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FX Strategy

Rally In USD/CNY Is Too Fast, Too Furious

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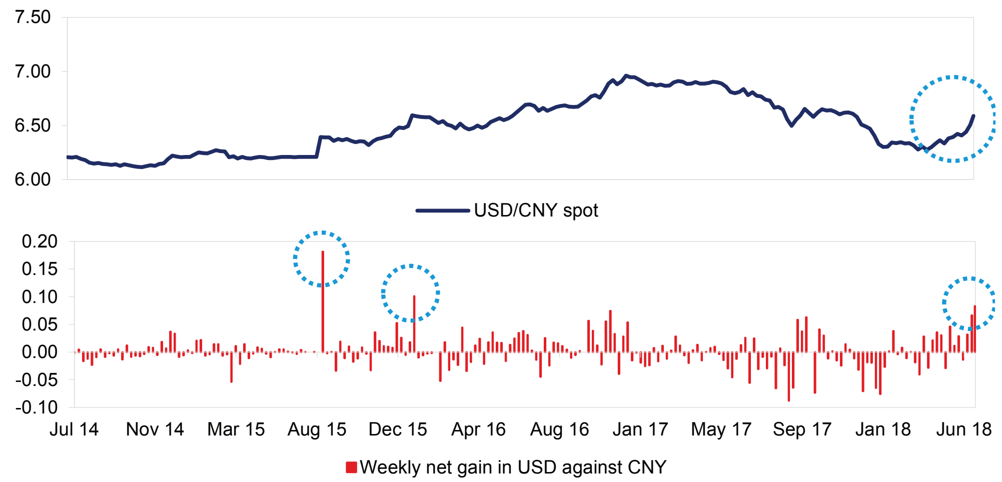
- The pace of CNY weakness intensified this week after PBoC weakened the CNY's fixing rate against the USD at a faster pace. Since 14th Jun, the CNY has weakened by more than 3% against the USD.
- At 6.60, the technical chart for USD/CNY is entering overbought zone, but an imminent top does not appear to be in place for now. The strong resistance cluster only resides much higher at 6.6820 to 6.7020. As for the downside, support is at 6.55 and only a pull back below 6.50 would indicate that USD/CNY is ready for a breather.
- Our base case remains for steady GDP growth for China at 6.7% YoY for FY18 and we see an eventual de-escalation of trade tensions. As such, while there will be near term CNY weakness because of the very fragile investor sentiment, CNY is expected to stabilize quickly should there be any signs of progress in trade negotiation between US and China.

Chart 1: USD/CNY Spot Stages Third Largest Weekly Rally Since 2015

Source: Bloomberg, UOB Global Economics & Markets Research



USD/CNY Stages Third Largest Weekly Rally Since 2015

The pace of CNY weakening intensified over the past few days, leading to a further jump in USD/CNY spot above 6.60. At the moment of writing, USD/CNY registered an intra-day high of 6.6140 by noon time of 27 Jun (Wed). From the low of about 6.27 in mid-April this year, USD/CNY has rebounded strongly to last December's level of 6.60 and has recovered about half of its loss from the early January 2017 high of 6.96.

In particular, with this move to 6.60, USD/CNY has staged the third largest weekly rally since the broad CNY devaluation crisis in late 2015. Conditions were very different back then when there was widespread capital outflow, coupled with intense fears of hard landing in China.

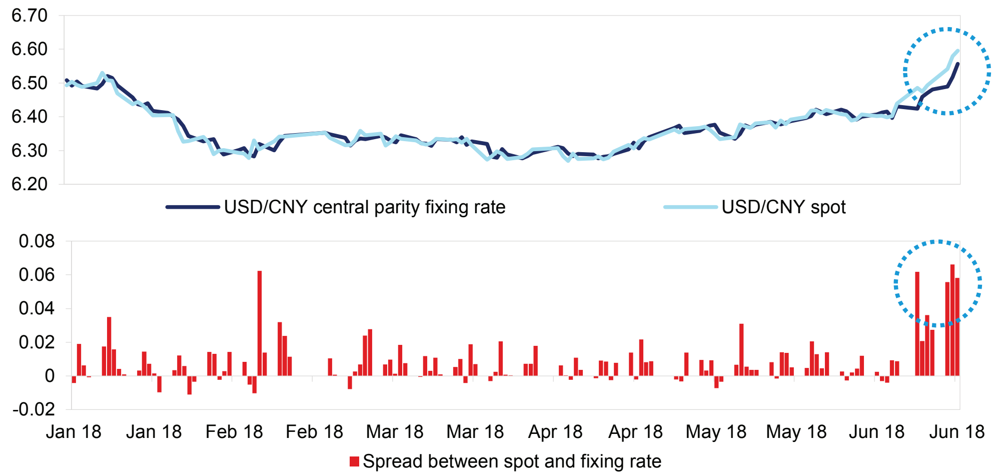
Strictly speaking, on the topic of US-China trade conflict, there is no new news flow since the start of the week when the flurry of comments from the White House suggest that the Trump administration will announce by this weekend new measures to limit Chinese investment in US technology firms as well as cap US export of technology to China. In addition, market sentiment is also frayed ahead of the implementation of the first block trade tariffs on USD 34 bn of mutual trade between US and China.

