All Signal, No Noise

MARKET ANALYSIS

MNI MARKET ANALYSIS: China Reopening: Positive For Equities and CNY?

29 June 2022, Yvan Berthoux

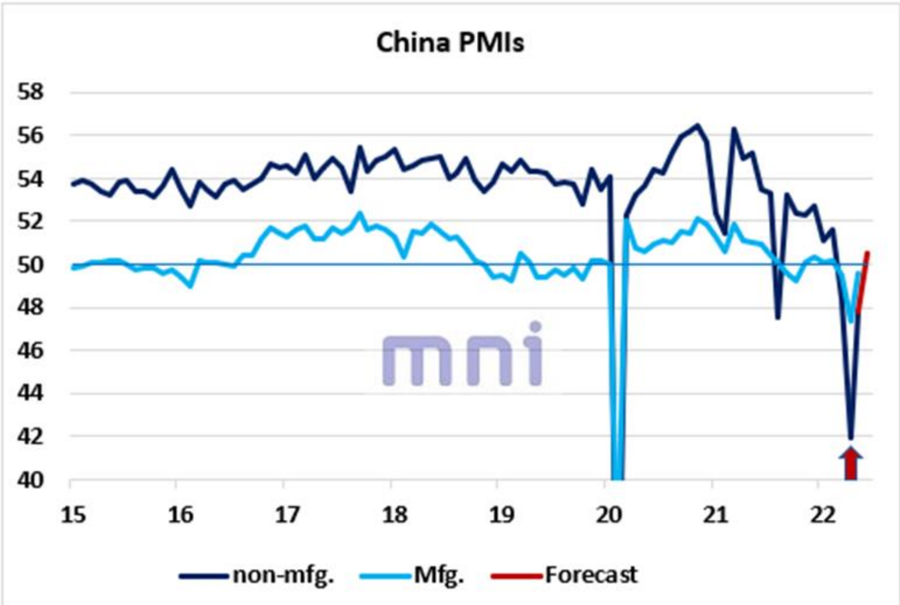
Executive Summary:

- In the past week, business sentiment has started to pick up in China following the positive headlines on China 'declaring victory' on Covid.
- Hence, investors have been questioning if risky assets and CNY could receive support in the short term if soft data continue to improve.
- China 10Y Yield could also see further upward retracement in the current environment.

Business Sentiment Picking Up Amid China 'Reopening'

In the past week, business sentiment has started to pick up in China following the positive headlines on China 'declaring victory' on Covid. The National Health Commission announced on Tuesday that China will slash the quarantine time for inbound travellers by half (from 14 to 7 days) and will cut the at-home health monitoring from 7 to 3 days.

Figure 1



Source: Bloomberg/MNI

PMI surveys out in the coming days and are expected to bounce back above the 50-line threshold that separates growth from contraction. For instance, 'official' manufacturing and non-manufacturing PMIs are expecting to rise to 50.5 (June 30) according to analysts (figure 1).

Equities To Continue Their Bull Momentum?

Market has been reacting positively to these headlines so far; the Hang Seng Index continues to retrace higher this week, breaking above its 100DMA on Monday. Next resistance to watch on the topside stands at 23,100 (200DMA / 61.8% Fibo retracement).

Figure 2

Source: Bloomberg

Investors have started to question if China tech could experience a short-term rally in the coming weeks. We previously saw that tech equities have not responded to the strong rebound in China 'liquidity' since the start of the year. Figure 3 shows the significant divergence between year-on-year change in tech equities and China TSF (also referred to as 'liquidity').

