Macro | FX Research and Strategy

Global

RMB Watch

US China Relation Remains At the Fore For Now

Less Than One Month Before The US-Mid-Term…

"Nothing binds a people to their leader like a common enemy. Voters don't change governments during war." ~ Harvey Fierstein

There are a few drivers that have kept RMB on the backfoot vs. the USD - slowing growth, an accommodative bias in its monetary policy and finally, the trade war. We do not think it is a pure coincidence that Trump started the trade war this year, ahead of the mid-term election that will happen on 6 Nov. According to many anecdotal accounts, Trump and his administration has disregarded most corporates who have tried to dissuade him from raising tariffs on steel and on China. It is also a known fact that there is no clear winner in a trade war so Trump's motivation has always been political and that is to retain the votes for his party.

Beyond the election on 6 Nov 2018, we see less political motivation for the US to continue this costly trade war. With rates on the rise, global growth forecasts trimmed, it could make more sense to take a pause here and focus on other policies. That could also ease the pressure on the RMB.

Analysts

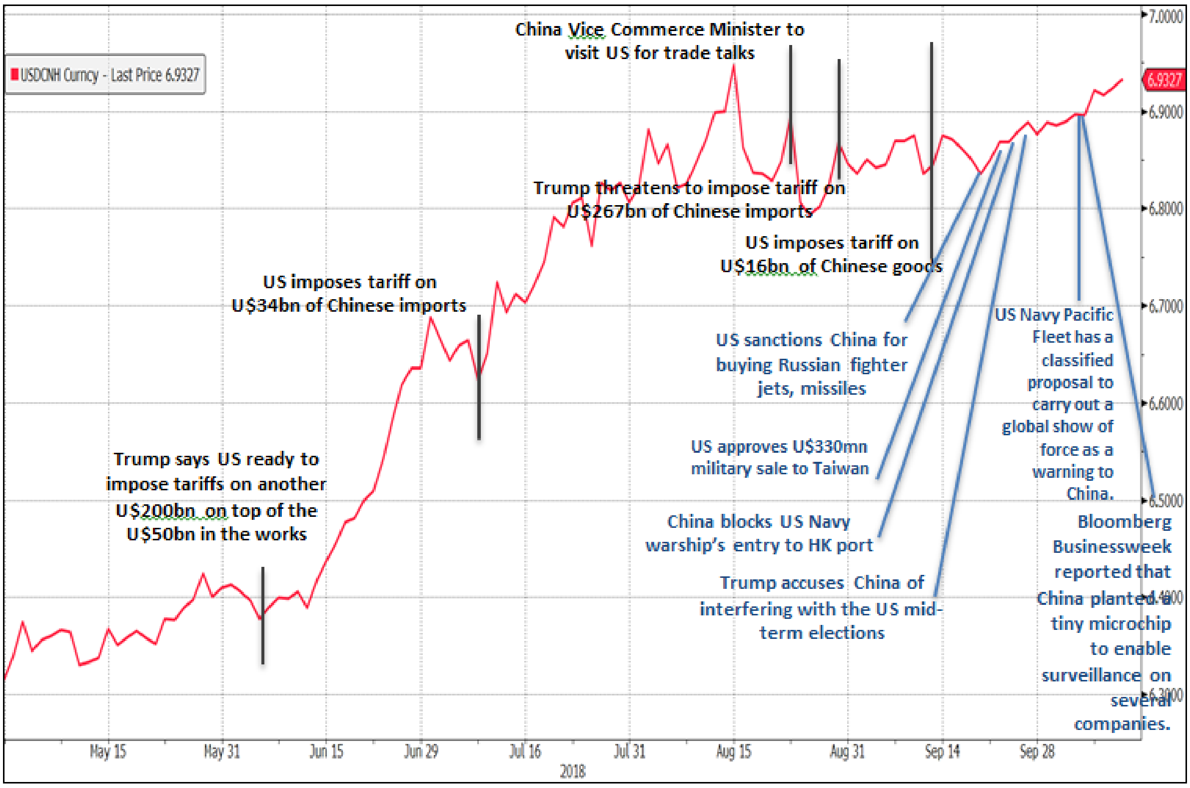
Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

