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Weekly Report

Weekly FX Market Update

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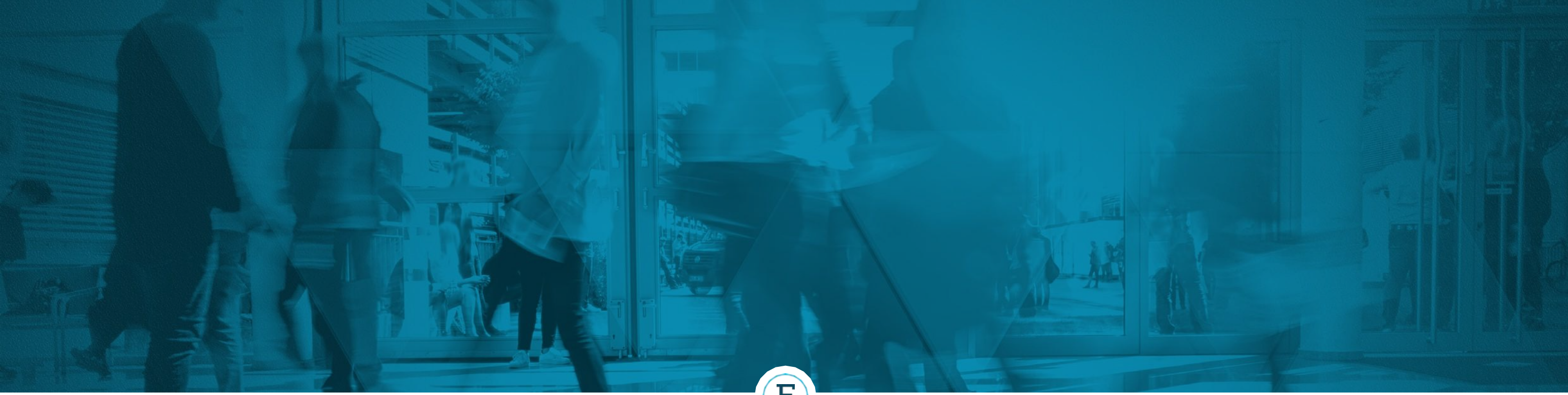


ECB hawkishness fails to rescue euro as Russian invasion continues to drive markets

The ECBs unambiguously hawkish messaging last week did not stop the euro from sinking to new lows as concerns mount over stagflation or worse.

We also saw a significant rebound in Eastern European currencies led by the Polish zloty, as central banks in the region both raised interest rates aggressively and/or intervened directly in the market in order to prop up their currencies. We also saw continuing rallies in commodity currencies far away from the war, such as our long standing favourite, the Brazilian real.

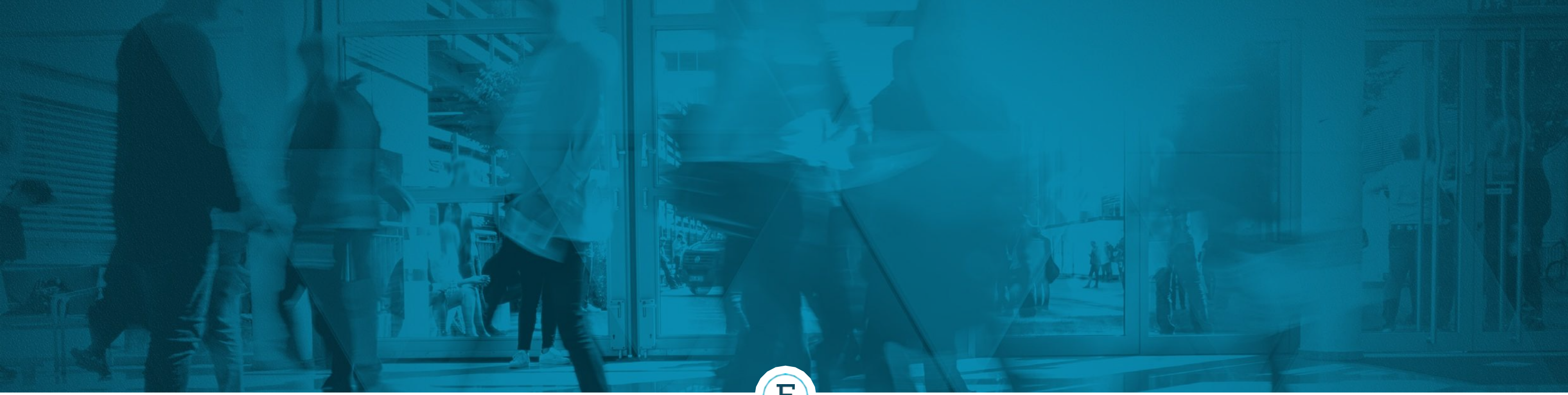
Economic news will continue to take a back seat to the newsflow from the war on one hand, and the reaction to the fresh supply shock from the world's major central banks on the other. This week will be the Federal Reserve's turn. Market expectations for a 25 basis point hike look correct to us, and we also expect an unambiguously hawkish message as the Fed has fallen severely behind the curve. We expect more or less the same outcome from the Bank of England meeting the following day.

