# The Global *RMB*

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**Highlights**

- **USD/RMB has climbed in a hurry; we update thoughts in the CNH section**
- **China is in a nationwide scramble for funds**
- **We're still dubious about recent Chinese growth figures**
- **Factors/reasoning behind our once very contrarian depreciation outlook for CNY/CNH remain but the speed has accelerated on the back of Trump-China brinkmanship**

# CNY: Review and Outlook

**Trader Color.** The cross traded firmly traded above last month's range but slower than DXY which burst from 92 to 95. Corporate selling contributed and as a result CFETS was still kept at a high level. Any bad news on trade negotiations between China and America may hit CNY depreciation if bad news comes out. Buying flows for dividends may also support the cross. The curve stayed within a narrow range, with further action by PBOC expected but policy moderate. 1-year deliverable points ended at 740 compared with April's 700.

**A lot can happen in a month.** In just a month, USD/CNY blew past both our old 2Q18 and 3Q18 forecasts. At least we got the direction of weakening correct, a direction that didn't seem very popular with many market participants a few months ago.

**The USD's strength is acknowledged but may not be unidirectional.** The proximate culprit for a faster rise in USD/CNY was, of course, the dollar. Our new forecast path acknowledges the stronger level of the dollar as relevant new information for the balance of the year (also reflected in stronger USD team forecasts). But while it may look like a unidirectional path we would not be too shocked if there was some consolidation between 2Q and 3Q due to the Fed pause we have pencilled in for September.

**USD demand and corporate defaults may both be about funding.** Over the yuan's weakening in April and May it was impressive to us onshore USD demand which flared up from time to time. That's consistent with another observation, which is that we appear to be in another episode of corporate credit difficulties, something we expected but which seems to be occurring faster than we had thought. We still believe therefore that interest rate differentials are continuing to make a difference and will be even more influential after Fed hike #7. In the search for financing, even foreigners count.

**Defaults don't proliferate in a strong growth environment.** On growth, what can we say? We began this year thinking we'd have to shave another 0.5ppt off of official #s and at this stage we're not sure what to believe. Defaults shouldn't proliferate in a strong growth environment. But since we do believe actual de-leveraging is ongoing, the reluctance to show a slowdown is frustrating; a de-leveraging that doesn't affect any part of the real economy – nice work if you can get it. Some #s make sense. Infrastructure at the local level remains key as Trumped steel might as well be used at home. Housing sales so far show there is no sign of a property slowdown as we'd proposed (which means what de-leveraging there is occurring elsewhere). But we think a wiser view is to expect local governments which cannot maintain their present pace of spending will have to fall back in 2H. Similar expectations should exports be frontloaded in an attempt to head off Trump in 1H18. And though early, if China is demographically shifting into an era of smaller and sometimes negative current accounts, that's material for the currency as well. The Big Turnaround, of course, would occur if the Politburo decides it's time to ease.

**Once more, with feeling: De-leveraging is not restructuring.** The jury is still out with re to expected liquidity tightness in June-July, but not so far out that we don't anticipate another RRR cut to take effect in 2H18. But as with the cut in April, we don't anticipate major interest rate effects. Instead, China safe yields are no longer tightening vs. US Treasuries as we had written, so the next Treasury sell-off will be painful for China as well. Meanwhile onshore credit spreads are still widening. The CERC default and cross-triggers added up to another USD1bn-size credit event, but it's hardly the only default. We acknowledge progress in de-leveraging: The TSF trend is still slowing; entrusted loans, trust loans and BAs appear to have been wrapped into bond form; and liquidity felt much tighter in April and likely also in May with offshore CNH rates feeling the effect. But there remain official hints the true state of banking balance sheets are not known and the extension of WMP rules (again) till end-2020 is a clear sign of forbearance meaning less resolve to tackle troublesome debt, which the market had partly anticipated. At the end of the day, it's all about restructuring zombies instead of hanging onto them.

# CNY: Onshore RMB

# CNH: Offshore RMB

### CNY Snapshot — 20-Jun-18

| Tenor | Last Bid | Last Ask | Last Mid | Last Month Range Min | Last Month Range Max |
|---|---|---|---|---|---|
| Fix | | | 6.4586 | 6.3345 | 6.4207 |
| Spot | 6.4715 | 6.4728 | 6.4722 | 6.3302 | 6.4339 |
| O/N | -5.11 | -4.77 | -4.94 | | |
| T/N | -4.71 | -4.71 | -4.71 | | |
| 1W | 8.03 | 8.73 | 8.38 | | |
| 1M | 85.53 | 86.53 | 86.03 | | |
| 2M | 154.53 | 158.53 | 156.53 | | |
| 3M | 227.03 | 227.49 | 227.26 | | |
| 6M | 398.53 | 400.53 | 399.53 | | |
| 9M | 563.53 | 565.93 | 564.73 | | |
| 12M | 724.53 | 727.53 | 726.03 | | |
| 2Y | 1423.53 | 1443.53 | 1433.53 | | |
| 3Y | 2133.53 | 2263.53 | 2198.53 | | |