Chart 1: USDCNH is Buoyed By the Deterioration in the US-China Relation



China is Not Expected to Be Labelled as Currency Manipulator but Risks Cannot be Ruled Out

Much of the development is suspiciously timed ahead of the political event and accelerated for the sake of it. Even the FX report expected by the US Treasury is widely watched on whether the US can brand China as a currency manipulator. China certainly does not fulfil the 3 assessment criteria to be labelled as such. According to the US Treasury, the three criteria are

(1) a significant bilateral trade surplus with the United States is one that is at least $20 billion;

(2) a material current account surplus is one that is at least 3 percent of gross domestic product (GDP); and

(3) persistent, one-sided intervention occurs when net purchases of foreign currency are conducted repeatedly and total at least 2 percent of an economy's GDP over a 12-month period.

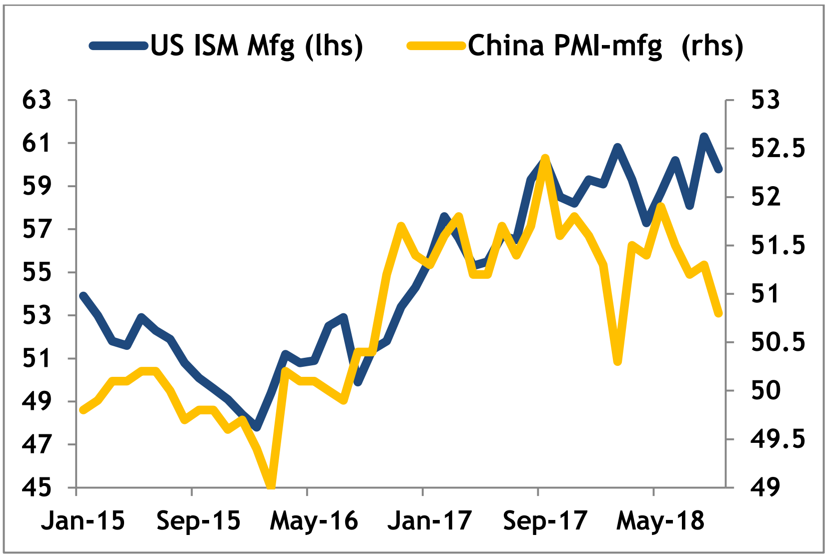
Overnight, the Treasury is said to have informed Mnuchin that China has not been manipulating the RMB.

However, in light of the current US-China trade war and the steep decline in the RMB vs. the USD, the US Treasury could still tweak the conditions or the Treasury Secretary Mnuchin could invoke a vague 1988 Trade Act to label currency manipulation just to step up on the trade war. After all, given the amount of tariffs already imposed, this move has virtually not much cost in terms of dollars and cents. The USDCNH is thus rather bid recent sessions. And as such, we do not rule out further CNH deterioration even beyond the key 7-figure in the near-term.

Less China Bashing Beyond Mid-Term Election

Regardless of who takes control of the Houses of Congress after 6 Nov 2018, the political event is over and our base scenario is that China bashing would not dominate the headline as much. The depreciation pressure on RMB could lessen as well. We are thus expecting USDCNH to head towards 6.80 by year end still.

