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RMB Watch

Neckline is Threatened

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Head and Shoulders Completed, Neckline is Threatened

In the last issue of the RMB Watch, we urged our readers to watch the formation of the head and shoulders of the USDCNH. On 27th Sep, we look for another tentative peak in the USDCNH to come around 7.12-7.15. The right shoulder was formed with a peak of 7.1684 before diving towards a low of 7.0503 this morning. That low threatens the neckline of the head and shoulders formation that could usher more CNH gains towards the 7.00. However, the neckline is not broken yet and we continue to monitor the close for today, the USDCNY fix tomorrow as well as the Sep activity data along with the 3Q GDP on Fri.

There are few things that could be as fluid as the US-China relation and USDCNH and USDCNY could have somewhat priced in much of the euphoria from such a lean trade deal that can only be inked 4-5 weeks later, possibly on the 17th Nov APEC world leaders meeting. We took partial profit this morning on our short USDCNH trade in view of the partial deal and we stand by our expectations for USDCNH to break 7.07 for greater extension beyond 7.00 towards 6.95/6.90. This pair was last seen around 7.08 at this point, underpinned by whispers that China "wants more talks before signing Trump's 'phase one' deal". There could be some caution warranted for now as markets look out for further exchanges between the US and China.

De-Escalation Could Mean USDCNH to Catch Down Towards Gold/Agricultural Ratio

Note: The Gold/Agricultural Ratio Can Be Seen as Another Proxy for Trade-War Escalation/De-escalation as gold is a safe haven to be unwound in better risk environment while the agricultural index tends to rally when China announces purchases of more US agricultural goods.
Source: *Bloomberg, Maybank FX Research & Strategy*

What Is In The Deal?

US President Trump announced that an agreement on *Phase 1* of the trade deal has been reached after a meeting with Vice Premier Liu He on 11th Oct (last Fri.) The announcement of a deal itself was enough to give markets a good cheer into last weekend and RMB bulls continued to rake in gains this morning. Insofar, we have monitored the USDCNY fixes and noted our suspicion that PBoC is taking a bet on the fact that talks are likely to be positive enough to pull the USDCNY spot lower towards the USDCNY fix at around 7.0730. The harder question is what is in this latest mini-deal?

Key Highlights

- A deal is not a deal yet as it is not yet "put in writing".
    - The deal could be signed 4-5 weeks later, possibly in the APEC meetings of global leaders hosted by Chile on 17th Nov which is attended by both President Xi and Trump.
- China to purchase additional $40-50bn of **agricultural US products.**
- Concessions on the **financial services**. This came after CSRC announced that overseas institutions can apply for total control of onshore ventures starting in 2020. The first round of applications for future firms can start on 1st Jan while fund management businesses can apply from 1st Apr and the securities industry will be able to file for 100% stakes on 1st Dec.
- Measures to enforce **intellectual property** in China.
- Concessions on **currency** (no details).
- **Enforcement part of the deal** is being worked out.
- The US to **review the Chinese companies** on the Black List.
- The US to delay the tariff hike on 15th Oct.

What is Not in the Deal?

- Huawei is not part of the deal "today".
- The Tariffs Set to Take effect on 15th Dec was not mentioned

Other related comments:

Protests in Hong Kong has "toned down"

Trump remarked that he sees protests winding down. The protests in Hong Kong have been brought up time and again by Trump as part of a pre-cursor before a deal can be reached. This was not helped by the fact that the US House plans to vote on bills to support the protestors in Hong Kong including 1) Hong Kong Human Rights and Democracy Act of 2019 to ensure annual assessments of whether Hong Kong is sufficiently autonomous from Beijing; 2) the House vote on Protect Hong Kong Act to halt the export of crowd-control devices such as tear gas and rubber bullets; 3) the House to vote on a resolution to re-affirm the relationship between the US and Hong Kong. Trump's latest comments address concerns at home while paving the way for a better relationship with China.

China May Not Be a Currency Manipulator afterall

US Treasury Secretary Steven Mnuchin is said to consider removing the currency manipulator label from China. The Treasury Department made a move to label China as a currency manipulator in Aug after China allowed the RMB to weaken past the 7-figure. Just as the designation by the US Treasury as a currency manipulator is largely symbolic of the deterioration in the US-China relations, the removal of the label is also unlikely to have any significant impact.

Beyond the Current Partial Deal

Trump said in the Oval Office with China's Vice Premier Liu He next to him that "Phase two will start almost immediately" after the first phase is signed.