### CNH Snapshot — 20-Jun-18

| Tenor | Last Bid | Last Ask | Last Mid | Last Month Range Min | Last Month Range Max |
|---|---|---|---|---|---|
| Fix | | | 6.4499 | 6.3310 | 6.4260 |
| Spot | 6.4752 | 6.4753 | 6.4753 | 6.3098 | 6.4324 |
| O/N | 1.00 | 6.00 | 3.50 | | |
| T/N | 1.00 | 7.00 | 4.00 | | |
| 1W | 17.27 | 19.77 | 18.52 | | |
| 1M | 98.52 | 118.52 | 108.52 | | |
| 2M | 193.52 | 213.52 | 203.52 | | |
| 3M | 300.52 | 312.52 | 306.52 | | |
| 6M | 513.52 | 543.52 | 528.52 | | |
| 9M | 708.52 | 758.52 | 733.52 | | |
| 12M | 938.52 | 958.52 | 948.52 | | |
| 2Y | 1618.52 | 1718.52 | 1668.52 | | |
| 3Y | 2290.52 | 2370.52 | 2330.52 | | |

### CNY Curve — 20-Jun-18

| Tenor | Outrights (mid) Onshore DF | Outrights (mid) NDF | Outrights (mid) Diff (pips) | Implied Rates (%, mid) Onshore DF | Implied Rates (%, mid) NDF | Implied Rates (%, mid) Diff (%) | NDS Bid | NDS Offer | NDS Mid |
|---|---|---|---|---|---|---|---|---|---|
| Spot | 6.4722 | 6.4722 | | | | | | | |
| O/N | 6.4723 | | | | | | | | |
| T/N | 6.4723 | | | | | | | | |
| 1W | 6.4736 | 6.4805 | -68.65 | 3.5651 | 9.0460 | -5.4809 | | | |
| 1M | 6.4814 | 6.4925 | -111.00 | 4.0348 | 6.1130 | -2.0782 | | | |
| 2M | 6.4885 | 6.5040 | -155.50 | 3.8757 | 5.4743 | -1.5986 | | | |
| 3M | 6.4955 | 6.5145 | -189.77 | 3.7675 | 4.8938 | -1.1263 | | | |
| 6M | 6.5128 | 6.5420 | -292.50 | 3.7168 | 4.6067 | -0.8899 | | | |
| 9M | 6.5293 | 6.5658 | -364.80 | 3.7413 | 4.5085 | -0.7672 | | | |
| 12M | 6.5454 | 6.5895 | -441.00 | 3.7818 | 4.4549 | -0.6732 | 4.55 | 4.75 | 4.65 |
| 2Y | 6.6162 | 6.6620 | -458.50 | 3.9149 | 4.2391 | -0.3242 | 4.22 | 4.35 | 4.29 |
| 3Y | 6.6927 | 6.7295 | -368.50 | 3.9940 | 4.1728 | -0.1788 | 4.18 | 4.40 | 4.29 |

### CNH Curve — 20-Jun-18

| Tenor | Outrights (mid) Offshore DF | Outrights (mid) NDF | Outrights (mid) Diff (pips) | Implied Rates (%, mid) Offshore DF | Implied Rates (%, mid) Depo | Implied Rates (%, mid) Diff (%) | CCS Bid | CCS Offer | CCS Mid |
|---|---|---|---|---|---|---|---|---|---|
| Spot | 6.4753 | 6.4722 | | | | | | | |
| O/N | 6.4756 | | | | | | | | |
| T/N | 6.4757 | | | | | | | | |
| 1W | 6.4778 | 6.4805 | -27.50 | 4.3102 | 4.3000 | 0.0102 | | | |
| 1M | 6.4868 | 6.4925 | -57.50 | 4.3921 | 4.2500 | 0.1421 | | | |
| 2M | 6.4963 | 6.5040 | -77.50 | 4.2493 | 4.3000 | -0.0507 | | | |
| 3M | 6.5066 | 6.5145 | -79.50 | 4.1573 | 4.3500 | -0.1927 | | | |
| 6M | 6.5288 | 6.5420 | -132.50 | 4.0375 | 4.4000 | -0.3625 | 3.96 | 4.06 | 4.01 |
| 9M | 6.5493 | 6.5658 | -165.00 | 4.0338 | 4.1500 | -0.1163 | 3.96 | 4.06 | 4.01 |
| 12M | 6.5708 | 6.5895 | -187.50 | 4.0695 | 4.3000 | -0.2306 | 4.01 | 4.06 | 4.03 |
| 2Y | 6.6428 | 6.6620 | -192.50 | 4.0819 | | | 4.00 | 4.07 | 4.03 |
| 3Y | 6.7090 | 6.7295 | -205.50 | 4.0599 | | | 3.98 | 4.05 | 4.01 |