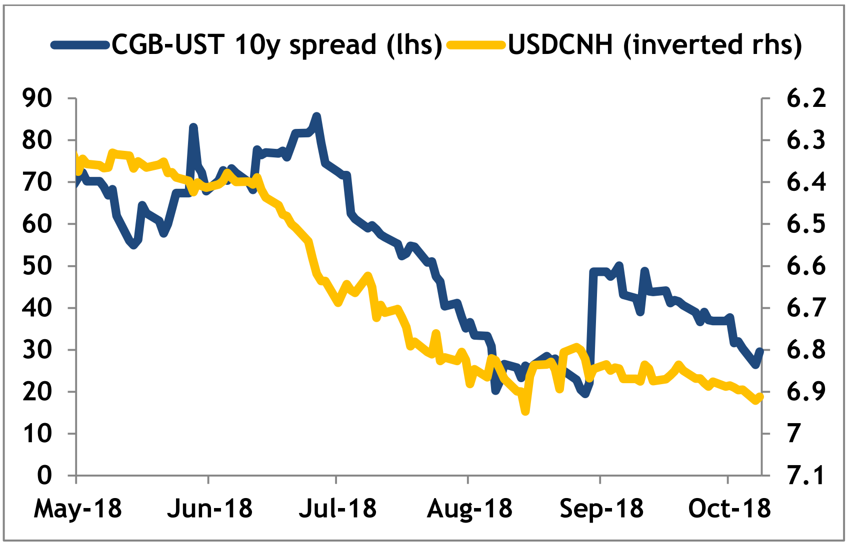
<u>**Chart 2: Growth Momentum Diverges Between the US and China**</u>



Source: Bloomberg, Maybank FX Research & Strategy

However, we are increasingly less positive on the RMB given the divergence between the growth momentum of the US and China. That has given rise to narrowing yield differential between the China government bond yield vs. that of the US treasuries. Recent comments by Powell of hiking above the neutral rate also saw the CGB-UST 10y yield differential narrowed to its narrowest seen this year at 38bps at one point before the current equity rout drove demand back to the UST.

<u>**Chart 3: Narrowing Yield Spread Weigh on USDCNH**</u>



Source: Bloomberg, Maybank FX Research & Strategy

We see risk of USDCNH and USDCNY remaining at an elevated range as long as the CCAF is in play into 2019.

RMB On The Technical Charts

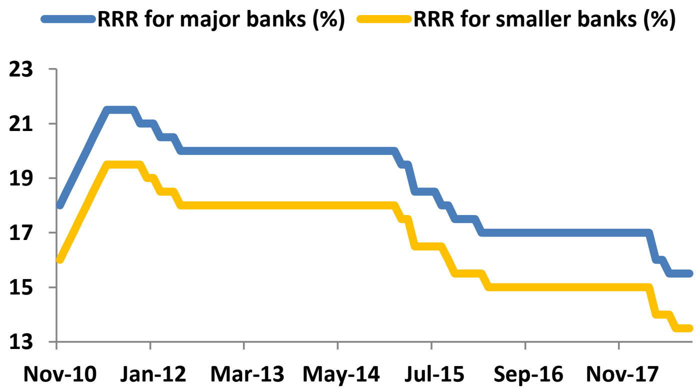
<u>(USDCNH daily) – Eyes The 6.95</u>

USDCNH pressed higher towards the year high of 6.9586 and was last seen around 6.9193. Bullish momentum is intact though stochs show signs of turning lower. Support is seen at 6.8640 (50-dma). Next resistance at 6.96 (recent highs) and subsequent support level is seen at 6.78 (23.6% Fibonacci retracement).

<u>(USDCNH Weekly) – Bullish Momentum Wanes</u>

Source: Bloomberg, Maybank FX Research & Strategy

Keeping Track

Date	Events/Data Headlines	More Details, Impact and *Views*	Relevant Charts (if any)
2 Oct	**China To Open Up** Premier Li Keqiang had stated at a meeting of State Council that China will broaden market access and speed up the process for foreign investment in the country.	Foreign and domestic investment should receive equal treatment. *This comes amid the trade war with the US and as China continues to woo foreign investors to its financial markets. This also comes at a time where Europe is still rather lukewarm to One Belt one Road initiative.* The French Treasury had recently noted that the sustainability of finances provided by China is "uncertain" and economic benefits for Europe still depends on how open China is.	
8 Oct	**China Cuts RRR** China is said to cut RRR by 100bps for major banks with effect on 15 Oct.	The reserve requirement ratio cut should release a total of CNY1.2trn of which CNY450bn is meant to be used to repay existing MLF facilities that are due soon. Accompanying the decision is an assurance by the central bank that the move will not see a runaway depreciation in the RMB. CCAF was visibly in play for the sessions that followed. 3M CNH hibor spiked to 6.0%, on 9 Oct, a day before the PBoC issues offshore yuan bonds.	

