FX

Global

RMB Watch

Reining in the RMB Bulls for Stability Sake

A Series of Actions To Dampen Potential Swings

Key Points:

- In the past two weeks, we witnessed a 50bps RRR cut by PBoC, targeted relending rate cuts for SMEs and rural sector, a 200bps FX reserve ratio hike and a dramatically higher USDCNY fix on 10 Dec. The FX reserve ratio hike was announced after USDCNY reached a new low for the year at 6.3424 on 8 Dec, a form of policy signal to rein in the strength of the CNY.

- The last time PBoC hiked FX reserve ratio, USDCNY consolidated for around four months as USD and UST 2Y yield rose significantly in reaction to the surprise hawkish tilt by the Fed in Jun. We see possibility that the FX reserve ratio hike to be less impactful this time compared to the one announced in May earlier this year unless Fed is able to make a significant hawkish shift. That could be unlikely given that overnight index swaps suggest that around two Fed hikes are priced in over the next one year already. In addition, USDCNY has shifted away from the broad USD direction since Oct. Near-term, we keep an eye on FOMC on 16th Dec and MLF, LPR this week. Meanwhile, the Central Economic Work Conference concluded last week with an emphasis on growth stability.

- **Technical Analysis:** For USDCNH, bearish bias remains intact but stochastics flag rebound risk. Support at 6.33. EURCNH remains bearish and next support at 6.97. SGDCNH and MYRCNH are bearish bias but bullish divergences intact for potential reversal.

What We Watch (13 -31 Dec):

Date	Data	Month
13-16 Dec	MLF	Dec
15 Dec	Retail sales, Industrial Production, Fixed Asset Investment-ex rural	Nov
16 Dec	FOMC Policy Decision	Dec
20 Dec	Loan Prime Rate (1y, 5Y)	Dec
24 Dec	FX Net Settlement - Clients	--
27 Dec	Industrial Profits	Nov
31 Dec	Official Mfg, Non-Mfg	Nov
31 Dec	Current Account	3Q

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We wish our readers a Merry Christmas and Happy 2022 in advance! This will be the final RMB Watch for 2021. We thank you for the support.

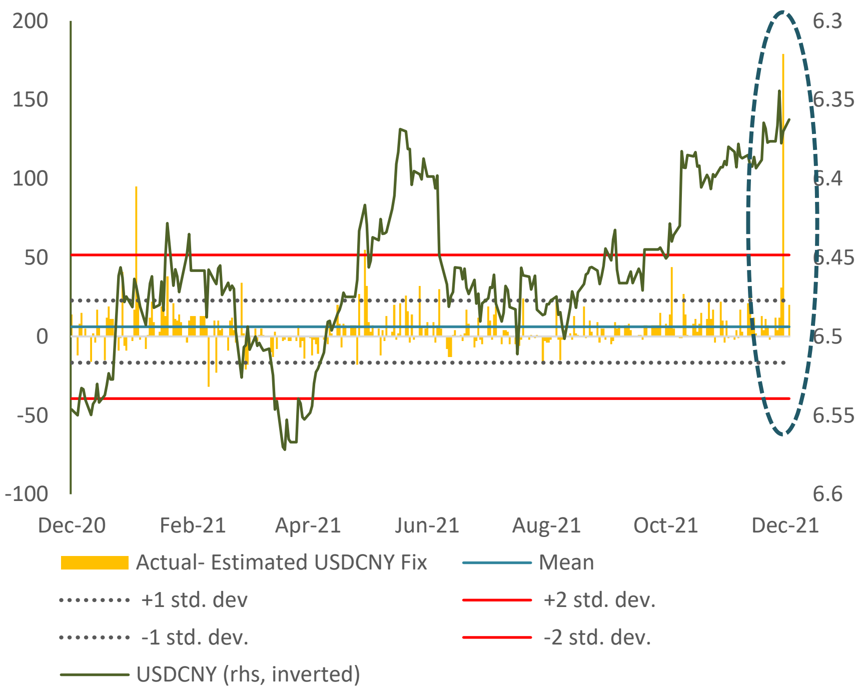
Where Has RMB Been?

USDCNH slipped to a low of 6.3305 and USDCNY also recorded a low of 6.3424 before a series of action by PBoC reversed the move. USDCNY stabilized around the 6.36-figure at last seen.

