Maybank

Macro | FX Research and Strategy

Global

RMB Watch

What is In the Price?

Can There Be More Gains in the RMB?

In the past couple of weeks, the US and Chinese authorities have been soothing market sentiments by consistently providing positive headlines on the phase 1 of the US-China trade deal progression. These headlines do provide some distraction from the economic carnage of the trade war itself. China's industrial profitability slipped by another -5.3%y/y for Sep, a deeper fall vs. the previous -2.0%. The contraction was already hinted by the fall in the PPI released mid of Oct at -1.2%y/y. That said, USDCNH and USDCNY still drifted lower for much of Oct, bringing to fruition the head and shoulders formation that we have been monitoring and now our trade idea is about to bear fruit. At this point, USDCNH are both around 7.06. It is worth considering what is in the price of the RMB right now after several positive headlines and what can bring the RMB beyond the 7 against the USD.

Agricultural Purchases in Exchange for Tariff Cancellation + Removal

Ahead of the US-China call that happened last Fri, Reuters cited a few US sources stating China would exempt some US farm products from tariffs including soybeans, wheat and corn and around $20bn of agricultural purchases could be made annually. China is expected to ask US to drop plans for tariffs on $156bn worth of Chinese goods and seek the removal of 15% tariffs imposed on Sep 1 on about $125bn of Chinese products. Subsequently, China's Ministry of Commerce that both sides have agreed on "agricultural product regulatory issues" and that there would be more conversations were perceived as signs of progress for trade 1 of the US-China deal.

Nothing is confirmed until the deal has been inked. Comments from the officials are still vague. While it is highly likely that the cancellation of the tariffs due to take effect on 15th Dec could be in the price of the RMB, there is no sign from the US officials, thus far, of a roll-back in tariffs. We anticipate that a roll-back in tariffs, presumably the Sep tariffs, could be viewed as a concrete progress for the US-China trade deal. China had requested for a substantial rollback of tariffs for them to "be able to" step up purchase of the US agricultural goods.

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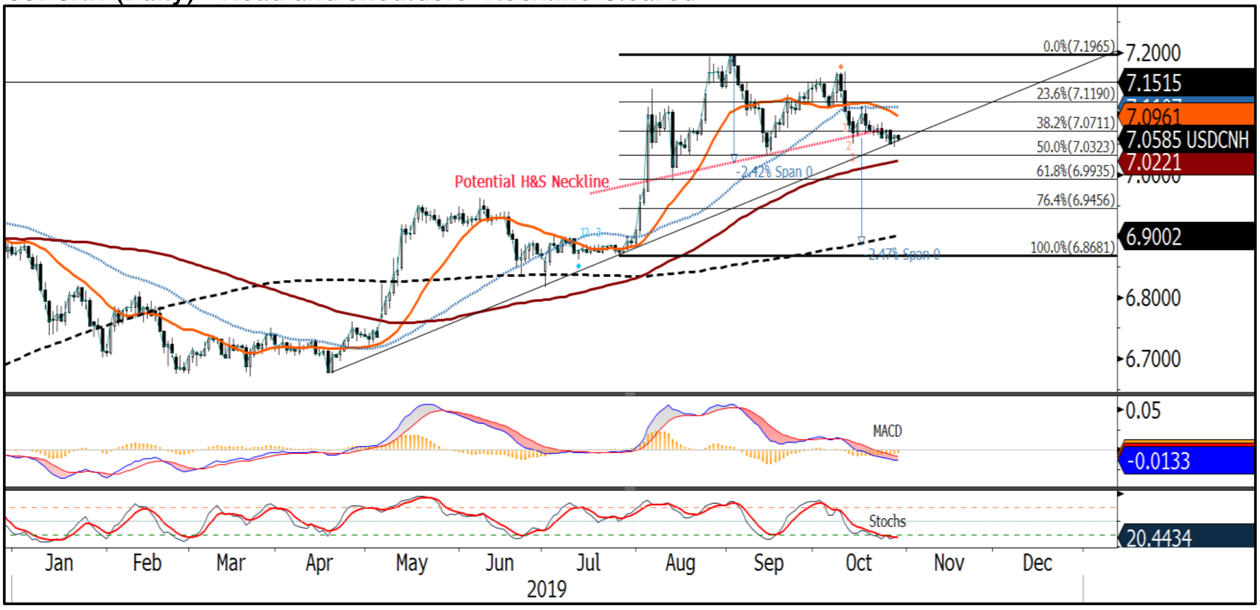
USDCNH (Daily) – Head and Shoulders Neckline Cleared



A rollback of tariffs for phase 1 of US-China trade deal has been a view of ours, stated here. We do not think that China would accept a deal without any rollback of tariffs.