**News Sources from Xinhua, Bloomberg, China Daily, China Securities Journal, China Business News, People's Daily; Data from CEIC, Bloomberg, NBS, SAFE, PBoC*

Date	Events/Data Headlines	More Details, Impact and *Views*	Relevant Charts (if any)
9 Oct	**China Will Not Give In** Chinese Commerce Minister Zhong Shan said that the US should not believe that ever higher tariffs can induce China's government to give in to US' demands.	*He repeats more of the same rhetoric that we have seen so far with regards to the trade war. However, this came right after the RRR cut, underscoring the ammunition that China has to support the economy even as external headwinds worsen.*	
10 oct	China plans to increase the number of companies that is considered to be systematically important financial institutions (SIFIs).	A minimum of 50 (vs. 20 currently) largest financial institutions in China will be shortlisted as possible SIFIs. Those named will be subject to extra capital requirements, and may face additional rules on leverage, risk exposure and information disclosure. *As China continues to strengthen its financial market oversight, expect PBoC to continue to lower RRR almost every quarter to support credit activities.*	
11-Oct	MOFCOM said China and the US should address trade differences via talk, urges the US to stop unilateralism, protectionism.	*This seems like a warning for the US not to label China as a currency manipulator as a move to escalate the trade war.*	

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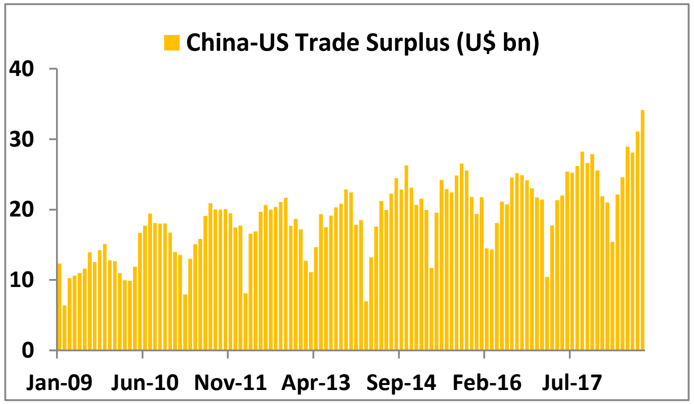
Date	Events/Data Headlines	More Details, Impact and *Views*	Relevant Charts (if any)
11-Oct	**Not Guilty of Currency Manipulation** US Treasury Department's staff advised Secretary Mnuchin that China is not manipulating the yuan	*Regardless, Mnuchin still has the discretionary power to tweak the assessment criteria to name China as a currency manipulator. He is known to be under pressure from the POTUS to do so.*	
12 Oct	**Trade surplus for Sep Widens** In yuan terms, exports rose more than expected to 17.0%y/y from previous 7.3%. Imports slowed a little to 17.4%y/y from prev. 18.7%.	Just base on headline alone, the trade war seems to be having little impact on China's trade balance. Scrutinizing at the breakdown of the trade with US, exports to the US have picked up pace to 14%y/y from previous 13% while imports from the US contracted -1.2%. The trade surplus widened to a record high of U$34bn. *The growth divergence of the US and China underpins but frontloading of purchases ahead fresh tariffs on 1 Jan cannot be discounted.*	