Increasing the Policy Signals on the RMB

For a while now, the USDCNY daily reference rates have been fixed rather persistently above the median estimates (released minutes before the actual fixing at around 9.15am SGT). On 8 Dec, USDCNY made a sharp pullback to a low of 6.3424. The next day, PBoC raised FX reserve ratio by 200bps to 9%. This policy signal to weaken the RMB was further reinforced by a higher USDCNY reference rate, fixed 179pips above the estimate on 10 Dec. This was quite a bit drastically higher than recent daily fix-estimate differential which has been mostly within 1 standard deviation from the its mean for the past one year.

Reining in the RMB gains With Daily Fix

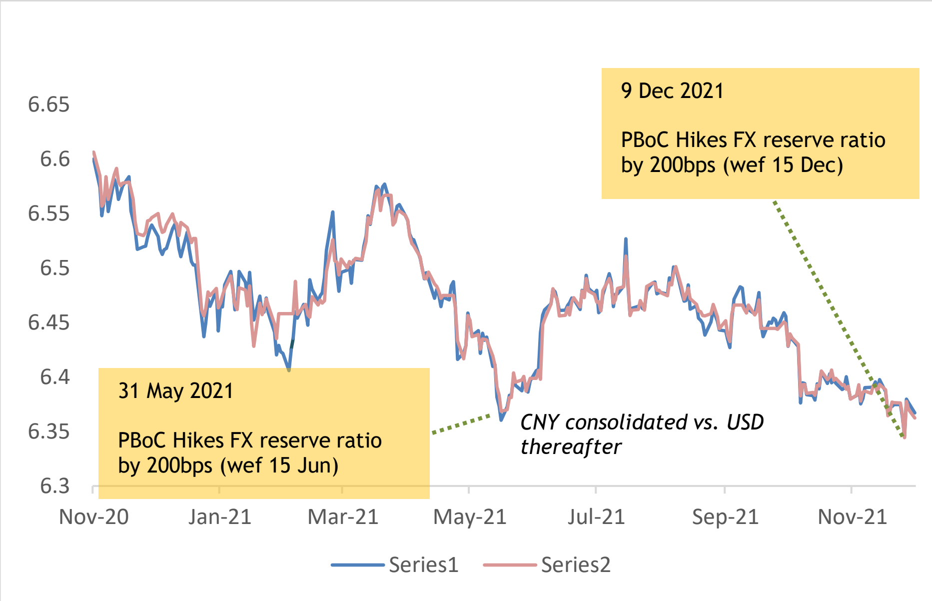


Source: Bloomberg, Maybank FX Research & Strategy

The FX Reserve Ratio Hike

PBoC has raised the FX reserve ratio for banks by 200bps from 7% to 9%, the second move done this year. The move can be considered as a way to tighten onshore foreign exchange liquidity in order to slow the appreciation pace of the CNY. This strengthens policy signals for weaker RMB. The higher FX reserve ratio will take effect on 15 Dec. This would be the second time the central bank raises the FX reserve ratio for 2021. Earlier this year, the PBOC also declared the same on 31 May. That marked the tentative end of the CNY rally against the USD then and USDCNY consolidated for around four months (Jun-Sep).

