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FX

Daily FX Strategy: Nasty cocktail for cyclical FX pairs

The Chinese yuan has fallen to the lowest level against its basket since 2014. This is all bearish for risk assets and cyclical currencies



➔ USD: Look out for Trump tweets on the dollar later

Following last week's: (i) less dovish than expected Federal Reserve meeting and (ii) the extension of US trade tariffs on China, risk assets are today faced with the prospect that (iii) Chinese authorities are now using the Chinese yuan as a policy tool in the trade war. As [Rob Carnell writes today](#), the weaker CNY fixing looks a deliberate decision. The context here is that during past periods of CNY pressure, the People's Bank of China have used the counter-cyclical factor (or manual over-ride) to set the USD/CNY fixing below levels determined by pure model-based measures. So for today, while models did suggest fixing levels close to 6.92, the market had expected the PBOC to resist this by announcing a figure under 6.90. Instead, the PBOC fixed at 6.9220 suggesting the PBOC is letting the CNY go and we've now seen that in the CNY falling to the lowest level against its basket since 2014 and USD/CNY breaking through 7. In theory, today USD/CNY can trade +2% over the fixing (i.e. to 7.06) and USD/CNH could potentially trade into the 7.16/20 region – repeating the extreme CNY-CNH basis seen in 2015. This is all bearish for risk assets and cyclical currencies. Expect the safe havens of Japanese yen and Swiss franc to remain in demand (especially with very limited room for FX intervention), while commodity FX and emerging markets FX in general should stay under

pressure – the South African rand and Indonesian rupiah have had the highest correlation with CNY this year. There is also a risk later that President Trump responds to 7+ levels in USD/CNY by claiming that China is playing a ‘big currency manipulation game’. This may extend to a threat to weaken the dollar, which will only encourage short positions in USD/JPY and a pick-up in traded volatility prices. DXY looks mixed, but favour short USD/JPY & USD/CHF.

↓ **EUR: Escalating trade war bad news for the cyclical euro**

EUR/USD has got a lift from US equity futures being marked 1%+ lower this morning. Escalating trade tensions won't help the euro and will only encourage thoughts of ECB QE2. EUR/JPY to trade to 116.50, [EUR/CHF en route to 1.05](#), EUR/USD to struggle at 1.1160/80 – unless Trump tweets about FX intervention.

↓ **GBP: Preparing for an election**

Domestic UK politics (more NHS spending announced) looks like the Johnson government is bracing for early elections. Sterling unlikely to find buyers soon.

↓ **AUD: RBA's pause unlikely to come to the rescue**

The Reserve Bank of Australia will announce monetary policy at 0530 GMT on Tuesday. Last week's robust 2Q CPI number helped cement market expectations (92% implied probability) that the central bank will keep its cash rate at 1.00% after delivering 50 basis points of monetary easing in the past two months. Our views are in line with consensus and we expect the focus to be on the RBA's forward-looking language, which will likely reiterate the pledge to adjust rates again to further support inflation. The battered Australian dollar is unlikely to find much support from the rate outlook and may continue to suffer from the new tariff-induced risk-off mood. In turn, we expect AUD/USD to press the 0.6740 January flash crash low.

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