Another Warning Signal

- **Gold providing useful signal of growing concerns around currencies**
- **Currency and monetary policy issues appear drivers**
- **Growing significance of CNY for a range of markets**

There’s little doubt that the prime driver for the recent move in gold has been the ratcheting up of expectations about the pace of Fed rate cuts that has emerged since the breakdown in the US/China trade talks.

Indeed the 20-day correlation between gold’s performance against the USD and that of June 2020 Fed funds futures is a pretty robust 94%.

It’s therefore not surprising that the USD index spent much of the period since late May under pressure.

Something changed last week, however.

While expectations about the path of US policy continued to turn increasingly dovish (at least until Friday’s numbers) and gold tracked these expectations against the USD, it was also noticeable that the USD index remained stable to higher.

Rather than saying anything about the USD, this was a fairly clear indication that faith in other currencies was starting to erode as well.

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**Newswatch**

1. **China:** Meng Wei, spokeswoman for the NDRC, says that it will study and roll out relevant polices on rare earths as soon as possible.

2. **China:** The PBOC says that the second phase of a cut in the
Rather than saying anything about the USD, this was a fairly clear indication that faith in other currencies was starting to erode as well.

While last week saw dovish comments or actions from a number of central banks, it’s worth noting that there was also a sharp increase in discussions about what China might or might not allow to happen to the CNY in the weeks ahead.

The net result of this was a steady creep higher in the USD/CNY one-year NDF outright towards the key CNY 7.00 level.

So why does this matter? As clear an example as to why comes from looking at the relative currency impact on Japan’s TOPIX stock index.

It’s worth recalling that when the BOJ finally pulled away from its multi-decade intervention program in March 2004 one of the most notable results was that the TOPIX began to show a high reverse correlation with the performance of the JPY against the USD.

However, it’s noticeable that another relationship has emerged over this period, with the TOPIX tending to have a slightly higher correlation with CNY/JPY (using a rolling 200 day correlation).

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This pattern has become more pronounced since the end of 2013, at around the time of the third plenum. Since then the Japanese equity market has typically proved far more sensitive to shifts in the CNY than those in the USD.

reserve requirement ratio will free about CNY 100 bn worth of long term funds. It also injects CNY 150 bn via 14-day reverse repos to “keep liquidity level stable at end-June.”

3. Oil: Saudi Energy Minister Khalid al-Falih says there must be “a rapid and decisive response to the threat” to energy supplies, market stability and consumer confidence.

4. Eurozone: ECB executive board member Benoît Cœuré tells the FT: “The constellation of prices in the bond market paints a picture of the global economy which is very bleak. Central banks should never ignore market signals. They shouldn’t follow them blindly either.”

5. Eurozone: ECB Vice President Luis de Guindos tells Corriere della Sera (when asked what the bank needed to see to provide more stimulus): “What we need to see is a de-anchoring of inflation expectations.”
This pattern saw a brief breakdown in February, March and April (roughly equating to the period of relative optimism for the US/China trade talks).

However, as the CNY has come under pressure against both the USD and JPY over the past month and a bit, the relationship has begun to kick back in.

It therefore seems reasonable to suppose that a sustained weakening in the CNY could make itself felt in Japanese equity markets, in turn potentially impacting the JPY.

With other examples of the direct and indirect impact of the performance of the CNY continuing to emerge, it's understandable why investors might be cautious about a wide range of currencies.

That would seem to be the message from the gold market as well as from the quiet gains the CHF continues to make.

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On the Radar

June 17, 2019

- Speakers include the ECB's Mario Draghi (1800 BST) and the BOC's Lawrence Schembri (1930 BST)

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