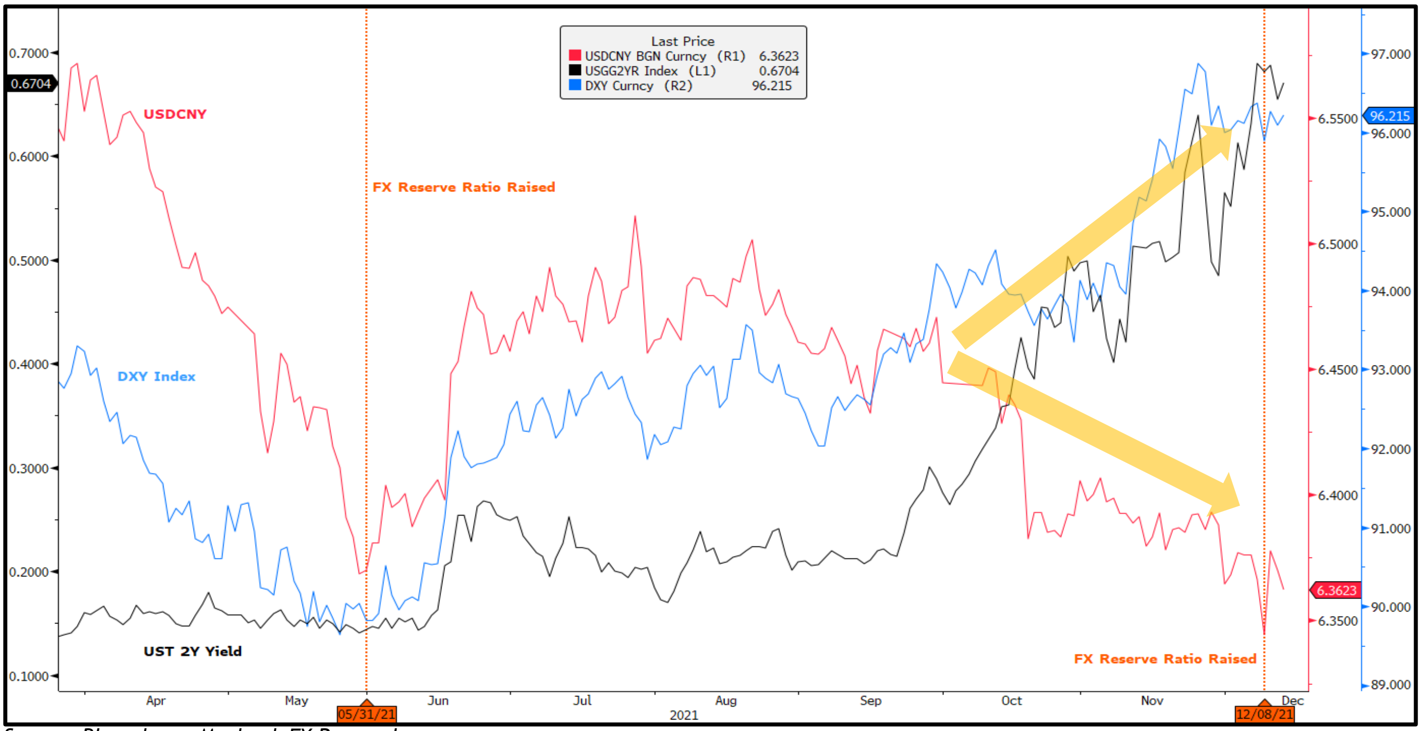
The Last Time PBoC Hikes FX Reserve Ratio, CNY halted appreciation Against USD for a while



Source: Bloomberg, Maybank FX Research & Strategy

The question to ask at this point is - Will the 200bps hike in FX reserve ratio bring about a pause in the RMB bulls once again? Before, PBoC raised FX reserve ration on 31 May, around two weeks before the Fed made a surprising hawkish shift (the first in this cycle) that amplified the USD strength and lifted the UST 2y yield persistently thereafter.

USDCNY Has Shifted away from Broader USD Direction Since Oct 2021



Source: Bloomberg, Maybank FX Research

The most recent move to hike FX reserve ratio comes just ahead of another FOMC meeting - a meeting that should see the Fed start its QE taper. From the chart above, USDCNY rebounded after the last FX Reserve ratio hike around Jun but since Oct, **the USDCNY has shifted away from the**

direction of the DXY index and the UST 2y yield (which is typically more reflective of the Fed policy shifts). In other words, USDCNY resumed its decline into Oct even as UST 2y yield and the DXY index marched higher. This is in spite of a second RRR cut announced on 6 Dec to reduce required reserve ratio of most banks from 12% to 11.5%. USDCNY went on to record a new low for the year at 6.3424 (a low not seen since May 2018). The recent move to hike FX reserve ratio did not seem to be nearly as impactful and unless the Fed make another significant hawkish shift this week, USDCNY may not see a strong reversal higher so soon.

Why Has the RMB Strengthened So Much Since Oct?

