CNY: Second-guessing the PBOC proves a challenge

Friday's move in USD/CNY raised speculation that the PBOC was preparing to allow a new period of weakness for the renminbi. Today's market activity suggests otherwise

Friday's CNY move gets partially unwound

Last Friday saw significant movement in the USD/CNH pair after the People's Bank of China raised its USD/CNY fixing by the largest amount since the start of the year, allowing for the USD/CNY onshore pair to trade through 7.20 for the first time since November. Markets speculated that this was a key moment indicating that the PBOC was finally willing to let the RMB weaken after ramping up the use of the counter-cyclical factor (the level to which they push back against depreciation) since the start of the year.

Factors supporting the idea of the PBOC tolerating a weaker renminbi included an overall weakening of Asian currencies and speculation that China's priority on market stabilisation around the Two Sessions period was over. As the CNY has recently been mostly trading on the weak-side limit of the USD/CNY fixing, less PBOC pushback would translate to a weaker RMB, given the current macroeconomic backdrop and capital flow situation. As a result, the CNH on Friday moved to the weakest level since November 2023 as investors positioned for this.

However, it appeared that offshore markets may have jumped the gun a little, as the PBOC pushed back against depreciation on Monday with a lower USD/CNY fixing. USD/CNH dropped sharply from around 7.28 before the fixing to just below 7.24 - but is starting to creep higher again. We believe that though short-term factors do favour a slightly weaker RMB, any depreciation that we get will be gradual and controlled. The Two Sessions indicated a priority to "stabilise the RMB at a reasonable and balanced level." Barring a shift in policy priorities, we believe the 7.34 level for the USD/CNY from 2023 is unlikely to be broached this year.

Dollar bears dodge a bullet

Speculation on Friday that the PBOC was allowing another discrete leg lower in the renminbi undermined emerging currencies across the board and reversed the dollar sell-off caused by Chair Powell's dovish testimony last Wednesday evening. Asian currencies have typically underperformed this year, and the fear was that a new leg lower in this bloc would see the dollar bid across the board. Today's activity from the PBOC has put that CNY depreciation genie partially back in the bottle - although investors will want to see whether the USDS/CNY fixings now continue to come in below 7.10 and whether USD/CNY can return below 7.20 again.

Should fears of a softer renminbi re-emerge for whatever reason over the coming weeks, in the G10 space year-to-date correlations suggest the Australian and New Zealand dollars would be most vulnerable. In the emerging currency space, the Singapore dollar is mechanically at risk by the nature of its basket arrangement, while South Africa's rand would typically be an under-performer too.

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