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**Highlights**

- **Powell's turn-of-heart about "neutral" leaves a prospectively longer period of time when Chinese yields can hover above US yields, providing support for yuan in farther horizons**
- **US-China trade truce after the Xi-Trump meeting: No joint statements, a 90-day pause in raising tariffs, China to import more from US**
- **Once down to lower-level negotiations, enthusiasm is expected to wane quickly**
- **The success of "Petroyuan" opens up the possibility of a wider scope for RMB denominated commodity trading**

**CNY: Review and Outlook**

**Trader Color.** Spot USD/CNY traded mostly in a narrow range between 6.9200 and 6.9700 after US midterm elections. Improving relationship between US and China and further RRR-cut expectations contributed to this. Besides, the month-end corporate demand was also limited, as everyone waited for the outcome of the Xi-Trump meeting at the G20 summit. The expectation of CNY depreciation to break the 7-handle can hardly be seen in November, while the curve remained downward biased, amid worse than expected economic data. Further RRR-cut expectation dominated the markets which locked 1Y in around -250 for quite a while till the end of November.

**Slower Fed hikes mean interest rate differentials that will help support RMB.** Of operative themes we have identified as driving USD/RMB, we think the biggest change in November was in prospective interest rate differentials with USD rates. Chairman Powell's 28 November speech took at least one hike out of our expectations (with some in markets romancing more). We expect more debate about "neutral" in 1H19 but with at least one fewer 2019 Fed hike, it's logical to lower USD/CNY forecasts over 2-3Q19.

**Trump wants a deal.** As for remaining themes, the trade war has bullied its way to the front of the queue as a crescendo builds over the post-G20 Trump-Xi dinner. We wonder if markets should care as much. Markets appear to have gotten smarter at distinguishing between a "deal" (for the cameras, lots of pomp, lots of pageantry, little policy; think North Korea) and a deal (one with real substance). When Trump tweets, almost daily, that the Chinese want a deal, that really means Trump wants a deal. He wants a deal because he's gotten worried about the US stock market, which is hovering on the border between loss/gain for 2018 (the Powell Put could eventually be re-christened the Trump Put). Because for this President, it's now all about re-election (registering his re-election committee was the very first act of the Trump Presidency).

**So does Xi, if he can get temporary tariff relief and lower interest rates.** For President Xi, would a ceasefire on tariffs be appealing if it lasts only a few months? You bet. Chairman Powell just did China a tremendous favor by signalling a break in the Fed's recent pattern of rate hikes. "Gradual" was not gradual enough for China's massive refi problem; even more gradual is more like it. There is a massive struggle to corral China's overweight bundle of debt before something toxic breaks into the open, so every month – every basis point really – matters.

**So, there was a "deal", in line with our expectations, but markets will ultimately demand a deal (real substance); a "deal" has only short-term effects.** When real negotiations begin over specific issues the Americans want resolved, we expect enthusiasm to fade away. A "deal" will have only short-term effects. There are areas – eg, in ownership restrictions – where the Chinese can conceivably offer something of substance. But when Americans demand action on cyberhacking or some attempt at major currency management, we expect the Chinese to fall silent. And if they do, remember Trump recently declared, "I'm the tariffs guy." China may not even be the main attraction in 1Q19, when auto tariffs may be in play.

**Chinese growth and credit problems remain.** As for remaining themes, China slowing and China's re-emerging credit problems are both still a go from where we sit. Therefore it's still a slow grind higher for USD/CNY for now.

**Powell's opening provides Chinese authorities more leeway to lower yields.** Powell's opening will give Chinese authorities more leeway to lower onshore interest rates without hurting the currency, particularly for bond yields, which we have updated into our forecasts. Notwithstanding higher headline inflation, more defaults in 2018 and a great majority of LGFVs not even covering costs, interest rates must decline! Though China's original four asset management companies are buying up more NPLs, a couple of these that have gone public really behave more like investment banks nowadays, and we suspect NPL disposals will ultimately need new entities. After activities by China's national team in equities in preceding months, the securities regulator sent out a directive to onshore analysts in early November that can only be described as the "happy talk" directive – that onshore analysts take care not to denigrate Chinese assets too much. There have been talk analysts even had to sign agreements but we have not been able to confirm that. One wonders whether that's necessary, as a number of analysts and many Mr. and Mrs. Chens seem content with the Xi Jinping put.

