The CNY in the Spotlight

- The CNY’s weakening is firmly in focus
- Past speculation about a breach of 7 to the USD has been the source of instability
- Market restraint apparent but the mood is changing

After posting the fifth largest weekly fall against the USD since 2010, the CNY slid a further 0.8% yesterday to leave the currency trading at more than 6.9 to the USD in offshore markets for the first time this year.

So, from the relative stability of 6.7 to the USD - at which level the CNY traded for much of the first quarter – investors now find themselves contemplating the possibility of a renewed test of the all-important 7 to the USD level.

That stocks globally and a number of emerging currencies have weakened markedly in tandem with the CNY’s slide amid prevalent uncertainty over US-Sino trade relations is now a familiar sight.

Certainly, where the CNY goes, other Asian currencies seem bound to follow, as with only one or two exceptions, cross-correlations in USD-Asia have been very strong, historically.

In fact, since the start of last year, relative to the USD, the CNY’s daily correlations with the SGD, KRW, THB, IDR, MYR and PHP have ranged from 0.96-0.98% and...
although, clearly, this does not in itself imply causality, China’s economic dominance in Asia has long made the CNY a benchmark against which all regional competitors are measured and stability inferred.

The potential for instability in regional and by extension, global equity and currency markets is all too apparent

Hence, as the CNY slipped steadily from 6.4 to the USD from June last year (stoking fears that the US/China trade spat had morphed into a currency war), a number of Asian central banks were obliged to defend their currencies – including Bank Indonesia, for example, following the IDR’s biggest fall in two years on July 15.

And as the momentum built for a move beyond CNY 6.9 to the USD on August 10-14, regional stocks came under concerted pressure, with the Kospi, Hang Seng and Thai SETI, for example, losing 2.4%, 4.5% and 2.7% respectively.

Stocks stabilised after the PBOC tweaked its methodological control over the CNY (in order to ‘promote stability’) on August 26, but a second concerted phase of CNY weakening through to the end of October (after the PBOC cut banks’ reserve requirements on October 8th) contributed to a marked retreat in stock prices globally.

A concurrent rise in Treasury yields also played a part, but the S&P500’s 6.5% rally (through to November 7) amid USD/CNY retreat from USD 6.97 to USD 6.91 was notably cut short as USD/CNY ventured swiftly back towards 6.96 over the next few days.

A genuine case for a weaker CNY could be made on the basis of weakening export trends and a diminishing current account surplus.

---

3. President Trump: "I have a feeling [US trade delegation] going to be very successful"

4. Australian business confidence nudges higher as conditions falter

5. Japan’s 'economy watchers' index nudges up from near two year lows

On the Radar

May 14, 2019

• UK Mar ILO unemployment (0930 GMT+1)
• DE May ZEW index (1000 GMT+1)
• EZ Mar industrial production (1000 GMT+1)

Featured Article
Of course, for the moment at least, the fact that even the one year USD/CNY NDF outright has yet to break CNY 6.90 suggests that investors are not yet contemplating a sustained move beyond CNY 7.

Lasting hope that there may yet be a deal is possibly a factor (with both sides still willing to talk) and the market is also conscious of Beijing’s wariness of risking capital outflows. However, as we argued last week, the fact remains that the mood is clearly shifting.

Certainly, a genuine case for a weaker CNY could be made on the basis of weakening export trends and a diminishing current account surplus, but the fact is that irrespective of previous assurances about the CNY’s stability, it may be impossible to separate the CNY and its potential leverage in trade negotiations.

As we ponder Beijing’s intent, then the potential for markets to remain wary of taking-on risk is all too apparent.

Please direct questions or comments to:

AerialView@BNYMellon.com