

RMB Watch

Looking for Some Strength

Rising Correlation between US Equities and the RMB

USDCNH has drifted lower as market players become optimistic on US and China getting a deal at some point. However, the outcome of the trade talks to be held on 30-31 Jan becomes less clear as more recent comments suggest that the US seems to have hardened its stance ahead of the US trade talk with China's Vice Premier Liu He. Commerce Secretary Wilbur Ross warned that the US and China still have some distance away from reaching a deal and that the latter needs to accept deeper economic reforms, grant equal market access to foreign investors as well as stop the forced technology transfers.

The recent change in attitude may just be a tactic for China to accede to more of their demands next week. However, it can also be interpreted as a way to manage market expectations ahead of the talks. Hardening its stance prevents market players from pricing in too much optimism in the deal before it even happens. An overly optimistic market could result in a typical "sell-on-fact" reaction when a trade deal is being reached or worse, a deeper sell-off if the deal disappoints. By providing words of caution at this point could tilt the risks towards a "buy on relief" market reaction rather than "sell on fact/disappointment". While the focus of the US administration is likely to be on the equity markets, we think the impact is likely to be similar for USDCNH. After all, we see that the 30-day rolling correlation between the CNH (vs. the USD) and US stocks (with DJI as the proxy) has been strengthening into the event. The last time this happened was around the mid-term elections when the US President Trump suddenly signalled a deal with China.

The stronger correlation between the performance of the US stocks and the offshore RMB could be due to the rising expectations of the US to slow amid increasing headwinds from the US government shutdown as well as the impact of the trade tariffs that were imposed in 2018. As the impact of a slower China and concomitant weakening demand for American products becomes more apparent, so does the correlation of the CNH vs. the USD with sentiments in the US (as reflected in the stock markets) strengthen. Hence, we expect a positive outcome from the US-China trade talks to be reflected in both CNH as well as equity markets. We anticipate that a stable yuan is also looked upon more favourably by the US and that also increases risks to the upside for the CNH.

Analysts

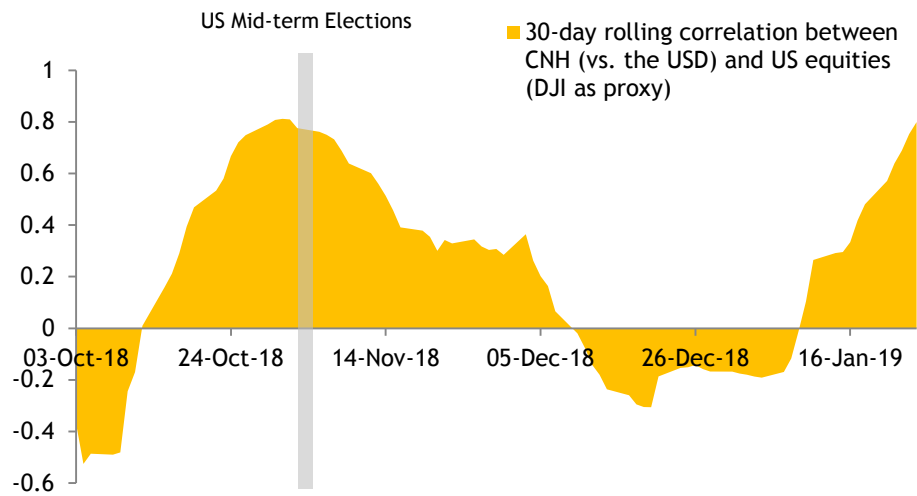
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Chart: Recovery in US Stocks Could also Mean more Strength for the RMB



