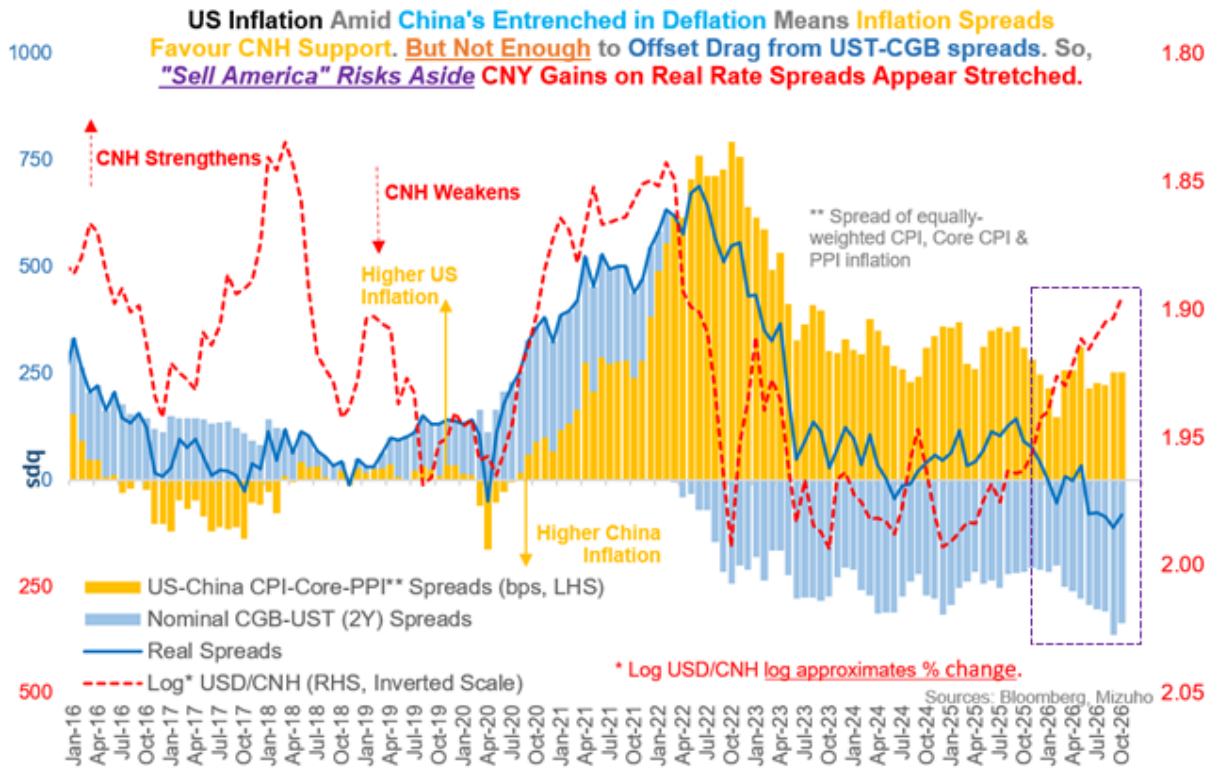
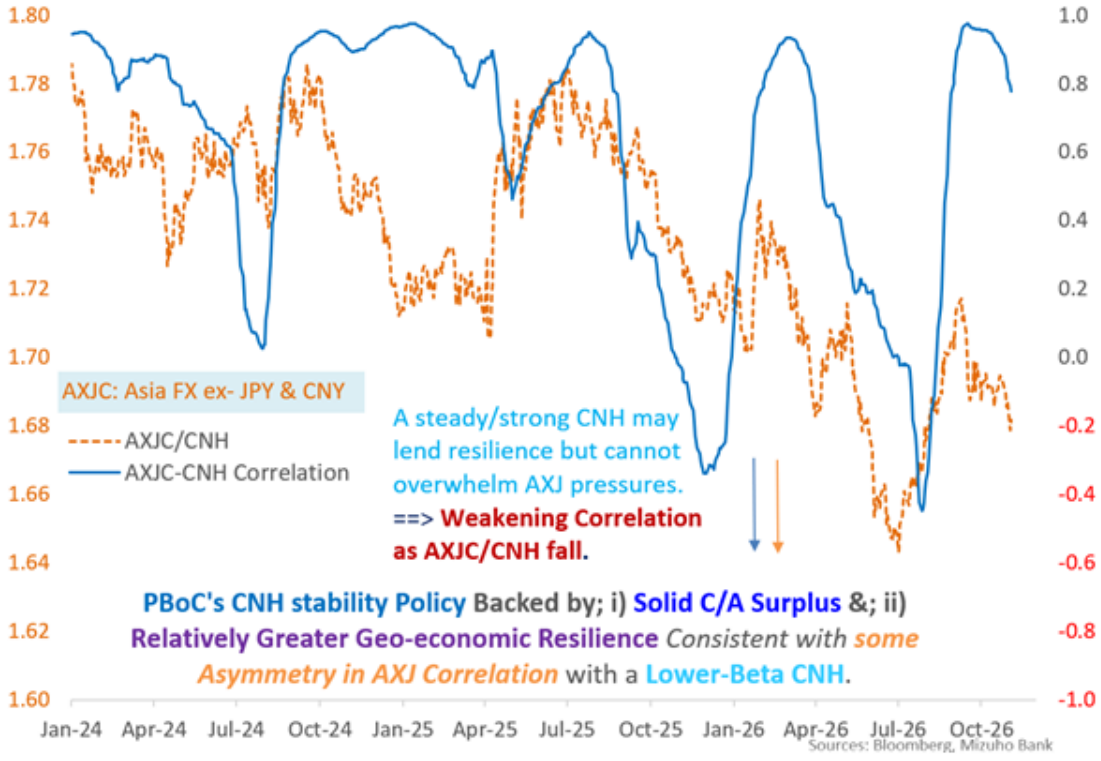
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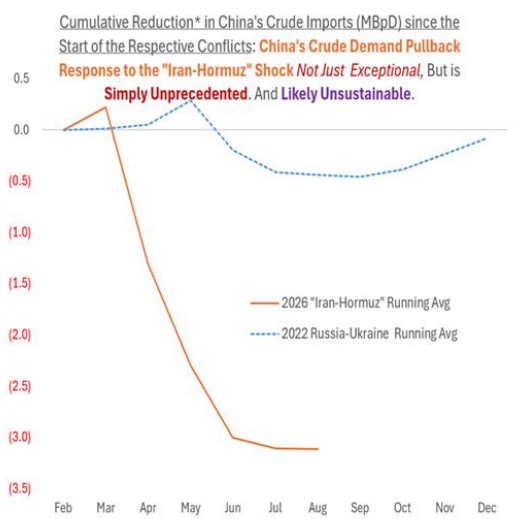
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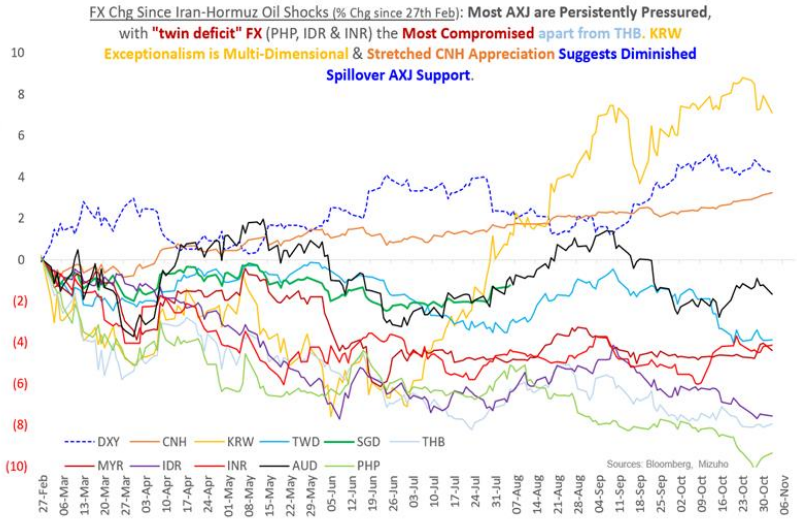
Why Stretched CNH Gains May Compromise AXJ





- Recent **PBoC steps to temper the pace of CNH appreciation** (by lifting FX reserve requirement by 2%-pt to 6%) should come as **no surprise**.
- Not just because of the *PBoC's preference for gradual moves* **anchored in a policy of broader CNH stability** (assessed flexibly across USD/CNH moves and the trade-weighted CNH).
- But notably, **as underlying fundamentals suggest stretched CNH appreciation**.
- In fact, **real rate spreads have been persistently shifted to the *disadvantage of CNH* for months now**, highlighting defiant CNH gains.
- ***Unchecked,*** this **excessive CNH overshoot** runs the **risk of less orderly corrections** amid *hawkish Fed surprises* conspiring with *broader market "risk off"* and/or *global liquidity squeeze*.
- More so, considering that **steady CNH gains since the start of the "Iran War"** (CNH up >3%) **have defied** marked, if not sweeping, **USD strength** during this period.
- In fact, *outside of the exceptional rebound in the KRW (from rather beaten down levels) since Q3* , CNH gains was *an anomaly in the AXJ space*.
- And **at odds with CNH depreciation** *alongside other AXJ* witnessed **during the oil spike from the Russia-Ukraine war**.
- Notably, the **exceptional reduction in crude imports by China** *in response to the "Iran war"* **probably exaggerated CNH buoyancy** via positive Current Account (C/A) dynamics.
- **But** this is **not a durable source of CNH boost**, susceptible to fade when crude imports (and presumably, the replenishment of strategic reserve) resumes.
- The upshot is that the **PBoC is justifiably** (and prudently) **checking excessive CNH gains** (amid broader economic and geopolitical risks) to avert future volatility.
- In turn, **diminished CNH appreciation** (or worse, correction) **could accentuate AXJ pressures** given the high correlation between other AXJ and CNH.
- **Especially as CNH-AXJC correlation tends to be asymmetric –** *more muted when CNH is out-performing* but *potentially enlarged when the lower-beta CNH under-performs.*
- And **twin deficit currencies *with accentuated energy reliance vulnerabilities*** remain the **most vulnerable**.





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