# CNY: Onshore RMB

# CNH: Offshore RMB

CNY Snapshot						CNH Snapshot					
5-Dec-18						5-Dec-18					
Tenor	Last		Last Month Range			Tenor	Last		Last Month Range		
	Bid	Ask	Mid	Min	Max		Bid	Ask	Mid	Min	Max
Fix			6.8476	6.8976	6.9670	Fix			6.8640	6.9068	6.9725
Spot	6.8452	6.8473	6.8463	6.8730	6.9703	Spot	6.8462	6.8463	6.8463	6.8525	6.9812
O/N	-6.85	-6.85	-6.85			O/N	-4.00	3.00	-0.50		
T/N	-6.86	-6.86	-6.86			T/N	-3.00	3.00	0.00		
1W	-8.80	-8.79	-8.79			1W	-21.35	12.65	-4.35		
1M	-7.35	-7.15	-7.25			1M	24.15	29.15	26.65		
2M	-25.19	-22.18	-23.68			2M	78.15	86.15	82.15		
3M	-38.65	-35.74	-37.19			3M	104.85	124.85	114.85		
6M	-102.02	-99.76	-100.89			6M	184.15	234.15	209.15		
9M	-180.09	-178.85	-179.47			9M	261.15	311.15	286.15		
12M	-257.56	-226.85	-242.20			12M	338.15	368.15	353.15		
2Y	-416.85	-376.85	-396.85			2Y	678.15	738.15	708.15		
3Y	-346.85	-326.85	-336.85			3Y	1023.15	1223.15	1123.15		

CNY Curve										5-Dec-18		
Tenor	Outrights (mid)			Implied Rates (% mid)			NDS					
	Onshore DF	NDF	Diff (pips)	Onshore DF	NDF	Diff (%)	Bid	Offer	Mid			
Spot	6.8463	6.8463										
O/N	6.8463											
T/N	6.8462											
1W	6.8461	6.8495	-34.44	2.7499	2.5396	0.2103						
1M	6.8462	6.8530	-67.90	2.7613	3.1283	-0.3670						
2M	6.8446	6.8620	-174.34	2.7054	3.7644	-1.0590						
3M	6.8432	6.8675	-242.84	2.6302	3.7904	-1.1602						
6M	6.8368	6.8825	-456.54	2.6088	3.8146	-1.2058						
9M	6.8290	6.8928	-638.12	2.5759	3.7628	-1.1869						
12M	6.8227	6.9025	-797.85	2.5574	3.7291	-1.1717	3.82	4.02	3.92			
2Y	6.8073	6.9500	-1427.50	2.6598	3.7028	-1.0430	3.68	3.88	3.78			
3Y	6.8133	7.0050	-1917.50	2.7732	3.7315	-0.9583	3.85	4.05	3.95			

CNH Curve										5-Dec-18		
Tenor	Outrights (mid)			Implied Rates (% mid)			CCS					
	Offshore DF	NDF	Diff (pips)	Offshore DF	Depo	Diff (%)	Bid	Offer	Mid			
Spot	6.8463	6.8463										
O/N	6.8462											
T/N	6.8463											
1W	6.8465	6.8495	-30.00	2.9182	2.6000	0.3182						
1M	6.8496	6.8530	-34.00	3.3024	3.3500	-0.0476						
2M	6.8552	6.8620	-68.50	3.4491	3.4250	0.0241						
3M	6.8584	6.8675	-90.80	3.8106	3.7000	0.1106						
6M	6.8679	6.8825	-146.50	3.4546	3.8000	-0.3454	3.37	3.47	3.42			
9M	6.8756	6.8928	-172.50	3.4441	3.6500	-0.2059	3.34	3.44	3.39			
12M	6.8823	6.9025	-202.50	3.4441	3.9000	-0.4559	3.35	3.42	3.39			
2Y	6.9178	6.9500	-322.50	3.4712			3.38	3.46	3.42			
3Y	6.9593	7.0050	-457.50	3.4857			3.44	3.49	3.46			