Our view on the partial trade deal (stated on 14th Oct)

	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

Currency Manipulator No More? Currency Pact in Phase 1

China may no longer be designated as a currency manipulator anymore. The FX report is typically released in Apr and Oct every year by the US Treasury. So eyes are on the release. Since the announcement of a possible partial deal, Treasury Secretary Mnuchin is said to consider removing the currency manipulator label from China. That does not preclude the scenario that China would still be on the watchlist. Nonetheless, the removal of the label would be symbolic of progress and a prelude to a possible currency pact within the phase 1 of the agreement, due to be inked in Chile.

We have mentioned in our last report that there is a possibility of an agreement on "no currency manipulation" that could roughly be aligned with 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 bring gains to the RMB** and the steady USDCNY fixes that we have seen 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 inevitably turn more dovish (albeit perhaps not at this meeting) 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. We maintain our USDCNY forecast to be around 7.05 by the end of 2020.

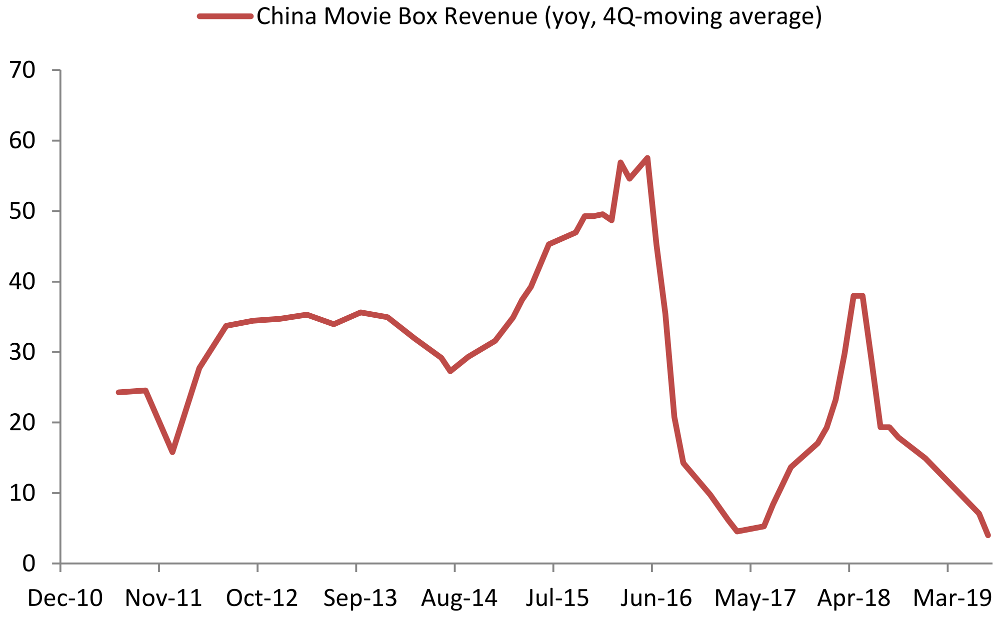
RMB Weakness Would Be More Apparent Against the Basket

We have been on the more optimistic camp, expecting USDCNY to breach the 7-figure in the near-term but gains beyond 7 are unlikely to be sustained as we anticipate subsequent phases of trade deal to be harder to achieve. In a nutshell, phase 1 is most likely to be a "Trade (only) Deal". The broader technology conflict and issues on intellectual properties would be harder to tackle. While rhetoric on trade has been mostly positive, the US telecommunications regulator plans to vote in Nov to label Huawei and ZTE as national security risks. US rural carrier customers would not be able to use government funds to purchase their equipment and services. The Federal Communications Commission may require those carriers to swap equipment from such companies to alternatives.

We do not like to rule out an underwhelming deal between the US-China that could leave USDCNH in sideway drifts within 7.00-7.20.

Macro-wise, China's slowdown could continue to crimp appetite for the RMB. While there are signs of improvement in industrial production and PMI-mfg prints, the fall in industrial profits weighed could have knock-on effects on hiring and consumption. As one can see, consumer sentiment has weakened considerably, based on China's movie box revenue.