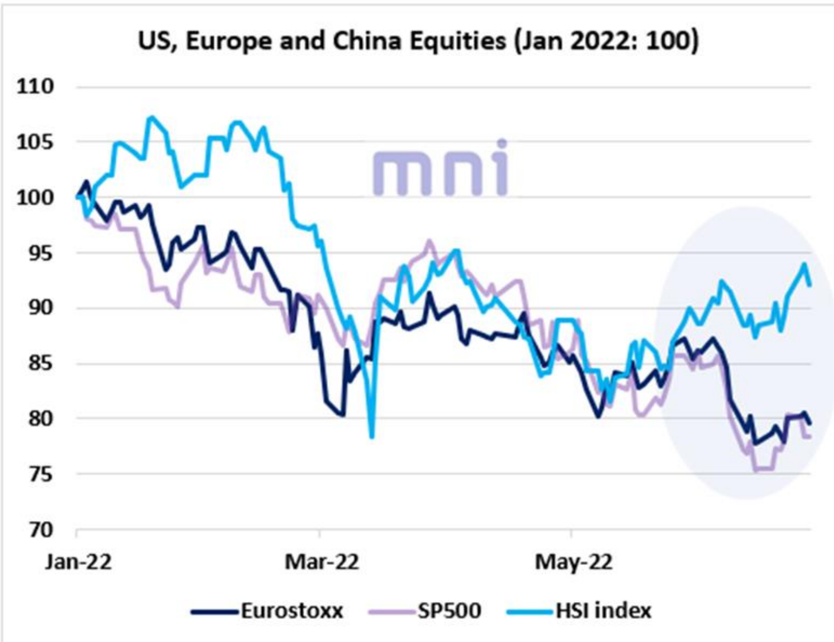
The major risk remains the global macro picture as geopolitical uncertainty combined with stagflation fears could continue to weigh on risky assets globally.

Figure 3

Source: Bloomberg/MNI

Interestingly, China equities have done significantly better than European and US equities in 2022. Figure 4 shows that while US/Europe equities are down by over 20% since the start of the year, China equities (Hang Seng Index) are down by 7%.

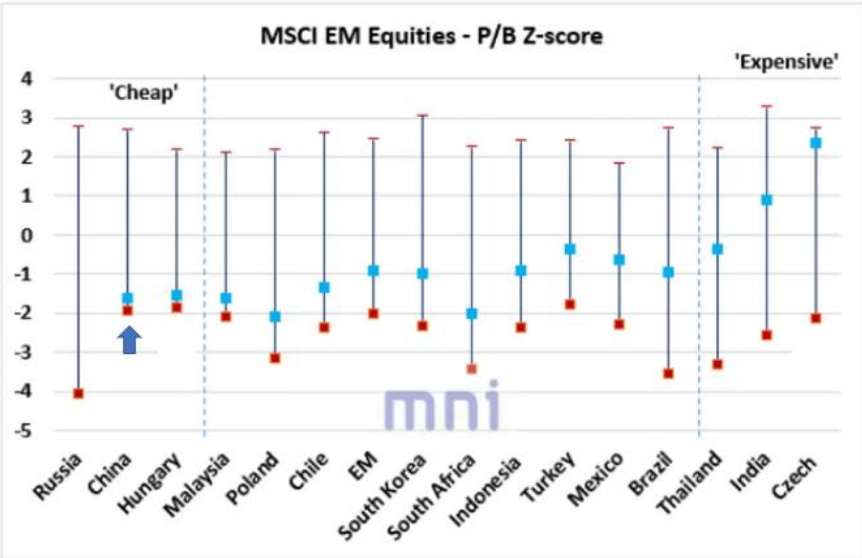
Figure 4



Source: Bloomberg/MNI

China Remains The Cheapest Equity Market Among EM (excluding Russia)

Figure 5



Source: Bloomberg/MNI

Is China 10Y Yield About To Break Above Its 200DMA?

