Chinese renminbi

	Spot close 28.02.18	Q1 2018	Q2 2018	Q3 2018	Q4 2018
USD/CNY	6.3335	6.3500	6.4000	6.4500	6.5500
USD/HKD	7.8262	7.8350	7.8200	7.8100	7.8050
		Range	Range	Range	Range
USD/CNY		6.2500-6.5400	6.3000-6.5000	6.3000-6.5500	6.4000-6.6000
USD/HKD		7.8100-7.8400	7.8000-7.8300	7.7900-7.8200	7.7900-7.8200

MARKET UPDATE

Weaker; tiny hike in OMO rates expected

The renminbi consolidated and weakened in February as USD/CNY rose from 6.2920 to 6.3335 in terms of London closes; CFETS rose from 95.70 to 96.48. Authorities are allowing greater intraday variability to allow the market greater say in determining the exchange rate. PBOC is signalling a tiny +5bp rise in its open-market interest rates as the Fed hikes in March.

OUTLOOK

Near term, can a 6.25-6.36 range hold?

The near-term challenge this month is to see if a February 2018 range of roughly 6.25-6.36 will hold over the rest of 1H18. Our team's weaker USD view remains little changed and if there is more USD weakness, there are those onshore who want to take USD/CNY lower (eg, to 6.20).

Authorities don't want to go < 6.25

But we are saying authorities won't want to go there, which is what we think we learned in February. Official preferences can be fickle but those who have a blue-sky perspective on China's economy and credit problems will not be able to explain why we bounced back from 6.25.

Whether we manage to bounce > 6.36 depends on Chinese exports

We are actually claiming more than this, that there is a reason for a further (and small) USD/CNY bounce above 6.36. At this stage that seems most intimately tied to China's future export performance, as January+February export order sub-diffusions in the official PMIs turned weaker than is justified by the Chinese New Year timing effect. And while the onshore market is probably square by now, the larger FX world, we suspect, could still be quite short the Big Dollar.

January was a USD/CNY Trump trade, but it may not help

With more due consideration we now interpret the remarkable move down in USD/CNY in January (the biggest monthly move ever) as an effort to pre-appease US President Trump. While this is related to the mercantilist Trump weak USD trade we discussed more than a year ago, it's not quite. China is using an old playbook to try to assuage the Yanks (in this case, one particular Yank). When China de-pegged in 2005 we were struck then by how former President Hu was motivated by a desire to "gift" former US President Bush with a stronger currency, and have since then viewed the bilateral cross as perhaps the most important tool for China in managing its US relationship. But the US business community's attitude towards China trade has changed, and we no longer think currency movements alone will suffice. This is primarily due to Trump insisting on using the sole criterion of the bilateral trade balance as his measuring stick, and while China and US bureaucrats might be able to dream up USD10-20bn of managed trade flows, they can't fix a USD350-400bn problem. We expect US-China trade tensions will lead to quite detailed sectoral negotiations. Though we don't expect sectoral negotiations to change an exchange rate's long-term direction and valuation, if the stronger renminbi does not do the trick for US-China, the thought is USD/CNY could bounce back up.

	Interest Rate Close	Q1 2018	Q2 2018	Q3 2018	Q4 2018
Policy Rate	4.35%	4.35%	4.35%	4.35%	4.35%
7-Day Repo Rate	3.49%	4.50%	4.00%	3.50%	4.50%
5-Year Yield	3.69%	3.50%	3.25%	3.75%	4.25%

** Interest rate assumptions incorporated into BTMU foreign exchange forecasts.*

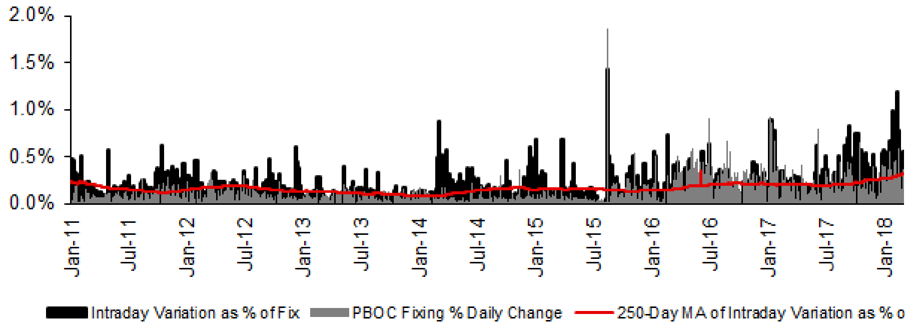
INTEREST RATE OUTLOOK

Some signs of credit problems and funds demand

The trend slowdown in measured TSF continued over January but January's credit #s cannot be considered small. Our view remains for technocrats to be given, say, six months to work their magic but serious de-leveraging will also mean slower growth (some are already complaining). Ultimately this requires a longer-term commitment if de-leveraging is to work. We were bothered by unexpected liquidity demands after Chinese New Year so adjust our money market rate views higher this quarter. We still think credit problems are bubbling underneath: February confirmed that some Chinese PPPs (public-private partnerships) issued bonds falsely classified as corporate debt. Then there was the Chalco switcheroo, where this SOE seemed to have had to shuffle internal assets (about USD1bn's worth) *twice* since November to cover entrusted loans. Chinese corporates continue a faster march offshore to borrow unhedged (before USD bond yields get to 4%) but onshore we still expect efforts this year to push bond yields *down* in the first half, despite the rising US yield. We still expect credit issues to resurface later in 2018.

The leash extends

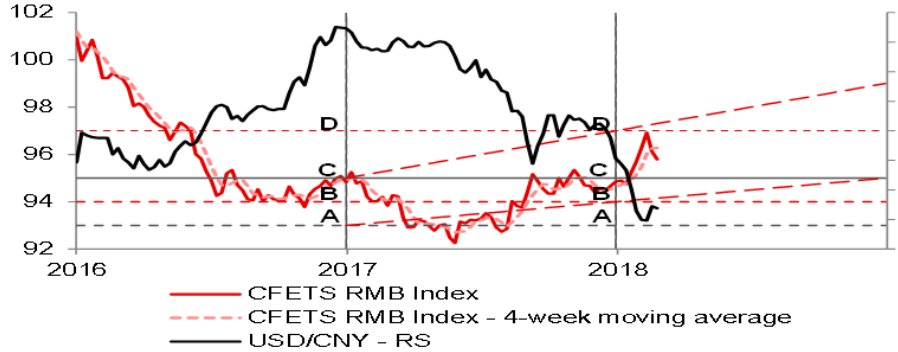
CNY: THE TREND IN INTRADAY VARIATION



Source: Bloomberg & MUFG

Tracing out a range

CNY: A FEW MONTHS INTO A BASKET PEG



Source: Bloomberg & MUFG

MUFG

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