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Highlights

- **Markets occasionally treat US President Trump on trade as a paper tiger, but that is not the case in Beijing, as a stronger currency is again proffered as an olive branch to Americans**
- **Such time-worn tactics may be a harder sell as US business attitudes harden, and it could take up to a decade to resolve Section 301**
- **USD/CNY forecasts are brought down, albeit retaining an upward trajectory, based on expectations of moderating growth, widening credit spreads and interest rate differentials**
- **CNY denominated crude oil futures started in late March with positive sentiments which some global commodity giants joined trading, apart from domestic state-owned giants. Perhaps, it'll be the third global price benchmark**

CNY: Review and Outlook

Trader Color. Onshore USD buying interests remained strong in the first half of March as well as February, while selling needs started to appear in the remaining half, as some corporations must complete USD selling operation before the end of Q1. Momentum-wise, USD/CNY looked weak and struggled to maintain the 6.2500 level without a bullish USD. CFETS RMB index was around the historic high level, which would probably be seen as a ceiling by the Chinese authorities. So, if USD goes up for some reason, USD/CNY may eventually rise. On the swap front, the expected policy divergence between Fed and PBOC resulting in a narrower rate spread between USD and CNY has driven the swap curve down a lot.

Stronger; tiny hike in OMO rates achieved. Renminbi traded mostly within a narrow range till a spurt of late-month strengthening left USD/CNY at 6.2904 compared with February's London close of 6.3335. CFETS had been also weaker till late but ended a little stronger. PBOC made the tiny +5bp hike to RRP and SLF rates it signalled in February, the mildest possible reaction to Fed hike #6. Markets expect another +5bp reaction in 2Q18 to hike #7.

US-China trade seems prime driver for Chinese exchange rate policy. A 2-day sprint down in USD/CNY broke our 1Q18 lower bound and also the 6.25-6.36 range discussed last month (lo = 6.2418). Just as elections seem to be playing an inordinate role in US President Trump's decisions, the nearest proximate motivator for recent Chinese exchange rate management may be US-China trade tensions. Upcoming trade/investment talks seem complicated and we think it could take a decade for Section 301 talks to conclude. Along the way, an even stronger currency plus official dominance in renminbi markets bring down levels of USD/CNY forecasts but we retain an upward trajectory. We have 6.34 at 2Q18, but suffice to say we're not expecting a straight line.

We remain watchful for export moderation and a smaller growth contribution from net exports. The official lean now seems to be for growth to moderate very gradually and capital outflow controls to be loosened very, very gradually, which implies a small bias to the upside for USD/CNY if Big Dollar is stable. If last year's growth was due to credit, and if corralling risks means a credit squeeze, logically growth should slow. That's one reason for a weaker currency. We remain watchful for moderation in Chinese export growth rates as very good global growth moderates and may have driven commodity prices lower. A trade surplus shrinkage should be joined by more overseas tourist spending amid a stronger CNY, leading a smaller contribution to growth from net exports. Property sales and construction in some parts of the country shows retreat, and prices may decline if smaller developers are forced to clear inventory. If authorities decide they can't countenance slower growth and turn credit taps back on, that worsens the already heavy debt problem and provides another reason for the currency to weaken.

Actual tariffs = stronger USD? Finally, though nowhere in markets yet, should tariffs be actually implemented, the best trade/macro models we know of would suggest USD could even strengthen.

Interest differentials will play a bigger role and credit spreads have widened. As Fed normalization progresses, US-China interest differentials should play a bigger role in FX/rates from 2H18; attractions of holding USD will increase, so PBOC hikes in 1Q19. It's still 2018 and not 2013 for the capital account, as a stable currency co-exists with what still looks like USD30-50bn of flow out of the country every month. That pace may matter more if the trade surplus shrinks. Safe haven government bond yields have indeed declined as posited in January, but towards Fed hike #7 in June there may be a limit to official nudging. There remains much to refinance, eg CNY800bn+ of puttable bonds this year and even more next year. Onshore credit spreads have already returned to near-record wides, happening faster than what we'd expected. Our 4Q18-1Q19 currency forecasts assume continuation of a murky, non-transparent workout of bad debts in the system. We would consider changing forecasts if there is more transparency; alternatively, no transparency is a bad sign.

