

Article | 25 October 2022

FX

## FX Daily: People's Bank of China loosens its hold on the renminbi

As the FX market awaits the big ECB and Fed meetings over the next week, the hottest topic right now is what Chinese authorities are doing with the renminbi. Having tried to stabilise it since late September, a much higher USD/CNY fixing overnight suggests the PBoC is prepared to let market forces have a greater say. This is a dollar-positive story



### ➔ USD: Episodes of renminbi weakness have helped the dollar more broadly

The conclusion of the Communist Party congress in China has garnered much market attention over the last few days and culminated in intense pressure on Chinese equities yesterday. Here is my colleague [Iris Pang's take](#) on what personnel changes mean for economic policy direction. Iris has had a good call on USD/CNY as she has [made the case for 7.40](#).

USD/CNY has been pressing the upper limit of its +/- 2% daily trading range around the onshore fix. Notably, the People's Bank of China (PBoC) had been fixing USD/CNY flat near 7.11 since late September – presumably to provide some stability to the renminbi ahead of the National Congress. But overnight – and now that the Congress is finished – the PBoC has

allowed an onshore fixing much higher at 7.1668. This suggests it will now allow market forces to play a greater role in setting the USD/CNY rate. At the same time, the PBoC has adjusted macro-prudential factors to allow Chinese institutions to take on greater FX borrowing – a liberalisation of inflows to China. Yet this measure looks far more indirect than control of the USD/CNY fixings or emulating Japan in aggressive outright FX intervention in spot markets. 7.40 certainly looks like the direction of travel for USD/CNY now.

The reason we dwell on renminbi developments is that the two episodes of PBoC-sanctioned CNY weakness earlier this year (mid-April to May, and mid-August to late September) saw some of the strongest dollar gains of the year. Some currencies are directly managed against the CNY – for example, the Singaporean dollar – but many emerging market currencies and pro-risk currencies in the G10 space (including the euro) have strong positive correlations with the renminbi. A move in USD/CNY to 7.40 or higher should provide a supportive backdrop to the dollar over the coming weeks.

For today, the US data highlight will be the October consumer confidence reading. This has recently bounced given lower gasoline prices and good employment prospects. We doubt the data has much impact on Fed pricing, where the terminal rate is still priced near 4.90% for next Spring. DXY to trade a 111.50-112.50 range.

*Chris Turner*

### ➔ **EUR: IFO should add to the gloom**

The focus of the European morning will be the German October IFO data. As my colleague Peter Vanden Houte discussed [when reviewing the PMIs yesterday](#), it looks as though the eurozone is already in recession. Another soft IFO reading today will add to that sentiment but is unlikely to have much bearing on Thursday's ECB meeting. We have released an [ECB cribsheet](#) looking at scenarios for Thursday. ECB hawkishness has not helped the euro this year and EUR/USD rallies may well be capped around the trend channel at 0.9950.

*Chris Turner*

The Hungarian central bank [meeting](#) is on the agenda today. After the emergency rate hike in mid-October, we expect today's decision to be a non-event. This is backed up by the stronger levels of the Hungarian forint, which is supported mainly by the sharp drop in gas prices in recent days and the calming of the energy crisis. Although the National Bank of Hungary does not need to hike rates again at the moment, we expect the central bank to confirm its readiness to act if the forint decides to weaken again. Considering that HUF remains sensitive to global risk aversion, we cannot rule out some periodic correction. For the time being, however, the forint should remain supported and enjoy this moment of peace created by recent central bank actions and global conditions. Thus, we expect the forint to return to the 405-410 EUR/HUF range.

*Frantisek Taborsky*

### ↓ **GBP: 'Profound' challenges will delay any sterling re-rating**

Rishi Sunak will be given the keys to 10 Downing Street today. He has talked up the 'profound' challenges facing the UK economy, following on from Chancellor Jeremy Hunt's remarks that 'eye-watering' decisions will have to be made on spending decisions. Sunak has been voted in on a ticket of fiscal rectitude which may be good for gilts, but less good for sterling. True, the UK's sovereign risk has been re-priced lower (e.g. the UK's 5-year credit default swap trading back to 32bp from 52bp), but the prospective policy mix of tighter fiscal/less tight than thought previously, monetary policy looks to be sterling negative. After all, sterling is traded as a growth currency.

Clearly, 31 October is going to be another massive day for UK financial markets as Sunak/Hunt present their fiscal fix. But backing the dollar as we do, we doubt GBP/USD needs to trade above 1.15 and retain sub 1.10 targets for later in the year. EUR/GBP to trace out a 0.8650-0.8800 range for the time being.

*Chris Turner*

### ↓ **BRL: Over-rated**

Many commentators seem to be backing Brazil at the moment, arguing that its asset markets have defied the sell-off seen in many developed markets this year. This is largely down to Brazil having hiked early and aggressively. The 12%+ implied yields available through the forwards are some of the highest in the world.

Through our [FX talking publications](#), we have been taking a more negative view of the Brazilian real this year. Brazil took on a lot of debt through the crisis and the turn in the inflation cycle has largely been down to government intervention in energy prices ahead of the presidential elections. Here, Sunday sees the second-round run-off between Jair Bolsonaro and Luiz Inácio Lula da Silva. The latest polls point to a 54:46 lead for Lula. We think the prospect of a close and potentially disputed election result means that a greater risk premium should be priced into the real. We could see USD/BRL trading at 5.40/45 into Sunday's election.

Those looking for high yields and better quality credit should look to the Mexican peso. 3m MXN implied yields through the forwards are close to 11%. The sovereign CDS of Mexico trades at 182bp versus 288bp for Brazil. And one month traded volatility stands at just 11% for USD/MXN versus 26% for Brazil – serving as a reminder of the risks in holding the real.

*Chris Turner*

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