Sucden Financial

FX Monthly Report- China Focus

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FX Monthly Report

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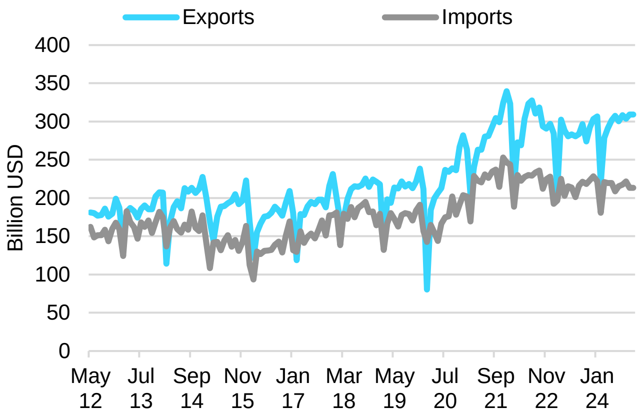
China Focus

Chinese Stimulus Analysis

China's economy has been subject to increased scrutiny in recent months as the government works to address its muted growth. Despite some data indicating a slight improvement in economic performance, market confidence remains shaky. In Q3 2024, GDP grew by 4.6% YoY, surpassing economists' expectations of 4.5%. Retail sales and industrial production also exceeded forecasts, growing by 5.4% and 3.2% YoY in September. China's exports have been on the rise, and key indicators point to a more optimistic outlook for the consumer sector. In October, the Caixin Service PMI hit 52.0, reflecting the strongest growth pace since July.

Chinese Exports and Imports in Billion USD

Exports out of the country have been rising rapidly, mainly in anticipation of Trump Presidential win.

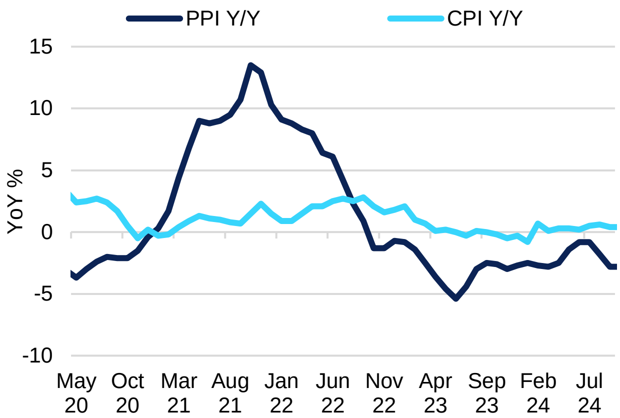


Source: Customs General Administration

However, China's CPI figures reveal a persistent deflationary environment, characterised by year-on-year declines in producer prices and muted growth in the consumer segment. We believe that market expectations regarding China's longer-term recovery are priced in further down the curve, keeping the near-term sentiment uncertain. As a result, this has negatively affected the yuan's performance for much of the year, keeping the currency close to 7.30 against the dollar.

China's CPI and PPI YoY Performance

China's pricing growth points to slowing appetite from both producers and consumers.



Source: National Bureau of Statistics

The sentiment began to shift by the end of August, which brought a wave of optimism with the announcement of a substantial fiscal stimulus package in China. The package, which was the largest since the pandemic, included cuts to interest and mortgage rates, along with measures aimed at shifting household investment away from the troubled property market. Additionally, the fiscal intervention included the issuance of 2 trillion yuan in bonds, half of which was allocated to support local governments, many of which are teetering on the brink of default due to the collapse of the property sector.

The anticipation surrounding this fiscal stimulus sparked an overwhelmingly positive response, leading to an 30% rally in Shanghai Composite stocks and a 2.30% increase in the yuan. The market's impatience for positive developments from China led to exaggerated optimism for its recovery, particularly as Chinese assets have been oversold, prompting investors to seize short-term volatility opportunities. However, the subsequent lack of clarity from policymakers added uncertainty regarding the trajectory of China's economic recovery.

Shanghai Composite Index

Shanghai stocks rallied on the back of stimulus announcement.

Source: Bloomberg

The path to recovery is expected to be extensive and complex. China's challenges are deeply complex and interconnected, meaning there isn't a quick fix to revive the economy within just a few months. Even with significant liquidity being injected into the broader economy, the flow of money will likely be halted by individuals who would typically invest in property but are now hesitant due to the ongoing real estate crisis. In such a scenario, consumers are more likely to save rather than spend or invest, limiting the impact of stimulus measures.

We believe that the government is aware of the current situation and that regulators are focused on stabilising the housing market instead of rejuvenating it. Easing mortgage rules and injecting funds into the sector is unlikely to facilitate recovery in the meantime, as consumer confidence is the key driver of spending decisions that directly impact new house purchases. There is still potential for further announcements and monetary policy easing to ensure continued action. However, we anticipate that subsequent announcements will likely be made at times of economic weakness to prevent further loss of confidence.

