7 September 2021

THEMATIC

In this report:

MYR, RMB face weakening trend vs. USD

AmBank Group

AmBank Research

Tuesday, 07 September 2021

Dr. Anthony Dass
Chief Economist/Head
anthony-dass@ambankgroup.com
03-20322972

Muhamad Farid Anas bin Johari
Economist
muhamad-farid-anas@ambankgroup.com
03-20363020

MYR, RMB face weakening trend vs. USD

We expect the USD/RMB pair will weaken, hovering around 6.45–6.55 with the upside at 6.65–6.80 by end-2021 while reiterating our MYR outlook to the USD at 4.15–4.20 with the upside at 4.30 by end-2021.

With both the MYR and RMB seen to be on a weakening trend against the USD, we expect the RMB/MYR to hover around the 0.63–0.66 levels for 2021 with the upside at 0.66 should the MYR weakening trend be far more significant compared to the RMB against the USD.

The downside of the RMB/MYR is close to 0.63 on the assumption that the RMB weakens more than the MYR against the USD.

Short-lived volatility

- The MYR started 2021 strongly at 4.02 against the USD. However, by end-May 2021, the MYR had depreciated by 2.6% to 4.12, its eight-month low since October 2020. Despite surging global commodity prices, and improving global economy and trade outlook, the local currency took a hit from rising domestic Covid cases, slow vaccination speed and domestic political uncertainties with the pace of economy recovery weighed down by the impact of the MCO 2.0 (January–February 2021).

- Meanwhile, the RMB which started at 6.53 against the USD, reached its three-year high (since June 2018) of 6.37 against the USD, translating to a 2.5% appreciation by the end of May 2021. This was amidst surging global commodity prices and raised suspicion that the People's Bank of China (PBoC) had deliberately used the RMB depreciation earlier to curtail rocketing imports.

- Due to the tight correlation between both currencies and the USD of around 0.64%, the ringgit fell by 4.7% against the RMB between January and end-May. The RMB/MYR exchange rate hovered between 0.62 and 0.65 during the period.

MYR and RMB's losing strength

- However, the trend for both the MYR and RMB had turned negative since end-May 2021. From early June until 3 September, the MYR had dropped by 0.5% to 4.15 against the USD, while the RMB fell by 1.2% to 6.46 against the USD.

- The drag on both currencies was due to:

    1. Change in the USD outlook. The dollar's strength is partly due to growing expectations that the Fed will announce the tapering of its asset purchases. We expect the Fed would announce tapering in November. It would give Fed enough time to digest the macro data on labour market's recovery and economic growth.

       If the incoming data remains good, we expect tapering to start in December this year. But if the data is not strong enough over the next two months, we foresee the Fed moving its tapering timeline to 1Q2022.

       On the policy rate, a promising incoming data would allow the Fed to start raising its rates as early as 4Q2022. Otherwise, we expect rates to be revised upwards in 2023, factoring in two rate hikes, each by 25bps from its record low policy rate of 0%–0.25%.

And we believe the financial markets would be able to absorb the Fed's tapering without much volatility. Any concern will only come about should there be persistent market unrest and spills into the real economy.

Market fears will arise if the Fed's direction with regards to unwinding of its US$120 billion worth of monthly bond purchases remains unclear – whether by following the post-Great Recession playbook i.e. to first cut back Treasury purchases or mortgage-backed securities to calm a red-hot housing market.

The economic recovery from the pandemic is expected to be more rapid than previously expected. And the Fed could reach its dual mandate of 2% inflation and maximum sustainable employment much sooner. We project the GDP to grow by 7.0% and 4.5% with inflation at 3.0% and 2.0% for 2021 and 2022 respectively.

2. The RMB's climb was truncated after the PBoC announced a rare hike of the foreign deposit reserve requirement ratio by 2% on 31 May. The hike clearly signalled the PBoC's intention of limiting the fast appreciation of the RMB exchange rate.

3. Also, the USD which has a strong correlation with the RMB, has picked up pace since end-May. This resulted in the RMB depreciating quickly against the USD, falling to 6.46 as at 3 September, about a 1.2% below its previous low of 6.38.

