MARKET UPDATE

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Asia FX sinks on pressure from U.S. yields, weak China inflation

Asian currencies retreated on Friday as an overnight spike in U.S. Treasury yields drummed up fears of a looming recession, while the Chinese yuan was pressured by data showing that local inflation rose only slightly after the lifting of anti-COVID curbs.

The Chinese yuan fell 0.3% after data showed consumer price inflation grew less than expected in January, while producer price inflation fell further during the month. The readings painted a somewhat mixed picture of Asia's largest economy after it relaxed most anti-COVID measures earlier this year.

A staggered economic recovery in China bodes poorly for the rest of Asia, given the country's place as a dominant trading hub for the region. The reading also raises the prospect of more stimulus measures and interest rate cuts by the Chinese government, which could further dent the yuan this year.

Dollar edges higher; sterling lower despite U.K. avoiding recession

The U.S. dollar edged higher in early European trade Friday, on course to post another positive week, amid caution ahead of next week's crucial inflation data release.

At 03:00 ET (07:00 GMT), the Dollar Index, which tracks the greenback against a basket of six other currencies, traded 0.1% higher at 103.207, and is set to post its second straight positive week, a run it has not had since October.

The index has traded in a relatively tight range this week as traders digest economic data and try to parse speeches from a series of Fed policymakers for clues of the likely future pace of the Federal Reserve's rate hikes.

The number of Americans filing new claims for unemployment benefits increased more than expected last week, rising for the first time in six weeks, but remained historically low.

Fed Chair Jerome Powell took a fairly dovish stance in a speech earlier this week, reiterating his belief that disinflation was underway, but his Fed colleagues have tended to express their desire for further rate hikes as the week has progressed.

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Euro bulls get a reality check as investors assess rate outlook

Euro bulls might have to curb their enthusiasm after the rush to buy the single currency may have left it vulnerable in the short term, particularly given the uncertainty about many global central banks' interest rate plans.

The euro hit its highest in 10 months against the dollar earlier this month, having gained 13% from late September's 20-year low of $0.9528.

The prospect of a milder recession thanks to falling energy prices and plentiful supplies of natural gas, coupled with China finally emerging from three years of harsh COVID restrictions, have ignited investor appetite for European assets generally.

However, that enthusiasm has left the euro looking vulnerable, at least in the short term. The euro is set for a second straight week of declines and is currently around $1.075.

"I'm still positive on the euro, but if I look at our positioning data, it shows that current longs in euro, or what we call 'current over-held positions', reached a record high," BNY Mellon (NYSE:BK) EMEA strategist Geoffrey Yu said.

"The bar is extremely high for additional longs, or to add fresh euro exposure at current levels."

Such extreme positioning in an asset is often seen as a negative, as it suggests there are comparatively few investors left to buy and plenty who could decide to sell.

Proprietary iFlow positioning data from the custodian bank showed its clients' long euro positions against all other currencies (i.e. bets the euro will rise) are almost four times greater than the average position over the last 20 years, a record for the series.

Yu said some recovery was needed from September when "everyone was quite negative on the euro zone economy", but "this is overpricing things".

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