Chinese renminbi

	Spot close 30.04.20	Q2 2020	Q3 2020	Q4 2020	Q1 2021
USD/CNY	7.0629	7.1000	7.0000	7.0500	7.0000
USD/HKD	7.7517	7.7500	7.7500	7.7500	7.7800
		Range	Range	Range	Range
USD/CNY		6.9000-7.2000	6.8000-7.1000	6.9000-7.1500	6.9000-7.1500
USD/HKD		7.7500-7.7800	7.7500-7.7800	7.7500-7.7800	7.7500-7.8500

MARKET UPDATE

Stronger; PBOC accelerates MLF, LPR rate drops

The yuan ended April with a small gain as USD/CNY fell from 7.0825 to 7.0629 in terms of London closes. Following an early hint from a 7-day reverse repo rate drop in March, both MLF and LPR fell by the same -20bps, faster than our expectations.

OUTLOOK

Working through debt refi means a continuous USD, HKD demand

As China works through a massive year of debt refinancing, made far much more difficult by the COVID-19 outbreak, we look for continuous USD and HKD demand in 2Q20, marked by the occasional surge. We still maintain a slow grind higher in USD/RMB. Should global capital markets reopen by 3Q, China Inc. will rush in to complete its 2020 refi, which would be consistent with a stronger currency then, too.

We hope for the best but prepare for the worst = wide ranges

As economies globally prepare to exit lockdowns following China's earlier efforts, our general playbook is to hope for the best but prepare for the worst. China was the location of an early clinical trial of Remdesivir that did *not* show a therapeutic benefit, but we still judge this drug may help to lop off the worst of death tolls ahead. But it's not the game-changer some hope for. And due to the volatility of drug trials (as well as volatility coming from greed eager to tout advances), we leave forecast ranges wide in case of future disappointment, even as we hope against it.

The science suggests a return of COVID-19 in some form

We will, however, follow the science wherever we can, and that means building in expectations for some form of COVID-19 return in 4Q20 of an unknown ferocity. In forecasting we are *not* assuming a return to widespread global lockdowns, but admit this depends on the extent of any future return and whether an effective vaccine is available by then. Though work at Oxford could deliver by September, we assume a game-changer vaccine is still a 2H21 event.

China is a precursor to the rest of the world

What does make sense to do on the macroeconomic front is to treat China as a precursor. And what that has shown so far is that while locking down might be rapid, unlocking is proving to be a gradual process. In May, even as domestic demand normalizes China will still suffer from weak net exports due to the collapse of global demand. In that, Chinese trends will match up with those in its Northeast Asian neighbours of Taiwan, Korea and Japan. Though China's PMIs are in the same range as those reported by other locked down nations, its GDP will probably be significantly stronger because we think 1Q20 growth was fudged higher. The veracity of Chinese statistics is under intense scrutiny due to COVID-19, where some have suggested Chinese deaths may have been undercounted by 16 times and infections by 35 times.

Less interest rate support for the renminbi in the future

More rapid interest rate decreases undertaken in China may have been done on the premise of greater currency stability, but it also means less interest rate support for the renminbi in the future.

	Interest Rate Close	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Loan Prime Rate 1Y	3.85%	3.65%	3.45%	3.15%	3.15%
MLF 1Y	2.95%	2.75%	2.55%	2.25%	2.25%
7-Day Repo Rate	1.93%	1.75%	1.55%	2.00%	2.00%
5-Year Yield	1.76%	1.80%	1.60%	2.05%	2.05%

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

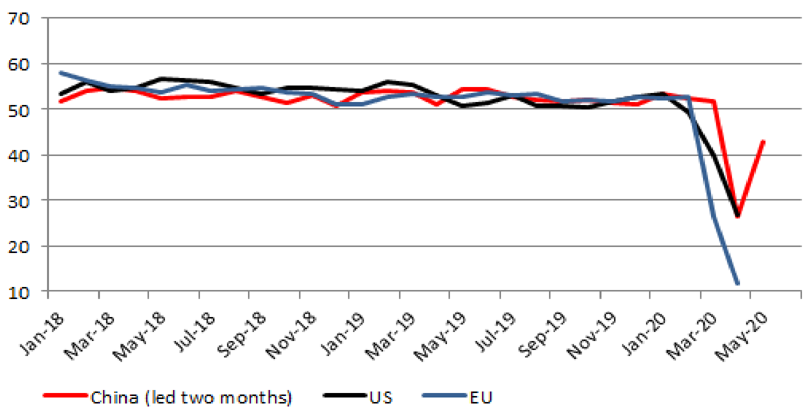
INTEREST RATE OUTLOOK

Lower rates, faster; and more bond issuance

Faster interest rate cuts, of course, may also signal greater concern over a weak economy, including in the real estate sector (where prices, implausibly, rose in both February and March). Front-end money market rates collapsed, we thought, to encourage bond buying and arbitrage a steeper yield curve. Local governments may double to CNY4trn issue of special bonds this year. Real estate developers appear to have gotten away CNY80bn of issuance through April. Credit problems laid bare by COVID-19 may have also laid bare the lack of a true credit culture in China, which matters to institutional investors. Central government management of its debt workout saw a prominent private conglomerate criticized for favouring only large strategic stakeholders. Another provincial issuer may have cut off communications with foreign investors about a haircut. While a third tried to unilaterally change a coupon payment without buy-in from its bondholders (it backed off in the end). China defaulted on CNY142bn of bonds last year.

COVID-19 has hurt services the most

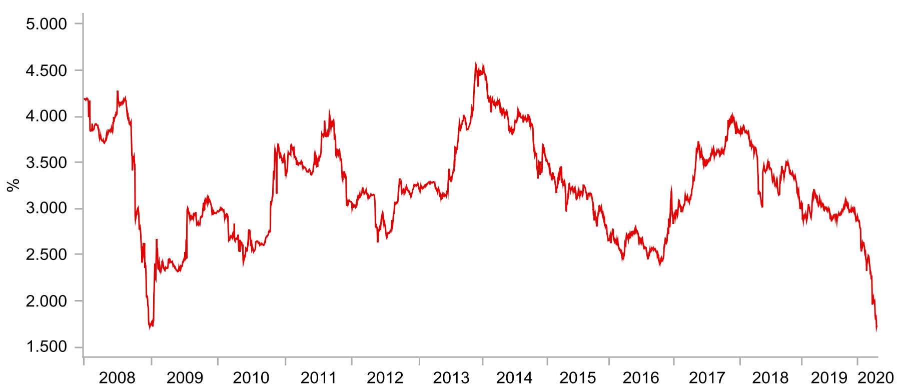
CHINA SERVICE PMI LEADS THE REST OF THE WORLD



Source: MUFG GMR

Should break below the GFC trough

CHINA 5-YEAR GOVERNMENT BOND YIELD



Source: Bloomberg & Macrobond

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