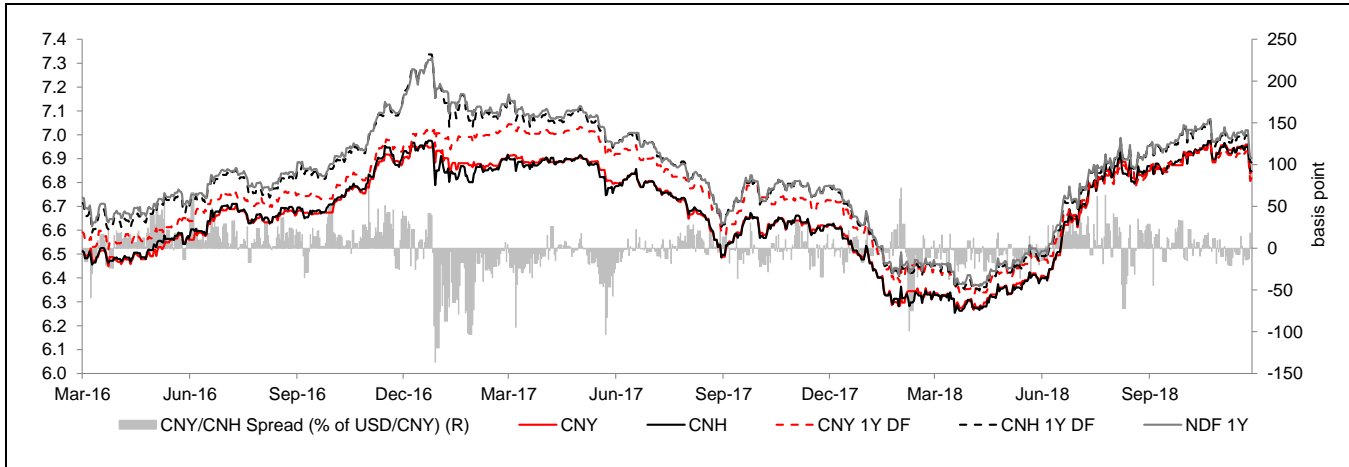
  

USD/CNY Onshore						USD/CNH						USD/CNY Offshore					
Implied Volatilities (in %) 5-Dec-18						Implied Volatilities (in %) 5-Dec-18						Implied Volatilities (in %) 5-Dec-18					
Tenor	Mid					Tenor	Mid					Tenor	Mid				
	ATM	Score	25C	25P	25DRR		ATM	Score	25C	25P	25DRR		ATM	Score	25C	25P	25DRR
1W	5.46	1.38	5.92	5.53	0.39	1W	6.96	0.80	7.24	7.20	0.04	1W	6.14	0.99	6.38	6.43	-0.05
2W	5.23	1.14	5.69	5.30	0.39	2W	6.53	0.52	6.85	6.75	0.10	2W	5.87	0.08	6.15	6.15	0.00
3W	5.19	1.10	5.68	5.23	0.45	3W	6.22	0.20	6.56	6.46	0.11	3W	6.04	0.32	6.34	6.24	0.10
1M	5.05	0.61	5.52	5.15	0.37	1M	6.03	-0.36	6.40	6.23	0.18	1M	5.58	-0.71	5.95	5.80	0.15
2M	5.09	0.56	5.65	5.12	0.53	2M	6.09	-0.68	6.64	6.18	0.46	2M	5.67	-1.00	6.23	5.70	0.53
3M	5.15	0.64	5.84	5.13	0.71	3M	6.23	-0.56	6.96	6.21	0.74	3M	5.79	-0.97	6.51	5.73	0.78
6M	5.14	-0.64	5.92	5.09	0.83	6M	6.29	-1.17	7.24	6.14	1.11	6M	5.92	-1.31	6.82	5.73	1.09
1Y	5.18	-0.78	6.14	5.10	1.04	1Y	6.40	-1.41	7.59	6.14	1.46	1Y	6.13	-1.32	7.28	5.81	1.47
18M	5.37	0.23	6.39	5.20	1.19	18M	6.56	-1.43	7.80	6.30	1.50	18M	6.27	-1.41	7.46	5.95	1.51
2Y	5.54	0.84	6.66	5.38	1.29	2Y	6.66	-1.44	7.95	6.40	1.55	2Y	6.35	-1.43	7.60	6.04	1.56