### USD/CNY Onshore Implied Volatilities (in %) — 20-Jun-18

| Tenor | ATM (Mid) | 20D Z-Score | 25C | 25P | 25DRR |
|---|---|---|---|---|---|
| 1W | 3.90 | 2.81 | 4.06 | 3.94 | 0.13 |
| 2W | 3.90 | 2.99 | 4.08 | 3.96 | 0.13 |
| 3W | 3.87 | 2.87 | 4.05 | 3.93 | 0.12 |
| 1M | 3.77 | 2.66 | 3.96 | 3.81 | 0.15 |
| 2M | 3.64 | 2.70 | 3.86 | 3.66 | 0.20 |
| 3M | 3.61 | 2.69 | 3.85 | 3.61 | 0.24 |
| 6M | 3.49 | 1.75 | 3.76 | 3.52 | 0.24 |
| 1Y | 3.70 | 2.06 | 4.00 | 3.73 | 0.26 |
| 18M | 3.78 | 1.36 | 4.29 | 3.97 | 0.32 |
| 2Y | 3.89 | 0.33 | 4.43 | 4.15 | 0.29 |

### USD/CNH Implied Volatilities (in %) — 20-Jun-18

| Tenor | ATM (Mid) | 20D Z-Score | 25C | 25P | 25DRR |
|---|---|---|---|---|---|
| 1W | 5.66 | 2.36 | 6.08 | 5.47 | 0.61 |
| 2W | 5.31 | 2.18 | 5.75 | 5.14 | 0.62 |
| 3W | 5.17 | 2.08 | 5.65 | 4.99 | 0.66 |
| 1M | 5.17 | 2.09 | 5.64 | 4.98 | 0.66 |
| 2M | 5.08 | 1.96 | 5.60 | 4.91 | 0.69 |
| 3M | 5.10 | 1.99 | 5.67 | 4.93 | 0.74 |
| 6M | 5.18 | 1.95 | 5.79 | 5.00 | 0.79 |
| 1Y | 5.30 | 1.78 | 6.03 | 5.13 | 0.90 |
| 18M | 5.51 | 1.88 | 6.32 | 5.33 | 0.99 |
| 2Y | 5.63 | 1.90 | 6.52 | 5.44 | 1.08 |

### USD/CNY Offshore Implied Volatilities (in %) — 20-Jun-18

| Tenor | ATM (Mid) | 20D Z-Score | 25C | 25P | 25DRR |
|---|---|---|---|---|---|
| 1W | 5.17 | 2.54 | 5.60 | 5.03 | 0.57 |
| 2W | 4.90 | 2.28 | 5.34 | 4.76 | 0.58 |
| 3W | 5.01 | 2.03 | 5.52 | 4.85 | 0.67 |
| 1M | 4.98 | 2.29 | 5.42 | 4.85 | 0.58 |
| 2M | 4.94 | 2.23 | 5.45 | 4.79 | 0.67 |
| 3M | 4.97 | 2.16 | 5.52 | 4.81 | 0.71 |
| 6M | 5.03 | 2.09 | 5.60 | 4.88 | 0.72 |
| 1Y | 5.14 | 1.94 | 5.78 | 4.97 | 0.81 |
| 18M | 5.35 | 1.95 | 6.14 | 5.20 | 0.94 |
| 2Y | 5.50 | 1.93 | 6.35 | 5.34 | 1.01 |