Our view on the partial trade deal:

	US' Tariff Action on China	China's Tariff Action on US	Phase 1 of Trade Deal
6 Jul 2018	US imposes 25% tariffs on $34bn of Chinese products.	China also levies 25% on 545 US-origin products, valued at $34bn.	
23 Aug 2018	US imposes 25% tariffs on $16bn of Chinese products.	China imposes 25% of tax on US products	
24 Sep 2018	US imposes 10% tariff on $200bn of Chinese products.	China imposes tariffs on U$60bn of US products.	
10 May 2019	US raises 10% Tariff on $200bn of Chinese imports to 25%		
1 Jun 2019		China raises tariffs on $60bn of US products.	
1 Sep 2019	US imposes 15% tariff on est. $112bn of Chinese imports	China imposes tariffs on $75bn of US products	*We see risk of a rollback of this set of tariffs as goods targeted here are final consumer goods.*
15 Oct 2019	US to Raise Tariff on $200bn of Chinese products from 25% to 30%		*Deferred officially on 11 Oct in anticipation of a trade deal that can be signed in mid-Nov Chile.*
15th Dec 2019	US to impose 15% tariff on est. U$160 bn of Chinese products.		*No mention.*

Source: Bloomberg, PIIE, Maybank FX Research & Strategy

Risks of an trade war re-escalation could stem from differing views on IP

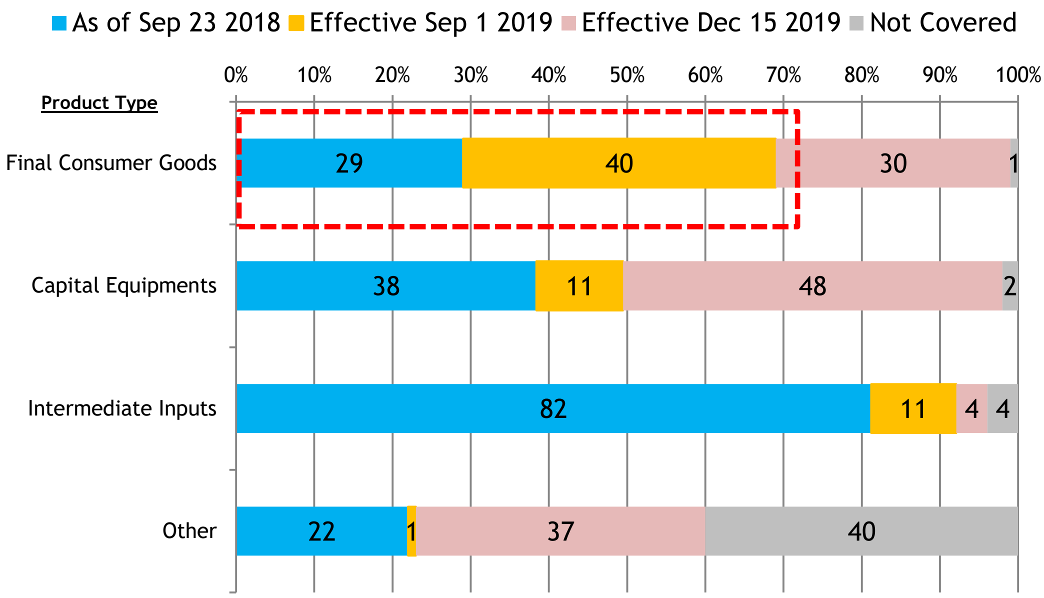
The devil is always in the details and the mention of Intellectual Property measures that are meant to be included in the current deal without further details suggest that there are lingering risks of re-escalation should the US demand more structural reforms from China.

What is different this time?

The fact that China is no longer asking for a roll-back in tariffs, a significant compromise on China's part in our view, suggest that there is a lower risk of another breakdown and that an agreement on the first phase of the deal could be more probable than before. Notwithstanding this conservative view, we see a small potential for a roll-back of the tariffs that took effect on 1st Sep as final consumer goods took the brunt of the 15% tariffs levied on Chinese-origin imports since then. The portion of final consumer goods from China that are taxed rose from 29% to 69% on 1st Sep. That could fan price pressure higher and limit the room for the US to ease (another on the wishlist of Trump). Based on last release, US Core CPI was elevated at 2.4%y/y for Sep, near Jul 2018 high.