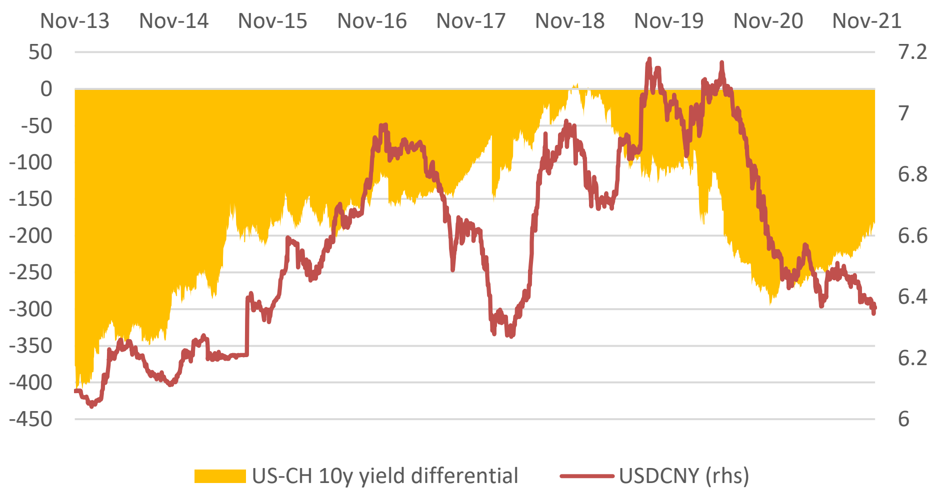
The USDCNY started to drop more precipitously in Oct came ahead of the start of the inclusion of Chinese government bonds into FTSE's World Government Bond index. The final approval was given earlier in Mar but Chinese government bonds would be added over three years from the end of Oct. Estimates of inflows range around \$3.5-\$4bn per month. Not coincidentally, the Southbound bond connect was launched on 24 Sep 2021 for mainland investors to access offshore bonds via Hong Kong and serve as a counteracting channel of outflows.

Why is RMB Strength an Issue?

Due to the WGBI inclusion, demand for domestic sovereign bonds via passive index funds that track the index should continue to underpin the CNY. This is structural in nature and adds on to the other fundamental underpinnings such as its strong current account surplus that we covered in the last RMB Watch. Fortunately, the strength of the RMB comes at a time where energy and commodity prices are lofty and serve as a buffer to some extent against imported inflation.

However, too much appreciation in RMB is seen as a risk. The authorities are concerned that speculative build up in RMB bets could overshoot and risk an aggressive unwinding and the optics could be even uglier as the economy slows and monetary policy divergence is amplified vs. the rest of the world. Any sign of US-China tension escalating meaningfully could also potentially hurt the CNY vs. the USD. According to the chart below, USDCNY does not always track the US-CH 10y yield differential closely but moves observed in the past 8 years that included the last Fed rate hike cycle show that USDCNY may still revert (weaken) towards the trend of the yield differential (narrow).

USDCNY Moved in Contrary to US-CH Yield Differential Before Reversions



Source: Bloomberg, Maybank FX Research & Strategy

Fresh from the Central Economic Work Conference that ended last week, the government also stressed on growth stability as a top priority for 2022. There was also a warning to be “cautious in imposing measures that will have contractionary effect”. The tone alluded to more fiscal supports and possible more monetary easing.

In a nutshell, we see reasons to be less bullish for the RMB.

We see reasons to be less bullish on the RMB for 2022 compared to 2021. Current account surplus may start to narrow should monetary policy easing (targeted or broad) start to boost private consumption. Eyes are on the MLF and LPR amid speculations of rate cuts. Chinese consumers may also start to adapt to frequent Covid-triggered restrictions as live-streaming e-commerce become more mainstream. In addition, rate hikes by the Fed could continue to narrow the US-CH yield differential and provide some lift to the USDCNY as illustrated. The launch of the Southbound bond connect could also serve to mitigate net portfolio inflow.

That said, fundamental underpinnings are not likely to fade easily as China continues to keep a strict border control for pandemic management purposes. That could keep tourist-imports outflow depressed. Structural inflows into the Chinese bond market due to the WGBI inclusion are likely to be steady and sticky. In fact, portfolio inflows could be buoyed by potential monetary policy easing. As global growth recovery broadens, demand for Chinese exports can remain resilient and countercyclical USD should also soften in such an environment.

