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Weekly Report

Weekly FX Market Update

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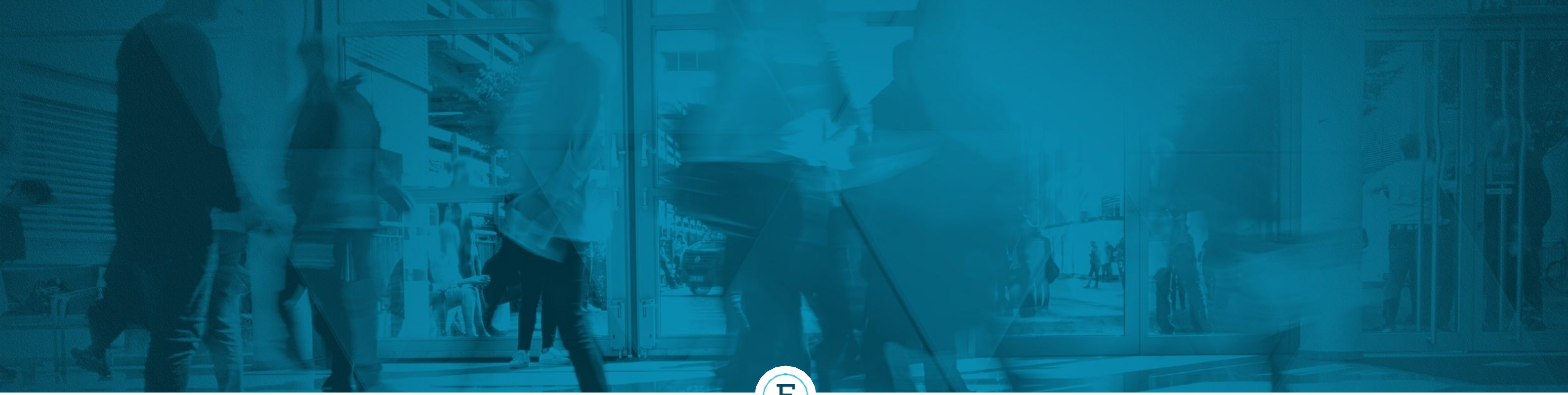


Forint and koruna lead CEE gains

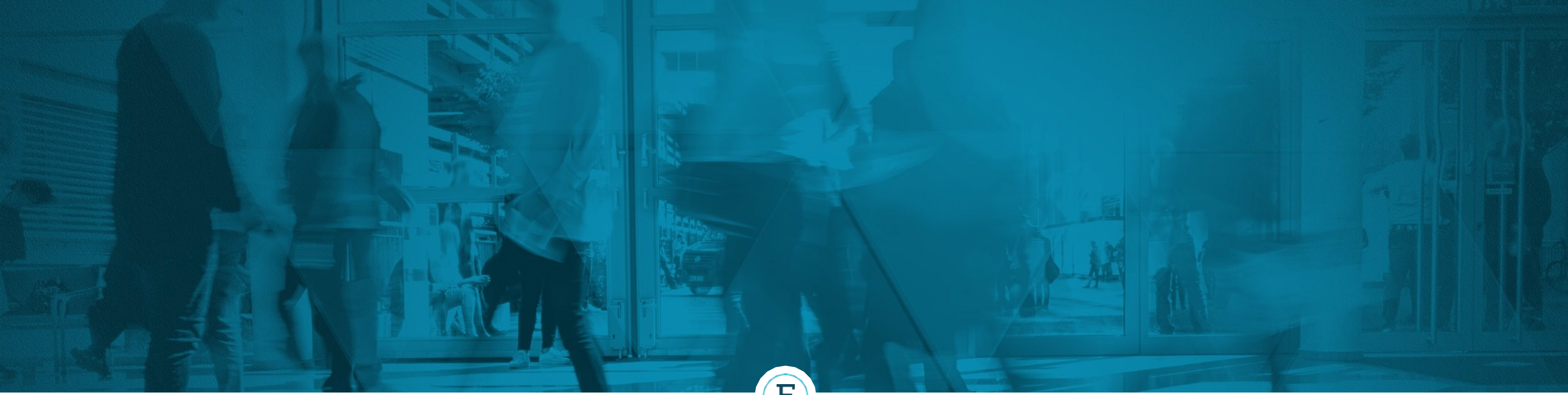
The most dramatic moves in financial markets last week took place in fixed income markets. At the same time, CEE currencies rallied, lead by the Hungarian forint and the Czech koruna.

Treasuries continue to get pummelled as the Fed steps away from the bid and no one else appears to be interested in buying them. What's remarkable is how little the dollar has benefitted from the spike higher in both nominal and real yields, that left the 10 year Treasury flirting with two years high near 1.8%. The euro held up remarkably well, finishing the week flat against the dollar, while sterling actually managed to eke out gains again and finish at the top of the G10 rankings. Emerging market currencies were mixed but, again, moves were not dramatic considering the turmoil in the bond market.

