Chinese yuan at a glance: There and back again

It’s been a hectic April as the whirlwind of tariff news after Trump’s 'Liberation Day' announcement consumed markets. As we have reached a period of relative calm, it’s a good time to reflect on the developments of the last month and how they have impacted the USD/CNY, which has come full circle this month

There and Back Again – a USD/CNY tale

To borrow from the great JRR Tolkien, the USD/CNY story in April has been much like Bilbo Baggins’s autobiography from The Hobbit – There and Back Again.

Ahead of the 'reciprocal' tariff announcements, the USD/CNY and USD/CNH traded at 7.26 and 7.27, respectively. The abrupt escalation of tariffs sent yuan depreciation pressure to a new peak, with the USD/CNY eclipsing 7.35 and the USD/CNH nearing 7.43 at their respective summits.

However, the People's Bank of China's fixings in the post-tariff escalation confirmed that the objective of currency stabilisation remained intact, and the depreciation pressure fell away sharply. At the time of writing, the USD/CNY and USD/CNY are back to around 7.26, more or less where we started before the tariff shocks.

What to make of the PBoC's stance as the trade war broke out

The PBoC's fixings over the past month continued to signal that the currency stability objective, which has featured prominently in the past few years, remains securely in place despite the trade war.

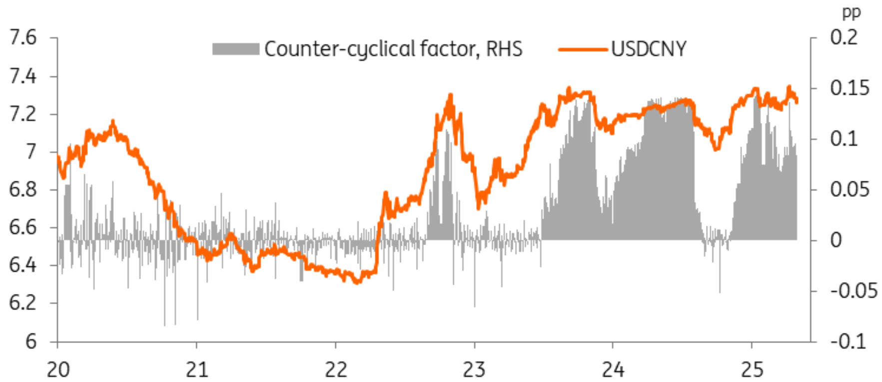
During the peak of the depreciation pressure in April, the PBoC only set a small move higher in the fixings, and set the countercyclical factor near historic highs in early-mid April. While the USD/CNY fixing was set above 7.20 for the first time since 2023, it peaked at a little over 7.21, showing limited tolerance for a weaker yuan.

There has been much speculation in markets that China would intentionally devalue the yuan to help offset tariffs. We've been repeatedly arguing against this since last year, and the developments of the last month appear to be proving us correct on this front.

As we saw from the whirlwind escalation of tariffs to 145%, intentional devaluation would have been ineffective, as there's no real ceiling on how high tariffs could go, and intentional devaluation would have been met with further tariff hikes. A 5, 10, or even 20% devaluation would've done little to offset 145% tariffs and would also have significant implications on purchasing power, confidence, and RMB internationalisation goals.

With official communication continuing to emphasise currency stability and action backing it up, we see little reason this will change.

PBoC maintained tight grip on CNY amid market turbulence



Sources: Refinitiv, CEIC, ING

History does not always repeat itself - why the CNY may not repeat the depreciation from the first trade war

One common argument that CNY bears have used is to look at the trajectory of the USD/CNY during the first trade war, when the pair moved from around 6.27 in April 2018 to 7.18 by September 2019, a depreciation of around 14.5%.

