

# RMB Watch

## Fed, Yuan and Copper

### Was the Fed Really Behind The Move in CNH?

The Fed’s decision to keep Fed Fund Target Rate unchanged and a more cautious outlook that is reflected on both its policy statement and its dot plot (which now shows no rate hike in 2019) saw a broad retreat in the USD vs other currencies, including the CNH and CNY. While this goes in line with our view that the Fed is near the end of its tightening cycle and USD strength to fade somewhat, the yuan recovery, sharp as it may have been in the past two sessions, may not be entirely due to the Fed. The first move in the USDCNH earlier on 20 Mar coincides with a move up in copper.

We observe that the sensitivity of the CNH to the Fed policy may have been high in the earlier phases of the rate tightening cycle when RMB was under more intense depreciating pressure. However, the converse may not be symmetrical. In an environment where the Fed is merely signalling a pause (not yet a cut), China is outright easing with more RRR cuts already signalled and multiple RRR cuts done in 2018 because of a deterioration in its growth outlook. We think that CNH could be more driven by proxies of its activity momentum (such as the copper prices) rather than the Fed, although we should not totally discount the latter. The chart below shows that copper prices and USDCNH (inverted) have moved more in tandem of late, vs. the USDCNH (inverted) and the DXY index.

### Analysts

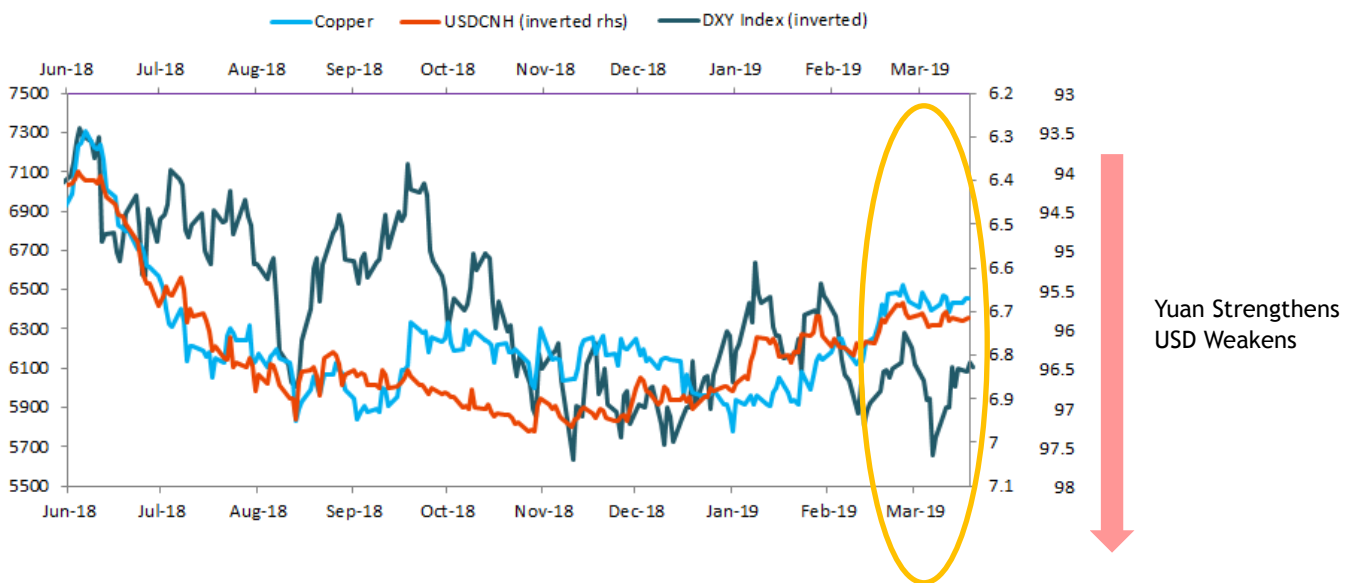
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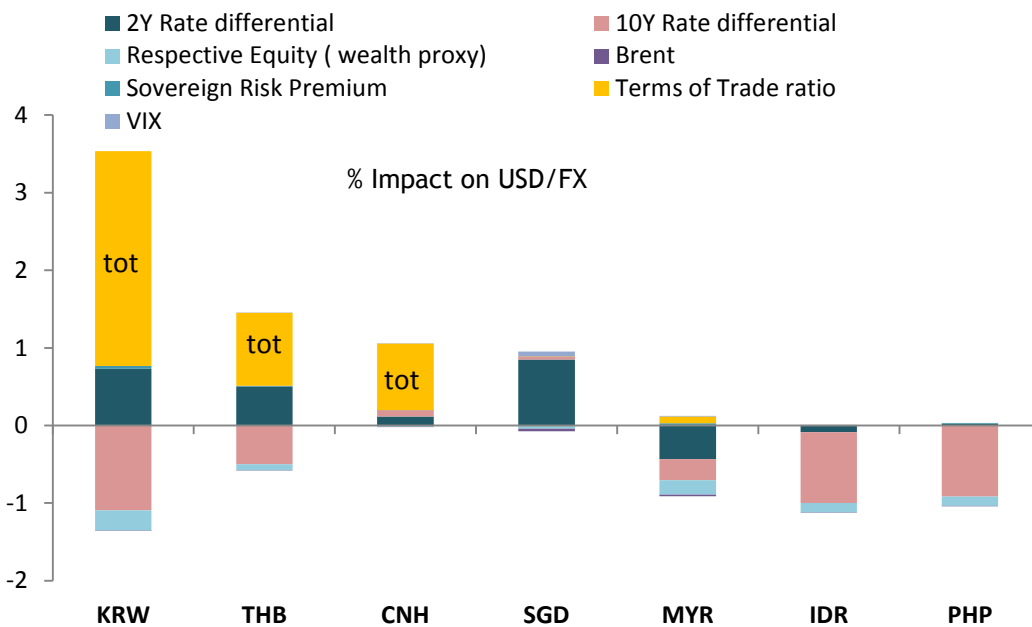
**Chart 1: CNH Moves More in Tandem with Copper Than USD**



