Dollar/Yuan Offered Tuesday

- Elevated dollar/yuan fixing-spot gap spurs a big dollar selloff on Tuesday afternoon
- The inverted fixing-spot gap could return to positive territory and widen again on account of lingering concern over the yuan's strength
- Yuan will remain relatively steady against a basket of currencies and trade in a catch-up mode from time to time, with the CFETS RMB Index stabilizing at around the 93 mark for now
- Rising concern over ECB tapering QE could undermine EM Asian currencies

Asia Overview - EM Asian currencies were mixed versus the dollar during Tuesday's Asian session. The CNH and CNY advanced markedly on Tuesday afternoon. China's Premier Li Keqiang said Tuesday that the nation remains on track to meet its main economic goals for 2017. The SGD edged up yesterday in line with the EUR's strength. The THB was little changed on Tuesday. USD/THB is expected to trade at around the 34 level for now. The KRW closed flat yesterday. Korea's President Moon Jae-in on Tuesday urged the parliament to quickly approve the supplementary budget to ensure an economic recovery. The INR reversed most of its initial gains and settled almost flat. US President Donald Trump urged Indian Prime Minister Narendra Modi to relax the trade barriers in order to reduce their trade deficit. India's cumulative monsoon rainfall was 1% below normal as of 27 June. The TWD edged down as onshore shares dipped. The PHP declined slightly on Tuesday. The 50 level remains a support for USD/PHP on the technical side. Moody's has affirmed Philippines' Baa2 long-term issuer and senior unsecured debt ratings and maintained the outlook at stable. The JPY weakened further in NY session due to rising UST yields.

Regional equity indices diverged on Tuesday. China's SHCOMP index advanced 0.18% yesterday, while India's NIFTY50 index slid 0.66%. Korea's KOSPI index rallied 0.14% with foreign investors buying a net USD 72.4mn of local shares. In the meantime, Taiwan's TWSE index dipped 0.02% yesterday after surging 1.31% the previous session, although global funds added to their holdings in local main board shares by TWD 110mn (USD 3.6mn) on Tuesday. Thailand's SET index ended 0.05% higher amid USD 51.8mn of equity inflows. Onshore markets were closed Tuesday in Indonesia and Malaysia for public holiday.

China • Both onshore CNY and offshore CNH surged shortly after 2:00pm HKT on Tuesday, catching with gains in other EM Asian currencies.

It comes as no surprise to us. As we reiterated earlier, **the elevated USD/CNY fixing-spot gap would spur a dollar selloff as what happened in late May should the dollar weaken broadly.**

Onshore USD/CNY closed well above the same day's fixing from 15 June to 26 June. However, other regional currencies have rallied in the past several sessions given a broad dollar pullback. In addition, USD/CNY and USD/CNH suddenly dropped at around 4:20pm HKT last Tuesday. It was aimed at capping onshore 4:30pm closing prices to prevent the central bank's daily reference rate from rising too much on the following session, in our opinion.

As the market could remain in doubt about the yuan's strength, the fixing-spot gap that inverted yesterday following the dollar selloff could return to positive territory and widen again. Meanwhile, historic data suggest the gap remaining above +100 pips for several consecutive sessions will herald looming sharp corrections in the yuan exchange rate. We stay cautious in the foreseeable future as the pattern is expected to continue.

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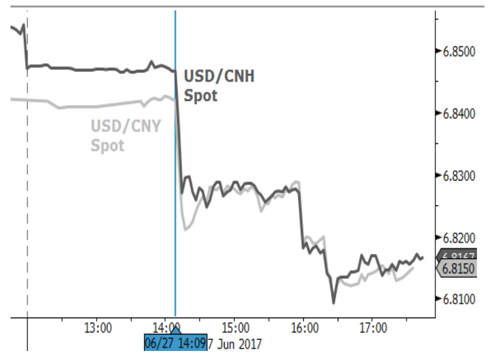
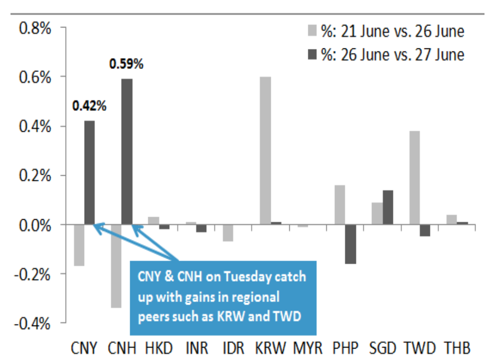
USD/CNY & USD/CNH Tumble Tuesday Afternoon



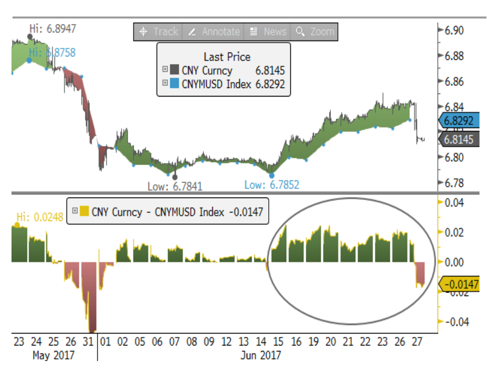
Source: Bloomberg & Scotiabank FICC Strategy

EM Asian Currency Performance (%): CNY & CNH Catch up with Gains in Regional Peers



Source: Bloomberg & Scotiabank FICC Strategy

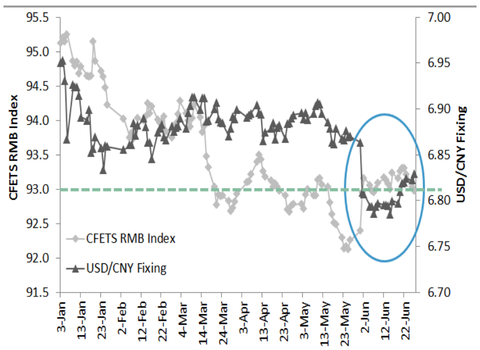
USD/CNY: Spot Intraday vs. Fixing



Source: Bloomberg & Scotiabank FICC Strategy

The CNY will remain relatively steady against a basket of currencies and trade in a catch-up mode from time to time, with the CFETS RMB Index stabilizing at around the 93 mark for now. Over the remainder of the year, we believe the nation will manage to a) avert any intense market worries over the yuan's depreciation before the 19th Party Congress in the autumn; b) avoid engineering the yuan weaker and refrain from competitive currency devaluation and; c) prevent the yuan from appreciating excessively to drag down the nation's economic growth.

Scotiabank CFETS RMB Index vs. Fixing



Source: Bloomberg & Scotiabank FICC Strategy

Separately, ECB President Mario Draghi on Tuesday hinted the central bank might start winding down its monetary stimulus due to an accelerating economy. Meanwhile, Fed Chair Janet Yellen described asset valuations as "somewhat rich if you use some traditional metrics like price earnings ratios" in London on Tuesday. In addition, CNN reported that US Senate Majority Leader Mitch McConnell will delay the vote on the Republican leadership's health-care bill until after the July 4 recess from Thursday.

EM Asian currencies are expected to decline Wednesday on rising concern over the ECB tapering its QE programme. The CNY and SGD will likely outperform other regional currencies as both are managed against a currency basket in which the EUR accounts for a large proportion. In addition, falling US stocks and rising UST yields have dampened market sentiment. The TWD is more susceptible to tumbling US technology stocks.

TODAY'S CALENDAR

Time (HKT)	Economy	Type	Release	Period	Consensus	Last	Significance
13:00	JP	DATA	Small Business Confidence	Jun	49.2	48.9	med

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