Aug 23, 2021

Maybank

RMB Watch

Exploring Some Bearish Risks

FX

Global

CNY TWI could Still Remain Elevated

Key Points:

- USDCNY slipped back under the 6.50-figure this morning after breaching the key level multiple times last week on broader risk aversion. CNY might have looked weak then but its TWI strengthened (alongside the DXY index) to a 5-year high as delta variant and Fed's tapering came into focus.

- In the past two weeks, we had the release of weaker-than-expected activity data for Jul, hints of more regulations to curb "excess income" to achieve "common prosperity" and increasing expectations for RRR. We see a possibility of another 50bps RRR cut ahead of a surge in MLF maturing in Nov and Dec 2021. Past episodes of RRR cuts saw a rise in USDCNY and we explore other key factors that contributed to the upmove then that may not matter now. We think PBoC would stick to targeted support and RRR cuts would be used sparingly with other liquidity instruments. Pressure on the RMB would also be correspondingly smaller. **Focus on Jackson Hole Economic Symposium on Thu and the delta variant in the near-term, potentially keeping the USDCNY supported.** That said, the pair has shown resilience compared to non-USD peers in the face of recent risk aversion.

- **Technical Analysis:** USDCNH retains upside bias towards 6.53. EURCNH forms a falling wedge even though momentum is bearish. Nearer-to-home, there could be serious bullish risk for MYRCNH if 1.5480 resistance is broken. SGDCNH on the other hand, could remain consolidative 4.75-4.80.

What We Watch (23 Aug - 3 Sep):

Date	Data	Month
26 - 28 Aug	Jackson Hole Economic Symposium	
27 Aug	Industrial Profits	Jul
31 Aug	Non-mfg, Mfg PMI	Aug
1 Sep	Caixin Mfg PMI	Aug
3 Sep	Caixin Services, Composite PMI	Aug

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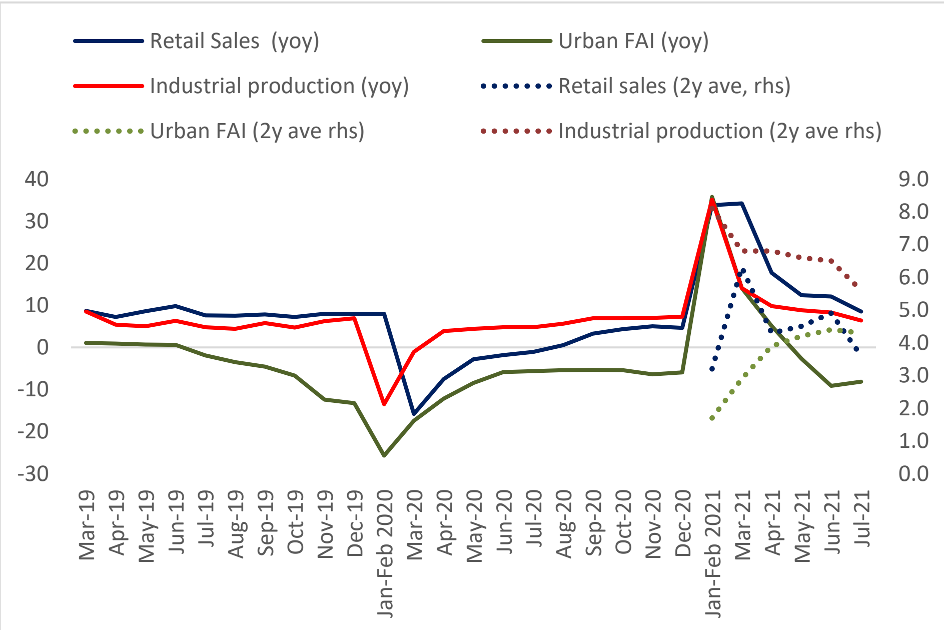
Where Has RMB Been?

USDCNY broke out of the 6.45-6.50 range last week as risk aversion drove demand towards the safe haven USD. Even with the upmove of both USDCNY and USDCNH, the pairs have been relatively resilient compared to DM and EM peers. PBoC clearly prefers RMB and the local bond markets to be a source of stability in the backdrop of the broader risk aversion and domestic regulatory crackdowns that have hurt the equity markets. As a result of its resilience, the RMB strengthened on a trade-weighted basis. USDCNH has slipped back under the 6.50-figure this morning, in tandem with broader USD movements.