Source: Bloomberg, Maybank FX Research & Strategy

Recently, we also did a panel regression [here](#) that includes the performance of the USD vs. the Asian FX. CNH did not stand out. For the variables that we picked including the 2Y and 10Y rate differentials of the US vs. the respective Asian sovereigns, equity (as a wealth effect proxy), brent (as a gauge for commodity), terms of trade ratio, sovereign risk premium and VIX (as a gauge of market sentiment), CNH did not stand out except perhaps for the impact of changes in the terms of trade ratio (US-CH). The changes in the short-term (2Y) rate differentials and the long-term rate differentials (10Y) of US vs. CH were not significant for the USD vs. the CNH base on the study that was done with daily data between Jan-2009 and Feb-2019 via a panel data regression using the Pooled Mean Group Estimate (fixed effects) here. The converse should also be true.

**Chart 2: CNH Did Not Stand Out in Our Study, though ToT matters**

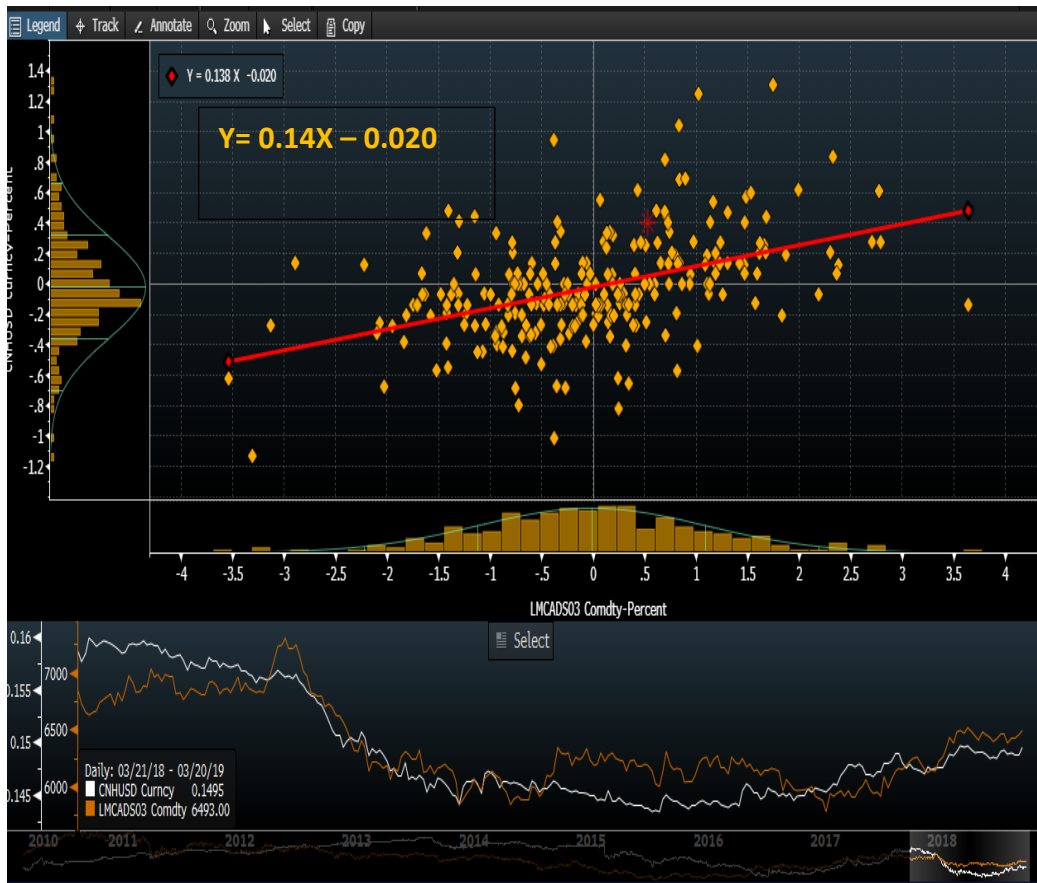


Source: Maybank FX Research & Strategy Estimates, CEIC, Bloomberg, EView

Based on the rather high coefficient for terms of trade ratio, we found that CNH is driven by China’s ability to pay for its imports relative to its exports vs. that of the US. This is reflective of its exchange rate regime and influence of the daily USDCNY reference rate fixing on offshore yuan which is calculated based on the CFETS trade-weighted basket. Our study shows that a 1 unit improvement in the terms of trade in favour of the US vs. China’s could see 0.86% appreciation of the USD vs. the CNH. We believe the reverse is true. This gels with our view that the RMB gains may be capped by the fact that it could crimp on its export performance in an environment of already moderating global growth.

Our panel regression may not be comprehensive in determining all factors that drive the RMB and we suspect that activity momentum should be determining the price of the RMB more. As such, we investigate the statistical strength of the relationship between the CNHUSD and copper and found that a 1% increase in the copper price