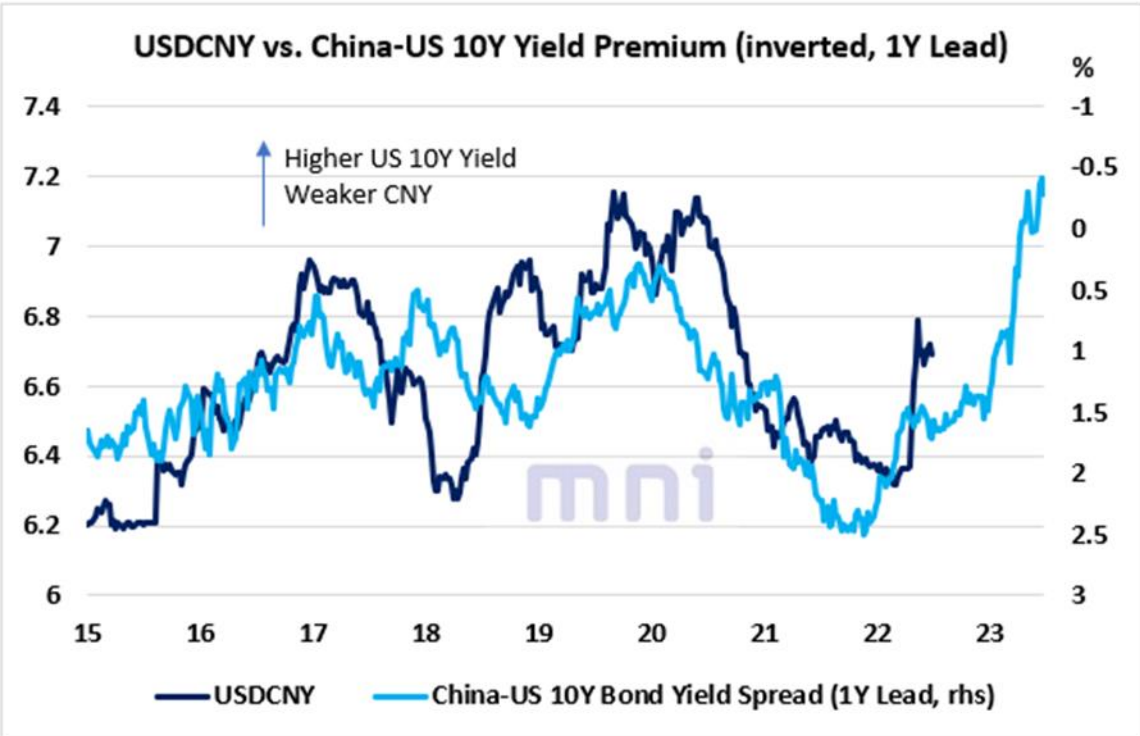
China 10Y yield has been testing its 200DMA resistance in recent days (2.84%). Further acceleration in the business activity could lead to a breakout on the 10Y yield; next key level to watch on the topside stands at 2.92% (50% retracement of the 2.4660% - 3.3720% range (figure 6).

Figure 6 (source: Bloomberg)

USDCNY: Tactical ST 'Bear' Retracement, But Negative China 10Y Bond Premium Could Push USDCNY To New Highs in MT

Logically, a short-term rebound on China equities should lead to inflows supporting the CNY in the near term. However, CNY still remains risky in the medium term as the China 10Y bond yield premium remains 'deeply' negative (figure 7). We previously saw that for countries where LT bond yields have remained low in the past few months despite the rise in global inflationary pressures, the 'reflation trade' has been played out through the currency (i.e. Japan, and to a lesser extent China in April/May).

Figure 7



Source: Bloomberg/MNI

Technical Chart Looks CNY Bullish (vs. USD)

USDCNY reached a local high of 6.8125 in mid-May, then reached a lower high at 6.7610 in mid-June and the pair has been trading around the 6.70 level in the past two weeks. Technical chart is currently showing that we may be in a tactical 'bear' consolidation (lower highs on the pair); however, USDCNY may find some support in the near term around the 6.64/6.66 area, which corresponds to the 38.2% Fibo retracement (6.3060 – 7.1780) and the 50DMA. On the topside, first resistance to watch stands at 6.7420 (50% retracement), followed by 6.80.

Figure 8

Source: Bloomberg