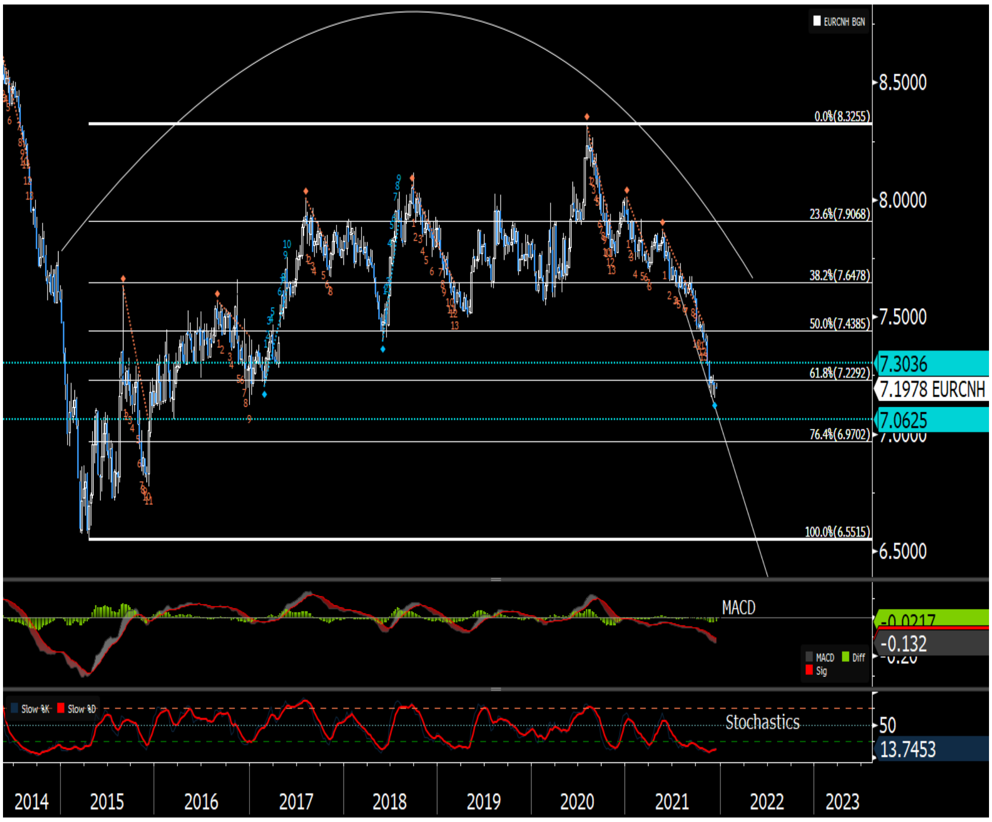
USDCNH (Weekly) - Bearish Momentum Wanes, Falling Wedge

USDCNH was last at 6.3680 after touching a low of 6.3305 last week. Pair starts this week, back on the decline.

Momentum on the daily chart is mildly bearish but stochastics show signs of rising from oversold condition on the weekly chart. Resistance at 6.40.

Bias is still to the downside for this pair at this point but stretched conditions suggest that a rebound cannot be rule out. In addition, recent price action forms a falling wedge – precedes bullish reversal.

EURCNH (Weekly) - Bearish



EURCNH continues to press lower with each week, touching a low of 7.1509 and was last at levels around 7.1970.

Bearish momentum miught have slowed a tad over the recent weeks but bias is still rather bearish. That low has formed the tentative support. We looked at the price moves since 2014 to find key support levels. Next support is seen around 6.9702 (76.4% fibo retracement of the 2015-2021 ascent). Resistance levels are seen at 7.2292 (61.8% fibo retracement of the 2015-2021 ascent) before the next at 7.3040.

Legend: Orange Line = 21-sma; Blue dash = 50-sma, red solid = 100-sma, green dash = 200-sma

MYRCNH (Weekly) - Stretched, Bearish

MYRCNH touched a low of 1.4984 before reversing higher and was last seen around 1.5130.

Weekly chart is also bearish but falling wedge is intact along with a bullish divergence as the cross extended decline.

Bias remains to the downside but we are cautious of potential rebound. Resistance is seen around 1.5290 (61.8% Fibonacci retracement of the 2015-2016 rally) before the next at 1.54.

SGDCNH (Weekly) - Retracement Cannot Be Ruled Out, But Downtrend intact

SGDCNH slipped to levels around 4.6620 as we write. This cross remains within a falling trend channel and presses on the lower bound of the channel.

Bullish divergence remains intact and there could be a brief retracement withinj the trend channel

Resistance is seen around 4.7250 (61.8% fibo retracement of the 2015-2019 rise). Support at 4.6130.

Legend: Orange Line = 21-sma; Blue dash = 50-sma, red solid = 100-sma, green das = 200-sma

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