Source: Bloomberg, Maybank FX Research & Strategy Estimates

Chart (Weekly): Bottoming of the CNYSGD

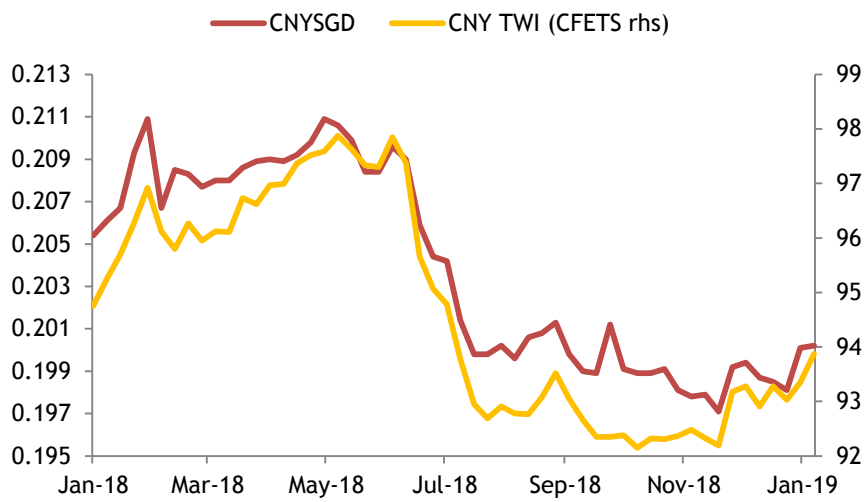


Bullish momentum may be building for CNYSGD and this cross has just formed a trend channel. Near-term we could see a move lower from current 0.2007 towards 0.1994 (21-dma). CNY is expected to strengthen against the SGD beyond this 1 week and we look for this pair to break the neckline of the inverted head and shoulders at 0.2015 for further upside towards 0.2022. This is also underpinned by our expectations for SGD to underperform vs. the CNY in the next few weeks as the tech downcycle poses a stronger drag on the SGD vs. the CNY.

CNY Recovery Could Stall At Some Point

The prospect of a trade deal as well as signs that the Fed would pause drove CNY higher in the TWI perspective. However, what we like to highlight is the likely limit in the recovery of the CNY as its economy remains under pressure and that China has already started to ease its monetary policy via RRR cuts and the introduction of tools such as targeted MLF. As such, RMB stands to weaken vs. trading peers - most of which have not embarked on easing cycle. In addition, one of China’s promises in the trade talks in Beijing was to boost the annual purchase of US imports in the six years to 2024 and that would be a combine value of US\$1trn which is meant to bring the trade surplus to balance. Combine that with a continued push for a more consumption-reliant economy, the potential for current account deterioration could weaken the CNY. As such, further CNY strength could be limited beyond the near-term. In fact, a weaker CNY could help to boost its net export contribution to growth this year.

Chart: CNY TWI Recovery May Stall at Some Point



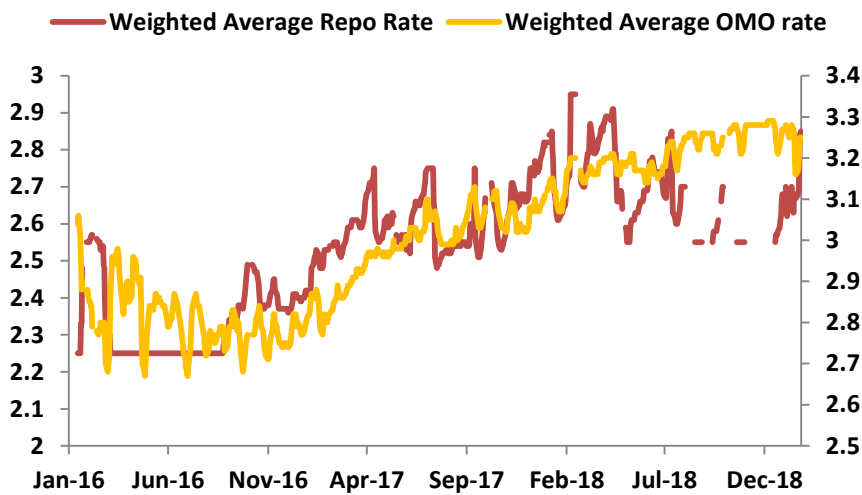
Source: Bloomberg, Maybank FX Research & Strategy

Upcoming Events to Watch in The Next Two Weeks

28 Jan	- Industrial Profits
29 - 30 Jan	- Special session for NPCSC (second review of the draft Foreign investment Law)
30 - 31 Jan	- US-China Trade Talk
31 Jan	- PMI-mfg
1 Feb	- Caixin PMI-mfg
7 Feb	- Foreign Reserves