*Source: Bloomberg, MUFG Bank*



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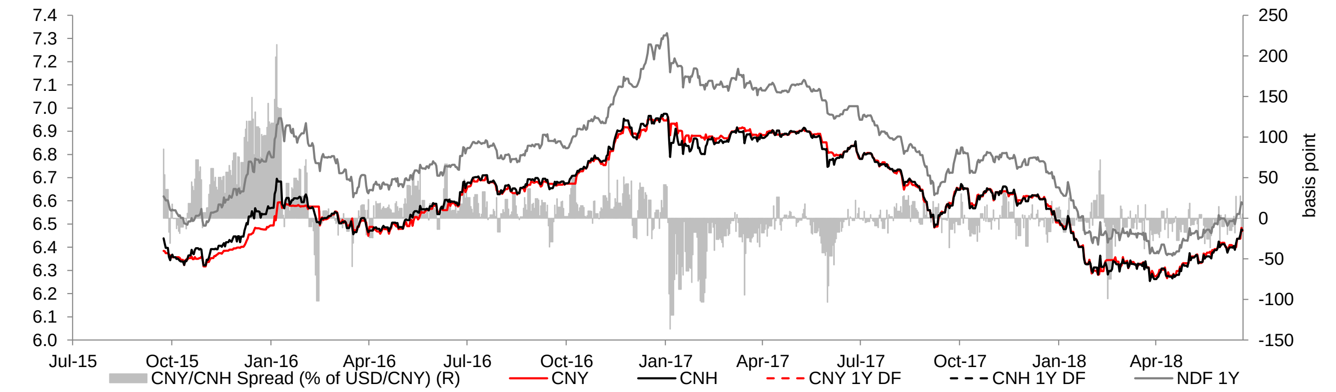
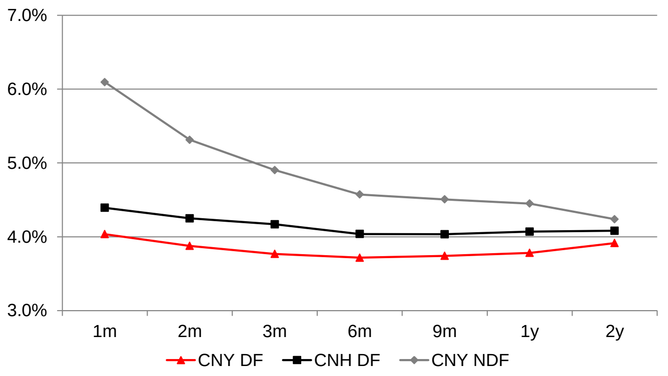
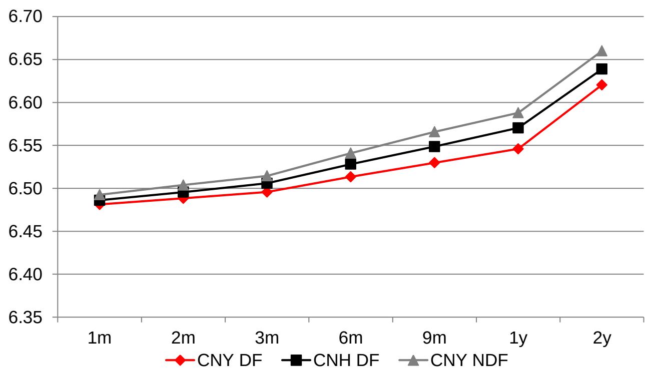
# CNY: Onshore RMB

