Ebury What borders?®

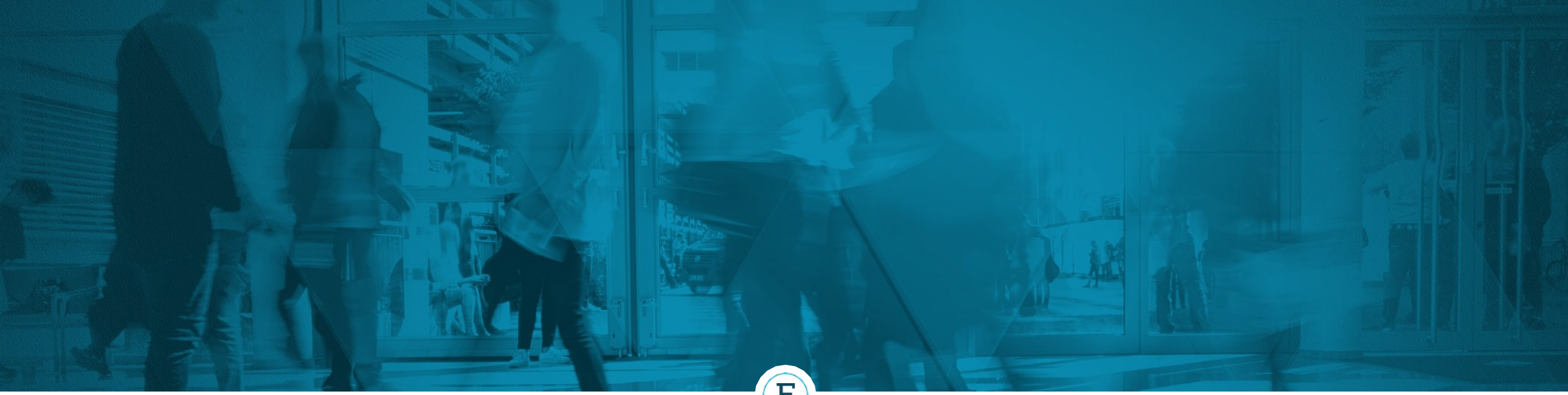
Weekly Report

Weekly FX Market Update

Written by:

Enrique Díaz-Alvarez, Matthew Ryan, CFA, Roman Ziruk & Itsaso Apezteguia

5th September 2022



Worsening energy crisis knocks euro in late-Friday trading

The euro seemed to be about to lock in a decent performance last week, buoyed by expectations of a hawkish ECB and a labour market report in the US that signalled to the Fed that pressures there may be easing.

However, the announcement by Gazprom that it was cutting off gas supplies to Western Europe indefinitely late-Friday sent the euro, and indeed most currencies, tumbling against the dollar. This news brings the prospect of widespread shortages of energy in Europe closer to reality and has increased market jitters surrounding the possibility of a global recession.

An energy supply shock, while unemployment remains low and inflationary pressures are at record levels, poses an unusually difficult challenge for the ECB at its meeting on Thursday. Traders will be looking at a finally balanced decision between hiking interest rates by 50 or 75 basis points, as the Governing Council tries to make up for lost time. The gas shock last week adds even more uncertainty to the decision.

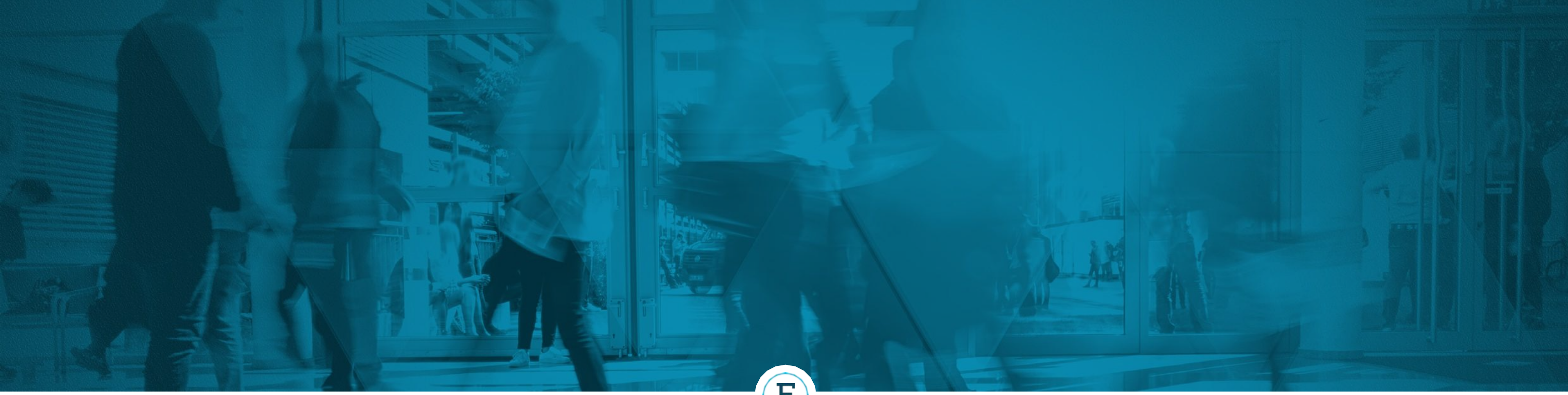
CZK

The Czech koruna has traded largely in line with its regional peers in recent days, initially rallying, only to sell-off at the turn of the week following news that Gazprom will not restart gas flow to Europe through Nord Stream 1.