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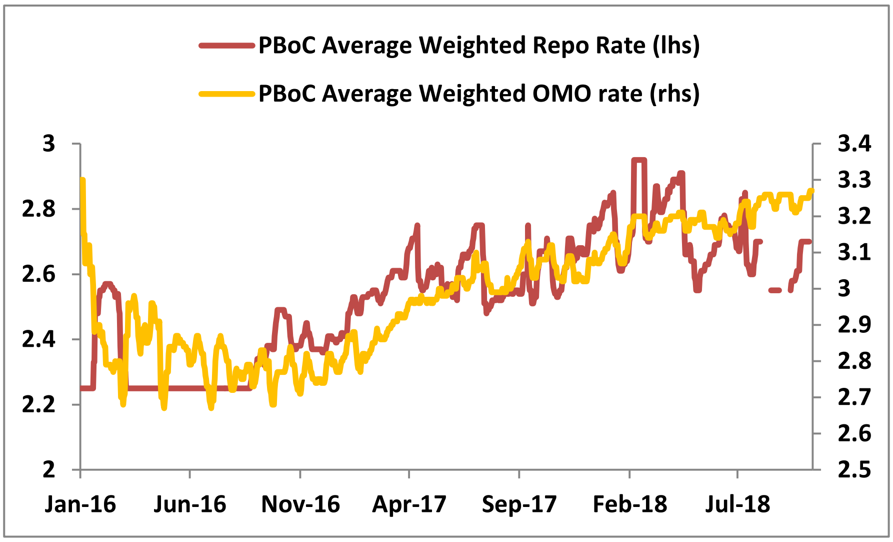
Upcoming Events to Watch in The Next Two Weeks

Now – 15 Oct	- Credit Numbers for Sep
15 -19 Oct	– US Treasury Releases FX Report
16 Oct	– Sep PPI, CPI
19 Oct	– 3Q GDP, IP, retail sales, urban FAI (Sep)
20 Oct	- New Home Price (Sep)
25 Oct	- SWIFT Global Payments, FX Net Settlement

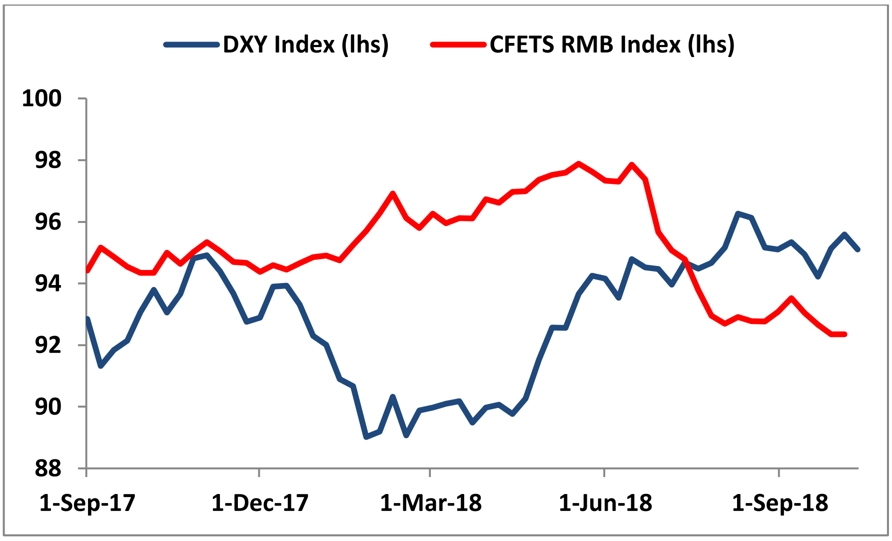
Charts We Monitor

Chart 1: Repo Rates and OMO Rates Are Rather Supported



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Weakens Against the Basket As USD Strength Fades



Source: Bloomberg, Maybank FX Research & Strategy

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Saktiandi Supaat
Head, FX Research
saktiandi@maybank.com.sg
(+65) 63201379

Christopher Wong
Senior FX Strategist
wongkl@maybank.com.sg
(+65) 63201347

Fiona Lim
Senior FX Strategist
Fionalim@maybank.com.sg
(+65) 63201374

Leslie Tang
Senior FX Strategist
leslietang@maybank.com.sg
(+65) 63201378