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Weekly Report

Weekly FX Market Update

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Koruna holds ground as Ukraine headlines worsen

Inflation and central banks have taken a backseat to geopolitics in financial markets, and currency markets are no exception.

Among the G10 currencies, the Japanese yen and the Swiss franc, the traditional safe-havens, rallied against the US dollar. It must be noted that commodity currencies, like the Australia and New Zealand dollars, did reasonably well, as commodity prices show resilience to the flight to safety flows. Unsurprisingly, Eastern European currencies were the worst performers, dragged down by the turn for the worse in news out of the crisis in Ukraine.

The main macroeconomic releases on tap this week are the PMI advance indices of business activity in the US, Eurozone and the UK. However, the geopolitical crisis in Ukraine will probably overshadow them. It is not yet clear what impact a full on conflict would have on the EUR/USD exchange rate. While the dollar has traditionally been a safe-haven during crises, the shifts in US yields that would likely ensue would knock off one of the supports underpinning the recent dollar rally.

CZK

The Czech koruna ended last week higher, making up some of the earlier losses against the euro. The bulk of the appreciation took place on Tuesday when koruna rallied alongside its peers on market hopes of de-escalation of the Russia-orchestrated European security crisis following Russia's declarations that it's pulling out some of its troops from near Ukraine. Since then, however, reports from other countries followed, conflicting with Russia's claims and stating the number of troops increased substantially of late. Additionally, there's been a string of worrisome news from temporarily occupied territories in Eastern Ukraine. Furthermore, the U.S. warned about a threat of an 'imminent' Russian invasion of Ukraine, including its capital Kyiv, under a false pretext. This has led to renewed pressure on a number of assets perceived as risky.

Interestingly, although the Polish zloty and the Hungarian forint were pressured lower the Czech koruna was able to hold its ground and even eke out small gains late in the week. This could be a manifestation of a somewhat different risk profile between currencies, with koruna being viewed as the 'safest' currency in the CEE. Nonetheless, if there's a significant further escalation or indeed an invasion of Ukraine, we have little doubt that the currency would be pressured lower.

EUR

While ECB President Lagarde has continued to push back modestly against expectations of Eurozone hikes, her chief economist Lane appeared to back away from his extreme dovish views last week, finally acknowledging the possibility that the deflationary environment prevalent in the teens may never return.

This week's PMIs may be overshadowed by the first February flash inflation data from France, which is almost certain to show further sharp increases. There is still plenty of room for markets to price in a faster schedule of hikes from the ECB, and we expect the common currency to be well supported as they do.

USD

This week will be a relatively slow one for US data releases, with just PMIs and PCE inflation on tap. Focus should remain on geopolitical headlines on one hand, and Federal Reserve communications on the other, with five Fed members slated to speak during the week. We wait for the uncertainty over the dollar reaction to a potential worsening of the crisis described above to be resolved soon.

Unlike other major economic areas, particularly the Eurozone, it will be difficult for US rates to price much faster hikes than they already do, so there is scope for a partial unwind of the dollar rally against the euro.

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