



Ebury What borders?®

Weekly Report

Weekly FX Market Update

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Volatility returns with a vengeance on Fed hawkishness

Interest rates are going up everywhere, hard and fast, and markets are finding it increasingly difficult to ignore the consequences.

Stocks staged a relief rally in the wake of the Federal Reserve's 50 basis point hike, but it was short-lived, and by the following day they resumed their downward trend, closing the week at the lowest levels since late-2020. The great beneficiaries of the flight to safety were the dollar and, less predictably, the euro, which benefited from the sense that the ECB's quest to ignore the reality of inflation is finally coming to an end. The focus in markets this week will be on April inflation data out of the US. Any sign that inflationary pressures are peaking could prompt a sharp countertrend sell-off in the dollar and rates, both of which have been rising in tandem for a while now. The euro could receive further support from hawkish commentary from ECB officials, which are starting to sense how far behind the inflation curve they have fallen.

CZK

Surprisingly, the Czech National Bank's decision to hike rates by 75 basis points instead of the widely expected 50 bp did not prove to be the most market-moving news from Czechia last week. We did see some immediate strengthening of koruna supported by repricing of rate expectations, but the extent of it was limited. Friday, however, brought a sharp increase in the FX market volatility with the EUR/CZK jumping above the 25.0 level, reaching the highest level since mid-March and posting one of the largest one-day increases in recent years (+1.8%), comparable to that from the beginning of the Russia-Ukraine war.

This was largely a consequence of a report from a media outlet Seznam.cz that Aleš Michl will be appointed as the new CNB governor. Considering Michl is known to be an ultra-dove, opposing rate increases, it could mean that the central bank is about to take a major turn. Nonetheless, it will largely depend on who the president appoints for the position of other Board members whose terms end next month. Assuming Michl becomes a governor, we'd see three members appointed to serve on the Board. A reappointment of Tomáš Nidetzký and Vojtěch Benda would most likely calm the FX market as it would mean that the hawkish balance within the Council is maintained. It's however, uncertain if this is going to be the case.

After last week's hawkish meeting, we suggested that rates (currently at 5.75%) should move to 6% or slightly more. We continue to think that that's going to be the case. Nonetheless, depending on personnel changes on the Board, we may see the hiking cycle reversed sooner than expected.

EUR

The euro bucked the general currency trend last week and managed to eke out some gains against the US dollar, making it the best performing currency in the G10 last week for the first time in a good while. No doubt the chorus of hawkish statements by ECB officials suggesting that a hike in July is a done deal and that June cannot be ruled out helped, as did the increasingly stretched market positioning, where the euro has come to be seen as a one-way bet and traders are increasingly short.

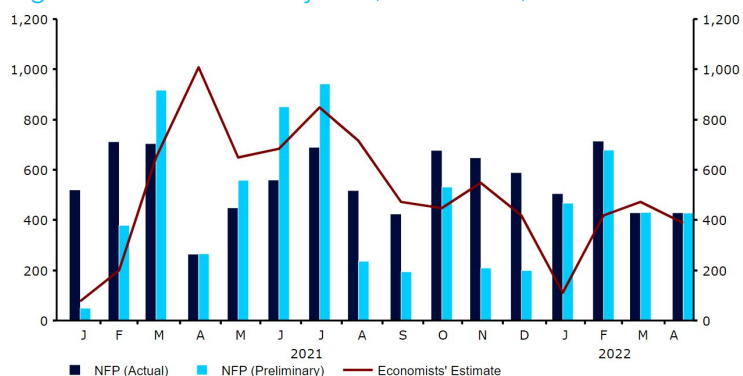
Expect more ECB officials, including President Lagarde on Wednesday, to reinforce this narrative and potentially help the euro stabilise.

USD

The Federal Reserve meeting on Wednesday provided some very short-lived relief to markets when Chair Powell appeared to take 75 basis point hikes off the table for now. However, risk assets and US Treasuries reversed course quickly and resumed their sharp sell-off the following day, and tech stocks and speculative favorites generally got pummelled for the rest of the week.

The payrolls report on Friday sent the same message of the last few months: the US is at or beyond full employment, no further help will come from expanding the labour force, and wages continue to lag prices. The latest one could be a silver lining of sorts for the Fed and, should we see any signs that price pressures are peaking in Wednesday's CPI report, as markets expect, Treasury markets could see some relief, and the relentless dollar rally could falter.

Figure 1: US Nonfarm Payrolls (2021 - 2022)



Source: Refinitiv Datastream Date: 09/05/2022

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