FX Daily: Reported IEA supply patch gives temporary respite

The IEA is reportedly proposing the largest ever oil stockpile release, which may keep oil volatility capped for now, despite offering only a temporary solution to the supply glut. This remains a headline-to-headline trading environment with all focus on assessing the length of the Iran conflict. US CPI today may have a more limited impact than usual

The FX market remains strongly driven by fluctuations in the oil price

USD: IEA reserve release only a temporary solution

The FX market remains strongly driven by oil swings. An erroneous claim by the US Energy Secretary that the US Army had escorted a vessel through the Strait of Hormuz caused sharp oscillations from $81/b to $92 in Brent yesterday. Overnight, a report by the *Wall Street Journal* that the IEA is ready to release a record number of oil reserves has pushed Brent back below $90, trading at $87 at the time of writing. That would mean above the 182m released in 2022 after the Ukraine conflict started. Simple maths suggests IEA members are looking to make up for at least 10 days of the 20mb/d lost in the Straight of Hormuz blockade.

Depending on the actual size of the reserve release, we could see some capping in oil prices in the coming days. However, oil reserve release is a temporary measure and only military de-escalation can drive crude sustainably lower, and the IEA move might be sending a hidden signal to markets of few expectations for an imminent ceasefire. In our view, these mixed signals could prevent the dollar from dropping much further today unless there are some encouraging headlines on de-escalation.

Bonds and equities are also closely tracking oil moves, making it challenging to find any alternative angle for the dollar. Nevertheless, FX volatility has not been excessive, with the relative resilience in equities acting as a stabilising anchor for high-beta currencies and perhaps limiting USD gains.

CPI data for February are released in the US today. We expect a 0.3% MoM print for core inflation, above the consensus 0.2% MoM. This may add some pressure on US treasuries, although oil developments will remain a much bigger driver. The spillover on the dollar may prove relatively contained.

Francesco Pesole

EUR: Kazimir gives first big hawkish comment

ECB President Christine Lagarde said yesterday that the eurozone economy is in a very different position than in 2022, with greater capacity to absorb an energy shock. But she also reiterated firmly that the ECB won't allow a repeat of the 2022-23 inflation increases.

This morning, we heard a more aggressively hawkish remark by Governing Council member Peter Kazimir, who said a rate hike on the back of the Iran conflict may be closer than thought. That will do little to defuse markets' aggressive hawkish bets, with a 25bp rate hike fully priced in within the next six months. Our macroeconomists' view is that this remains a lower risk scenario relative to swap market pricing and our baseline remains, despite all the uncertainty associated with the ongoing conflict, a dovish repricing in the EUR OIS curve.

It's important to note that this does not automatically translate to a view of EUR weakness. The beta of EUR/USD to short-term rate differentials has dropped to virtually zero, meaning expectations for ECB policy moves are having very little impact on the euro. Oil prices remain the absolute primary driver, and the IAE reserve release may be offering some temporary floor for EUR/USD around 1.160.

Francesco Pesole

GBP: EUR/GBP upward correction risk today

EUR/GBP continues to trade on the soft side, having dropped around 1.5% since the start of the Iranian conflict. This dynamic reflects both the larger hawkish repricing in the GBP curve and the relative resilience of equity markets, which have prevented a rotation from the higher beta GBP to the lower beta EUR.

The move does, however, start to look a bit stretched according to our short-term valuation metrics, and the decline in oil prices below $90 today may well encourage some dovish re-assessment in UK rate expectations and prompt a correction higher in EUR/GBP. We continue to favour a return to 0.870 rather than a drop to 0.860.

Francesco Pesole

CAD: Staying strong

The Canadian dollar has been the best-performing G10 currency since the start of the conflict. As discussed above, the equity market holding up relatively well remains very crucial as it allows the loonie (like AUD) to fully benefit from its energy net-exporter status without suffering from major risk sentiment fallout.

Domestically, markets have also priced in a rate hike by the Bank of Canada by year-end. We aren't convinced just yet and remain cautious about Canada's economic outlook due to upcoming USMCA renegotiations. However, further easing now seems off the table.

Should we see a somewhat gradual unwinding of the oil rally with risk sentiment recovering further, USD/CAD may stay under some pressure and break below the 1.35, late-January lows.

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