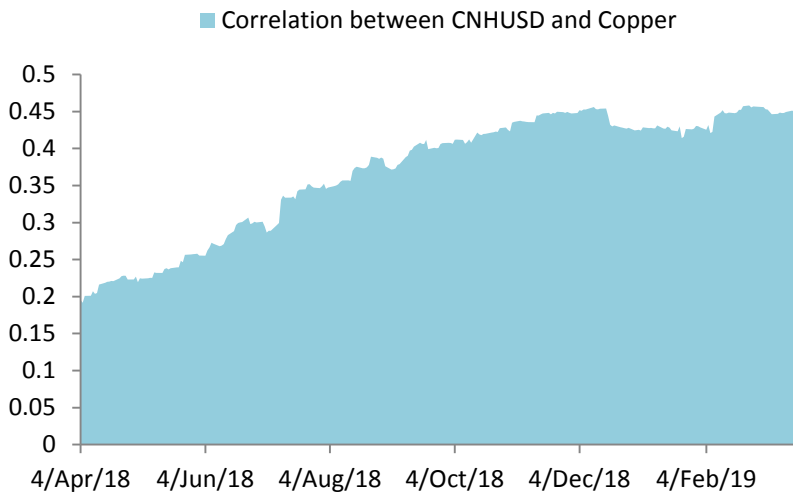
results in a 0.14% appreciation in the CNH vs. the USD. This is using the daily data between the period of 21 Mar 2018 and 21 Mar 2019.



Source: Bloomberg

Note: Copper prices are denoted by the LME Copper 3M Rolling Forward.

The 252 days rolling correlation also shows a strengthening correlation between Copper and CNHUSD.



Source: Bloomberg

## Why Copper?

Copper is essential to China's plans for "ecological civilization" in the economy - a term coined by President Xi. The country has a goal of connecting the electricity systems of neighbouring countries into transcontinental "supergrids" capable of swapping energy across borders and oceans (MIT technology review). These networks would be able to drastically lower climate emission by enabling fluctuating renewable sources like wind and solar to generate a far larger share of the electricity used by these countries. The longer, higher capacity lines make it possible to balance out the energy from a setting sun in one time zone with other energy source including wind, hydroelectric, or geothermal energy several zones away. According to a Forbes article (China unleashes a Major Copper Bull Market for the Second Time), around 50% of China's consumption of copper goes towards grid infrastructure. In addition, copper is also essential to electric vehicles technology and its supporting infrastructure. A conventional car needs 18-49lbs of copper while a hybrid electric vehicle needs 85lbs. With the recent shift and priorities of China towards a more sustainable economy, copper is a relevant proxy of China's activity momentum, especially in its transition to the new economy. We have already seen a ramp up in electric car production last year as well as a construction of a supergrid in Anhui province. The progress of the development of the new economy has concomitant impact on China's potential growth and RMB.