# CNH: Offshore RMB

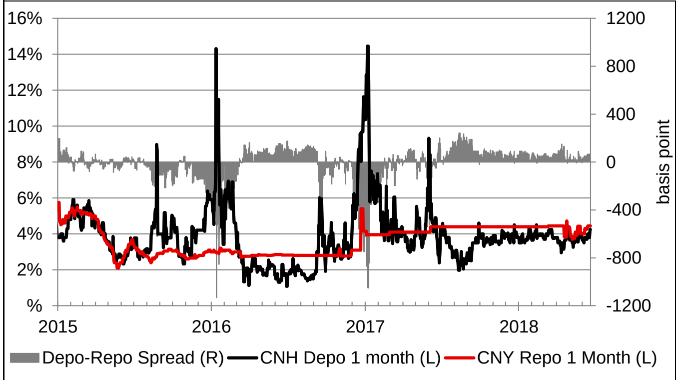


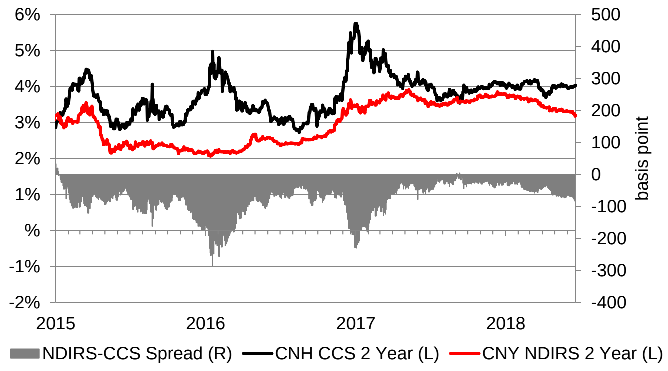

## RMB Curve: Rates vs. Outrights



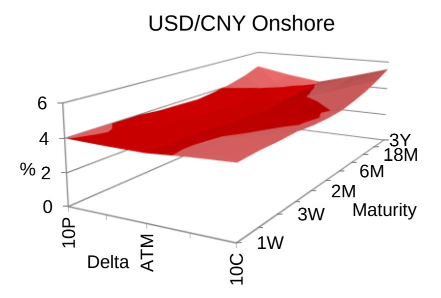



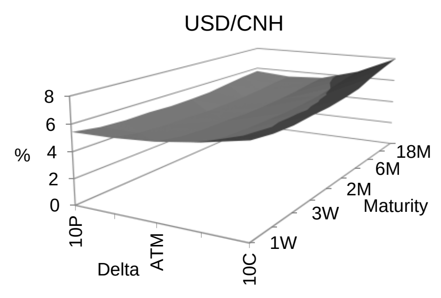

## RMB Rate: Offshore vs. Onshore

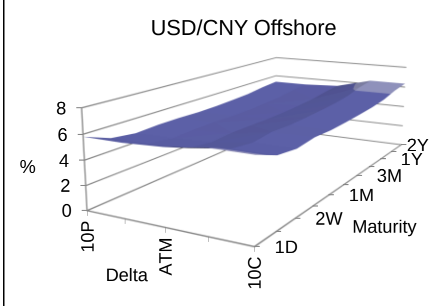



## RMB Implied Volatility: Offshore vs. Onshore




*Source: Bloomberg, MUFG Bank*

OUR LATEST FORECAST: CNY AND CNH

| | Spot close 20.06.18 | | Q2 2018 | Q3 2018 | Q4 2018 | Q1 2019 |
|---|---|---|---|---|---|---|
| USD/CNY | 6.4720 | Our forecast | 6.4200 | 6.4500 | 6.4800 | 6.5300 |
| | | Forward price | 6.4764 | 6.5124 | 6.5391 | 6.5644 |
| USD/CNH | 6.4745 | Our forecast | 6.4200 | 6.4500 | 6.4800 | 6.5300 |
| | | Forward price | 6.4766 | 6.5057 | 6.5289 | 6.5493 |

*Source: Bloomberg, MUFG Bank*

# CNH:  Review and Outlook

**Trader Color**. Spot CNH was quite rangey in the first three weeks of May, 6.33/6.38 traded. On the last week, following global risk off sentiment from Italy and onshore breaking above the key 6.4000 level , the pair traded up to its highest 6.43 low side. PBOC announcing relaxation for FIs to borrow and lend money from onshore pushed down the offshore DF curve to +850, only a 100pip premium to onshore. However, after no more details were announced offshore DF rebounded and followed outright flows with Italy risk off news, 1-year traded to, at its highest, +1030. A shares were included in MSCI, with funding on the final day of the month squeezed up to +18/+20 (1 day) as funds transferred onshore from Hong Kong. 1-year closed at +930 but funding loosened back to +2 pips per day.

**Spot.** We're late this month but it gives us an opportunity to comment on recent spot movements intramonth.

Factors/reasoning behind our once very contrarian view of CNY/CNH depreciation in 2018 **remain intact: Weakening growth, widening interest rate differentials with the US and reappearing credit problems, they're all still here.** We take these as drivers behind the path of depreciation we had staked out.

The speed of such depreciation, however, has been faster than what we anticipated for a month-and-a-half now, and we put this down to the degree of brinkmanship we are seeing between Trump and China on trade (though we'd warned as early as 8 December 2016 – *Asia Cross Current:* *Ctrl-Alt Right, The Limitations of Donald Trump in Asia, Part 1* – about such an eventuality). What we find sobering in recent news is the observation *no* negotiations have been scheduled between the US and China. Since Trump likes to lump all sorts of issues together, we could get some clues from the way he is handling North Korea, where he has found it useful to keep "maximum pressures" sanctions in place in hopes of giving him leverage on denuclearization. If so, Trump may also find Section 301 tariffs, the first of which go into effect on 6 July 2018 (and which he has threatened to escalate significantly), useful to keep in place as leverage. However, both China and Europe have said they cannot negotiate with a gun to their heads, so it begs the question of how negotiations can begin afresh? **Remember, trade wars are accidents.**

We had earlier written – eg, *Asia Cross Current:* *USD/Asia – How Bad Can a Trade War Get? (Pretty Bad)* – that in the event of a trade war, it's likely USD/EM heads higher.

## Disclaimer