South China – Asia Business Report
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Forex Market Review and Outlook

~ USD/JPY and USD/CNH ~

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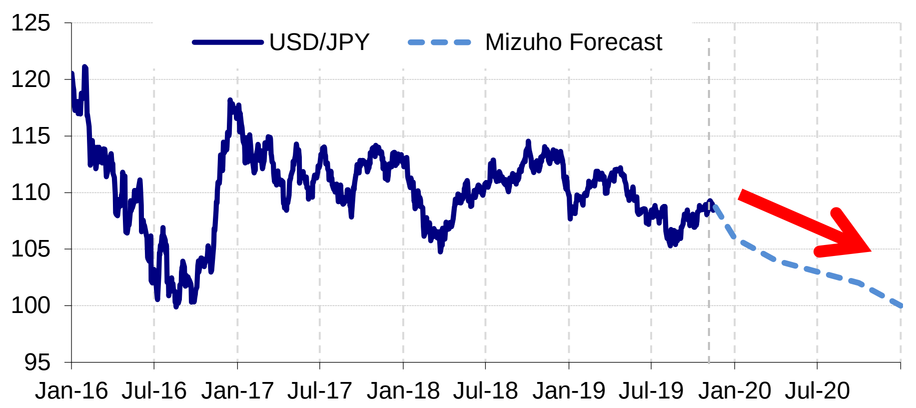
USD/JPY 2019 H2 Review

USD/JPY recovered to 108/109 area after printing its year-to-date low of 104.46 in late August. The China-US trade war and Fed's rate cut cycle were the main drivers of USD/JPY in the H2-2019. Trump broke the agreement on the ceasefire at G20 and raised tariffs on China in early August. The tit-for-tat tariffs and mounting fears of no-deal Brexit fueled safe-haven demand and sank USD/JPY. Moreover, the beginning of Fed's rate cut cycle in July amid the risk-off mood also sent 10Y UST yield lower to its 3-year low of 1.427% and lowered return of long USD/JPY carry trade. Dramatically, the positive development of China-US trade talks, receding fears of no-deal Brexit and the pause of Fed's insurance rate cut cycle lifted USD/JPY back to 108/109 area. BoJ's monetary policy was little changed while negative impact of the consumption tax hike to 10% in October was relatively modest.

USD/JPY 2020 H1 Preview

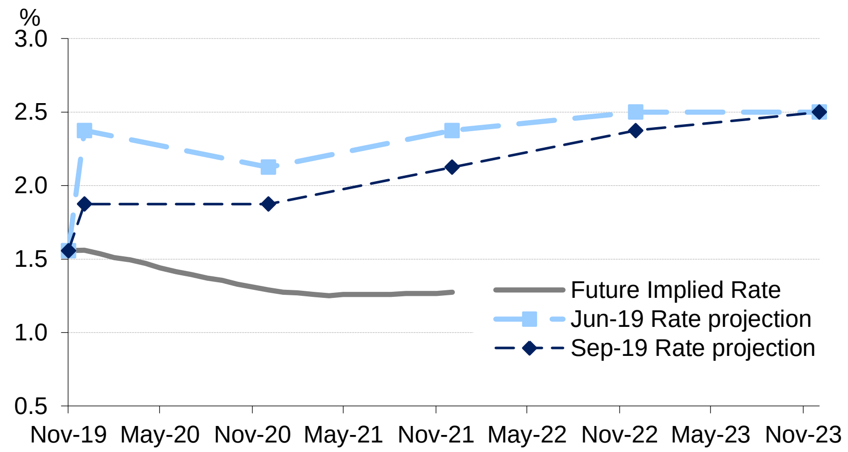
We expect USD/JPY to fall to 103 level gradually given our soft USD view and deteriorating global growth outlook (See Fig. 1). In our view, the Fed's

Fig. 1: Trade war and soft USD to drive USD/JPY lower



Source: Bloomberg, Mizuho Bank (*as of 19 Nov. 2019) insurance rate-cut cycle is paused but not yet over (See Fig. 2). The Fed should still keep its easing bias and is ready to cut its policy rates again when US data deteriorate. Indeed, the collapsing leading indicator of ISM PMI mfg. pointed to deteriorating US outlook after a decade long expansion in H1-2020. While no-deal Brexit risk had receded, China-US trade tensions will probably linger. As conflicts between China and US are structural and broad-based, it would be difficult for both sides to reach a comprehensive deal before their economies worsened. US President Trump's re-election campaign will fuel uncertainties over the trade talks as well. With weakening global outlook, global easing cycle will likely continue, boosting safe-haven demand. The BoJ's room for monetary easing will likely prove to be limited, and the divergence of monetary policy between the BoJ and other central banks will lead to stronger JPY.

