Chinese renminbi

	Spot close 31.10.19	Q4 2019	Q1 2020	Q2 2020	Q3 2020
USD/CNY	7.0350	7.0000	7.0700	7.1400	7.2100
USD/HKD	7.8375	7.8300	7.8200	7.8100	7.8000
		Range	Range	Range	Range
USD/CNY		6.9500-7.1600	7.0000-7.1800	7.0700-7.2500	7.1400-7.3400
USD/HKD		7.7800-7.8450	7.7700-7.8300	7.7700-7.8250	7.7600-7.8250

MARKET UPDATE

Stronger; swine flu preventing lowering bond yields

The phase 1 announcement saw CNY strengthen 1.4ppt in October with USD/CNY falling from 7.1381 to 7.0350 in terms of London closes. PBOC allowed more market-determined trading of renminbi but had problems lowering bond yields.

OUTLOOK

Current levels of USD/CNY imply quite a bit of Tariff rollback

The announcement of a “phase 1” US-China trade agreement (by President Trump on 11 October 2019) captivated market sentiment and sent USD/CNY below its level when Trump announced his maximum Tariff escalation to date (23 August 2019). We think current levels incorporate an already rescinded threat to re-escalate 25% Tariffs to 30%, an expectation that 15% Tariffs on USD156bn of US imports from China will not be imposed on 15 December 2019, and even some expectation already imposed 15% tariffs on USD116bn of US imports will be lifted.

Even a deal with a small “d” seemed sufficient to ignite risk on

FX Markets seem in a forgiving mood (it’s notable onshore equities have been less enthusiastic). Though we feel certain what we will see out of phase 1 will be only a DINO, at present even a deal with a small “d” is deemed sufficient for Markets to turn risk on. Part of this is also a new version of the Powell put, whereby though the Fed has signaled it’s on hold it seems to have put a much higher bar against future rate hikes than future rate cuts (unless US inflation surprises to the upside).

DINO = ag goods + promises; the currency pact may not have teeth

What we expect out of phase 1: As already reported in the news, the Chinese to buy USD20bn of US ag goods in Year 1 and presumably another USD20-30bn in Year 2 to total the USD40-50bn promised by Trump. Past Chinese buying has always turned on price so the USD40-50bn level may become a future point of contention between the two sides. The Chinese will also make promises re IPR enforcement including promises to increase punishment. In China, such promises always boil down to implementation, including in the country’s fledgling IPR courts. Team Trump signaled a currency pact of sorts, said to be the strongest ever. That probably is not saying much because if it’s in line with USMCA strictures, there’s not much leverage over the Chinese. The Chinese agree to basic stability (a phrase they have used for more than a decade), defined in terms of CFETS. In mid-October CFETS suddenly weakened below the 91.5 level we had posited following 805, perhaps in anticipation of future American scrutiny.

But Tariffs may persist into 2020

In return the Chinese are pressing for Trump Tariff rollbacks, all of them if they can get them. Markets have priced in quite a bit on this and may eventually be disappointed. Our expectation is for most Trump Tariffs to persist into 2020, which will continue to hamper Chinese exports, including those to the US. Trade uncertainties will eventually force large MNCs to redeploy a part of their China supply chain abroad, leading to outward capital movements that may amount to USD10-50bn next year and offset expected portfolio inflows.

MUFG

	Interest Rate Close	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Policy Rate	4.35%	4.35%	4.35%	4.35%	4.35%
7-Day Repo Rate	2.80%	3.00%	3.10%	3.20%	3.00%
5-Year Yield	3.06%	3.15%	3.25%	3.00%	3.00%

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

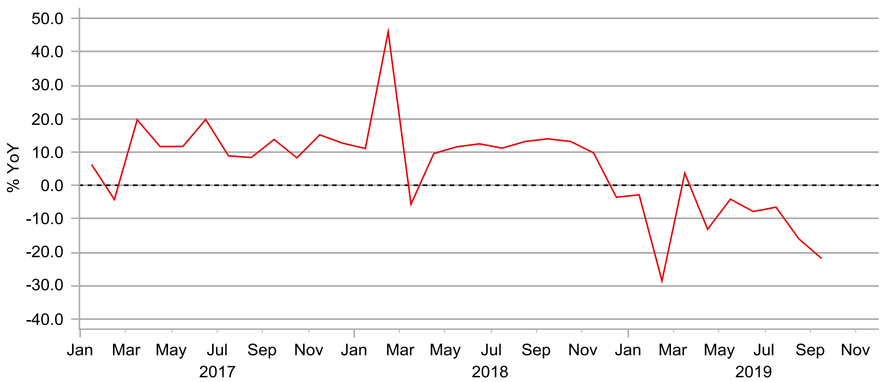
INTEREST RATE OUTLOOK

Even faster pork price inflation will keep a floor under bond yields

China's economy continues to slow, and we expect an additional tell-tale marker of an unsatisfying DINO will be the inability of phase 1 to reignite the Chinese economy, though many will romance the notion. One should look to see if either overall Chinese export growth or export growth to the US rebound. Continued sluggishness in the economy is a difficult backdrop against a wall of local government and property developer debt that falls due in 1H20. Though we hadn't highlighted this lately, we continue to expect additional credit events to roll out as we finish 2019 and transition into 2020. A recent Bank of Jinzhou decision to skip coupon payments to offshore creditors is an example. Food price inflation continues to surge and should keep headline CPI well above a 3% floor to finish 2019. That has made it difficult to lower rates as bond yields begin to move up. More expert pig husbandry views than ours suggest China's herd won't grow but shrink in 1H20, so we maintain that CPI inflation will remain elevated into 1Q20. Nonetheless PBOC brought back the Pledged Supplementary Lending Facility and will do TMLFs this quarter.

Trump finally got what he wished for

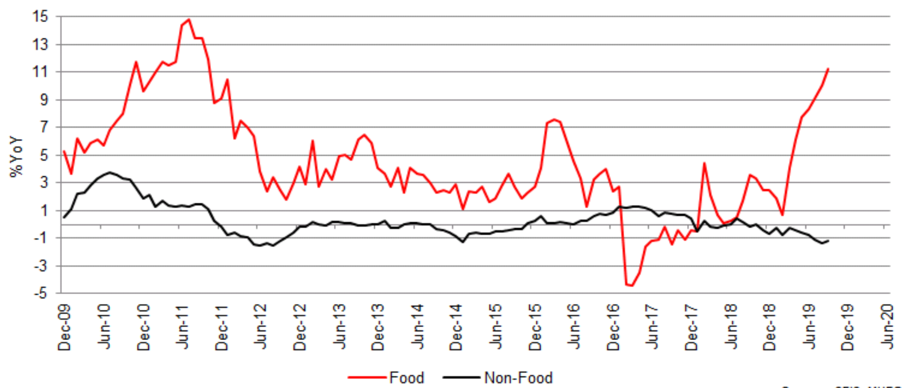
CHINA EXPORT GROWTH TO THE US



Source: Bloomberg & Macrobond

We probably still haven't peaked

CHINA: PORK PRICES CONTINUE TO DRIVE UP CPI INFLATION



Source: CEIC, MUFG

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