CNY: Onshore RMB

CNH: Offshore RMB

CNY Snapshot						9-Apr-18						CNH Snapshot						9-Apr-18					
Tenor	Last			Last Month Range			Tenor	Last			Last Month Range												
	Bid	Ask	Mid	Min	Max	Bid		Ask	Mid	Min	Max												
Fix			6.3114	6.2785	6.3451	Fix			6.3055	6.2491	6.3597												
Spot	6.2955	6.2970	6.2963	6.2418	6.3622	Spot	6.2930	6.2934	6.2932	6.2359	6.3686												
O/N	-4.80	-4.80	-4.80			O/N	-1.00	2.00	0.50														
T/N	-4.62	-4.62	-4.62			T/N	0.00	2.00	1.00														
1W	4.70	5.25	4.98			1W	1.46	5.96	3.71														
1M	42.94	43.70	43.32			1M	44.71	57.71	51.21														
2M	88.70	96.70	92.70			2M	121.96	134.71	128.33														
3M	141.20	145.70	143.45			3M	181.51	191.91	186.71														
6M	278.70	281.70	280.20			6M	363.71	393.71	378.71														
9M	411.20	411.20	411.20			9M	538.71	588.71	563.71														
12M	533.70	533.70	533.70			12M	726.21	758.71	742.46														
2Y	1068.70	1093.70	1081.20			2Y	1513.71	1563.71	1538.71														
3Y	1983.70	1993.70	1988.70			3Y	2243.71	2443.71	2343.71														

CNY Curve										9-Apr-18		
Tenor	Outrights (mid)			Implied Rates (% mid)			NDS					
	Onshore DF	NDF	Diff (pips)	Onshore DF	NDF	Diff (%)	Bid	Offer	Mid			
Spot	6.2963	6.2963										
O/N	6.2964											
T/N	6.2964											
1W	6.2974	6.2990	-16.23	3.2976	4.9113	-1.6138						
1M	6.3012	6.3065	-52.88	3.3347	4.2822	-0.9476						
2M	6.3062	6.3175	-113.50	3.3074	4.2904	-0.9830						
3M	6.3112	6.3265	-152.75	3.3212	4.2541	-0.9330						
6M	6.3249	6.3485	-236.00	3.3000	4.0316	-0.7316						
9M	6.3380	6.3675	-295.00	3.3181	3.9638	-0.6457						
12M	6.3503	6.3910	-407.50	3.3413	3.9547	-0.6134	4.45	4.65	4.55			
2Y	6.4050	6.4695	-645.00	3.4278	3.9553	-0.5275	4.10	4.30	4.20			
3Y	6.4958	6.5430	-472.50	3.6908	3.9292	-0.2384	4.10	4.30	4.20			