Portion of Final Consumer Goods That Originate from China That Attracts Levy on 1st Sep 2019 jumps from 29% to 69%

Percentage of US imports from China Subject to Section 301 Tariffs



Source: Peterson Institute for International Economics, Maybank FX Research & Strategy

Currency Pact

With regards to a currency pact, there is a possibility of an agreement on "no currency manipulation" that draws inspiration from the IMF Articles of Agreement "to avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage". This would be similar to the Chapter 33 of the USMCA. Any commitment by China to ensure that RMB would not weaken excessively against the USD could strengthen the RMB and the steady USDCNY fixes that we have seen over the past weeks that arguably defy market forces are a testament to China's commitment to support the RMB. However, we also like to stress that long periods of strong CNY fixes that defy market forces cannot be possible in an environment of USD strength and we are of the view that current USD strength is not sustainable as we look for Fed to turn more dovish as a strengthening USD would inevitably tighten financial conditions. We also based our USD view on the medium term risks of fiscal and current account deficit deterioration that could eventually weigh on the USD.

Where Next for the RMB?

USDCNY touched a low of 7.0476 today and the low of USDCNH was printed at 7.0503. This has brought to fruition our view that USDCNY spot could move towards the very stable USDCNY fix and is likely to trigger a fresh USDCNY fix that is lower tomorrow after 15th consecutive sessions of being fixed near the 7.07-handle. The timespan of 4-5 weeks (before a deal is inked) can see a lot of swings in FX and it would be naïve to think that USDCNY is a one-way trade from now. We continue to monitor the usual indicators that have served us well including, the behavior of the USDCNY fix, the spread between USDCNY fix and the spot which has converged as well the spread between actual USDCNY fix and our estimate of the USDCNY fix.

We have 3Q data due for China on Fri and expectations for GDP are set rather low. Consensus so far is for a 6.1%y/y growth for 3Q but there are quite a number of calls for sub-6.0% growth. This was encouraged by Premier Li Keqiang's recent comment that "it would be very difficult for China's economy to grow at a rate of 6% or more because of the high base… and the complicated international backdrop". This was published on China's government website. That said, the improvements in the PMI-mfg prints also hint that the infrastructure boosts and other fiscal stimulus including tax cuts and fee reductions could start to see effect. If these were to translate to firmer-than-expected activity prints (which have surprised to the downside for the past few releases), CNY gains may extend beyond 7.00. RMB stability could in turn be anchor for Asian FX gains.

USDCNH (Daily) - Head and Shoulders Formation Completed, Watch for The Break of the Neckline

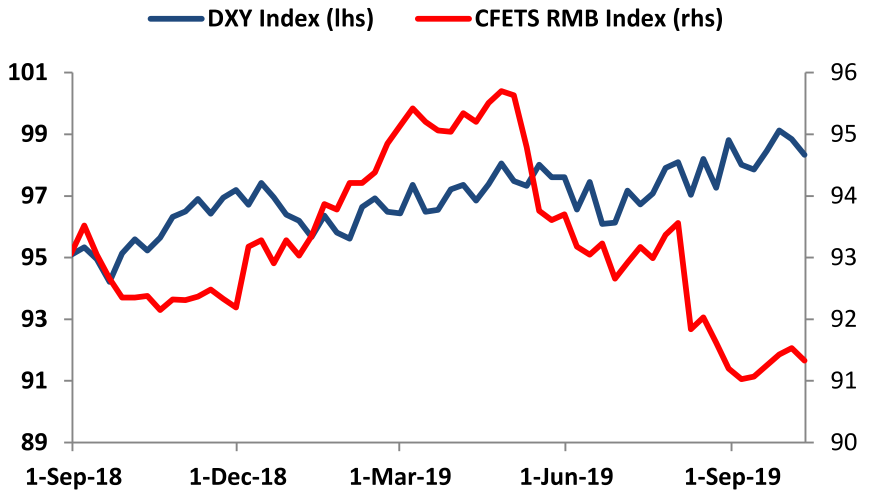
Source: *Bloomberg, Maybank FX Research & Strategy*
Every yellow label denotes a report and our MBB (Maybank) View stated within the note.

USDCNH is at the cusp of breaking the neckline of the head and shoulders formation that started in Aug this year. The break of the neckline could come with a daily close below the 7.07. That may not come easily as trade talks between the US and China broke down frequently in the past. Retracement to meet resistance at 7.12 before 7.15 again. Break of the 7.07 could open the way towards 7.0.

Upcoming Events to Watch in The Next Two Weeks

By 15th Oct	- Money Supply M2 Growth, New Yuan Loans, Aggregate Financing
15th Oct	- CPI, PPI (Sep)
18th Oct	- FAI (urban), Industrial production, retail sales (Sep), 3Q GDP
21st Oct	- New Home Prices (Sep)
27th Oct	- Industrial Profits (Sep)

CNY TWI Stabilizes as DXY Looks Increasingly Toppish



Source: Bloomberg, Maybank FX Research & Strategy

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