4. Meanwhile, the MYR fell against the USD due to the rising number of Covid cases which resulted in MCO 3.0 despite the increasing speed of vaccination. It disrupted the gradual economic recovery, pushing the economy back into a negative growth in 3Q2021, dashing hopes of a modest recovery in 4Q2021. We have lowered our 2021 GDP to 3.0%–3.5% with a downside at 1.5%.

Will RMB enjoy the appreciation against USD again?

- To recap, during the first five months of the Covid-19 pandemic in 2020, the RMB tumbled 2.49% against the USD to a deep trough of 7.14 in May 2020, as China bore the brunt of the unprecedented pandemic, on top of escalating China-US tensions. The MYR plunged by 6.25% to a low of 4.35 vs. the USD, while against the RMB, the local currency depreciated by 3.67% to 0.61. During this period the dollar index rose 1.97% to 98.34.

- As for the RMB, it gained strength from May 2020 till May 2021, jumping 10.6% to reach 6.37 against the USD supported by macro fundamentals. During this period, the MYR appreciated by 4.5% to 4.12 against the USD. But against the RMB, the MYR fell by 6.5% to 0.645.

- Nevertheless, the macro fundamentals that supported RMB are not sustainable due to:
  1. Growth divergence as China's "first-in-first-out" of the pandemic is expected to ease from global recovery;
  2. The USD would strengthen in 2021 from the Fed's potential tapering;
  3. Gradual ease of trade balance and current account surplus will weigh on the RMB's rise as:
     - ✓ Exports, although strong, would lose momentum when global GDP normalizes, though it may take time;
     - ✓ Services trade deficit due to almost zero outbound tourism, etc in 2020 will gradually rev up as more countries start to open their borders to support their tourism sector; and
     - ✓ Recent surge of commodity price compared to domestic pent-up demand increases import values.

- Besides macro fundamentals, the China-US relations, global capital flows, China's policy reforms and credit crunch regulations, and the PBoC's policy intentions on the exchange rate will need to be carefully and evaluated.

- We expect a depreciation trend in the RMB vs. the USD as we thread into the remaining months of 2021. The pair will likely hover around 6.45–6.55 levels and with room to reach 6.65–6.80 by end-2021.

And MYR is expected to remain soft against USD

- Looking ahead, the MYR's outlook against the USD is seen to come under slight downward pressure driven by:
  1. A downgrade of 2021 GDP growth to 3.0%–3.5% due to the rise in local Covid cases despite increasing vaccinations. It will sharply lower 2H2021 GDP to 0%–0.5% from 7.1% y/y in 1H2021;
  2. The government's plan to widen the budget deficit to 6.5% to 7% of GDP from the initial estimate of 6.0% would mean the statutory debt limit will be raised from 60% to 65% of GDP; and
  3. Domestic political noises pending GE15, which means investors will remain cautious on future debt ratings, added with the risk of being downgraded.

- However, the weakening trend of the MYR could be softened under the following circumstances:
  1. A reopening of the economy by the end of October where all states transition to Phase 3 of the National Recovery Plan (NRP) and Phase 4 by November after Malaysia inoculated its entire adult population;
  2. Favourable external demand environment, supportive economic policies and a gradual improvement of domestic demand would help steer the economy into recovery in 2022;
  3. Political stability that boosts consumer, business and investors sentiments, effective implementation of policies and clearer SoP procedures that will improve mobility, pent-up demand and business expansion while reducing stress on the labour market.

- Besides macro fundamentals and political stability, global capital flows, domestic policy reforms, policies after the rollback of stimulus measures, credit crunch, bankruptcies/delinquencies, unanticipated provisions and BNM's policy intentions on the exchange rate will also need to be carefully considered and evaluated.

- We expect the MYR to continue its depreciation trend against the USD in the remaining months of 2021. It will likely range from 4.15 to 4.20 levels and with room to reach 4.30 by end-2021.

How will MYR trend against RMB?

- To answer this, we took into consideration of the behaviour of RMB and MYR against USD, given that both have strong correlations with the USD.

