Chinese renminbi

	Spot close 31.07.18	Q3 2018	Q4 2018	Q1 2019	Q2 2019
USD/CNY	6.8255	6.9500	7.0000	7.0000	7.0500
USD/HKD	7.8487	7.8450	7.8350	7.8250	7.8150
		Range	Range	Range	Range
USD/CNY		6.6000-7.0000	6.7000-7.0500	6.7000-7.0500	6.7500-7.1000
USD/HKD		7.8000-7.8500	7.8000-7.8500	7.8000-7.8500	7.7900-7.8400

MARKET UPDATE

CFETS plummets; full loosening mode

CNY underwent a second month of extraordinary weakness as USD/CNY climbed from 6.6246 to 6.8255 in terms of London closes; though bilateral weakening was less than the month prior, CFETS plummeted more steeply by more than 3%. Authorities seem to be in full loosening mode (below). The two are connected.

OUTLOOK

Credit deterioration onshore appears to be emerging as a further factor for renminbi weakening

Heuristically, the third of three factors for renminbi weakening we have highlighted for 2018 – credit deterioration (others being slowing growth and a narrowing interest advantage to the US) – seems out of sight but may have been the main factor at play in July, judging by official reactions of loosening. Money market conditions and the disposition of the CNY/CNH curve (at times short forward points were *negative*) mean authorities are paying traders to buy USD. As long as policy is oriented in this fashion we keep forecasted USD/CNY levels rising.

All hands on deck to promote growth

As discussed above, the most noticeable move in exchange rates during July was not in USD/RMB but in the basket. The plummet of CFETS put paid to an earlier guess authorities would be happy with a 94-97 range for all 2018. We're fond of saying all Chinese officials have only one goal, which is growth. When growth is threatened, all hands are on deck to push it back up. The last stage of the recent CFETS drop, from mid-June onwards, is *not* a general USD phenomenon, so it's hard not to read it as anything but a purposive anti-Trump trade move by the Chinese. Adding up USD and HKD weights in the CFETS basket, the plummet so far would seem enough to negate eventual US tariff levels of about 20% on Chinese products. August ends with a deadline for US President Trump to decide whether to escalate in the next stage of the Section 301 tariff/intellectual property war. His mercurial nature means two-sided risk for USD/CNY.

Fiscal stimulus is monetary stimulus

In the Summer of 2013 we had written monetary stimulus in China nowadays seems only to work if accompanied by fiscal stimulus. We doubt that lesson has been lost. Though smoke screens are up about "quality" infrastructure, at this stage we think any infrastructure will do (any port in a storm). Despite a month of record depreciation (in CFETS terms), property developers seemed all the *more* eager to take on USD debt.

Infantile data should be ignored

Meanwhile data quality problems have come home to roost. Authorities are finally fessing up to ridiculous problems with industrial profits. For some time we'd realized claimed profit growth rates did not match up with previously reported profit levels, and now the explanation is proffered that past data is extensively massaged in terms of composition. Investors may not be aware of the extent of this massaging. For a monthly total profits of, say, between CNY600-750bn, the massaging implies some CNY100bn might be massaged away (so the subsequent year shows healthy growth), making the data useless. This has been going on for some years.

	Interest Rate Close	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Policy Rate	4.35%	4.35%	4.35%	4.35%	4.35%
7-Day Repo Rate	2.67%	2.75%	3.00%	4.25%	4.50%
5-Year Yield	3.17%	3.50%	3.60%	3.60%	3.90%

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

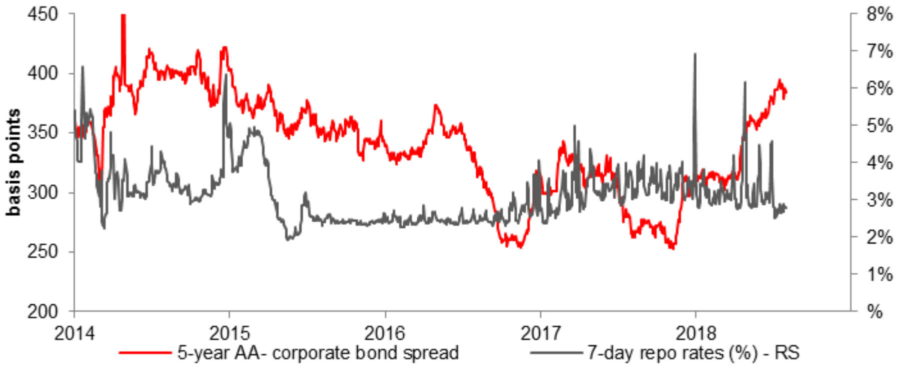
INTEREST RATE OUTLOOK

Throwing caution to the winds

It was hard for us to shake the impression over July that China's persistent struggle to refinance troublesome debts may have ratcheted up to a greater level of urgency, maybe even one of desperation, as authorities threw caution to the winds. From the very top came directives to local governments to hurry up and start issuing bonds! PBOC accompanied that with a massive CNY502bn MLF injection and rigged rules so banks can allocate funding toward *lower*-rated bonds despite credit risks. With our expectation of another RRR cut before 3Q18 is out, the green light for credit will continue. A clear shift in policy direction means we take out any thoughts of PBOC hiking despite the Fed. Ample liquidity meant all short rates on- and offshore collapsed (including government deposit auction rates). The current policy shift has further narrowed 10-year yield differentials to US Treasuries in a month when Treasuries stabilized, but we don't expect that to last forever.

Pushing on a string

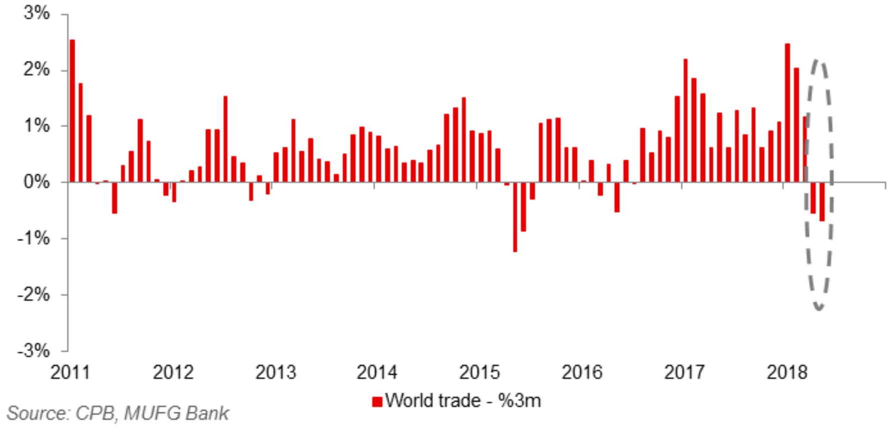
CHINA: LOWER RATES, HIGHER CREDIT SPREADS



Source: CEIC, MUFG Bank

Courtesy of Mr. Trump?

WORLD REAL TRADE MOMENTUM MAY BE FLAGGING



Source: CPB, MUFG Bank

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