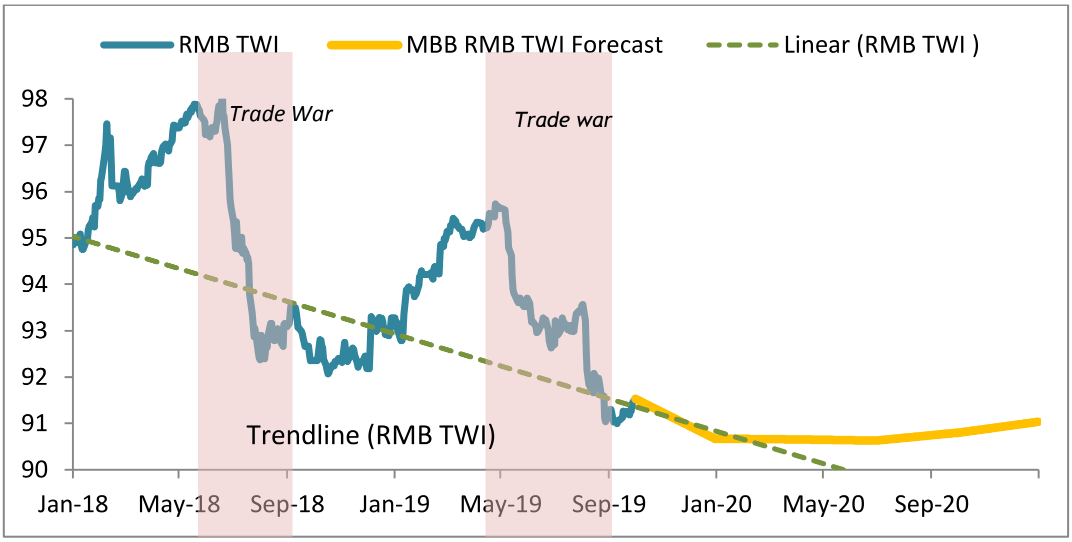
Consumer Sentiment (as proxied by movie box revenue) Weakens



Source: State Administration of Radio and Television

We are less optimistic on the RMB on a basket basis. Based on our current forecast numbers for 2020, RMB is poised to weaken modestly against most other trading partners although the softer USD profile could mean small gains/neutral against the greenback.

<u>RMB TWI (based on CFETS weights) Should Continue to Trend Lower</u>



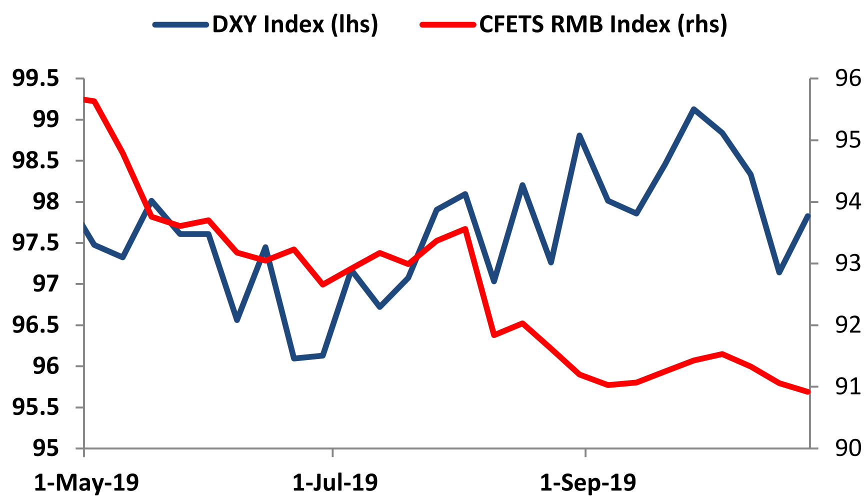
Source: Bloomberg, Maybank FX Research & Strategy Estimates

In other words, we do look for RMB TWI to keep its downtrend. However, without the escalation of trade/tech-war, the decline could be milder.

Upcoming Events to Watch in The Next Two Weeks

28-31st Oct	- 4th Plenary Session of the CPC Central Committee
31st Oct	- NBS PMI (Oct)
1st Nov	- Caixin PMI (Oct)
7th Nov	- Foreign Reserves (Oct)
8th Nov	- Trade data (Oct);
9th Nov	- CPI, PPI (Oct);

CNY TWI Softens Even in the Absence of Trade War



Source: Bloomberg, Maybank FX Research & Strategy

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