FX Daily: China's yuan absorbs US-China tensions, for now

Hong Kong seems set to see another round of mass protests against recent Chinese security laws and the US is reportedly considering a plethora of sanctions on Chinese entities. The yuan is absorbing most of the impact so far, with USD/CNY breaking above 7.15 to levels last seen in September 2019 when trade tensions with the US peaked

USD: The downside looks limited as global tensions rise

Price action in FX has stabilised in early trading today after the vaccine-generated risk-on move gave a boost to pro-cyclical currencies yesterday. European stocks and US equity futures remain in mildly positive territory signalling no change to the general market mood just yet, helped by reports in the Asian session that Japan may deploy another USD1 trillion in fiscal stimulus. Investors continue to turn a blind eye to US-China tensions, which continue to rise nonetheless. Hong Kong seems set to see another round of mass protests against recent Chinese security laws and the US is reportedly considering a plethora of sanctions on Chinese entities (freezing assets, controlling transactions may be the main ones). The yuan is absorbing most of the impact in the FX space so far, with USD/CNY breaking above 7.15 to levels last seen in September 2019 when trade tensions with the US peaked. Markets are now seeing a rising possibility of the People's Bank of China allowing its currency to depreciate further in reaction to the possible US sanctions. The complacency of global markets to rising geopolitical tensions places a big question mark over the robustness of the recent risk rally, which leaves high-beta currencies exposed to the material risk of a correction (Australian and New Zealand dollars in particular) and suggests the USD may have bottomed out. Apart from geopolitical developments, today's calendar offers a few other catalysts, with the key release being the Fed's Beige Book - which should help gauge the pandemic fallout on the US economy – and remarks by Federal Reserve member James Bullard. Both of these events may have a limited market impact.

EUR: Waiting for good news on the Recovery Fund

EUR/USD was mostly lifted by a weaker dollar, as the euro seems to be lacking idiosyncratic news to rally on. The feeling is that the EU Recovery Fund holds the key for the euro so markets will closely monitor any signs that the so-called "frugal four" are ready to make concessions on the shape of the Fund.

GBP: Stalling Brexit negotiations

Bank of England Chief Economist Andy Haldane poured cold water on negative rates speculation yesterday, which helped cable stabilise above 1.23 as the US dollar weakened. Brexit negotiations with the EU still haven't fully taken centre stage in GBP, but they may well do so in the coming days, which hardly bodes well for sterling considering the rising chance that no deal will be agreed.

CHF: Speculators raise bets on parity

The latest CFTC data on FX positioning (last updated on 19 May) showed a jump in CHF net longs which likely denotes rising speculative bets that the Swiss National Bank may soon stop defending EUR/CHF at the 1.05 level (seen as a line in the sand by the markets lately) and may let the pair slide through parity. We discuss why this could happen in "EUR/CHF: The case for parity".

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