

## FX Daily: CNY depreciation risk adds to bullish dollar tone

As if high US inflation and strong activity data, geopolitical risks and a looming ECB rate cut were not enough to drive the dollar stronger, the dollar could now be buoyed by Chinese authorities allowing a weaker renminbi. For today, let's see how sterling reacts to important wage data, and Canadian CPI could add to speculation of a June rate cut



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### USD: The dollar has plenty going for it

Instead of geopolitical risks, Monday's FX session was dominated by the very strong March [US retail sales numbers](#). Consumption was meant to be the weak link in the US economy, but the lack of slowdown in this segment very much supports the view that the Federal Reserve is in no rush to cut rates. US two-year Treasury yields pushed back close to 5.00% and the dollar extended recent gains.

The broadly stronger dollar is now having some ramifications for Asian currencies. Many high-yielding or high-profile currencies such as the Indonesian rupiah and Korean won are falling sharply - alongside the Japanese yen. The fact that China has been keeping the renminbi stable

has meant that the trade-weighted renminbi has surged about 1.3% (quite a big move) over the last week. On investors' minds is the question of whether the People's Bank of China (PBoC) will now allow more flexibility into the renminbi - a not unwelcome development given very low Chinese inflation and [weak export growth](#). That is why investors are hyper-sensitive to the PBoC's daily USD/CNY fixing.

Back on 22 March, the PBoC experimented with a fixing above 7.10 - which resulted in heavy losses for both the onshore and offshore renminbi. Subsequent fixes were made sub 7.10, but last night the PBoC fixed USD/CNY at 7.1028 - suggesting it was acceding to market pressure to allow the renminbi to weaken. The prospect of the PBoC allowing a weaker renminbi is a bullish one for USD/Asia and for the dollar in general. The highest correlations with the CNH in the G10 space are the Australian and New Zealand dollars. In the EM space, apart from the directly managed Singapore dollar, the South African rand has the highest correlation with the CNH.

In short, should the PBoC start to allow a higher series of USD/CNY fixings - acceding to market pressure - it could prove a boost to the dollar around the world.

Today's US calendar is quite light - just housing starts and industrial production. There are also a few Fed speakers, including Chair Jay Powell participating in a moderated Q&A with Bank of Canada Governor Tiff Macklem. This takes place at 1915CET. The only downside risk to the dollar we see today is from Canadian CPI. Should a soft March Canadian CPI firm up views of a June BoC rate cut, it could drag US yields and the dollar slightly lower intra-day.

It is very hard to fight the dollar bull trend right now and DXY may find support at 106.00 ahead of a trend towards 107.

*Chris Turner*

## ↓ EUR: Under pressure

Policy divergence remains the dominant story here. As discussed yesterday, the greater headwinds for global equities are allowing EUR/USD to play catch-up with yield differentials - which are at their most favourable for the dollar since late 2022.

There is not too much on the eurozone calendar today - just a few ECB speakers and the ZEW investor expectations survey. Technically, it looks as though EUR/USD will undergo a series of shallow corrections and drop to new lows - suggesting a 1.0500 target for the next week or so is a good one.

*Chris Turner*

## → GBP: Mixed data for sterling

Sterling is jumping around on this morning's employment and wage release data. While some may be focusing on the decline in employment, we think the 12% annualised month-on-month reading in private sector pay is far more consequential for the Bank of England. This is not the kind of benign wage data the BoE needs to see before it is prepared to cut rates.

Tomorrow's March UK services inflation will be the bigger story for sterling. But for today, from a macro perspective, we take issue with sterling weakness on the back of today's data and could easily see EUR/GBP returning to the 0.8530 area and maybe lower, once the UK rates markets have

a chance to sink their teeth into the high private sector wage data.

*Chris Turner*

## 📌 CAD: A key inflation print ahead of June

Canada's inflation numbers for March are released today and may tilt the balance further in favour of a June rate cut by the Bank of Canada. The inflation picture is already looking considerably brighter than in the US, with headline CPI having fallen to 2.8%, which is within the BoC's tolerance band

(1-3%) and core measures only modestly above 3.0%. The BoC acknowledged the disinflation success at the [April meeting](#) but said it wants to make sure the price deceleration is not temporary.

Consensus expects a slight rebound in headline CPI to 2.9%, while the median and trimmed mean measure of core inflation are seen declining further to 3.0% and 3.2%. We believe that unless we see a substantial rebound in all those metrics today or in the April print, then the BoC should cut rates by 25bp in June. The major risk to this call actually stems from outside of Canada, as strong US data would put easing by the BoC on a diverging path from the Fed. This is historically something the BoC has disliked, but we are observing more central banks (like the ECB) pushing that divergence narrative, and lower inflation can no longer justify the tight grip on very rate-sensitive Canadian households. Our call for now remains a June cut by the BoC.

The loonie remains in a stronger position in the short term compared to other commodity currencies on the back of its lower sensitivity to risk-off swings and geopolitical turmoil. However, if we see some stabilisation in market sentiment, CAD would look less attractive due to the underpriced (55%) risk of a BoC cut on 5 June.

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