FX Viewpoint Flash

Currencies
Global

USD-RMB: Sharp adjustment in external conditions

- With growing concerns over a US recession and more aggressive market pricing for Fed easing…
- …USD-RMB has followed its yield differential lower
- A global stock market sell-off may have less impact on the RMB when compared with its emerging Asian peers

USD-RMB was guided lower by its yield differential

As the market focus is now on US recession risks, market expectations for more easing by the Federal Reserve (Fed) have been a key driver of the fall in USD-RMB. Markets currently price in 125bp of Fed rate cuts by the end of 2024 (*Bloomberg*, 5 August 2024). The US-China 10-year government bond yield gap has quickly narrowed to around 160bp of late, the lowest since January 2024 (Chart 1). Some corporates that have been accumulating USD assets for the yield advantages may have started to increase their FX settlement and hedging as a result.

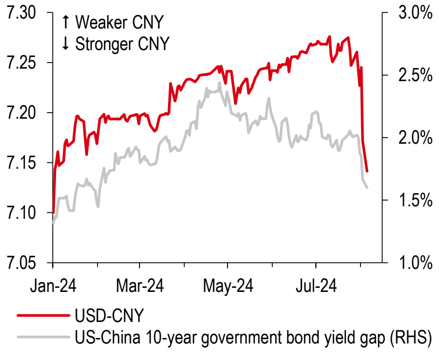
Stock markets tumbled globally, while the JPY surged

The RMB strength has also been aided by a rise of external risk aversion. Global stock markets had a torrid session on 5 August with equities falling and multiple circuit breakers being triggered on various stock indexes. Japanese stocks were particularly hurt with the **Topix and Nikkei 255 indices both falling about 12% on 5 August**, as the JPY extended its recent surge against the USD, with USD-JPY staying at around 142-143 (*Bloomberg*, 5 August 2024).

Under volatile market conditions, the RMB may be more stable, especially compared with its emerging Asian peers

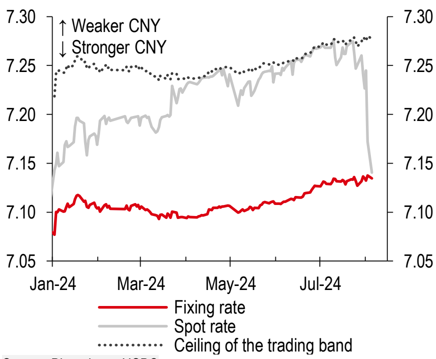
Historically, the RMB tends to be less affected by a sharp increase in volatility indicators, such as the VIX Index (which shows the market expectations of 30-day volatility of the US stock market). **The correction in global equity indices has triggered much less outflows from China**, compared to its emerging Asian peers. In fact, China has been one of the few Asian markets that saw foreigners' net equity inflows of USD443m last week via Stock Connect (*Bloomberg*, 5 August 2024).

1. USD-RMB and its yield differential



Source: Bloomberg, HSBC

2. USD-CNY: Fixing rate vs. spot rate



Source: Bloomberg, HSBC

The near-term focus for the RMB will likely be positioning adjustments

Domestically, PMI data for July shows little improvement (with a composite PMI of 50.2 vs. 50.5 in June), while the near-term price action will likely be dominated by positioning adjustments. The USD-CNY fixing rate (i.e., central parity rate) has been grinding slowly higher from c7.10 in May to above 7.13 of late (Chart 2). Despite the external market volatility, the fixing rate has remained stable at 7.1345 on 5 August (*China Foreign Exchange Trade System*, 5 August 2024). **The gap between the USD-CNY spot rate and the fixing rate has closed**, as a result. **If the fixing rate goes lower, this could trigger long USD liquidation**, resulting in a decline in USD-CNY.

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