

China's new approach to the trade war

The latest tit-for-tat-retaliation in the trade war may have given China new confidence that it has tools with which it can push back against the US - one of these is the CNY - we are revising our CNY forecasts upward.



Torn between trade and Brexit

As I mull the various headline articles today to choose a theme for today's note, the key themes seem to boil down to yet another commentary on trade, or a further review on the Brexit debacle. The trade story and China's new strategy in this is probably the most interesting, so I will start with that.

Trade: and China's reaction to the latest escalation

Trade:

I had a good chat with our China expert Iris Pang yesterday, and for all the talk of China asking to get back around the negotiating table in September, we don't see the upside for them. In the end, the question has to be, who are they negotiating with? If it is really with President Trump, then there is very little merit in them making concessions to the trade team only to be told at the last minute "Not good enough" by the President and be asked to do more.

Which is why we think the currency has come into play as a further tool for China to use in the tit-for-tat retaliation that has escalated recently. And this is also why we think that there is further upside to USDCNY, with an end of 4Q19 high of 7.20, rising to 7.30 at end 4Q20. Within this, we don't rule out even higher rates as currency spikes are used as tools in the trade war. The effective trading range thus widens out to 7.05 to 7.50.

We have penciled in a modest quarterly CNY appreciation thereafter, but that far out, our conviction is pretty limited, so let's stick with the near-term view.

Yes, this does run some risk of re-igniting capital outflows. But China has sewn up its capital account pretty tightly in recent years, so that may be limited. Moreover, by judicious use of the fix, enough two-way volatility can be generated that on a day to day basis, this is not a one-way bet. Together with their own "entity list" we think China is gearing up for no deal.

The longer note on this from Iris can be found [here](#).

Brexit: a thawing in Europe, a hardening in the UK

GBP looks a little stronger following some slightly less vitriolic comments on Brexit at the G-7 from Merkel and Macron, though I suspect Macron would just like to get those irritating "rosbifs" out of the EU as quickly as possible and get on with the EU project's other ambitions. So I'm less optimistic that a solution involving as yet uninvented technology or "trusted vendor" arrangements can deliver for the Irish Backstop question what previous negotiators have failed to do before.

Meanwhile, in Westminster, a plot is brewing to force PM Johnson to ask the EU for a further extension, and to stop the UK from crashing out on Halloween. The move takes an election off the table for the time being - the thinking being that if a no-confidence motion is called, the PM could drag his heels over calling a new election and the UK could simply drift out of the EU like a rudderless ship in the interim.

So the extension would deliver two goals:

1. It would provide more time if the Johnson government really is looking for a deal and not just a hard Brexit
2. It would allow for a no-confidence motion and a general election within a defined extension providing an opportunity for an incoming government (assuming it isn't the same one - which isn't at all clear) to set out a new Brexit vision.

Adding to the all of this, Nigel Farage's Brexit party has offered to back the Conservatives in a pact at the next election if they pursued a no-deal Brexit. The fun never ends.

Day ahead

Nothing, literally nothing.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

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