

USDRMB & CFETS RMB Index

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Amidst worsening Chinese fundamentals and net capital outflows, we think the US/China trade impasse is a long way from being rectified. PBoC has started to bleed reserves again. While this puts a brake on RMB weakness, it also suggests that net capital outflows are becoming more persistent. RMB rates are set to remain subdued as China aims to backstop economic growth. We expect a move in USDCNH to 7.06 in 3M as the US tariff deadline approaches. We expect the big dollar to turn south around mid-year, dragging USDCNH back down to 6.78 on a 1Y horizon.

Variable	1m	3m	6m	9m	12m
CFETS RMB Index (change from today, %)	0.00	-1.75	-1.55	-1.15	+1.51
USDCNY spot FX strategy view	6.89	7.06	7.00	6.95	6.78
USDCNH spot FX strategy view	6.89	7.06	7.00	6.95	6.78

Bullish USDCNH Factors

- The risk of further US-imposed punitive measures in 2019 is high. Many differences are tied to China's economic model and are effectively irreconcilable. The US is likely to threaten and cajole throughout Q1.
- PBoC is using administrative measures and efforts to backstop growth in order to restrain the pace of capital outflows & RMB weakness, but short-term rate differentials argue for a higher level of USDCNY. The slowing economy will severely restrain upward pressure on RMB rates.
- The current account surplus is shrinking, leaving the RMB more dependent on net capital inflows from abroad. Given the slowing economy and high debt levels, the RMB needs to remain weak in order to attract sufficient inbound flow.

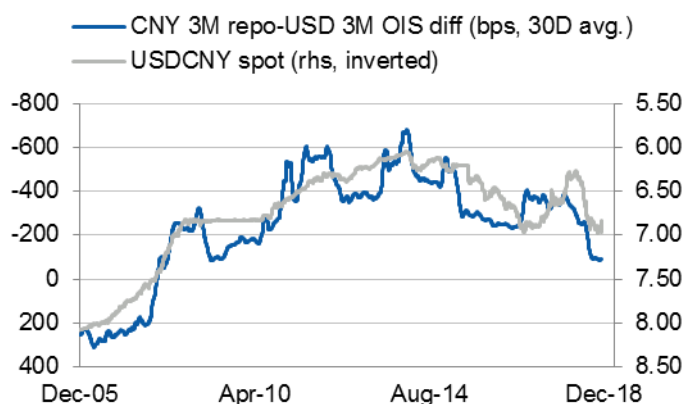
Bearish USDCNH Factors

- Given financial tensions and slowing domestic inflation, the Fed is turning more cautious with its rhetoric. A more dovish Fed will remove some of the upward pressure on USDRMB. SAFE's reserve account showed moderate intervention in November to stem RMB weakness.
- The annual growth rate of corporate outbound FDI has slowed considerably since 2015/2016. As such, the threat of indiscriminate capital outflows is considerably below the level observed during prior RMB depreciation episodes.
- Non-resident RMB deposits in Hong Kong accelerated in H2 2018 and foreign currency deposits held by Chinese non-financial corporations have continued to decline. Neither foreign nor domestic demand for the RMB has collapsed this year, despite the RMB's depreciation trend.

China FX Fundamentals & Facts

- Population and per capita GDP:** 1.39 billion, \$8,643 (2017 nominal) and \$16,660 (IMF PPP-adjusted for 2017)
- Key onshore policy rates:** 1-year deposits (1.50%), 1-year loans (4.35%), 7-day repos (2.55%), RRR (12.7%, system-wide avg.)
- 3M CNH HIBOR (3M SHIBOR):** 3.93% (3.13%)
- Official currency policy:** USDCNY adjustable-rate peg/managed float
- FX reserves:** \$3.062 trillion (-2.0% YoY in November)
- Latest real GDP growth rate:** 6.5% YoY (Q3 2018)
- Latest current account balance:** 0.40% of GDP (Q3-2018), 1.30% (2017 average)
- Latest CPI inflation:** 2.5% YoY (headline) & 1.8% YoY (core) (October 2018)
- Central bank governor:** Yi Gang (since March 2018)
- PRC President (General Secretary of the CC):** Xi Jinping (appointed to second 5-year term in late-2017)

USDCNY spot vs USD/CNY 3M rate differential



USDCNH price history and future view



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