

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.

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