Economic Update - A Gradual Slowdown, Zero Covid

RMB managed to remain relatively resilient to the recent bout of USD strength even as broader sentiment, slower global and domestic growth as well as regulatory landscape increasingly threatens the currency. China has to deal with a cyclical downturn made worse by the Covid outbreaks at home and the Jul economic data suggests that the slowdown in activity is rather broad. Retail sales, which have been ticking higher since Apr, lost momentum last month with two-year average growth at 3.6%, underscoring the dampening effects of the delta-driven Covid outbreak at home. Industrial production and Urban FAI too softened.

China Activity Slows Down Broadly, Especially in Jul Due to Delta



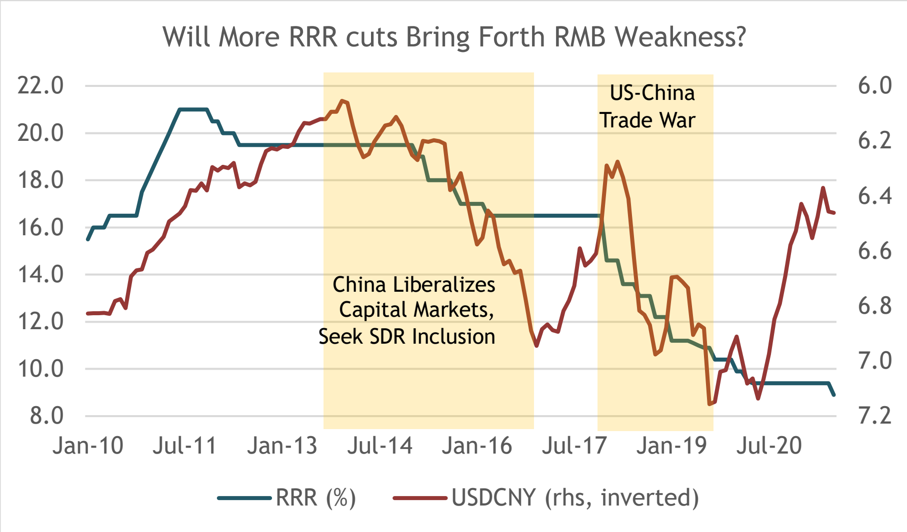
Note: 2 year average growth is used for data this year to have a better gauge of growth momentum with less distortion from base effects.
Source: National Bureau of Statistics, Bloomberg, Maybank FX Research & Strategy

China's swift lockdowns raised concerns on its zero-Covid strategy but these measures have also proven to be effective in bringing infections down with daily infection averaging 40 as of 20 Aug from high of 143 in early Aug. As of 20 Aug, China has administered 1.9bn doses of vaccines, sufficient to cover 68% of population with two doses. It is hard to say if the country will continue with its zero-tolerance strategy for Covid when its vaccination rate is higher. **There is a possibility that China could be more open to an endemic future with Covid-19 should its vaccines prove to be effective with every outbreak that comes.**

PBoC to Ease Further? And more RMB Weakness?

Despite the weak Jul data, MLF and OMO rates were left unchanged for Aug so far. As such, **the 1Y and 5Y loan prime rates were also steady at 3.85% and 4.65% respectively last Fri.** However, recent statements issued by the PBoC and Politburo suggest that PBoC has likely shifted towards easing bias and thus, bets on reserve requirement ratio (RRR) cuts remain very much alive. **If we just rely on historical data in the past decade, RRR cuts typically come in a bunch and have been accompanied by a rise in USDCNY.** However, it is equally important to examine the other key factors that contributed to weakness in the currency in those periods.

