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Weekly Report

Weekly FX Market Update

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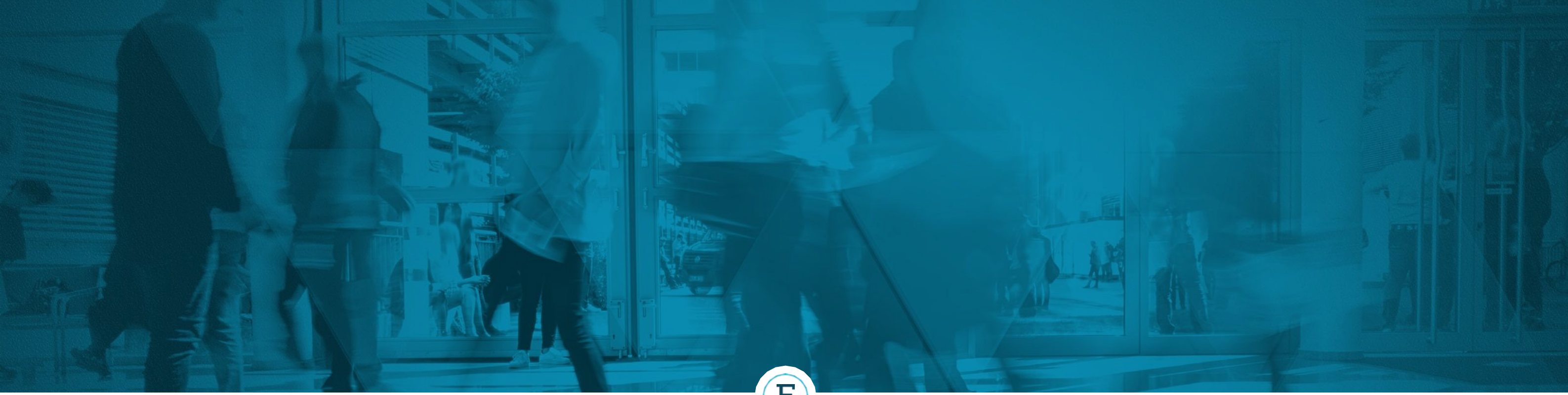


The risk of a possible Russian attack on Ukraine pressures koruna

Volatility has made a triumphant return to markets so far in 2022, as macroeconomic and geopolitical shocks continue to buffet markets. Koruna remains pressured by the latter.

The January inflation report in the US delivered yet another jolt to investors, coming in far above estimates at 7.5% on the year. Fixed income markets worldwide sold-off on the news, but the impact on currency markets was less straightforward. Emerging market currencies actually rallied, contrary to the experience of past Fed hiking cycles. The news of a potential worsening of the Ukraine crisis hitting the markets late-Friday only partially dampened the mood, and the Brazilian real led the week's rankings, followed closely by other Latin American currencies. In the G10, commodity currencies like the Australian, New Zealand and Canadian dollars also outperformed, as markets conclude that the Ukraine conflict may actually buoy commodity prices worldwide even further.

It seems that the latest inflation shock has forced some sort of tipping point at the Federal Reserve. James Bullard, a FOMC voting member, stated that he now considers hiking rates even outside the scheduled meetings, something that has not happened in decades. For the foreseeable future, markets will focus almost exclusively on two factors: inflation numbers, and central bank policy. As to the former, this week sees US producer inflation (Tuesday) and UK CPI (Wednesday). As for the latter, five Federal Reserve officials, as well as ECB President Lagarde and Chief Economist Lane are all scheduled to speak. Further, the minutes for the last Fed meeting will be released Wednesday, though it should be noted that these come with a three week lag.

CZK

The Czech koruna solf-off sharply last week. Most of its depreciation can be attributed to risk-off sentiment after the market started assuming there is a real risk of military aggression of Russia against Ukraine in the coming days following reports from the US. Heightened risk and various incoming signals mean koruna is highly volatile at the beginning of this week.

In the meantime, we received consumer price growth data from Czechia, which showed CPI inflation of 9.9%, much higher than expected. At the same time, core inflation jumped to 9.7%, a fresh record. We saw a similar surprise in Romania, where CPI inflation jumped to 8.4%.

Stronger price growth doesn't necessarily mean we're going to see more tightening from the Czech National Bank. In the context of its future steps, we think the key would be risks, with the most current one being a threat of war between Russia and Ukraine. It already affects oil prices and weakens koruna: if Russia indeed launched an invasion of Ukraine this would most likely result in further pressure towards higher energy prices and a weaker koruna exchange rate. In such a scenario it would be easy to imagine a further increase in interest rates in Czechia to 5% or even more.

EUR

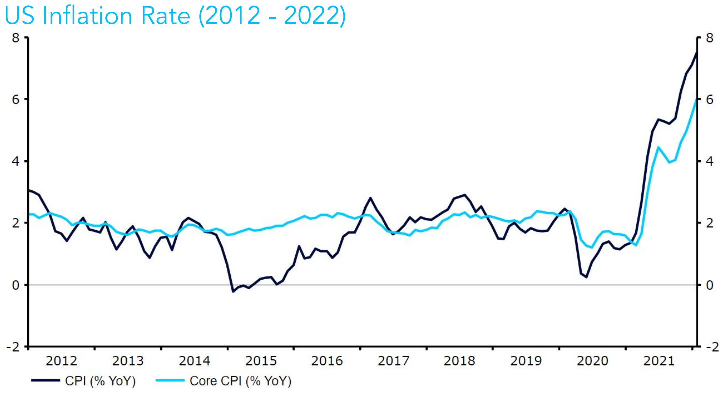
ECB President Laragde´s continued efforts to push back against market expectations for ECB hikes mostly failed until the flare up of tensions in Ukraine sent rates back down late Friday. As it stands, markets are now expecting 50 bp of hikes in 2022 but a terminal rate of just 0.7% , which strikes us as totally inadequate given the strength of inflationary pressures.

This week there is little in the way of market moving news. Focus will be on the leaders of the dovish faction within the ECB, Lagarde and Chief Economist Lane, who are both set to speak in public. Any sign that either of them is owing to the inflationary reality would be a positive for the common currency.

USD

The January inflation report was yet another shocker. Inflation rose to another 40 year high of 7.5%. Even more worrisome, price increases are becoming widespread. Of particular concern is the spread of pricing pressure to housing, a particularly sticky component that is not expected to ease any time soon. US yields rose sharply in the following days, only to give up some of those gains on news that the US thinks a Russian invasion of Ukraine may be imminent.

US Inflation Rate (2012 - 2022)



Source: Refinitiv Datastream Date: 14/02/2022

We expect producer prices to pull back slightly next week. More importantly, there are multiple Federal Reserve officials speeches on tap. We expect these to reaffirm mounting concern with inflation and suggest to markets that rates could go up every meeting and by more than 25 basis points unless inflation numbers start coming down soon.

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