OCBC Bank

CHINA Insights

RMB: Looking for a new anchor

Friday, November 18, 2016

Highlights:

- **The break of 6.80 and 6.83, once considered two strong resistance levels, so quickly created the space for imagination of swifter RMB depreciation.**
- **RMB depreciation against the dollar has re-accelerated since October. However, RMB still outperformed most of its peers in Asia. So it is a dollar story.**
- **Time to look for a new anchor. RMB index has been kept very stable recently at the expense of predictability of USDCNY fixing. The forecast error of daily USDCNY fixing has increased.**
- **RMB index could be the new anchor going forwards.**
- **Our sensitivity analysis shows that the fate of RMB is likely to depend on the outlook of USD. No change for year-end forecast now at 6.90.**

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RMB has shown the trading pattern of event driven for the past few months. The USDCNY broke 6.60 post Brexit shock and broke 6.70 after official SDR inclusion and again broke 6.80 post Trump shock.

6.83 was once seen as a strong resistance level by market from technical perspective as this is the level China has fixed RMB stable against the dollar for almost five quarters from 2009-2010 after the outbreak of Lehman crisis. However, since Trump's victory, RMB has retreated from those two key levels quickly without much resistance due to unexpected surge of broad dollar fuelled by re-inflationary expectation.

Since October, RMB's depreciation against the dollar has re-accelerated. However RMB is not alone and most of its Asian peers weakened against the dollar with Korean Won, Malaysia Ringgit, Indonesia rupiah and Singapore dollar even underperformed RMB as shown on chart 1.

Clearly RMB's depreciation in the past month was mainly the result of stronger broad dollar rather than country specific factors. Nevertheless, the recent break of key levels so easily created the space for imagination again. And the consensus on USDCNY has been shifted again. As such, it is important for China create a new anchor for RMB.

Looking for new anchor

For the past two weeks, the error of forecasting the daily USDCNY fixing has increased based on our own experience. Instead, RMB index, RMB's value against its currency basket, has become more stable. Since Trump's victory, RMB index has been kept in a narrow range despite volatile USDCNY. As shown on chart 2, RMB index has been fairly stable since late August. As such, our guess is that RMB index could be the new anchor again.

Chart 1: Magnitude of Asian currencies' depreciation against dollar since 10 Oct.

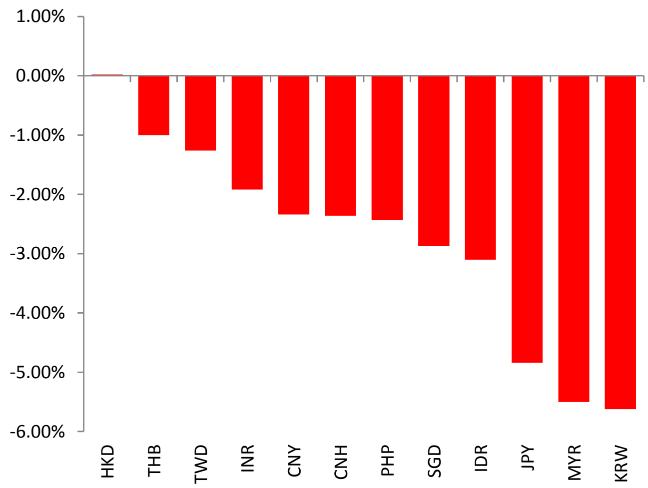
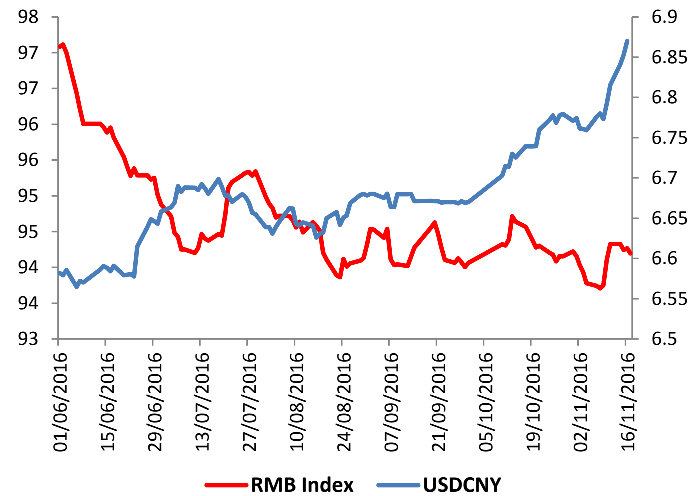


Chart 2: RMB index has been kept relatively stable since late August despite volatile USDCNY



Source: Bloomberg, OCBC

Sensitivity analysis

In the beginning of this year, we have done the sensitivity analysis for RMB from perspective of currency basket. Back then, our forecast is based on two parts including the forecast of RMB index, which reflects underlying macro and balance of payment fundamentals and its implied USDCNY based on the projections of major currencies such as EUR and JPY. However, our models failed after one way decline of RMB index. Given RMB is likely to be the new anchor again, it may be the time for us to re-visit our sensitivity analysis.

Sensitivity Analysis	
Scenarios	**Implied USDCNY**
1. EUR/USD 1.00, USD/JPY 115, RMB Index 94	**7.09**
2. EUR/USD 1.05, USD/JPY 110, RMB Index 94	**6.94**
3. EUR/USD 1.10, USD/JPY 105, RMB Index 94	**6.80**

In summary, we think RMB index is likely to be the anchor again. Our sensitivity analysis shows that the fate of RMB is likely to depend on the outlook of USD. Should USD continue to strengthen, the USDCNY is likely to break above 7 soon. Nevertheless, the stable RMB index will help contain the pace of depreciation and eliminate market panic about big devaluation.

Co.Reg.no.:193200032W