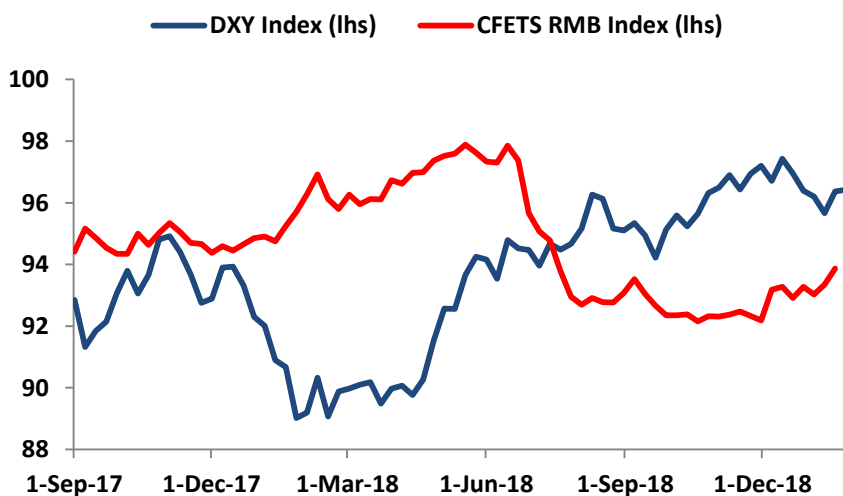
Charts We Monitor

Chart 1: Rates Stabilized But Elevated



Source: Bloomberg Calculation, Maybank FX Research & Strategy

Chart 2: Yuan Strengthens Against Trading Partners Of Late



Source: Bloomberg, Maybank FX Research & Strategy

Keeping Track

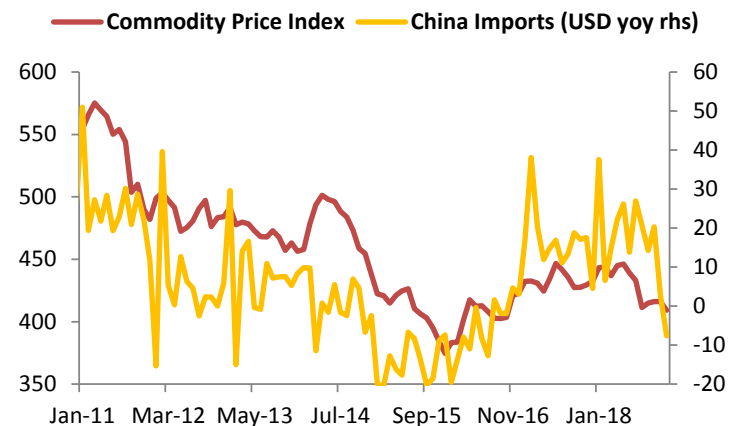
Date	Events/Data Headlines	More Details, Impact and Views	Relevant Charts (if any)
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14 Jan

Trade Flows Weaken

Exports slowed significantly last Dec from 8.7%/y previously to 0.2%. Imports collapsed to contract -3.1%/y from 7.7%. Trade bal widened to U\$57bn from U\$41.9bn.

Apart from fading front-loading effects, the fall in commodity prices as well as trade-war triggered substitution of soybeans also played a part. Breakdown of the imports print suggest that demand for high technological products saw a steep decline, in sync with negative outlook from Apple and Xiaomi. *Market did not react too negatively as policy makers have already promised more tax cuts, flexible monetary policy (liquidity injections) as well as infrastructure spending. Interestingly, the trade surplus with the US narrowed from previous U\$35.5bn to U\$29.9bn.*

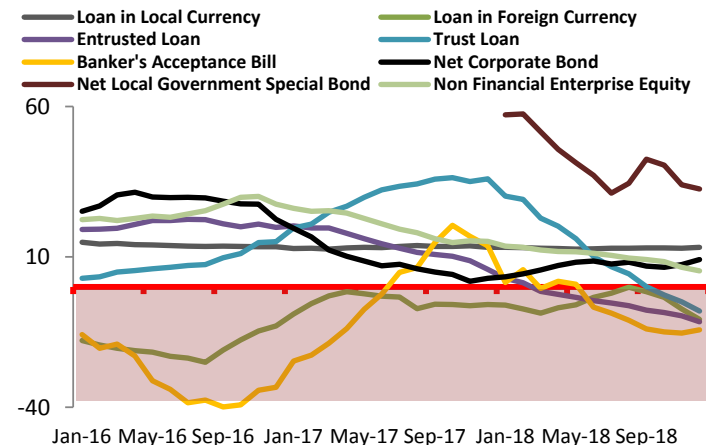


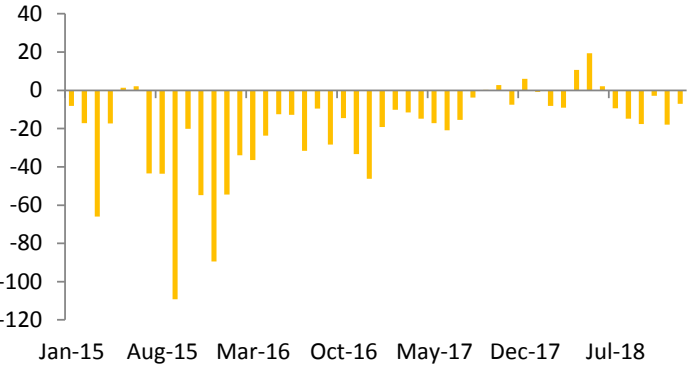
15 Jan

Credit Numbers Assure

Money supply M2 steadied at around 8.1%/y. Aggregate financing for Dec rose a tad to CNY1589bn.

