

FX Daily: Asian FX sell-off adds another leg to the dollar rally

A new front has been opened in the dollar's rally. The People's Bank of China has fixed the renminbi weaker than models were predicting over the last two sessions. This hints that the PBoC could be looking for a slightly weaker renminbi after all. This could unlock another leg lower in Asian FX and add to dollar gains more broadly



USD: Dollar rally broadens

The week starts with continued focus on peace talks in Ukraine - even though there seems to be no let-up in Russia's military pressure at all. Away from events in eastern Europe, China is starting to dominate the headlines, too. The sharp pick-up in Covid cases has put major cities such as [Shanghai and Shenzhen into lockdown](#) - with no suggestion that Chinese authorities are prepared to back away from their zero-tolerance stance to Covid.

The relevance of China to global FX markets is the following. Since Russia invaded Ukraine, USD/CNY traded (was managed) in a very tight range, such that the trade-weighted renminbi rose 3%. The view we had was that Chinese authorities were happy to see the renminbi play a role

(alongside the dollar) as a global safe haven. Yet over the last two sessions, the PBoC has fixed the renminbi quite substantially (150 pips last night) weaker than models would have predicted.

This suggests that the PBoC may be prepared to see - or even encourage - renminbi weakness as a means to support growth. For today, let's see whether USD/CNH pushes towards the 6.40 area. Such a move could see Asian FX soften even further (a strong renminbi had offered a little support to Asian regional FX). A stronger USD/CNH - especially backed by the narratives of lockdowns/slower Chinese growth - could also see some of the commodity-linked currencies like the South African rand and Brazilian real come under more pressure, too.

And weakness in the renminbi will merely add to the broad dollar bull trend ahead of [Wednesday's FOMC meeting](#). Barring any significant de-escalation in Ukraine, all indications point to the DXY trade-weighted dollar index rallying to 100 this week.

⬇️ EUR: Does the ECB care about the euro?

A report sourced by the European Central Bank last week claimed that EUR/USD weakness was partly responsible for the ECB's decision to wind down its Asset Purchase Programme scheme relatively quickly. The news had very little impact on EUR/USD, which remains pressured on the stagflationary shock to the region. We cannot really see the environment changing anytime soon and feel that some lasting damage has been done to the euro's fair value from this sharp decline in the region's terms of trade. More on that later this week.

EUR/USD trading in a volatile 1.08-1.10 range would be our guess this week and as we discuss in the [FOMC preview](#), we doubt a Fed underwhelming market expectations of seven rate hikes this year would do too much damage to the dollar.

➡️ GBP: Dollar trend dominates

The Bank of England meets to [set rates on Thursday](#). ING's James Smith, like the market, is looking for a 25bp rate hike. His view is that the market is far too aggressive in pricing six hikes this year, although Thursday may be too soon for the BoE to manage tightening expectations substantially lower. We say this because UK CPI looks set to push up towards the 8% year-on-year area in April and the BoE probably prefers a strong pound to try to alleviate some of the pressure from imported energy prices.

EUR/GBP can probably drift back towards the 0.8350 area. And one month realised EUR/GBP is back to the highest levels seen since early 2021. However, we continue to favour the dollar in the current climate and GBP/USD still risks a drop to the 1.2850 area after last week's downside breakout.

⬇️ JPY: 120/USD here we come

USD/JPY continues to press higher driven by both higher US yields and the fallout of the fossil fuel surge on Japan's trade balance. Tomorrow, Japan releases February trade data. The January trade deficit in Japan was the worst monthly trade deficit ever.

The Bank of Japan meets on Friday, but we doubt there will be any hint of monetary tightening. Instead, it seems that the Japanese government will once again look to fiscal support to alleviate high energy prices.

Mid to late-cycle bearish flattening of the US yield curve should remain a positive for USD/JPY. And we continue to see it grinding towards the 120 area. One of many wild cards this week is Russia's \$117mn payment on its Eurobond due this Wednesday. Russia has said that unless its FX reserves are unfrozen, it will only service this FX debt with roubles. This raises fears of a technical default. How such a technical default ripples through the global financial system (via the buy-side) remains to be seen. But a big leg lower in equities on the back of this could stop the USD/JPY rally in its tracks.

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