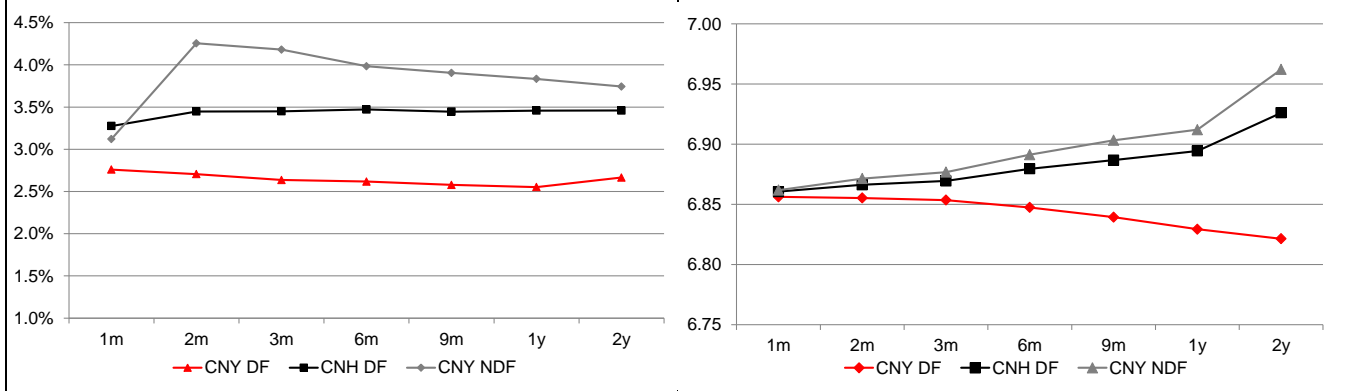
Source: Bloomberg, MUFG Bank

# CNY: Onshore RMB

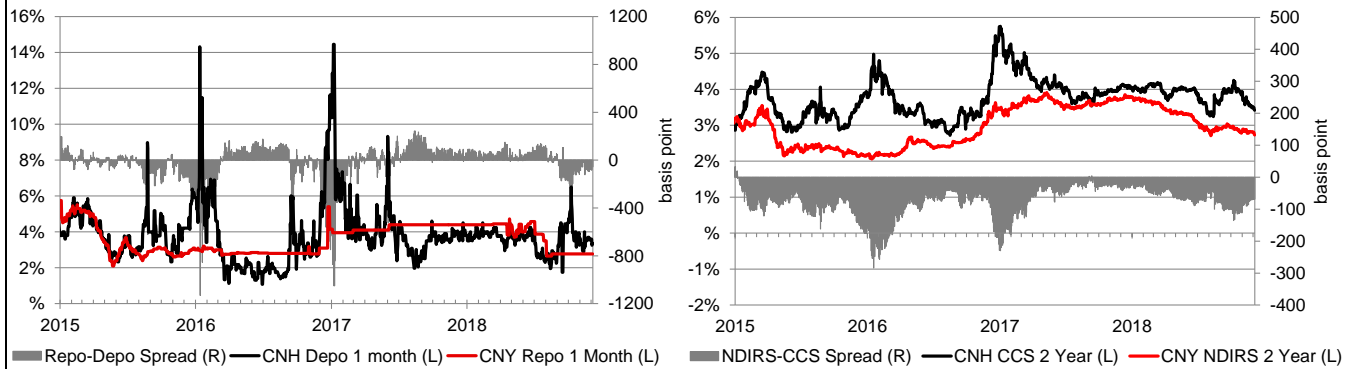
# CNH: Offshore RMB



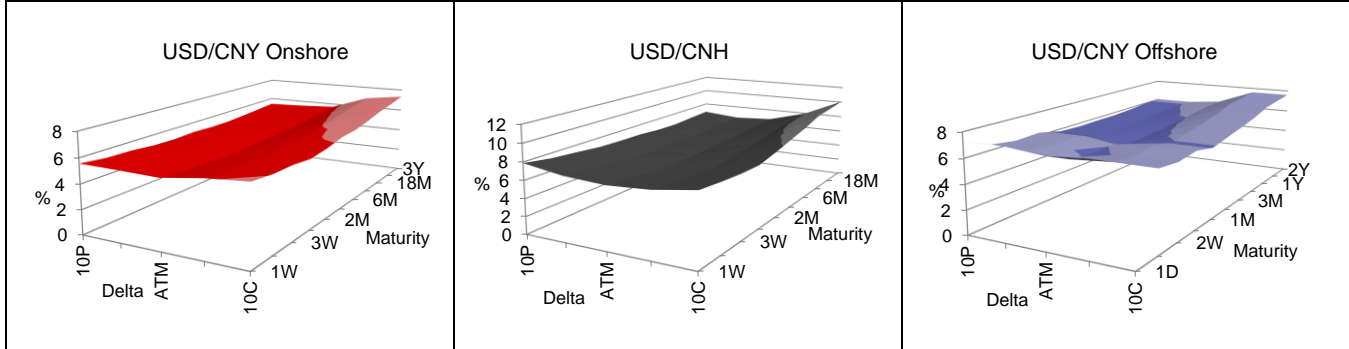
## RMB Curve: Rates vs. Outrights



## RMB Rate: Offshore vs. Onshore



## RMB Implied Volatility: Offshore vs. Onshore



Source: Bloomberg, MUFG Bank

## OUR LATEST FORECAST: CNY AND CNH

	Spot close 4.12.18		Q4 2018	Q1 2019	Q2 2019	Q3 2019
USD/CNY	6.8360	Our forecast	6.9500	6.9850	7.0500	7.1000
		Forward price	6.8601	6.8793	6.8922	6.9037
USD/CNH	6.8507	Our forecast	6.9500	6.9850	7.0600	7.1150
		Forward price	6.8623	6.8740	6.8828	6.8898

Source: Bloomberg, MUFG Bank

## CNH: Review and Outlook

**Trader Color.** Spot USD/CNH touched a low 6.8525 in early November, as US-China contacted positively. As the Chinese government announced policies to help private companies, onshore funding was expected to stay ample. US equities climbed ahead of midterm elections and onshore USD demands erased CNH gains in early November. Wider US-China interest rates gap led USD/CNH to 6.9698 high. DXY weakened after US midterm elections and Fed Chairman Powell's speech. Positive tone from Xi-Trump meeting in Argentina pushed the pair below 6.9000 towards December. Overall activities were subdued in November ahead of Xi-Trump meeting. Funding was ample and T/N was at -2/+2 per day in November. Liquidity drove lower when spot was near 6.9500. After US midterm elections, with a stabilized CNH, 1y on/off spread narrowed and stayed below +800 later November. CFETS index stayed in 92.00-92.50 in November.