- Some RMB appreciation versus the USD might help contain inflation arising from increasing commodity prices and supply-chain bottlenecks. And there is some evidence that suggested heavily indebted Chinese companies took the opportunity to pay down their USD-denominated debts.

- But such benefits come with risks. A stronger currency will result in smaller yuan-denominated revenues for exporters and can exacerbate the financial fragility of China where public and private debt exceeds 300% of GDP.

- And there are worries that too rapid an appreciation could spark a destabilizing of capital inflows or outflows. Managing the fallout from the Fed's weak dollar policy could also expose China to trade retaliation from the US. These are dangers coming from their credit-fuelled policy mistakes.

- Besides China's macro fundamentals, the China-US relations, global capital flows, China's policy reforms, credit crunch regulations, and the PBoC's policy intentions on the exchange rate will need to be carefully and evaluated. All points towards a weakening RMB to hover around 6.45 -6.55 with the upside at 6.65 -6.80 by end 2021.

- In the case of Malaysia, the underlying logic is quite straightforward. Besides macro fundamentals, domestic political uncertainties, economic blowout due to the pandemic that led to MCO 3.0; the speed of vaccination; uneven recovery; business sustainability, risk of ratings downgrade from ballooning fiscal deficit and public debt, global capital flows from Fed's tapering, policy reforms, bankruptcies, high provisioning, household debt and retirement crisis, and BNM's policy intentions on the exchange rate will weigh on the MYR.

- We reiterate our MYR outlook to the USD at 4.15 -4.20 with the upside at 4.30 by end 2021.

- With both the MYR and RMB seen to be on a weakening trend against the USD, we expect the RMB/MYR to hover around the 0.63–0.66 levels for 2021 with the upside to 0.66 should the MYR weakening trend is far more significant compared to RMB against the USD. The downside of the RMB/MYR is close to 0.63 on the assumption that the RMB weakens more than the MYR against the USD.

Chart 1: Daily USD/MYR

Source: Bloomberg/AmBank Research

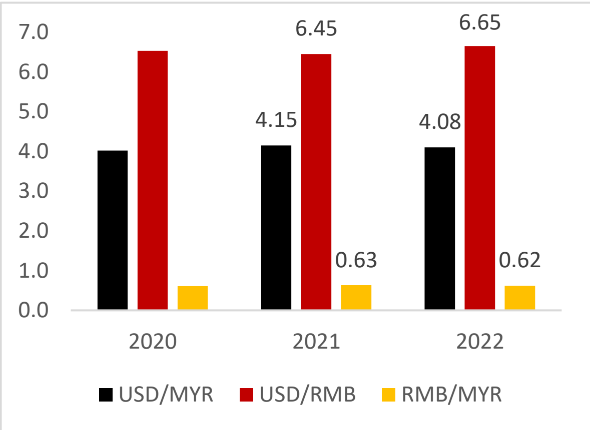
Chart 2: Daily USD/RMB

Source: Bloomberg/AmBank Research

Chart 3: Daily RMB/MYR

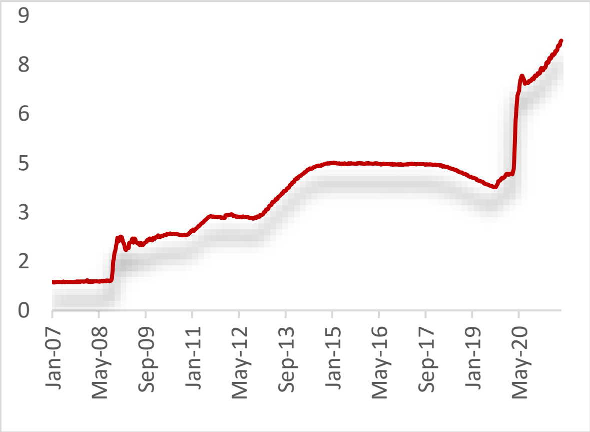
Source: Bloomberg/AmBank Research

Chart 4: Currency Outlook (End Period)