Fig. 2: Markets expect the Fed to cut rates again after the pause



Source: Bloomberg

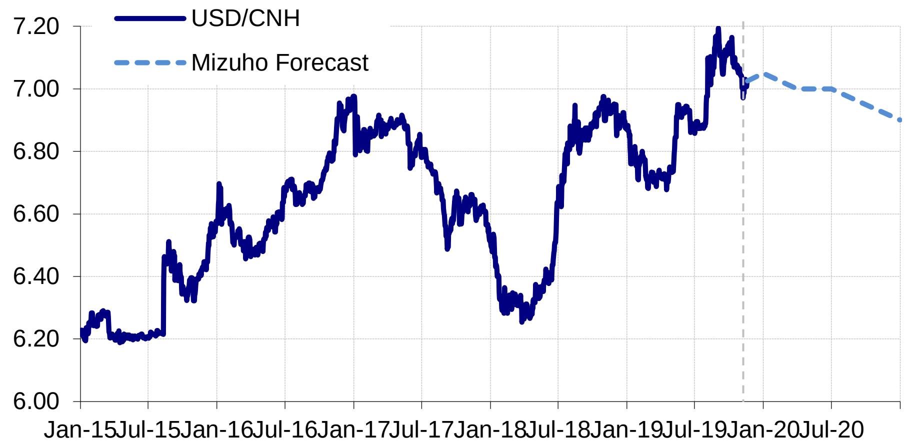
USD/CNH 2019 H2 Review

The CNH broke above the key psychological level of 7 after Trump's tariff hike and currency manipulator labelling in August. Importantly, the PBoC relaxed its grip on the CNY fixing and granted green light to RMB breaking above 7. Alongside the USD strength, the CNH dropped as much as to its record low of 7.1965 level in September. Dramatically, China and US managed to resume the trade talks and reached a partial agreement to suspend the US tariffs hike in mid-October. The mounting expectation of Xi-Trump meeting to sign the deal, with the possibilities of rolling back existing tariffs, sent the CNH back to below 7 briefly. However, uncertainties over Xi-Trump meeting heightened after the cancelation of APEC Summit in Chile and the CNH weakened to around 7 handle. Meanwhile, China Q3 GDP growth decelerated to its record low of 6.0%YoY amid the China-US trade war. The fiscal stimulus of taxes and fares cut had been abating and the PBoC delivered Required Reserves Ratio (RRR) cut and Medium Lending Facility (MLF) yield to support growth.

USD/CNH 2020 H1 Preview

The CNH is expected to fluctuate at around 7 handle in 2020-H1 (Fig. 3).

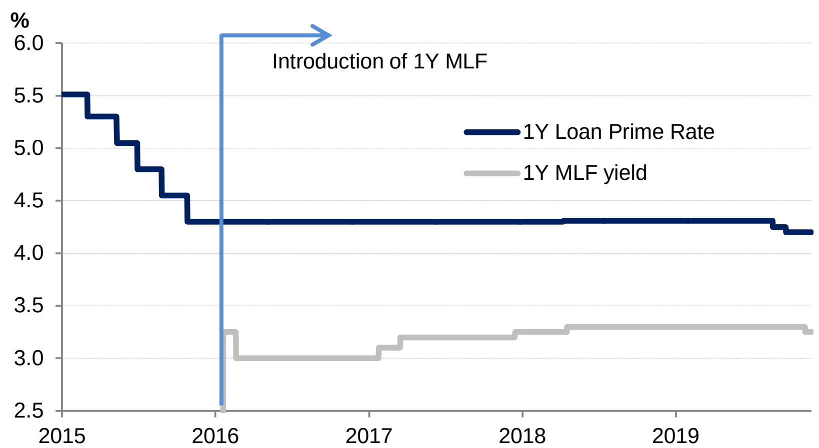
Fig. 3: CNH to fluctuate at around 7 for a while



Source: Bloomberg, Mizuho Bank (*as of 19 Nov. 2019)

The China-US trade war is set to remain as the primary FX driver in the coming year. While China-US trade tensions will probably linger, both sides may attempt to avert the full-blown trade war and continue the trade negotiations. Notably, the deteriorating China and US growth and Trump's re-election campaign created room for trade negotiations. In the US President election year, Trump will try to prevent US economy from falling into recession and bargain a deal favouring the US farmers to consolidate his support in US agricultural states. Hence, the China-US trade talks' prospect looks less negative in the coming year. Regarding monetary policy, China economic growth will remain under pressure and probably decelerate to sub-6% given the lingering trade war and changing China growth structure. We expect the PBoC to keep its prudent stance with easing bias, and the RRR and policy rates will go lower gradually in order to anchor RMB expectation (Fig. 4).

Fig. 4: PBoC began its rate cut cycle



Source: Bloomberg