The difficult energy situation is especially clear in Central Europe. It has led to a protest in Prague on Saturday which gathered an estimated 70,000 people who demanded a shift in the government's approach to the energy crisis, which is exacerbating a deterioration in purchasing power.

This week brings more dire news, as data confirmed an eye-watering drop in real wages in Czechia. At -9.8% year-over-year in the second quarter it's the sharpest in at least 25 years. The data is somewhat worse than expected by the market, albeit not as bad as forecasted by the CNB (-13.1%). Still, it only points to the difficulty of the situation which will likely remain similarly tough, if not worse in the near term.

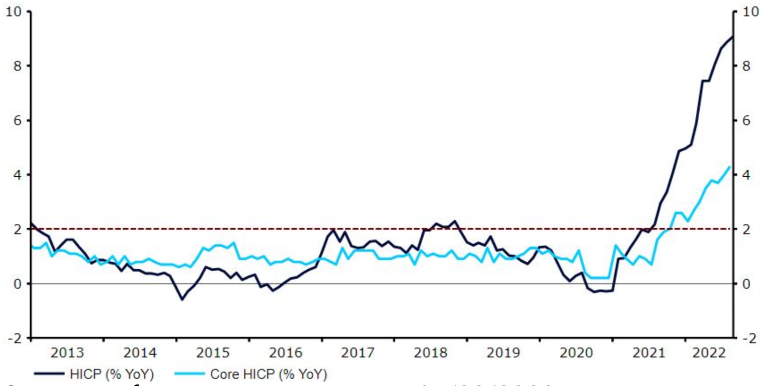
This week we'll focus on the economic data, including the industrial output and retail sales for July. However, for the koruna energy headlines are likely going to be key.



EUR

Inflation data out last week confirmed that the ECB faces perhaps the toughest job of any of the world's major central banks. Inflation yet again surprised on the upside, in both the headline and core indices, and in both cases printed another all-time record for the Eurozone. The ECB meeting is perhaps the most critical this year. The inflation numbers are awful and the central bank is clearly behind the curve; at the same time, the energy shock that has resulted from Central Europe's dependence on Russian gas is unlike that seen anywhere else.

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



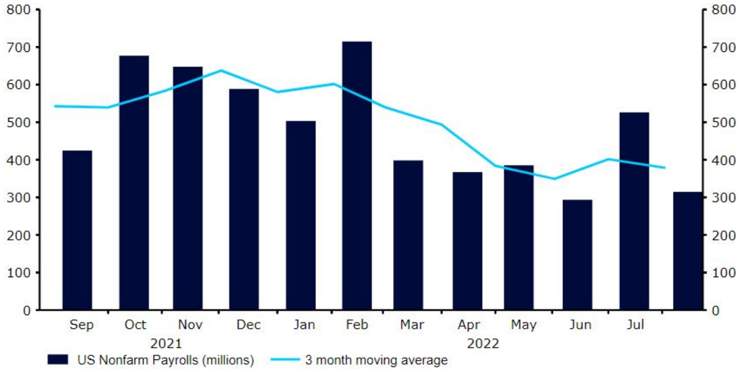
Source: Refinitiv Datastream Date: 05/09/2022

We think that the ECB will still hike by 75bps, as the level of rates in the Eurozone lags hopelessly behind its peers and economic reality, and there isn't much that monetary policy can do to conjure up gas and alleviate shortages.

USD

The key US labour report provided welcome relief to the Federal Reserve on Friday. While job creation continues apace, dispelling fears of a recession in the US, the labour force expanded and wages rose less-than-expected. This signals that labour demand remains hot, as confirmed by the JOLTS job openings report earlier in the week, but that it's resulting more on an increase in the size of the workforce than on a wage spiral.

Figure 2: US Nonfarm Payrolls (2021 - 2022)



Source: Refinitiv Datastream Date: 05/09/2022

Rates came down in the US as a response, and the week would have been a difficult one for the US dollar had it not been rescued just before New York closing time on Friday by that Gazprom announcement on the indefinite suspension of gas deliveries.

Ebury

Stodolní 9 702 00 Ostrava, Czech Republic

+420 558 080 074 | info@ebury.cz | ebury.cz