That said, China has emphasized that it will not have a "flood" of stimulus and with employment as a key priority this year, fiscal stimulus remains very controlled and targeted. It is thus unlikely that China will see a sharp acceleration in growth unless it goes by. As such, notwithstanding a kneejerk response to a trade deal that we expect with the US, gains in copper or RMB is likely to be moderate for the year.

**USDCNH (Daily) - Downside Bias**



USDCNH has made a sharp move lower yesterday and biased is to the downside according to the price action. This pair has a potential falling wedge that normally precedes a bullish reversal but apex is far away. While the breakout does not have to happen at the apex, it also suggests that this pair has room to continue to trade with a downside bias. Support is seen at 6.63 before the 6.60-figure.

**CNYSGD (Daily) - Rising trend channel Still Intact**



CNYSGD Currency (CNY-SGD X-RATE) Staple Daily 14MAR2018-21MAR2019 Copyright© 2019 Bloomberg Finance L.P. 21-Mar-2019 18:33:25

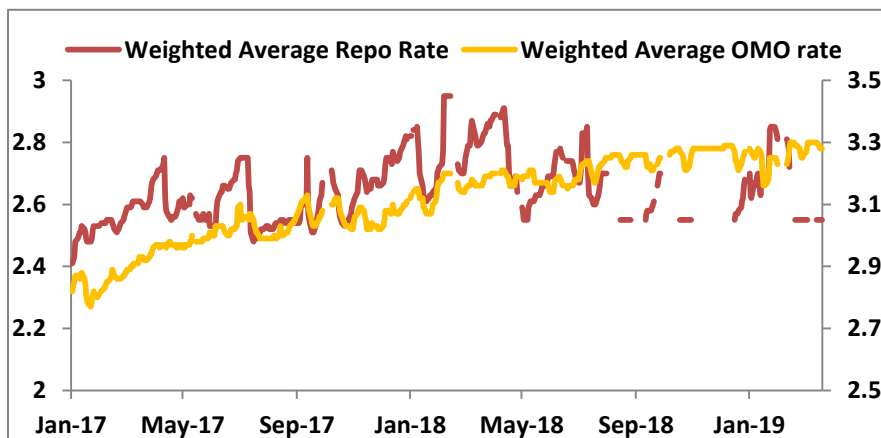
Source: Bloomberg, Maybank FX Research

## Upcoming Events to Watch in The Next Two Weeks

27 Mar	- Industrial Profits (Feb)
29 Mar	- BoP Current Account Balance (4Q F)
31 Mar	- Mfg PMI (Mar)
1 Apr	- Caixin PMI mfg
7 Apr	- Foreign Reserves for Mar

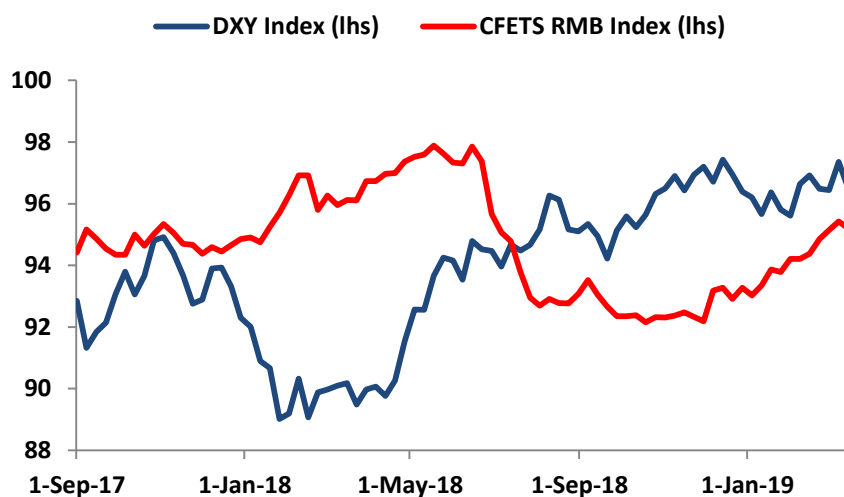
## Charts We Monitor

Chart 1: Repo Rates Remain In Range



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Came Off More Recently VS. its Trading Partners



Source: Bloomberg, Maybank FX Research & Strategy

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