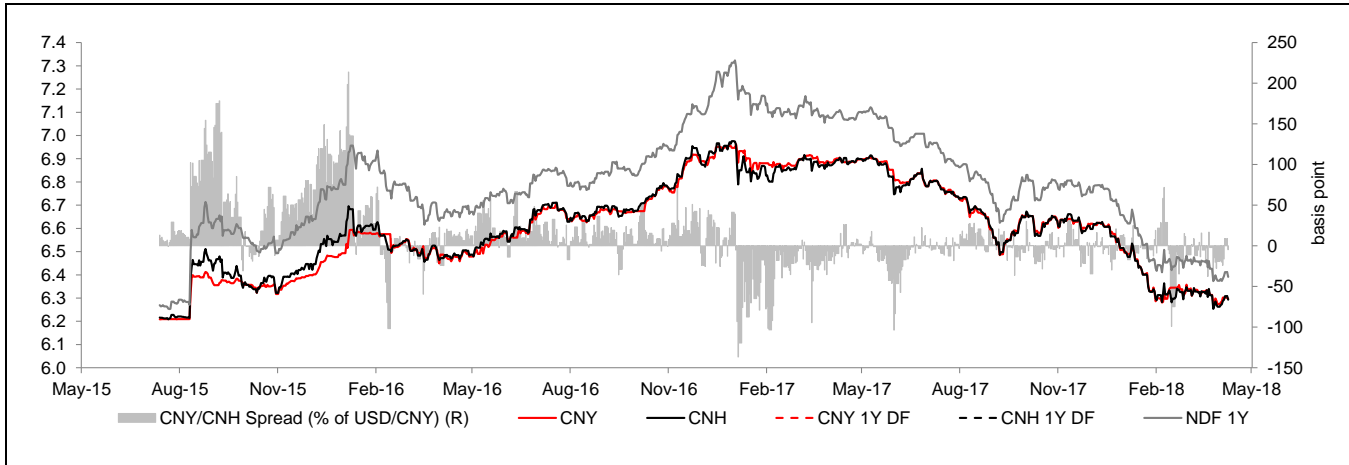
CNH Curve										9-Apr-18		
Tenor	Outrights (mid)			Implied Rates (% mid)			CCS					
	Offshore DF	NDF	Diff (pips)	Offshore DF	Depo	Diff (%)	Bid	Offer	Mid			
Spot	6.2932	6.2963										
O/N	6.2933											
T/N	6.2933											
1W	6.2942	6.2990	-48.00	3.1487	2.7500	0.3987						
1M	6.2990	6.3065	-75.50	3.4314	3.5000	-0.0686						
2M	6.3067	6.3175	-108.38	3.6027	3.7500	-0.1473						
3M	6.3125	6.3265	-140.00	3.5579	3.8500	-0.2921						
6M	6.3317	6.3485	-168.00	3.5689	3.9000	-0.3312	3.80	3.95	3.87			
9M	6.3502	6.3675	-173.00	3.5944	4.3000	-0.7056	3.88	3.98	3.93			
12M	6.3681	6.3910	-229.25	3.6356	4.4000	-0.7644	3.91	3.96	3.94			
2Y	6.4477	6.4695	-218.00	3.8206			3.95	4.01	3.98			
3Y	6.5282	6.5430	-148.00	3.9121			3.96	4.02	3.99			

USD/CNY Onshore						USD/CNH						USD/CNY Offshore					
Implied Volatilities (in %) 9-Apr-18						Implied Volatilities (in %) 9-Apr-18						Implied Volatilities (in %) 9-Apr-18					
Tenor	Mid					Tenor	Mid					Tenor	Mid				
	ATM	Score	25C	25P	25DRR		ATM	Score	25C	25P	25DRR		ATM	Score	25C	25P	25DRR
1W	3.92	-0.38	4.17	4.15	0.02	1W	4.92	0.22	5.17	4.94	0.23	1W	4.62	-0.25	4.87	4.66	0.21
2W	3.97	-0.31	4.24	4.19	0.05	2W	4.95	0.17	5.23	4.97	0.26	2W	4.72	-0.04	4.97	4.71	0.26
3W	4.03	-0.59	4.30	4.25	0.05	3W	4.86	0.39	5.18	4.86	0.33	3W	4.52	-0.80	4.81	4.49	0.32
1M	4.03	-1.15	4.29	4.24	0.05	1M	4.97	0.12	5.30	4.97	0.34	1M	4.86	0.03	5.14	4.86	0.28
2M	4.10	-1.16	4.40	4.34	0.06	2M	5.04	-0.12	5.41	5.03	0.38	2M	4.92	-0.10	5.26	4.90	0.37
3M	4.12	-1.45	4.42	4.36	0.07	3M	5.14	-0.06	5.56	5.13	0.44	3M	5.00	-0.17	5.41	4.97	0.44
6M	4.28	-2.11	4.57	4.50	0.07	6M	5.34	-0.32	5.87	5.32	0.55	6M	5.20	-0.39	5.70	5.16	0.55
1Y	4.46	-1.74	4.59	4.41	0.18	1Y	5.67	-0.50	6.38	5.59	0.79	1Y	5.50	-0.92	6.13	5.42	0.71
18M	4.78	0.24	5.42	5.05	0.37	18M	5.87	-0.91	6.69	5.77	0.91	18M	5.72	-1.22	6.51	5.63	0.88
2Y	4.91	0.08	5.64	5.18	0.46	2Y	6.01	-0.70	6.87	5.87	1.00	2Y	5.85	-1.06	6.72	5.74	0.98