**"Petroyuan" suggests the possibility of a wider scope for RMB denominated commodity trading.** "Petroyuan", the oil futures dominated in RMB, launched by the Shanghai International Energy Exchange eight months ago, appears to function well, with trading volume overtaking the dollar-denominated oil futures traded in Singapore and Dubai, though unsurprisingly lagging behind the Brent oil futures traded in London and the WTI oil futures traded in US, according to SCMP. The next step could potentially be to launch other RMB-denominated commodity trading products, further internationalizing RMB.

**Bloomberg started to take part in Bond Connect.** Bloomberg joined the scheme as a second e-trading platform on 29 November 2018, allowing Bond Connect investors to send RFQ via multiple e-trading platforms to trade with Bond Connect market makers for their China interbank bond market investments, according to Flash Report for Bond Connect (November 2018 issue). Besides, the taxation policy was clarified that there would be temporary exemption of corporate income tax and value-added tax for interest income of overseas institutions investing in the domestic bond market during the period from 7 November 2018 to 6 November 2021, according to China's Ministry of Finance and State Administration of Taxation. The latest developments would probably continue to help bolster the trading volume of Bond Connect in the future. The trading volume was RMB 74.3 billion with average turnover of RMB 3.38 billion in November, higher than that of RMB 55.0 billion and RMB 3.05 billion, respectively in October.

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