These factors are likely to provide strong support for the yuan through 2025, which should help maintain the support at 7.27 as the government seeks to prevent further erosion of confidence.

USDCNH Index

Chinese offshore yuan has been weak since the start of 2022.

Source: Bloomberg

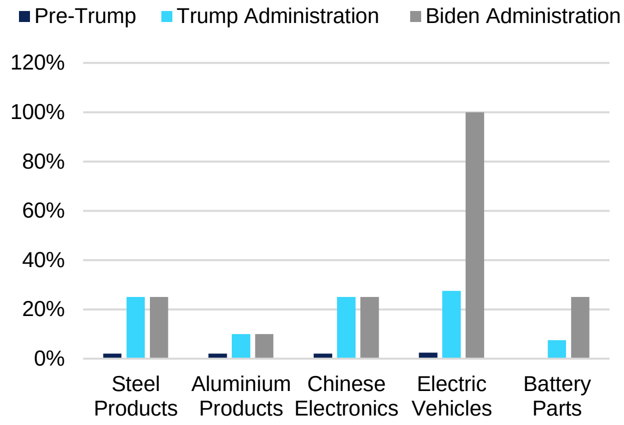
The Trump Tariff Impact on China

An additional layer of uncertainty is emerging with the newly elected US President, Donald Trump, who is infamous for his introduction of strict tariffs on Chinese goods during his previous term. Given the severity of the impact his trade policies had in the past, the market is anxiously watching for any signs of increased scrutiny on China.

Notably, in recent months, Trump has threatened to impose tariffs as high as 60% on Chinese goods. However, we will have to wait until he officially takes office in January to assess the strength of his conviction. The current scenario differs strongly from 2018 when the announcements took the markets by surprise. Now, there is a greater focus on his actions, and we believe that any disruptions to the supply chain are unlikely to be as significant as they were in 2018. Markets are already starting to hedge in anticipation of these announcements.

US Tariffs on Chinese Goods Across Presidential Terms

The Trump administration is likely to implement further tariff measures on Chinese export materials in the next 4 years.



Source: USITC

Over the past four years, the Biden administration has only continued to tighten export controls left by Trump. As a result, China has become better prepared to counter Trump's actions, taking strategic steps to enhance its resilience by expanding export controls on critical raw materials and imposing tariffs on agricultural goods. Still, the Chinese government will likely want to avoid a tariff battle with the US.

So far this year, China has heavily relied on exports of goods like electric vehicles and batteries to support its export growth segment. Another hit to the export of key goods could worsen the array of economic challenges China is currently facing, adding to the slowing growth and more prolonged recovery period. Given these conditions, China would struggle to retaliate the 60% tariff and would need to implement additional measures to buffer the economy against the wider impact of tariffs.

Desk Comments

GBP

The BOE cut rates as expected at the latest meeting, but we are expecting a slower path of decline after Rachel Reeves first UK budget. The general trend since the budget has seen GBP trade lower. The defining aspect of the budget is the hike in taxes to pay for spending on public services though there is no assurance of getting them in order. The NI rise amounts to one of the biggest tax raising budgets in recent memory. Reeves called the budget a 'Budget for growth' but the markets have not digested it this way. The measures in the budget do not boost the economy, it weighs down on disposable income and will likely hit private investment. The market concluded that growth is not on the horizon and the economy remains broadly stagnant. Inflation may be a bit higher than expected and thus interest rates higher as a result. The housing market has only just started to rise as buyers have returned to the market, but this could lead to a slowdown again.

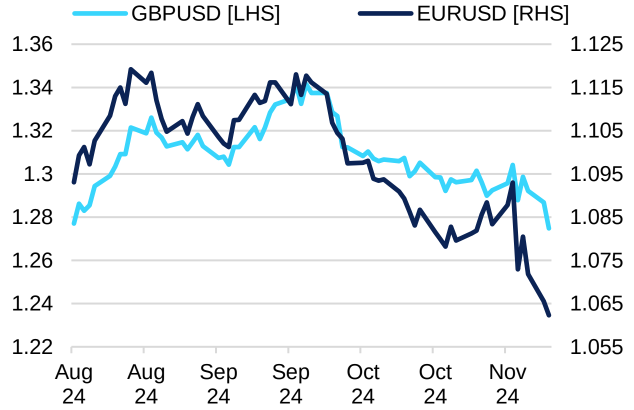
However, the news from across the Atlantic that is the red wave in the US, the coming tariff regime. It's widely understood, Europe is more sensitive to any tariff disputes or trade wars. EURGBP is already trading on yearly lows, add into that the positive carry for GBP and we don't see how this picture changes in the near term.

EUR

Post Trump election European bond yields did not follow US yields up; instead, we saw a modest decline in short-term rates, as the result was seen as increasing the risk of lower growth within the European economy therefore, heightening the chance of ECB rate cuts. Additionally, following from Trump's win the EUR weakened not only against the USD but also against all other G10 currencies with potential new tariffs posing significant risk to the eurozone economy. The impending effect of Trump's tariffs on the eurozone also creates uncertainty within European based companies as it won't be clear what the hedge ratios created by the tariffs are until he takes office in January and sets these them.