Recent Higher USD/CNY Central Parity Fix Triggers Faster Pace Of CNY Weakness

This latest round of CNY weakness started two weeks ago in the middle of June when USD/CNY spot started rallying from 6.40. Thereafter, in less than 2 weeks, the CNY has weakened by more than 3% against the USD. The pace quickened this week after the People's Bank of China (PBoC) announced a further targeted cut in Reserve Requirement Ratio (RRR). The series of higher USD/CNY central parity fix for the USD subsequently triggered a faster pace of CNY weakness in the spot market as well.

Chart 2: Recent Higher USD/CNY Central Parity Fixing Rate Triggers Faster Pace Of CNY Weakness

Source: Bloomberg, UOB Global Economics & Markets Research



In particular, this morning, the PBoC lifted USD/CNY's central parity fixing rate to 6.5569 (from 6.5180 yesterday), leading to elevated concerns that Chinese authorities may be managing the CNY in response to the increased trade conflict between US and China.

Our Base Case For China Remains That Of Steady GDP Growth At 6.7% YoY For FY18

As highlighted previously, the base case from our macroeconomic team on China remains that of steady growth, with GDP forecasted at 6.7% YoY for FY 2018, moderately lower than 6.9% YoY registered for FY 2017.

In addition, while the risk has remains for yet another targeted RRR cut going forward, the team does not see a change from the current "prudent and neutral" monetary policy stance. For more details, kindly refer to Macro Note titled "[China: PBoC Makes Another Targeted Reserve Requirement Ratio Cut]", dated 25 Jun 18.

Technical Chart: USD/CNY Rally Is Entering Overbought Zone, But There Is No Sign Of An Imminent Top

USD/CNY: 6.6020

USD rally is entering overbought zone but there is no sign of imminent top

Source: Reuters, UOB Global Economics & Markets Research

After breaking above the major 6.4346 resistance about 2 weeks ago, USD/CNY staged a torrid and blistering rally and at the time of writing, just broke above the round-number 6.6000 resistance. While the week has yet to end, based on the current level of 6.6020, USD is on track to register the largest 2-week gain since CNY devaluation in August 2015 (see chart above). After the strong surge, USD is entering overbought territory but with no sign of an imminent top, further advance in the next few weeks would not be surprising. That said, there is a cluster of strong resistance levels between 6.6820 and 6.7020 and unless there is a major development on the macro-economic front, we expect this resistance zone* to check the advance in USD, at least temporarily. On a shorter-term note, there is a minor resistance at 6.6510. To sum it up, while the current rally appears to be running too fast, too furious, there is no sign of a top just yet and further USD strength is still a distinct possibility. On the downside, support is at 6.5500 but only a break of 6.5000 would indicate that USD is ready to a breather.

*Resistance zone:
- 6.6820, high in October last year.
- 6.6855, 61.8% retracement of the decline from Jan 2017 (6.9603) to Mar 2018 (6.2410).
- 6.7000, internal boundary of ‘envelope’.
- 6.7020, declining trend-line.

CNY To Remain Weak Near Term, But Will Stabilize Once US-China Trade Tension Cools

When we published our latest quarterly report on 14 Jun, spot USD/CNY was trading at 6.40 and we were only expecting a gradual rise in USD/CNY to 6.45 by 4Q18 and 6.55 by 2Q19. That forecast has now been overtaken in under two weeks of intense CNY weakness.

Given that our view remains for steady GDP growth for China and that we expect eventual positive resolution of US-China trade relationship, we have decided not to revise our USD/CNY forecast for now. It is likely that given the overbought technical outlook for USD/CNY, spot may quickly stabilize should there be renewed clarity and de-escalation on the trade conflict.

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