
15 Mar	- New Home Prices (Feb)
18 Mar	- FX Net Settlement (Feb)
27 Mar	- Industrial Profits (Feb)
27 Mar	- Trump-Xi Summit (Probable)

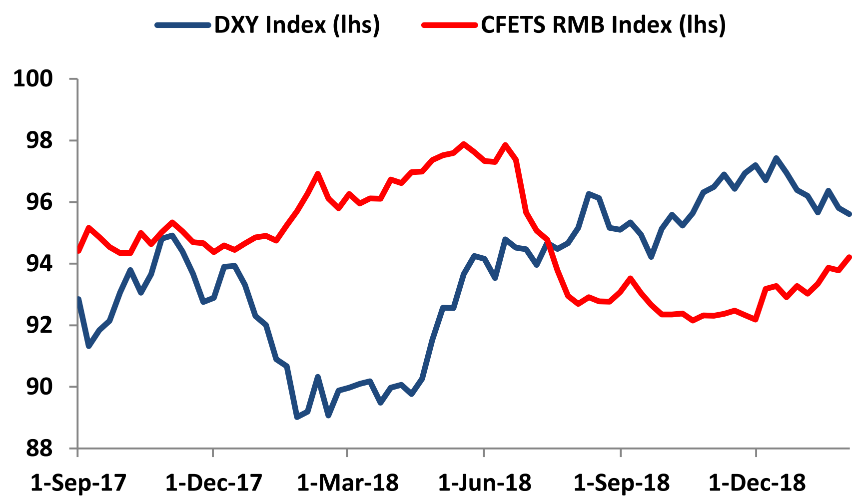
Charts We Monitor

Chart 1: Repo Rates Crept Up Again



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Strengthens Against Trading Partners Of Late



Source: Bloomberg, Maybank FX Research & Strategy

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