RRR Cuts Typically Sees RMB Weakness in the Past Decade



Source: PBoC, Bloomberg, Maybank FX Research & Strategy

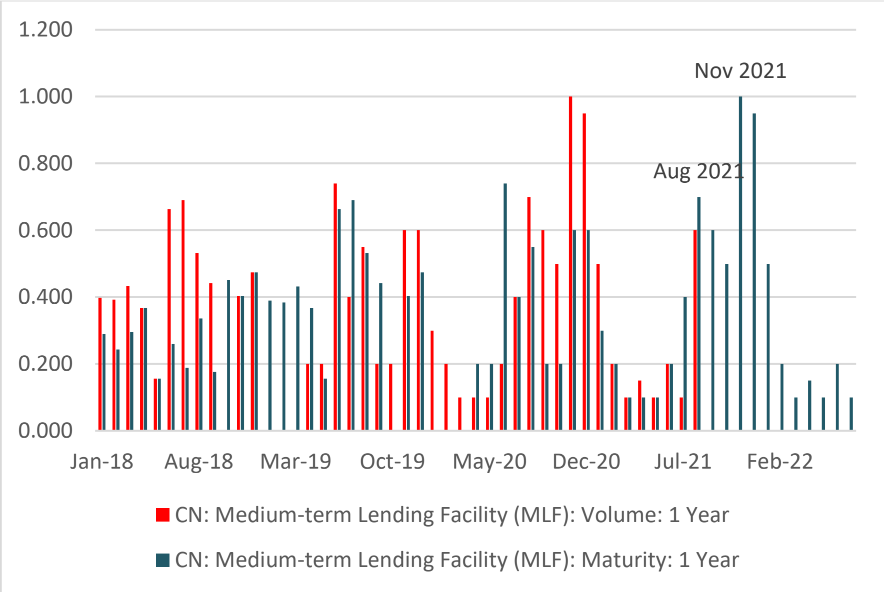
Between 2013-2016, China was easing capital controls, pushing forth yuan internationalization plans that includes seeking IMF SDR inclusion, resulting in fears of capital outflows and exacerbated RMB weakness. This was not helped by the fact that there was a one-off devaluation as a result of a change in the USDCNY reference rate fixing methodology in Aug 2015.

For 2018-2019, trade war dominated and RMB was not just a reflection of an economy under pressure, there was also a sentiment effect that weighed on the currency.

At this point in Aug 2021, PBoC is less likely to make a significant FX policy change and the Biden administration has so far been less willing to impose additional trade measures that have greater economic impact. Even so, it is clear that the economy is in a cyclical downturn. We do not rule out more RRR cuts but the central bank is likely serious about keeping prudence and keen to ensure growth supports are "flexible" and "targeted". Since 4Q 2020, PBoC has a rather specific aim of keeping "growth of money supply and aggregate financing to the real economy (AFER) generally in line with nominal GDP". Clearly, the central bank still wants to keep a check on macro leverage and thus, **RRR cuts are likely to be used sparingly in tandem with other liquidity tools such as the MLF and TMLF for a more targeted funding support.**

The last RRR cut was announced in Jul, ahead of a spike in MLF maturing in Aug. **The next 50bps cut for the RRR could be announced in Oct ahead of another surge of MLF coming to maturity in Nov (CNY1bn) and Dec (950mn) 2021.**

Next RRR Cut Could be in Oct 2021 before another tranche of maturity



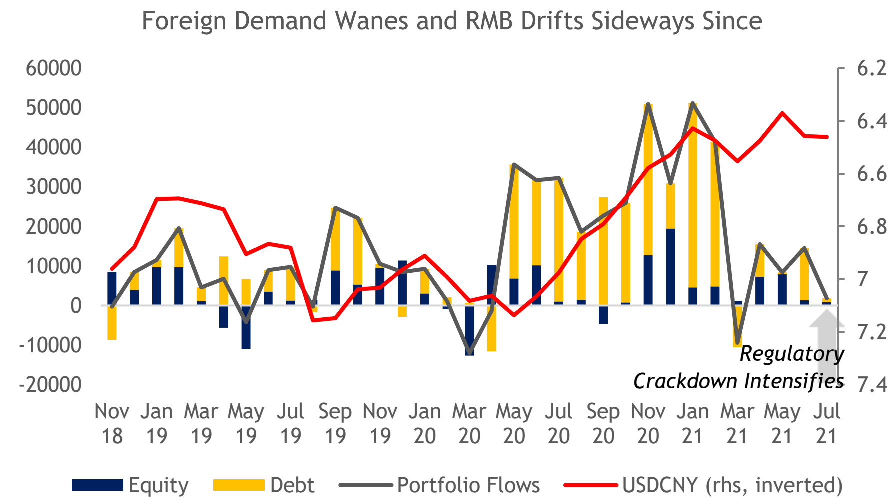
Source: Maybank FX Research & Strategy

In addition, **fiscal supports are also expected** such as infrastructure plans. Mentions of "cross-cycle policy designs" (seen in every monetary policy statement since 3Q 2020) could mean that just as tightening was at a measured pace last year, so could this period of "easing". **These targeted and finely balanced approach could mean that risks of significant RMB depreciation should thus be comparatively smaller than what was seen in the past, barring other risk factors such as faster-than-anticipated Fed rate hikes.**