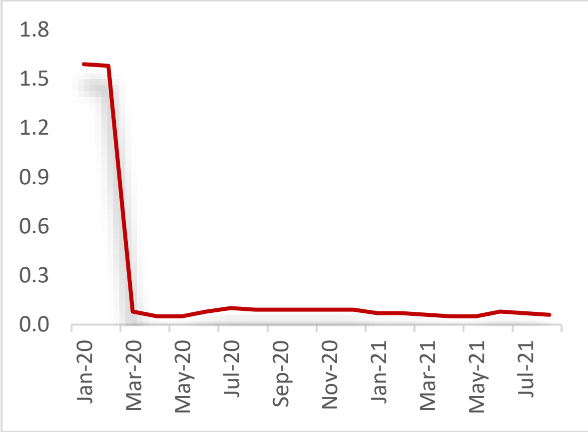
Source: Bloomberg/AmBank Research

Chart 5: Fed Balance Sheet (USD$'tn):



Source: CEIC/AmBank Research

Chart 6: Fed Policy Rate (%):



Source: CEIC/AmBank Research

Table 1: Currency outlook

	1Q'21 (a)	2Q'21 (a)	3Q'21 (f)	4Q'21 (f)	1Q'22 (f)	2Q'22 (f)	2022 (f)	2023 (f)
USDRMB	6.55	6.46	6.46 -6.50	6.45 - 6.55	6.55 - 6.60	6.60 - 6.65	6.65 - 6.70	6.50 - 6.55
USDMYR	4.15	4.15	4.18-4.20	4.15 - 4.20	4.12 - 4.18	4.10 - 4.16	4.08 - 4.14	4.06 - 4.12
RMBMYR	0.63	0.64	0.63 -0.66	0.63 - 0.66	0.63 - 0.66	0.63 - 0.65	0.62 - 0.64	0.61 - 0.63

Source: Bloomberg/AmBank Research

DISCLOSURE AND DISCLAIMER

This report is prepared for information purposes only and it is issued by AmBank (M) Berhad ("AmBank") without regard to your individual financial circumstances and objectives. Nothing in this report shall constitute an offer to sell, warranty, representation, recommendation, legal, accounting or tax advice, solicitation or expression of views to influence any one to buy or sell any real estate, securities, stocks, foreign exchange, futures, investment or other products. AmBank recommends that you evaluate a particular investment or strategy based on your individual circumstances and objectives and/or seek financial, legal or other advice on the appropriateness of the particular investment or strategy.

The information in this report was obtained or derived from sources that AmBank believes are reliable and correct at the time of issue. While all reasonable care has been taken to ensure that the stated facts are accurate and views are fair and reasonable, AmBank has not independently verified the information and does not warrant or represent that they are accurate, adequate, complete or up-to-date and they should not be relied upon as such. All information included in this report constitute AmBank's views as of this date and are subject to change without notice. Notwithstanding that, AmBank has no obligation to update its opinion or information in this report. Facts and views presented in this report may not reflect the views of or information known to other business units of AmBank's affiliates and/or related corporations (collectively, "AmBank Group").

This report is prepared for the clients of AmBank Group and it cannot be altered, copied, reproduced, distributed or republished for any purpose without AmBank's prior written consent. AmBank, AmBank Group and its respective directors, officers, employees and agents ("Relevant Person") accept no liability whatsoever for any direct, indirect or consequential losses, loss of profits and/or damages arising from the use or reliance of this report and/or further communications given in relation to this report. Any such responsibility is hereby expressly disclaimed.

AmBank is not acting as your advisor and does not owe you any fiduciary duties in connection with this report. The Relevant Person may provide services to any company and affiliates of such companies in or related to the securities or products and/or may trade or otherwise effect transactions for their own account or the accounts of their customers which may give rise to real or potential conflicts of interest.

This report is not directed to or intended for distribution or publication outside Malaysia. If you are outside Malaysia, you should have regard to the laws of the jurisdiction in which you are located.

If any provision of this disclosure and disclaimer is held to be invalid in whole or in part, such provision will be deemed not to form part of this disclosure and disclaimer. The validity and enforceability of the remainder of this disclosure and disclaimer will not be affected.