Figure 1: US 10Y Treasury Yield (December '21 - January '22)

Source: Refinitiv Date: 10/01/2022

Attention now shifts to the December inflation report out of the US, out Wednesday. Inflation reports will also be out in a number of emerging market countries. Any sign that inflation is peaking could be a catalyst for a rally there. However, sentiment in the bond market is fragile after last week's brutal sell off and another upward surprise in US inflation could test nerves there. If it were to happen, a disorderly sell off in bonds should be supportive for the US dollar, at least in the short term.



CZK

The Czech koruna had a stellar week, soaring by nearly 2% against the euro and ending it as one of the best-performing currencies worldwide and second-best in the CEE region, after Hungarian forint. We think recent rallies are largely justified and expect the koruna to strengthen somewhat further in 2022.

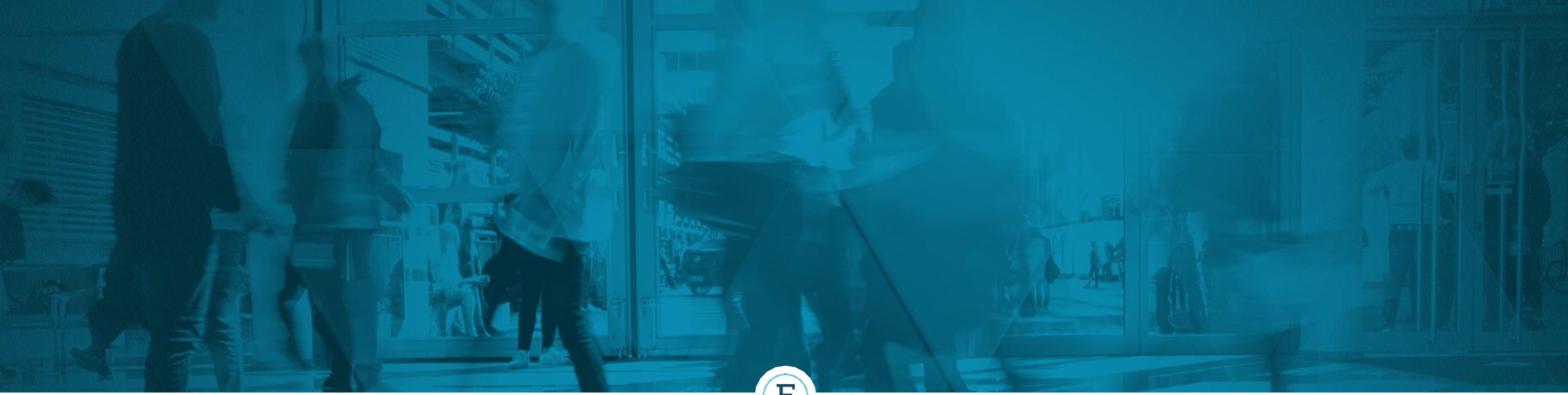
Koruna rally can be linked to CNB's interest rate hike in December, which surprised to the upside, and the bank's overall hawkishness, which makes the currency increasingly more attractive from the carry-trade perspective. Based on FRA rates, the implied 3M PRIBOR rate in 3 months hovers around 5%, suggesting traders bet interest rates will increase to close to that level in the near future.

This week, we'll focus on the domestic December inflation data, out Wednesday, which is expected to show another increase. A number of December inflation prints from other countries released already surprised to the upside, including in neighbouring Poland and the Euro Area.

EUR

Another month, another upside inflation surprise in the Eurozone. Contrary to market expectations, inflation rose again to hit 5% in the headline numbers and stood at 2.6% in the core, providing further evidence that inflationary pressures are spreading also in the bloc.

We think the next great shift in central bank policy will be the ECB's recognition that policy tightening cannot wait until 2023. In this sense, Isabel Schnabel's speech over the weekend highlighted the potential inflationary consequences of the shift to green energy, suggesting that a hawkish dissent is starting to develop within the ECB's council. As and when the shift becomes more manifest, it could provide a strong boost for the common currency.



USD

There were mixed signals from the two main components of the US payrolls report in December, the establishment survey (softer) and the household one (much stronger). All in all, the report suggests that the US is now close to a reasonable definition of full employment and that supply expansion will not be enough to alleviate inflationary pressures in the near term. The prospects for any sort of fiscal tightening remain remote, and this only adds to the pressure on the Federal Reserve to begin tightening policy sooner.

We now expect a first hike in March, and think that four hikes throughout 2022 is a real possibility. Again, the inflation report on Wednesday remains a key focus for traders in every financial market. Expectations are for yet another increase to multi decade highs in both the headline and core numbers, and we see no reason to differ.

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