

FX Daily: PBOC back in the (FX) game

The PBOC took another step to curb CNY appreciation through a weaker fixing this morning. The fading narrative of China welcoming a stronger CNY is, in our view, set to contribute to a strong dollar environment. Today, expect another rise in US CPI, while any below-consensus read will likely have limited negative implications for the dollar.



USD: A bit more upside room as CPI set to rise again

The dollar moved in line with our expectations yesterday, strengthening across the board after Wednesday's sell-off. Markets have clearly reconsidered their optimistic stance on Omicron, and what has quite evidently been the most sensitive currency to the new variant – NOK – experienced a very sharp correction.

Moves in CNY also appear to be favouring a bullish-dollar environment. The PBOC stepped in with two key moves to curb the yuan's appreciation: first by raising the FX reserve requirements yesterday and then by fixing CNY at 6.3702 this morning, significantly higher than the consensus model estimate (avg. 6.3520). We discuss this in detail below, but more signs that the PBOC is determined to keep the yuan capped are set to have negative implications for the most CNY-sensitive currency, and favour a positive environment for the dollar.

Market moves have been detached from data inputs since last Friday's NFP, but we should see fresh focus on the US inflation story today as November CPI numbers are released. Our economist expects rising gasoline, housing and second hand car prices to be the big movers, but growing evidence of rising corporate pricing power is also likely. All in all, we expect headline inflation to push towards the 7% level, and to fall close to consensus expectations (currently at 6.8%). There is likely some room for the dollar to rally further if the headline rate breaks above 7%, while we see quite contained downside risk for the greenback in case of a moderately below consensus read. That's because inflation would need to drop quite sharply before the market can reasonably price out the Fed tightening cycle in 2022. We still expect the dollar to remain generally supported into next week's Fed meeting.

↓ EUR: Markets not at ease above 1.1300

We have seen a confirmation that markets feel quite uncomfortable with levels of EUR/USD above 1.13, with the pair that stalled at 1.1350 first and now marginally below 1.1300 again. This is denoting, in our view, a strong reluctance to turn more structurally bearish on the dollar by the market, which made the above-1.13 levels quite attractive to build back some USD longs.

We've published [our preview for week's ECB meeting](#), which includes [a note](#) on why we see limited upside potential for the euro. On this topic, keep an eye on the slew of ECB speakers, including Lagarde, Weidmann and Villeroy, this morning.

→ GBP: Showing resilience

Sterling has held up significantly well (actually outperforming all G10 currencies) in the past two sessions and after the contraction induced by new Covid restrictions in the UK. This is probably signalling that GBP was already pricing in a good deal of negative factors and its [short positioning](#) has become quite overstretched. A testament of this is the very contained FX reaction to the below-consensus growth and industrial production numbers this morning.

Data should remain in focus in the UK as the BoE inflation attitude survey is released this morning. Another significant increase in the inflation gauge may impact GBP, although that may happen mostly through a change in 2022 rate expectations rather than for next week, as markets appear now fully settled for a BoE hold.

→ CNY: Strong yuan narrative fading

After the weaker yuan fixing this morning, markets are now reasonably wondering whether the PBOC has de-facto re-introduced the counter-cyclical factor in its daily fixing, a key obstacle to any sustained yuan strength.

It is also interesting that this is happening after a long-delayed 2H21 US Treasury FX Report showed a change in the criteria, making it – in theory – harder for a country to be labelled a manipulator. While China was nowhere close to receiving a manipulator tag, the Report did raise concerns about “unofficial” FX interventions made through State banks and emerging in net foreign exchange settlement data.

It appears that the narrative of China welcoming a stronger yuan (largely on the back of higher commodity prices) is fading, or that the currency has reached levels that are too high for comfort for the PBOC, especially given the recent efforts by both the central bank and the Chinese

government to ease the strains in the economy.

Daily fixings in the coming days will tell us more about whether the PBOC is happy with having curbed the CNY appreciation or whether it is aiming at bringing USD/CNY back towards 6.40+ levels.

Authors

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.