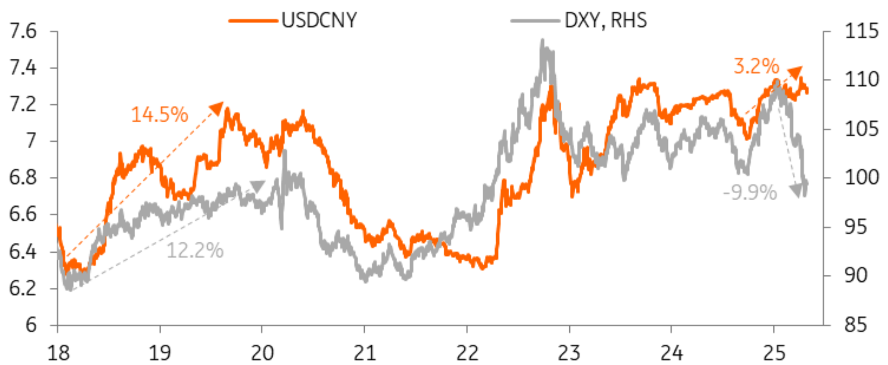
The argument was that China intentionally allowed the yuan to depreciate, but this ignores the broader context of markets at the time.

There are some key differences between the first and second trade wars for the FX market.

- First and most importantly, the first trade war took place during a Federal Reserve rate hike cycle, which prompted a strong dollar environment; the dollar index rose around 12.2% between the 2018 low and the 2019 high. The second trade war takes place during a rate cut cycle, prompting a weaker dollar environment, and the dollar index is already down around 9.9% from this year's high.
- Secondly, the first trade war featured relatively smaller tariff measures, which were partially absorbed by exporters and importers cutting margins, and generally was seen as more damaging to China than the US. Many Chinese firms were ill-prepared for a trade war, given the narrative at the time was that high levels of interdependence would prevent a trade war. The second trade war is of a much larger scale and threatens not just the economic outlook for China but also the US. Recession risks in the US generally look higher than in China this time around.
- Thirdly, the past few years have featured a significantly different backdrop for asset allocation and capital flows. In the past few years, we saw heavy capital inflows to the US after the rate hikes and the tech boom, while China has seen capital outflow pressure and a period of entrenched pessimism. The hot money available to flow out of each market is markedly different compared to 2018.
- Fourthly, China's focus on currency stability has strengthened in recent years. Compared to 2018, more Chinese companies are also expanding outward direct investment, and the yuan's role as a settlement currency has expanded. Maintaining consumer confidence and domestic purchasing power is also increasingly important given the pivot toward boosting domestic demand.

These factors explain why we cannot expect a simple repeat of 2018-2019.

Vastly different backdrop between first and second trade wars



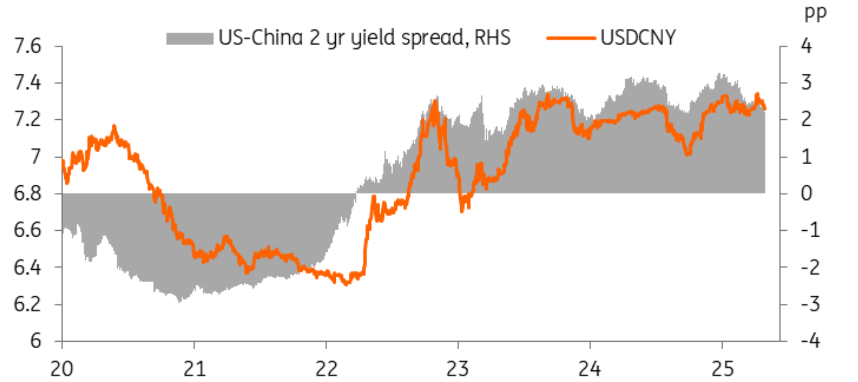
Sources: Refinitiv, CEIC, ING

Yield spreads moving in favourable direction for CNY

US-China yield spreads have been a major driving force behind CNY depreciation pressure since the US rate hike cycle in 2022. The 2-year yield spread peaked at 3.28pp in December 2024, and has gradually narrowed since then as expectations for Fed rate cuts picked up.

The current spread of around 2.2pp marks the lowest level since September 2024 and could narrow further. James Knightley forecasts 100bp of Fed cuts before year-end, while we are looking for just 30bp of cuts in China, which should result in a further narrowing of the US-China yield spread, and sets a foundation for CNY strengthening in the medium term.

