Chinese renminbi

	Spot close 28.02.19	Q1 2019	Q2 2019	Q3 2019	Q4 2019
USD/CNY	6.6868	6.6500	6.7000	6.7500	6.8500
USD/HKD	7.8497	7.8500	7.8500	7.8450	7.8450
		Range	Range	Range	Range
USD/CNY		6.6000-6.9000	6.6000-6.8250	6.7000-6.9000	6.7500-6.9500
USD/HKD		7.8300-7.8500	7.8200-7.8500	7.8100-7.8500	7.8000-7.8500

MARKET UPDATE

Fractionally stronger; record credit and lending

CNY strengthened fractionally in February, bringing YTD appreciation vs. USD to 2.6% as USD/CNY closed February at 6.6868 compared with January's London close of 6.7055. More notably, CFETS has completed a climb from 92 to over 95 over three months, a move likely tied to US-China trade negotiations. China reported record bank lending and aggregate financing in January, equivalent to 5% of GDP; but, please, don't anyone accuse them of "Chineasing."

OUTLOOK

China Inc. is very long China

Through a friendly client nudge and then corroborated around markets, we reacted to late-February Trade truce news by focusing more on market flows, where we think (to our surprise) foreign investors may remain *underinvested* into both Chinese equity and fixed income despite the feel-good narrative. *Viz.,* **China Inc. is very long China,** and waiting, frankly, to see if the rest of the world can be scared into joining in to help China Inc. out of its positions? If there are large capital inflows into China through Northbound Stock Connect and in preparation for China's inclusion into the Bloomberg Global Aggregate Index starting from April, why have monthly bank FX settlements for clients been so comparatively modest?!

We were wrong re tariff escalation as odds grow for Trump to accept a DINO

We bet wrong on a Big Trade War call. Trump's backing away from tariff escalation, previously implicit in our forecasts, means our USD/CNY projections have to be lower. The way Trump seemingly folded up his tent and gave away his bargaining leverage at the tariff deadline is making it more likely that ultimately he will declare victory even if it's only a DINO (Deal In Name Only). Trump told US state governors a Deal may come by the week of 11th March, but if he's given up leverage it's possible the Chinese side will push back in the final stages and lead to some delay. That's one sign it will be a DINO.

Too strong USD/CNY may make for awkward future currency diplomacy

There will be a currency component in any ultimate US-China Trade Deal and FX markets initially took that to mean USD/CNY has become a one-way bet (down, CNY stronger). But letting USD/CNY slide too far could leave China in an awkward starting point for future currency diplomacy, so we don't think China will go there. (Besides, authorities don't seem too fond of one-way bets.)

Fundamentals still matter

So we don't agree with the part of markets thinking we are at the end of President Trump's Trade War = 6.50 on USD/CNY ~ end 2017 levels, meaning all of 2018 is unwound. Instead, we are sticking with the fundamental views that China slowing + credit problems + possible future Fed changes all still matter in 2019. Our new forecasts are meant to convey not all 2018 will be unwound; that there will be romancing of a new currency stability pact in its first few months; but that by end 2019 you cannot camouflage everything, especially not credit problems.

	Interest Rate Close	Q1 2019	Q2 2019	Q3 2019	Q4 2019
Policy Rate	4.35%	4.35%	4.10%	3.95%	3.70%
7-Day Repo Rate	2.73%	3.00%	3.00%	3.00%	3.50%
5-Year Yield	3.03%	3.00%	3.05%	3.10%	3.20%

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

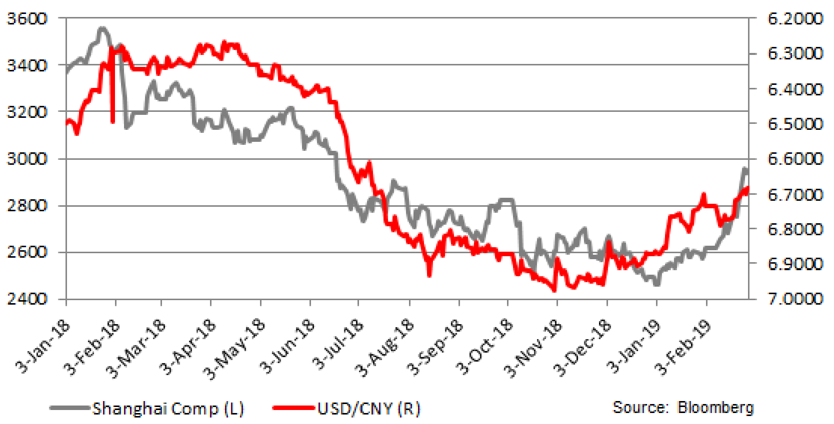
INTEREST RATE OUTLOOK

5% of GDP but, really, we're easing responsibly

China seems to be the only place in the world where you can pump in 5% of GDP's worth of credit *in a month* and then protest that you're not easing irresponsibly. To us, pretenses of not "Chineasing" have largely fallen by the wayside for now. Besides nosebleed credit/lending #s, shadow banking seems to be making a return (something we had hypothesized in November). YTD, 1,800 new trust products have been sold, the fastest such take-off since 2008, while January saw 22%YoY growth of bank-issued wealth management products. And after a year in which bond defaults may have nearly quadrupled (we may have earlier undercounted), banking system NPLs supposedly rose by only 5bp. We have built in expectations of -100bp of cuts to the official policy lending rate in the coming year. This is *not* an add to the "Chinease" above but should be mainly understood as a transition toward a new monetary policy guidance framework that will ultimately jettison this relic in favor of a money market rate corridor. There's still an RRR vs. interest rate cut debate but with #s like those above, one wonders why they bother?

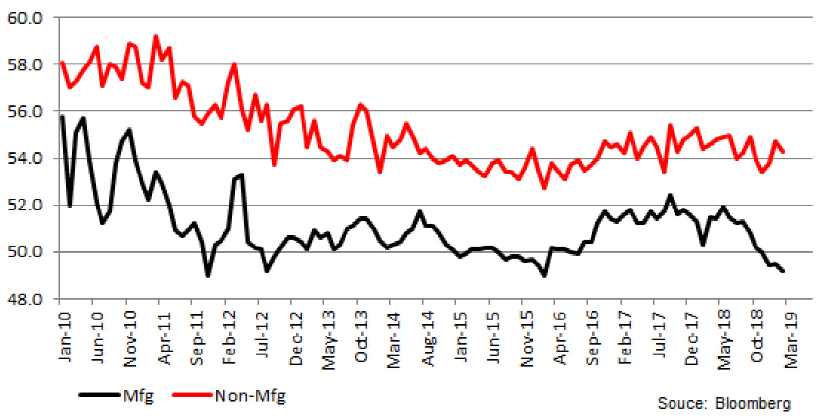
China is very long China

USD/CNY VS. SHANGHAI COMPOSITE



Stabilization pushed out to 2Q19 at earliest

CHINA'S OFFICIAL PMIS



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