Regulatory Crackdowns Dampen Foreign Inflows, Crimp on RMB

The Shanghai Shenzhen CSI 300 index (meant to replicate both the Shanghai Stock Exchange and Shenzhen Stock Exchange) has lost more than 17% of its value from its peak in Feb 2021. Foreign investors have lost quite a bit of interest with flows data from IIF also showing the smallest net inflow of debt and equities for Jul since Mar. It is still uncertain whether this net portfolio inflow could turn into a net outflow for Aug.

Slowing Inflows Dampen Gains in the RMB



Source: Institute International Finance, Bloomberg, Maybank FX Research & strategy

At the start of the Politburo Standing Committee meeting last week, President Xi Jinping had flagged curbs on “excessive incomes” and encourage the wealthy to “return more to society”. This is in line with his recent emphasis on “common prosperity” and the crackdown on certain sectors in order to heal social ills (online gaming, anti-monopoly, etc). This hints of more regulations that could be deemed less business friendly (e.g. capital tax) in the short-term.

Some Downside Risks to the RMB on the Margin

The above considerations (growth slowdown, zero-covid strategy, PBoC’s easing bias and uncertain regulatory environment) have slightly increased the downside risks to the RMB. Some of these risks have played out to a certain extent but could still be risks to our year-end forecast. However, we keep in mind other underpinning factors such as its healthy current account surplus, China’s Covid-resiliency that imparts RMB a proxy safe haven allure in a pandemic environment, RMB’s low sensitivity to UST yields that we have covered in the previous RMB Watches. These have likely nullified some of the downside pressure on the RMB too.

In the near-term, focus is on 1) Jackson Hole Economic Symposium where Fed’s QE tapering could be revealed, 2) fears of the delta variant hurting recovery dominate in the near-term. Fed Kaplan (non-voter) has sounded a note of caution as the delta-variant becomes a threat to economic recovery for the US. That said, speculations on the Fed’s taper schedule are likely to remain fluid and as such, provide some support on dips for the USDCNY. Given RMB’s low sensitivity to USTs and proxy safe haven allure in a pandemic environment, we expect the focus on Fed’s taper schedule and any spikes in the UST yields to also keep the RMB strong against other non-USD trading partners.

USDCNH (Daily)- Consolidation Likely

USDCNH was last at 6.4947. With the breach of the 6.50-figure, that level is no longer a strong resistance level and the next is seen at 6.5320 (76.4% fibo retracement of the Mar-May decline).

Momentum is still a tad bullish but stochastics are showing signs of turning from near overbought condition. With the golden cross happening for 21-dma and 200-dma, risks are still skewed to the upside for this pair. Resistance at 6.5320. Support remains at 6.47/6.45.

EURCNH (Daily) – Falling Wedge, Possible Rebound

EURCNH drifted to a low of 7.5818 recently before modest rebounds, bringing to fruition our bearish warnings. This cross still has bearish momentum at this point but a falling wedge has formed, preceding a potential rebound.

Support is seen at 7.5826 (Apr 2020 low) and then at 7.5490 (Feb 2020 low). Resistance at 7.6355 (21-dma) before 7.6760.

Legend: Orange Line denotes 21-dma; Blue dash denotes 50-dma

MYRCNH (Daily) – Falling Trend Channel Intact, Some Bullish Risks

MYRCNH has been trading sideways and was last around 1.5350. This cross needs to break above the resistance at 1.5375, before the next at 1.5480. This cross remains firmly within the falling trend channel.

However, MACD forest is increasingly bullish and risks are tilting towards the upside. Key resistance to break is 1.5480 for violation of the channel. Strong support is seen around 1.5205.

SGDCNH (Weekly) – Bearish Bias, Range 4.75-4.80 range

SGDCNH remains on the downtrend on the weekly chart and was last at 4.7760.

MACD is bearish and stochastics show signs of rising from oversold condition. Bearish divergence has been forming but a reversal is not yet compelling at this point.

Some consolidation is likely to continue within 4.75-4.80.

Legend: Orange Line denotes 21-dma; Black dash denotes 50-dma;

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