GBP and EUR vs the Dollar

EUR and GBP have been under significant selling pressure.



Source: Bloomberg

The final PMI's surprised coming in slightly to the upside with Composite, services and manufacturing all outperforming consensus (50.0/49.7, 51.6/51.2 and 46/45.9 respectively) largely due to growth in services in France, Germany and Italy. This growth in services continues to support a growth outlook in the eurozone despite the recent decline in manufacturing.

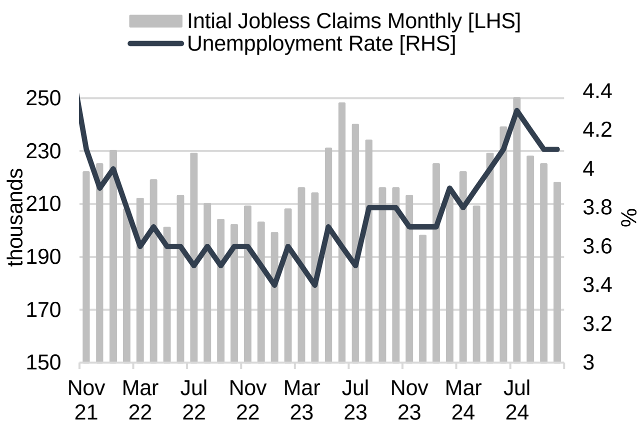
Politically the focus in the Eurozone has become Germanies Chancellor (Olaf Scholz) firing his finance minister (Christian Lindner) all the while calling for snap elections in March (Federal election now confirmed for February 23rd) which has thrown the country into political turmoil. The decision to fire the finance minister comes following months of disagreements surrounding the chancellors proposed 2025 budget (Aswell as his longer-term views on reviving Germanies already fragile economy). This increased political uncertainty will not only stand as a detriment to the German economy but compile the growing worries surrounding the eurozone's growth outlook following the confirmation of President elect Trumps election win.

USD

The US elections passed without the intraday volatility we were expecting. The DXY rose 2% in an orderly fashion. The USD traded positively as the odds of a Trump victory increased. The biggest USD moves were against high beta, tariff exposed currencies such as the MXN and CNH. The Republicans gained control of the senate and a clean sweep of the swing states. If the Republicans win the House, which is largely expected this may pave the way for Trumps political agenda. This will likely require a fiscal priority of increasing the budget deficit and public debt. In addition, any potential tariffs may heighten inflation pressures further. The US 10-year yield rose 20bp following the result.

US Initial Jobless Claims vs Unemployment Rate

Labour market data points to a resilient US environment.



Source: Bureau of Labour Statistics, Department of Labour

The FED delivered a 25bp cut at the latest meeting. Powell didn't give an indication on the future rate path. A further 56 bp of cuts are currently priced in by the middle of next year but we remain cautious on the rate outlook as Trump gaining unilateral control of government gives him more authority to implement his agenda.

The US economy has remained strong throughout the cutting cycle with the labour market particularly resilient. Treasury yields will likely push higher as we near inauguration day, so we expect Trump trades should continue to perform into year end, S&P 500 near the highs and USD continuing to move higher.

USDCNH Outlook

Our View: We anticipate that market sentiment regarding China's recovery will improve slightly into the year-end as bulls set their narrative for 2025 as a whole. During this period, short-term spikes in the market are more likely in response to fiscal and monetary policy announcements from the Chinese government.

However, by January, expectations are likely to become more subdued as markets begin to factor in the potential impacts of the Trump administration. We expect this narrative to persist in the first half of the year, with any announcements from the US likely to exert downward pressure on the CNH.

The economy should start showing signs of recovery in the second half of 2025. This, coupled with the continued cutting cycle from the Fed, will help ease some of the dollar pressures, allowing the yuan to reach 6.80.

Technical Analysis

GBPUSD

GBP/USD was unable to sustain levels above the symmetrical triangle resistance at 1.3030. Renewed USD strength triggered additional GBP/USD selling pressure, pushing the pair below the 200-day moving average at 1.2860. Key support now lies at the June lows of 1.2615 and the triangle support at 1.2580; a break below these levels could open the path to 1.2300. On the upside, previous clustered support and the 200-day moving average between 1.2810 and 1.2860 are expected to cap gains, offering an improved risk/reward ratio for GBP/USD short positions.

EURUSD

EUR/USD has broken through the trendline resistance at 1.0760. The strength of the USD, fuelled by a Trump victory, where not enough risk premium was priced in the market, suggesting further downside potential. The next support level is the 50% Fibonacci retracement at 1.0405. A more favourable risk/reward opportunity may arise on a EUR rally rather than pursuing the current price movement. Resistance is now positioned at the trendline and previous highs around the 200-day moving average, between 1.0930 and 1.0960.

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