The Dec print was not as bad as feared (better than consensus) but not entirely reassuring either. Local currency grew 13.2%/y in the month, steadying from the previous month. Net corporate bond financing saw stronger expansion in the month while local government special bond financing kept pace. On the other hand, entrusted loans, trust loans, banker's acceptance bills are still contracting.



<u>Date</u>	<u>Events/Data Headlines</u>	<u>More Details, Impact and Views</u>	<u>Relevant Charts (if any)</u>
14 Jan	<p><u>FX Net Settlement came in at a deficit of CNY56bn</u></p> <p>Banks bought a total of CNY1061bn of FX and sold CNY1117bn.</p>	<p>Deficit narrowed from previous CNY139bn. Adjusted for forwards, deficit was at CNY49bn. This is quite a substantial decrease from a deficit of >CNY100bn for 3 out of the past 4 months and is in line with SAFE's comments that the cross-border capital flows are stable.</p>	<p>■ China Net FX Settlement Balance (USD bn)</p>  <p>Jan-15 Aug-15 Mar-16 Oct-16 May-17 Dec-17 Jul-18</p>
14 Jan	<p>Vice Premier Liu He met with German Finance Minister Olaf Scholz. They agreed to lower market entry barriers</p>	<p>China and Germany issued a joint statement that included their commitment to expand two-way opening up and deepening pragmatic cooperation to bring bilateral financial relations to new high. Both sides reaffirm their pledge to strengthen macroeconomic policy coordination and cooperation in fiscal and financial fields.</p>	

<u>Date</u>	<u>Events/Data Headlines</u>	<u>More Details, Impact and Views</u>	<u>Relevant Charts (if any)</u>
21 Jan	China may raise the special bond quota from CNY1.35trn in 2018 to CNY2.15trn this year.	The NPC is likely to approve the proposal given the focus on infrastructure spending. That would suggest more liquidity injections via TMLF and RRR cuts. The NDRC had also spoke about encouraging more bond sales in sectors that benefit the Yangtze River Economic Zone, rural development, environment protection. NDRC aims to help high-quality private firms to increase their bond issuance. Loan tenors of more than three years are encouraged (BBG).	

22 Jan	CSRC Vice Chair Fang Xinghai assures at Davos that China is unlikely to reduce its investment in the US government bond market.	This assures investors that China will not use its massive UST holdings as a tool in the US-China trade war that many had speculated in 2018. <i>With short-term rates rising globally, not helped by issuance of US government debt to finance its expansionary fiscal policy, there are increasing concerns of the impact of higher rates on an already slowing global growth environment. This would be heightened if China decides to use this "nuclear option".</i>	 <p>The chart displays US Treasury bill holdings in billions of dollars, categorized by country. The legend includes: China (dark blue), Japan (red), Ireland (green), Brazil (purple), UK (teal), Switzerland (orange), Luxembourg (light blue), Cayman Island (pink), and Others (light green). The x-axis shows dates: Aug-10, Nov-11, Feb-13, May-14, Aug-15, and Nov-16. The y-axis ranges from 0 to 5000. China's holdings (dark blue) show a sharp increase starting in late 2015, reaching approximately 1200 billion by Nov-16. Japan's holdings (red) remain the largest, fluctuating between 1000 and 1500 billion. Other countries like Ireland, Brazil, UK, Switzerland, Luxembourg, Cayman Island, and Others represent smaller, relatively stable portions of the total holdings.</p>
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22 Jan	<p><u>Larry Kudlow Assures That US-China are talking</u></p> <p>White House Top Economic Adviser Larry Kudlow assures that the US-China meeting with Vice Premier Liu He will happen on 30 Jan.</p>	<p>This interview comes amid reports that US administration would call off the meeting with China's Vice Premier Liu He. Kudlow further stressed that there is a "fulsome discussion" going on with China on IP matters. <i>Between now and 30 Jan, the US may try to toughen up the stance in order to get China to accede to more of their requests in the coming trade agreement. Apart from that kind of negotiation tactic, we cannot rule out a ploy to manage market expectations in order for a stronger rally upon an agreement given that Trump is rather fixated on the stock market performance.</i></p>	
23 Jan	<p><u>First TMLF injected</u></p> <p>PBoC injected CNY257.5bn of liquidity to banks via the targeted medium-term lending facility today.</p>	<p>The cash was offered at 3.15% for a tenor of 1yr, 15bps lower than the normal 1-year MLF. The funding can be rolled over twice which fulfills the promise of a 3-year tenor. This was meant to boost lending to SMEs as well as to cater to the seasonal demands ahead of the Lunar New Year.</p>	

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

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