Chinese renminbi

	Spot close 31.12.19	Q1 2020	Q2 2020	Q3 2020	Q4 2020
USD/CNY	6.9662	7.0700	7.1400	7.1750	7.2100
USD/HKD	7.7864	7.8000	7.7900	7.7800	7.7700
		Range	Range	Range	Range
USD/CNY		6.8500-7.1000	6.9500-7.2000	7.0500-7.2500	7.1000-7.3000
USD/HKD		7.7650-7.8250	7.7650-7.8150	7.7600-7.8100	7.7500-7.8000

MARKET UPDATE

Small depreciation; interest rates fall a little

Over 2019 CNY depreciated by a small amount, 1.4%, against USD, but it was really a tale of two halves as USD/CNY crossed above 7 on 805 (something we predicted) without engendering a subsequent market panic. USD/CNY troughed at 6.6689 in March and peaked at 7.1854 in August. CFETS weakened 1.8% to 91.84 from the last official read of 93.28 in 2018. Starting in 2020, CFETS will be rebased with 2018 trade weights. The 91-mid level we thought authorities might be targeting is now around 93-mid. Interest rates fell a little in China despite PBOC protestations of prudency (something of a Fan Dance).

OUTLOOK

Short-term in renminbi but should not last more than a quarter

Mr. Market seems to have begun 2020 with a bias for stronger renminbi. Though we keep the last 1Q20 USD/CNY target of 7.07, as mentioned in the *Global Markets Monthly* we can't rule out occasional CNY strength (though we expect such episodes to last less than a quarter). There's a seasonality for USD/CNY to dip in January, but we are watching to see if PBOC will let markets be more decisive. We're cautious on further strength partly because markets may be counting their chickens before hatching, both for global growth and for US trade policy (where they may have drunk the Kool-Aid; see our CNY Theme article.)

Unvarnished faith in stimulus, but Chinese fiscal policy is more tapped out than appreciated

A good part of unvarnished optimism is based on hopes for stimulus, with the general thesis that since Asian nations are high savers, they can stimulate at will. And since China has the highest saving rate, *a fortiori* Chinese stimulus will float all boats. But you have to wonder why PBOC and the State Council have been so cautious in recent years about stimulus? There is a narrow focus in optimistic views on single-period budget constraints (even here China's official deficit is underestimated; IMF adjustments would push the central government deficit up from a commonly reported 3-4% to closer to 10%). But the government in China (like the government in Japan) may really (and properly) be concerned about multi-year budget constraints. Our continued focus on China's debt burden (see last year's theme article) is relevant here. A recent *New York Times* article, eg, on the swine flu noted the inability of local governments to pay in full compensation to pig farmers because of debt. Fiscal stimulus is more tapped out in China than is commonly appreciated.

Monetary stimulus can't do it alone and This Runner Will Tire Again

All this is supposed to produce upside surprises for the economy. We do think it's reasonable to note the OECD's composite leading indicator for China bottomed in March 2019, but we wonder how CLIs will behave in debt-burdened economies? In Summer 2013, we pointed out Chinese stimulus doesn't seem to work till both monetary and fiscal stimulus are used. But we pointed out above fiscal stimulus is more tapped out than commonly appreciated. Monetary stimulus won't be able do it alone, principally because much of it goes towards refinancing and not new projects. In 2015 we thought the refi proportion might be 2/3; these days it might be 3/4.

	Interest Rate Close	Q1 2020	Q2 2020	Q3 2020	Q4 2020
MLF 1Y	3.25%	3.20%	3.10%	2.95%	2.80%
7-Day Repo Rate	3.00%	2.75%	3.00%	3.00%	3.00%
5-Year Yield	2.92%	2.95%	2.95%	2.95%	2.95%

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

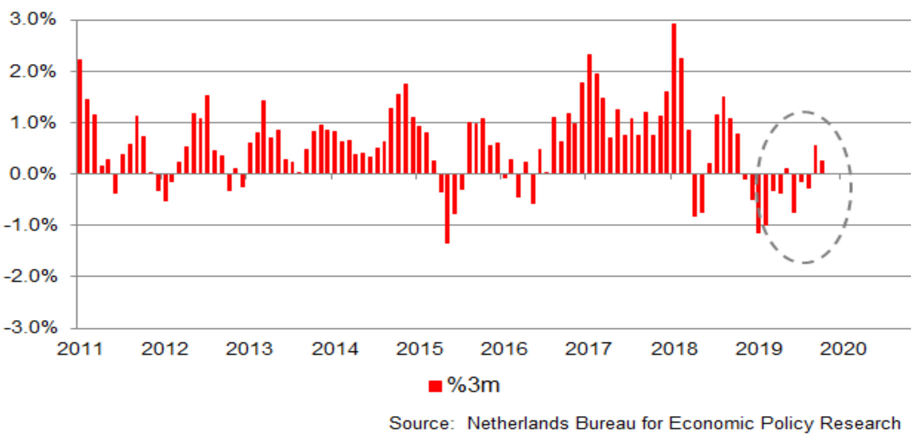
INTEREST RATE OUTLOOK

Pork prices may peak in 1Q20 but stay high another quarter, frustrating PBOC efforts to lower rates; 2H20, however, should see more LPR and MLF falls

PBOC occasionally flooded onshore markets in 2019 with liquidity but failed to lower bond yields much. We're still not fully confident pig price inflation onshore is under control. We think they would peak in 1Q20 but thereafter prices could remain high for another quarter. That will delay and frustrate PBOC's ongoing campaign to lower rates to facilitate refinancing. The global rates backdrop seems about as supportive as it can be for a nation seeking to refi, but as onshore rates drop we note the interest support for the currency will weaken. PBOC signalled continued easing with a January RRR cut that was expected. A decade or so of cuts has yet to dissuade Mr. Market from greeting each cut as if it was the Second Coming of the Chinese economy. We know of no empirical evidence such RRR cuts have had much real effect (not even to drive banks to become more efficient, which is a standard reason to cut RRRs in the first place). In many ways efforts to goose down rates and yields become an accounting exercise – something to keep the debt daisy chain from unravelling.

Waiting for trade recovery

WORLD REAL TRADE MOMENTUM (THROUGH OCTOBER 2019)



Waiting for growth recovery

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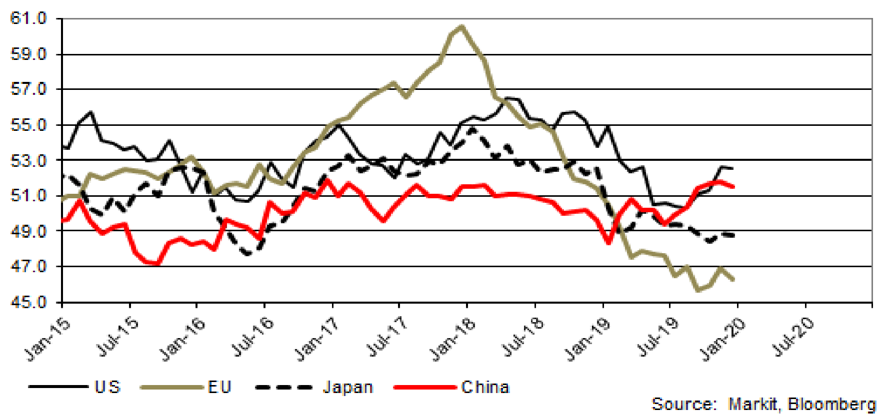

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