Chinese renminbi

	Spot close 31.01.19	Q1 2019	Q2 2019	Q3 2019	Q4 2019
USD/CNY	6.7055	6.7500	6.7800	6.8500	6.9000
USD/HKD	7.8467	7.8500	7.8500	7.8450	7.8450
		Range	Range	Range	Range
USD/CNY		6.6500-6.9000	6.6500-6.9000	6.7000-6.9500	6.7500-7.0000
USD/HKD		7.8000-7.8500	7.8000-7.8500	7.7950-7.8500	7.7950-7.8500

MARKET UPDATE

Significantly stronger; PBOC is trying to stimulate

In an eerie reminder of 2018, CNY strengthened significantly in January as USD/CNY fell to 6.7055 from a December 2018 London close of 6.8658. To us, it seemed PBOC is embarked upon a stimulus program which we'll call "Chinease."

OUTLOOK

2019 started like Groundhog Day

2019 started feeling like Groundhog Day. Once again USD/CNY has pushed and/or been pushed much lower. And in markets it's probably accurate to say considerable positions remain seeking a "good" outcome out of US-China trade talks, with the Chinese side eager to buttress an impression of good.

The Fed turn led us to suspend interest rate differentials considerations

Elsewhere – and this may be an understatement – a dovish turn by the Fed is always material for FX. With our team turning to only one hike in September 2019, we are taking out the interest differential consideration in USD/CNY thinking for now, one reason for our lowered forecasts. With RMB becoming more global (as our companion publication attest – London RMB trading has exceeded that of EUR/GBP, with the latter likely hurt by Brexit), global factors will play a larger role over time.

Will markets accept a Real Deal or a Deal in Name Only in US-China trade?

On US-China trade, we have continuously been debating whether markets will be happy with a Deal in Name Only (DINO) or a clear, transparent, substantive Deal which addresses the heart of complex IPR issues. Intra-month we adopted a view that a vague, non-specific Deal (DINO), which is what we have now, might be good for about -1,200pips down from YE2018 levels, or about to 6.75 and we're already there. We continue to think truly verifiable progress on IPR issues is very difficult, in fact impossible before 1 March, especially since Liu He apparently came to Washington without many specifics to offer (despite Chinese denials).

The assumption Trump will cave is a Big and Risky Assumption

In the latest trade talks handicapping, we are uncomfortable with a subtext that US President Trump will ultimately cave. A Loss in the Shutdown is extended to expectations of a Loss in Trade. We're not saying in all possible universes this (Trump caving) couldn't happen, but it's accurate to label this a BIG ASSUMPTION. It's also possible as an alternative that if the Chinese find the soft approach to Trump not working to advance their own goals, we may see a version of the same unwind of CFETS (98 down to 92) that we saw last year (94 down to 90?).

Lower expected USD rates and some romancing of a Trade Deal lead to lower USD/CNY forecasts

So the big changes this month are to factor in romancing of a Trade Deal, even if vague, and a more important Fed policy change; the latter led us to suspend the interest differential factor. We still expect China to slow in 1H19, sometimes dramatically, due to underlying credit problems and the ineffectiveness of monetary stimulus. It's very weird to see CFETS strengthening under such circumstances (as last year, a paean to Trump) as exports wilt; that's certainly not our sense for neither Korea nor Taiwan. The Trade War is not the primary driver of the slowdown.

	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	2.85%	3.00%	3.00%	3.00%	3.50%
5-Year Yield	2.92%	3.00%	3.05%	3.40%	3.50%

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

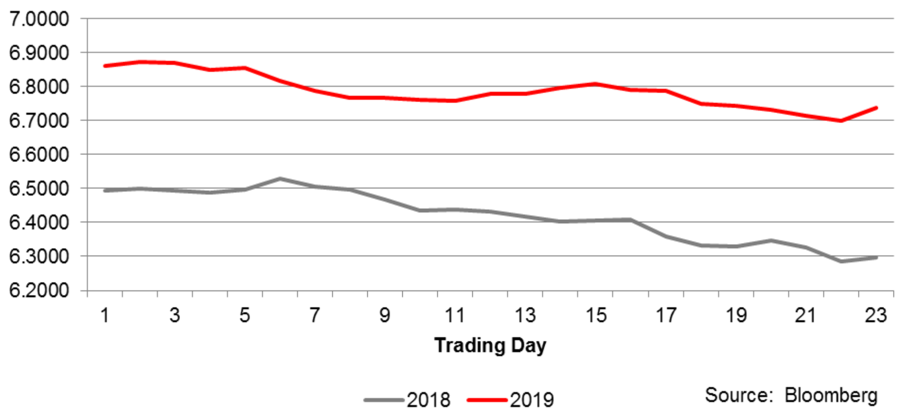
INTEREST RATE OUTLOOK

Credit problems still fester; "Chinease" won't solve them

Instead, credit problems are. We continue to expect credit events / accidents to resurface throughout 2019; unlike 2018, it won't only be a 2H problem. Out of sight does not mean solved. Meanwhile we continue to interpret recent monetary policy as "Chinease," leaving us with unease. One tell-tale example was PBOC's rush to get out a public denial to local press reports it had warned banks against reckless lending. Those cads! We've been generally suspicious that calls to lend to the private sector and SMEs are just a politically correct way to say lend, as authorities ignore the fungibility of credit in China. Voices are hinting shadow banking will be back this year and we've even received guidance as to how local government bond spreads should be priced (tighter, as if you needed to ask). Any pool of liquidity in a storm. There's also not so subtle advice in the form of newspaper commentators pushing for PBOC to cut RRRs four times again this year (it's already gone once). We were weirded out by the 1-day, CNY560bn money market injection – who needs such liquidity before Chinese New Year? We tweak up 7-day repo forecasts in response.

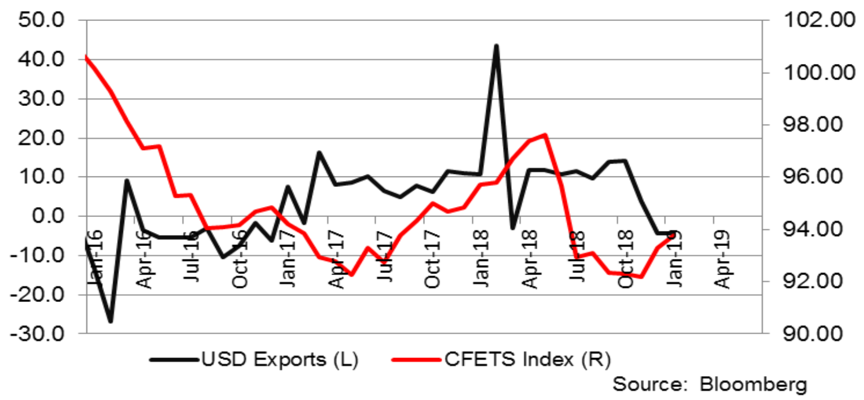
Once more, with feeling

USD/CNY: GROUNDHOG DAY



Currency movements seem counter-productive

CFETS VS. CHINESE EXPORT GROWTH



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