Yield spreads could narrow further and support CNY vs USD



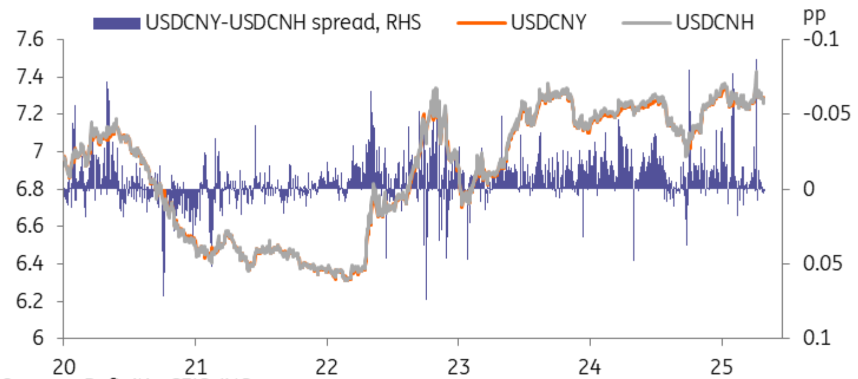
Sources: Refinitiv, CEIC, ING

CNH-CNY spread has narrowed as depreciation pressure eases

The CNH-CNY spread can be used as a sign of speculative pressure in either direction. We saw the peak of this speculative pressure in a short-lived surge of the USD/CNH to 7.43 on 8 April, a full eight cents higher than the USD/CNY at the time, marking the largest spread in over a decade.

Steady USD/CNY fixing and reports of intervention in the offshore market soon caused this spread to normalise again, and at the time of writing, the spread has narrowed back to near zero.

CNY-CNH spread briefly hit widest in a decade but quickly narrowed



Sources: Refinitiv, CEIC, ING

Dollar weakness and USD/CNY stability has led to depreciation vis-à-vis other currencies

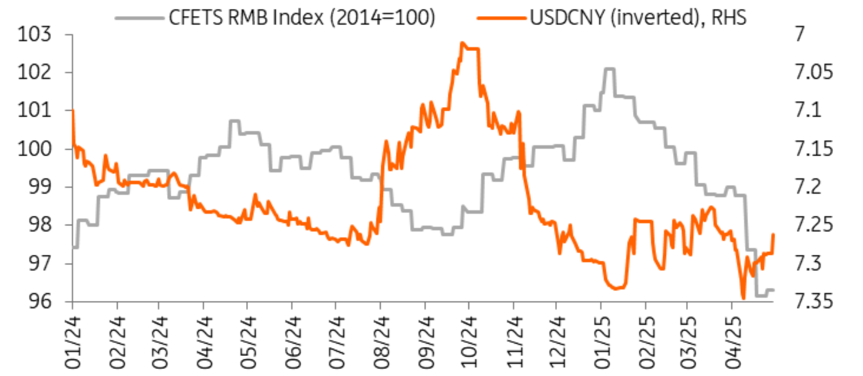
While the CNY has stayed remarkably steady against the USD, it has taken a hit against other currencies amid the broader dollar weakening trend. The CFETS RMB index is down around 2.7% in April.

The recent depreciation of the CNY vis-à-vis non-USD currencies is not an intentional move to devalue the yuan, but rather it is almost entirely a reflection of USD weakness and the focus on USD/CNY stability. The dollar index is down around 5% in April, an even steeper decline than the

CFETS.

As the two countries at the centre of the tariff battle, both the USD and CNY have been relative underperformers against other currencies in the past month, both down around 5.1% versus the EUR in April.

CFETS index has underperformed USD/CNY pair amid broader weak dollar environment



Sources: Bloomberg, ING

PBoC absorbs first big shock of 2025

The recent developments in the USD/CNY appear to be vindicating our FX call this year, though there's still a long way to go.

Our view has been that the CNY depreciation pressure will be highest in the second quarter this year. It looks for now that the worst of the depreciation pressure may have passed for now, as tariffs have already quickly hit the endgame.

With that said, the outlook remains highly uncertain given how fast things can change, and it's still possible that the Trump administration could choose further non-trade escalations, especially if frustration grows that China is refusing to capitulate. There's certainly no guarantee that the Chinese currency is out of the woods just yet.

We hold our forecast USD/CNY fluctuation band of 7.00-7.40. Risks to our year-end forecast of 7.30 look tilted to the downside (more CNY strength), especially if we do see some de-escalation of US-China tensions in the coming months, and if both the PBoC and Fed rate moves progress in line with our ING forecasts.

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