Chinese renminbi

	Spot close 31.12.18	Q1 2019	Q2 2019	Q3 2019	Q4 2019
USD/CNY	6.8658	6.9500	6.9800	7.0500	7.1000
USD/HKD	7.8317	7.8450	7.8250	7.8350	7.8300
		Range	Range	Range	Range
USD/CNY		6.8000-7.0000	6.8800-7.0500	6.9000-7.1500	6.9500-7.2000
USD/HKD		7.8000-7.8500	7.7900-7.8400	7.7950-7.8500	7.7900-7.8400

MARKET UPDATE

Weaker; over 2017-18, USD/CNY roundtripped

Renminbi weakened 5.6% vs. USD in 2018. Window dressing at year-end pushed USD/CNY down to a 6.8-handle, allowing authorities to claim only a 5-handle depreciation to 6.8658 (London close) in 2018 compared to its 6.5120 2017 counterpart. But a message of normality intended by 2017's appreciation unravelled. Trough for the cross was 6.2401 in March but from then on it was onward and upward till October's 6.9708 peak. The 200-day moving average finished in 2018 near its 2016 close, suggesting perhaps recent ranges are the new normal. PBOC succeeded in driving down interest rates. If liquidity was all that's required to resolve macroeconomic problems this central bank should be basking in triumph.

OUTLOOK

A trade truce pushes out depreciation expectations

Our last monthly was written the day before that Presidential dinner in Buenos Aires between Xi-Trump. Since the subsequent truce pushed out a tariff decision date by three months, our forecast profile has been shifted forward three months in time.

China's economic indicators will unroll much worse than normal, helping to drive the currency weaker

But there's much more than that. Though forecasts on the surface seem placid, our main point this month is to *increase* the emphasis on **China slowing,** one of four operative themes we have emphasized is driving the currency from since a year ago. We don't want readers to be surprised if China's usual indicators are going to unroll in much worse fashion than in the past, throughout 1Q19 but more likely to cover 2Q19 as well. Despite the Trade War truce, we think this factor is the most important at present.

Rolling over dud projects won't raise growth, underlining the limits of stimulus to support the currency

But won't slowdown bring stimulus like before? Not quite. To see why this time round we suspect government stimulus will be less effective than before, imagine all projects that could be financed in China lined up in a row, from the very highest returning ones to the very least. Since PBOC has been driving rates down but still complaining that not enough financing is getting done, imagine that the central bank in the future unleashes even more liquidity and directly directs banks to lend. Well highest returning projects shouldn't have had problems getting finance if they could reveal themselves as high-return projects in a world of perfect information. But low-returning projects are by definition the real dogs. Their problem is not revelation but too much information; they are known as bad projects which can't even handle the low hurdle rates that PBOC has engineered. Their potential failure and default is what threatens China's financial system and economy (see our *Themes of 2019* note elsewhere in this issue) so lending *must* be directed here. But by definition these are very low-return projects so the stimulative effect may be close to nil.

It may be 5.5% actual growth and 6.5% reported growth in 2019

In recent conversations onshore and offshore we had heard sobering tales of China slowing from a variety of clients, Asian and otherwise; Apple's revenue warning put a cherry on top of that. Our first growth 2019 estimate reported in October may prove too optimistic; onshore seems determined to report out 6.5% growth anyway.

	Interest Rate Close	Q1 2019	Q2 2019	Q3 2019	Q4 2019
Policy Rate	4.35%	4.35%	4.35%	4.35%	4.35%
7-Day Repo Rate	2.96%	2.90%	3.00%	3.00%	3.50%
5-Year Yield	2.89%	3.00%	3.05%	3.40%	3.50%

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

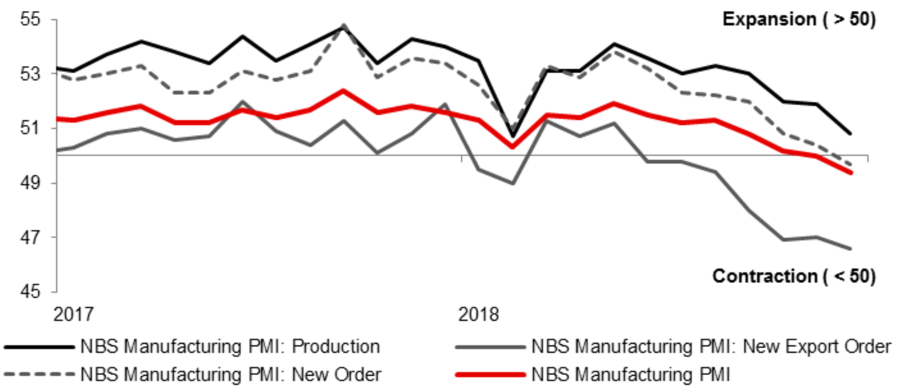
INTEREST RATE OUTLOOK

Credit risks still rising but the government seems to want more

The discussion above about ineffectiveness of stimulus should have brought up thoughts of whether the Chinese credit problems we correctly anticipated in 2018 are still getting worse? They are. We leave further discussion to the theme article. But some prominent real estate developers may be among the troubled of 2019 (and probably a lot of other, much smaller developers, too). The government seems to have now shifted in a bizarre turn to expect the real estate sector (15-30% of the economy depending on how you count) to *support* growth, bare months after the latter was a target of de-leveraging concerns. The Central Economic Work Conference this year proved disappointing, devoid it seemed of new ideas nor much conviction about anything (hence the flip flop above). Only the old playbook remains = stimulus, stimulus, stimulus. More flooding of front-end liquidity = why 7-day repo rate forecasts are lower. More massaging of bond yields – but later in 2019 they'll face challenges when the Fed begins to hike. Credit doesn't show up in these safe yields and, in fact, we expect safer paper to be increasingly demanded.

Trade War effects will be much more evident in 2019

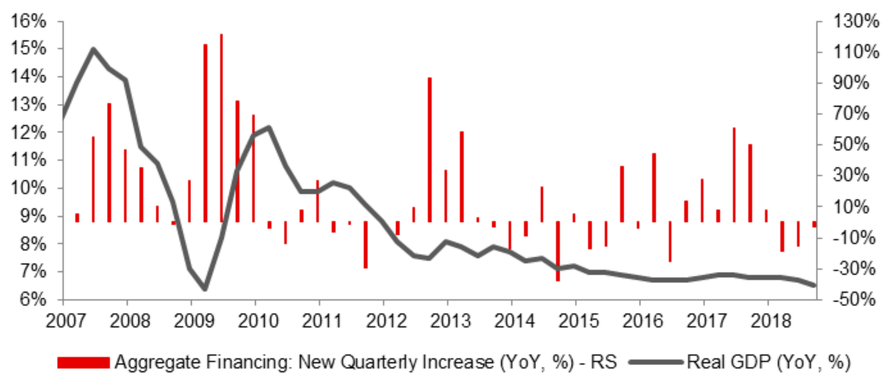
CHINA: THE SLOWDOWN ARRIVES



Source: CEIC, MUFG Bank

Increasingly pushing on a string

CHINA: MORE CREDIT, LESS GROWTH



Source: CEIC, MUFG Bank

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