CZK

The Czech koruna was the third-best performing EM currency last week and the second-best in the region, after the Polish zloty. It reversed a large chunk of its losses from the week prior.

Last week's inflation data showed consumer price growth jumping to 11.1%, its highest level since 1998 and far above expectations. Core inflation also soared to double-digits, reaching 10.4%, its highest level on record. Sharp increases in inflation paired with upside risks to price growth and pressure on koruna due to the Russia-Ukraine war make it more likely that the Czech National Bank will continue policy tightening in the near term. Investors seem to agree as the 6x9 FRA rate increased to approximately 5.50% indicating the market is pricing in approximately 75 basis points of hikes in the next 6 months.

Going forward, we'll continue to focus on the war in Ukraine: CEE currencies are particularly sensitive to the news with regards to the invasion. That said, it's not the only risk, considering China is seeing a sharp surge in new coronavirus cases to the highest level since February 2020. If this sparks growth and inflation fears we could see it affecting the sentiment beyond Asia and the yuan.



EUR

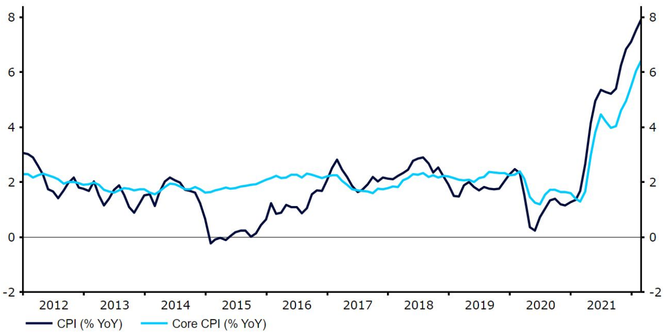
The ECB seems to have finally pivoted to restoring its inflation credibility, but for now markets remain focused on the war threat to the European economy and the euro seems unable to hold above the 1.10 level versus the dollar. This is for now a common struggle to all European currencies, but we think that any significant positive news from the war could lead to a rebound of the oversold common currency.

Meanwhile, a slate of ECB speakers are on tap for Thursday, which should add needed clarity to the ECB's intended schedule for higher rates. We continue to see a first hike by at least the bank's September meeting.

USD

February inflation in the US rose to yet another multi-decade high of almost 8% but, for the first time in a while at least, it did not exceed market expectations. Nevertheless, core inflation also rose sharply, up to 6.4% and its highest level since August 1982.

Figure 1: US Inflation Rate (2012 - 2022)



Source: Refinitiv Datastream Date: 14/03/2022

The macroeconomic calendar is light this week, aside of course from the critical FOMC meeting. In principle, the hawkish communications we expect should be positive for the dollar, but the failure of the euro to rally last week suggests that this correlation may have weakened in the wake of the invasion. With a 25 basis point hike fully priced in, we will be paying particularly close attention to the bank's updated interest rate projections - the 'dot plot'. We think that a sizable upward revision here is likely in light of the inflation ramifications of the Russia-Ukraine war.

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