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Weekly Report

Weekly FX Market Update

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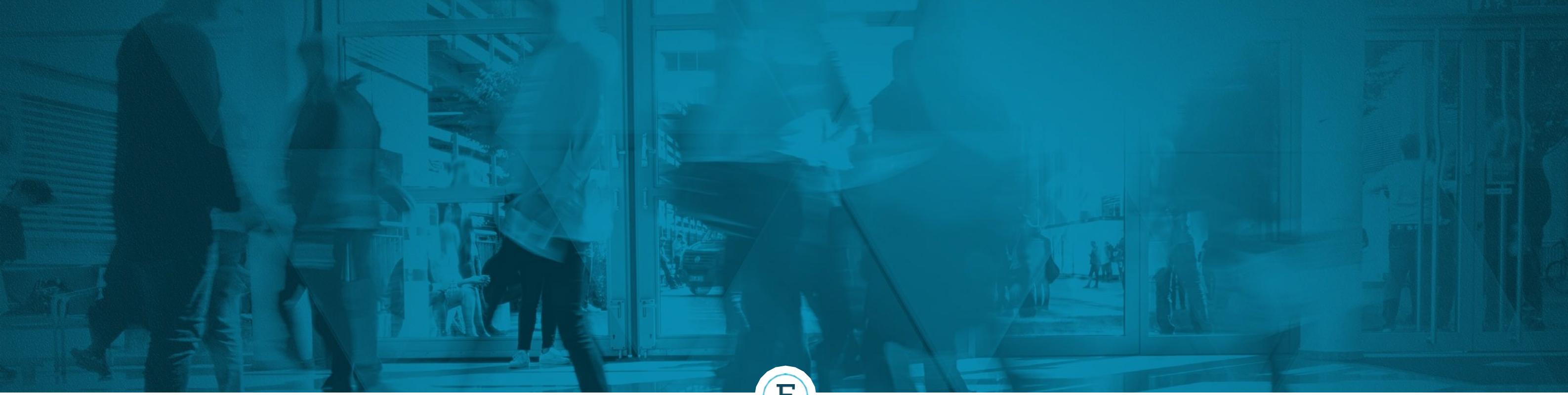
7th February 2022



Euro rallies sharply after ECB’s hawkish turn

We have been warning that the ECB's plans to wait until 2023 before hiking rates were a pipedream in a world of rising inflationary pressures, and our view was fully vindicated last week.

The massive upwards surprise in the Eurozone January inflation set the stage for Lagarde's hawkish pivot. Understandably, the common currency soared immediately after the news. A modest dollar rally the next day erased some of the greenback losses on the back of a strong US payrolls report, but the dollar still ended the week at the bottom of the G10 rankings. The euro rose sharply against every major currency, save the Swedish krona.

Traders' focus will keep shifting back and forth between central bank announcements and inflation data, the factors that will dominate currency markets for the foreseeable future. This week, all eyes are on the US inflation report for January on Thursday, with yet another increase to multi-decade records pencilled in by forecasters. Speeches by ECB officials will also be in focus, which could provide further fuel to the euro rally as the hawkish shift from last week's meeting is confirmed.

CZK

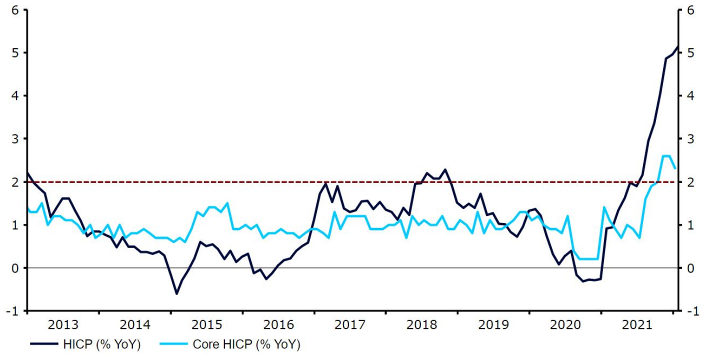
The Czech koruna had quite an eventful week, initially rallying to its strongest position since 2011 only to give up most of its gains following the meeting of the Czech National Bank. The CNB didn’t surprise this time and hiked the two-week repo rate by 75 basis points. At the same time, the bank suggested that significant hikes will likely not be needed and that it plans to reverse some of the recent tightening starting in the second half of 2022. Last week’s decision reinforces our expectation of limited koruna appreciation in the coming quarters. Aside from the CNB we received the fourth-quarter GDP data that were much better than expected (+0.9% QoQ, +3.6% YoY). It’s a positive signal suggesting the post-tightening landing may not be as hard.

Market nerves calmed a bit in that regard but going forward we’ll continue focusing on Russia risk as it has the potential to pressure the currency lower in the event of escalation or increased fears thereof. It’s currently a number one threat to the CEE currencies, in our view.

EUR

The Eurozone had one of its most momentous weeks in many months. It started with a massive upward surprise in inflation, and ended with a 180 degree pivot on the topic by President Lagarde at the February meeting of the ECB. Not only are assets purchases to be wrapped up earlier than expected, Lagarde also completely abandoned her pledge to wait until 2023 before lifting rates. The Council is now "unanimously" concerned with inflation, and sees "upside risks" in its future path.

Figure 1: Euro Area Inflation Rate (2013 - 2022)



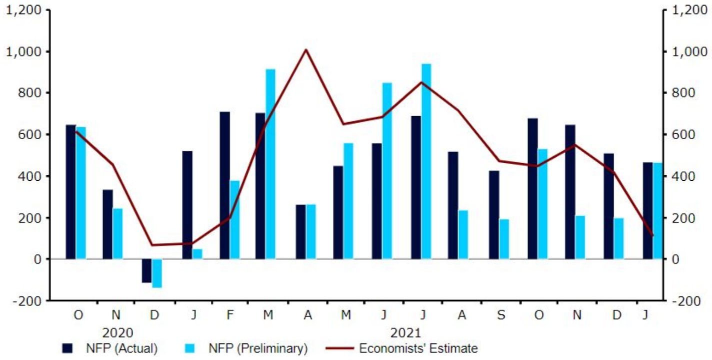
Source: Refinitiv Datastream Date: 07/02/2022

While euro rates had a massive upward move in response, we think that there is still room to go here, and are unsure the ECB can wait until September before raising rates. The euro should continue to remain well supported as markets adapt to the ECB turnabout on policy.

USD

Unusually for a labour report week, the US dollar found itself mostly driven by events across the Atlantic. However, the payrolls report itself appeared very strong in spite of the omicron distortions, with strong job creation, upward revisions to previous months' data, and wages rising, though not enough to keep up with prices, for now.

Figure 2: US Nonfarm Payrolls (2020 - 2022)



Source: Refinitiv Datastream Date: 07/02/2022

It is clear the US is essentially at full employment and Federal Reserve hikes are the only tool available to try and keep pressure off prices. It is, however, worth noting that monetary policy acts with "long and variable" lags, and we therefore think that rates have quite a long way to go before their impact on prices is felt.

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