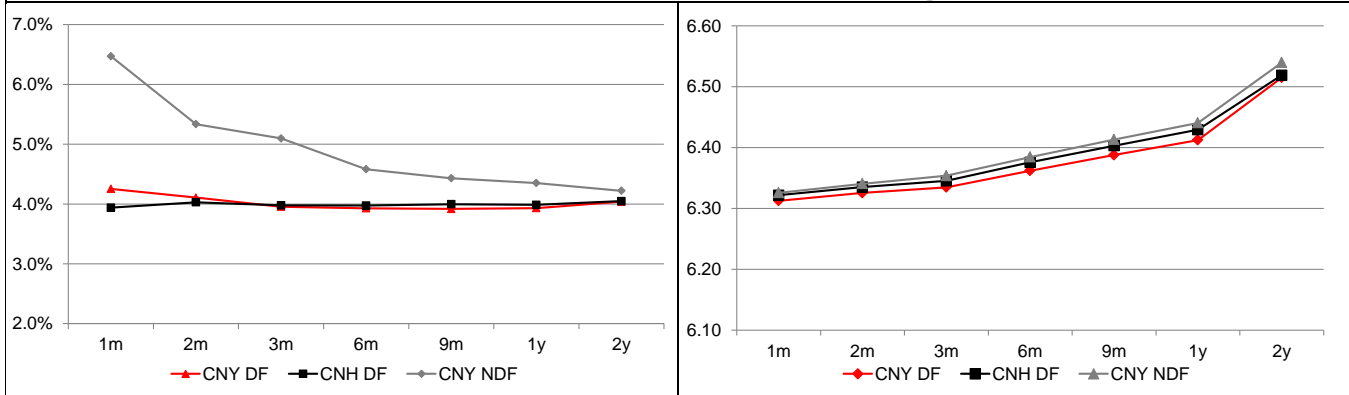
Source: Bloomberg, MUFG Bank

CNY: Onshore RMB

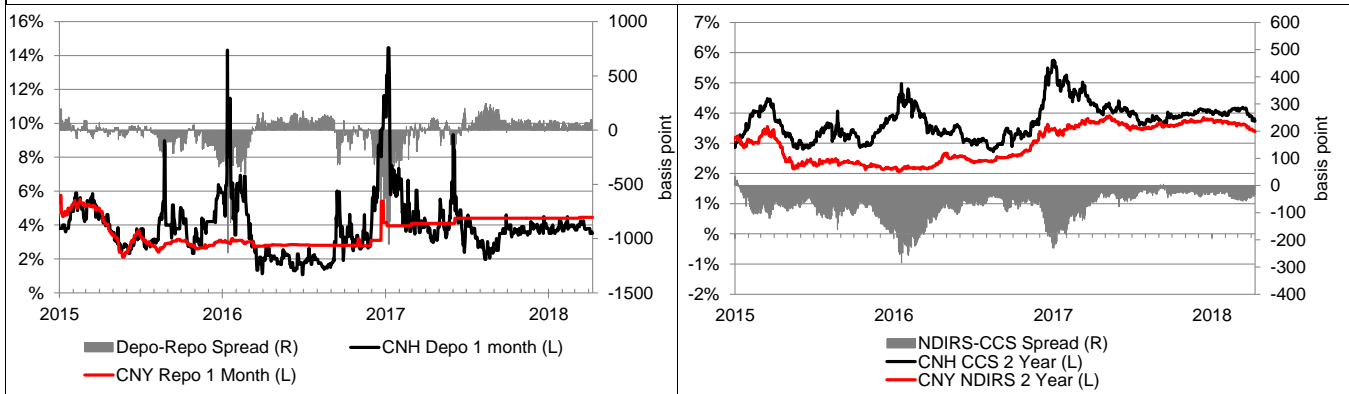
CNH: Offshore RMB



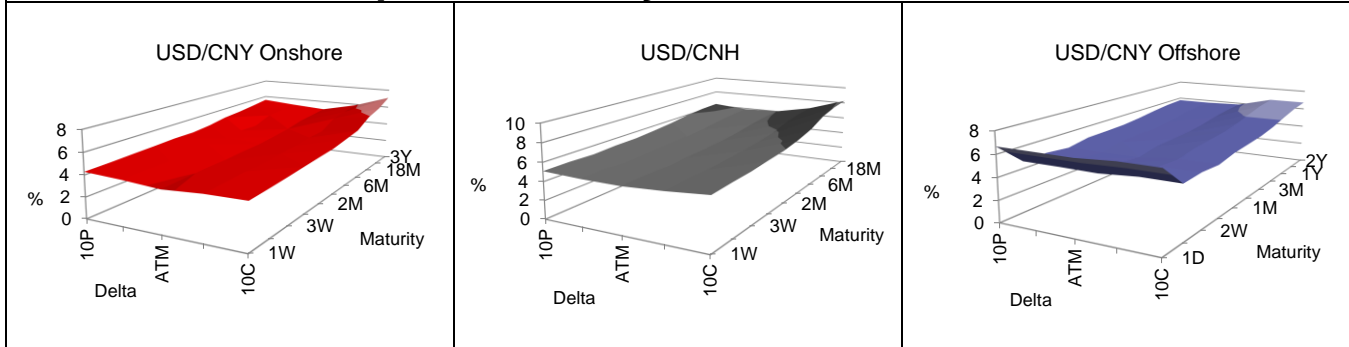
RMB Curve: Rates vs. Outrights



RMB Rate: Offshore vs. Onshore



RMB Implied Volatility: Offshore vs. Onshore



Source: Bloomberg, MUFG Bank

OUR LATEST FORECAST: CNY AND CNH

	Spot close 29.03.18		Q2 2018	Q3 2018	Q4 2018	Q1 2019
USD/CNY	6.2904	Our forecast	6.3400	6.3900	6.4500	6.5300
		Forward price	6.3187	6.3414	6.3625	6.3806
USD/CNH	6.2716	Our forecast	6.3400	6.3900	6.4500	6.5300
		Forward price	6.3096	6.3283	6.3471	6.3647

Source: Bloomberg, MUFG Bank

CNH: Review and Outlook

Trader Color. Spot CNH had been trading in a tight range until the final week of March. The pair broke the previous range of 6.30/6.35 and collapsed down to the 6.24 level. Buying flow was not sufficient to support the pair, and stop-loss order triggered made the spot CNH well capped by 6.30. The curve was down to 900 from 1200 handle after FOMC rate hike, while PBOC OMO only increased 5 bp, pushing down the curve in the light of ample liquidity. Tomorrow next (TN) forwards traded at 1.5/2 pips per day which made the curve all flat.

Products. Crude oil futures (denominated in CNY) started to trade on Shanghai International Energy Exchange on 26 March 2018, a milestone for RMB internalization. The countries along the route of the Belt and Road initiative, especially for those with financing and debts in RMB, and the oil-exporting countries, would now have an option to trade CNY oil futures. Global and Chinese oil companies can use CNY crude oil futures when hedging, to avoid exchange rate risks in trade, thereby slashing costs. Some global commodity giants, such as Glencore, Trafigura, Freepoint Commodities and Mercuria were among the first to trade this new contract¹, in addition to domestic state-owned oil corporates. Markets also showed optimism, expecting CNY crude oil futures to become a third global price benchmark alongside Brent and WTI crude. Yet, the conventional oil hedging practice which hedging is tied to a storage place that is close to the producing region (e.g., Brent oil for the North Sea and WTI for Cushing) could make it hard for CNY crude oil futures to penetrate the market.

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¹ [Shanghai crude futures roar into action as global merchants dominate trade](#), 26 March 2018, Reuters