

FX Daily: Overweight Europe and EM positions remain at risk

The Middle East conflict and its implications for energy prices continue to dominate FX markets. Energy-exporting currencies, including the dollar, are performing well, while the importers in Europe and Asia remain under pressure. Unless we see some breakthrough good news, such as the restarting of gas supply in Qatar, these trends will continue



FX traders will remain transfixed on gas and oil prices over the coming days

📈 USD: Sitting pretty on abundant energy

The dollar was stronger across the board yesterday as investors reacted to the surge in energy prices. One of the biggest intraday moves occurred when headlines broke of Qatar suspending gas production after an Iranian attack on its facilities. As our [commodities team notes](#), the gas market went into this conflict tighter than the crude oil market and thus is more susceptible to larger price spikes.

The focus will now be on whether Iran can escalate its attacks on the production facilities of the region's key marginal energy suppliers. For gas, that looks like a Qatari story, while for crude oil, the focus is on Saudi Arabia, the UAE and Iraq. In addition to the production facilities, the market

will be waiting for news about the Straits of Hormuz. While the sense is that the US and Israel have the military might to restore some sense of order in the coming weeks, FX traders will remain transfixed on gas and oil prices. The longer they stay elevated, the more the external accounts of the oil importers are damaged and the greater the drag on global growth from elevated inflation and curtailed monetary easing cycles.

For FX markets, this continues to look like a tale of the haves and the have-nots when it comes to energy independence. Our Asia team discusses local energy independence [here](#), while Europe is also on the wrong side of the ledger. The dollar looks the best currency to take advantage of this energy shock, as we [discussed yesterday](#), but other big natural gas exporters like Australia and Norway are seeing their currencies outperform too.

And given investors went into this crisis with large overweight positions in Europe and emerging markets – in currencies and equities – both currency blocs look susceptible to further unwinding should energy prices stay high. So, unless someone like China, a huge buyer of Iranian crude, can convince Iranian forces from attacking production facilities and threatening shipping, we expect European and EM currencies to stay vulnerable. For reference, European natural gas futures have just re-opened back near their highs.

There is little US data of note today, and we have a speech from the Fed's John Williams at 15:55CET. He sits at the doveish end of the spectrum. But any concern over sticky inflation could add to this week's upside pressure on short-dated US rates and lift the dollar further.

DXY looks likely to stay bid in the near term. 99.50/100.00 looks like the target whilst energy prices remain bid.

Chris Turner

EUR: The wrong side of the tracks

EUR/USD has come under increasing pressure as natural gas prices have soared. While most expect this spike in gas prices to be temporary, a reasonably large long positioning in the euro makes it unlikely that many will rush to buy this EUR/USD dip. Or at least some clear evidence will need to be seen of a de-escalation before EUR/USD can find support. With US equities now outperforming those in Europe, and rate differentials slightly widening in favour of the dollar, given the greater re-pricing to be done of Fed versus ECB easing cycles, expect EUR/USD to remain under short-term pressure.

Under 1.1650, the move could extend to the 1.1575/1600 area should European natural gas remain bid near EUR50/mwh. However, do look out for the February flash CPI release in the eurozone today. Any upside surprise could provide the euro a little support in that it would make the ECB more sensitive to energy-driven inflation.

Elsewhere, EUR/CHF got a lift from an emailed statement from the Swiss National Bank that it was increasingly prepared to intervene. The Swiss franc is exceptionally strong and risks pushing Switzerland back into deflation. Yet we are not sure that EUR/CHF needs to rally far at present, and in 2Q22, the SNB only bought CHF5bn in FX during the quarter – during a more volatile period than we are seeing now.

Chris Turner

📌 JPY: Heading back into the intervention zone

USD/JPY has turned understandably bid on the Middle East energy crisis. As a large fossil fuels importer, Japan suffers from an energy spike, as do large parts of Asia. This has sent USD/JPY back into the FX intervention zone of something like 158-160. Japanese officials sound like they are ready to intervene to avoid a weaker yen, adding to the spike in imported energy prices and worsening the cost-of-living crisis – a key priority for the government.

Japan's position as an energy importer undermines the yen's position as a safe-haven currency, and it looks like the official sector will have to be the key marginal buyer of the yen now. Tokyo talks of a coordinated FX approach with Washington. The Fed did check rates last month on behalf of the US Treasury, but neither Japan nor the US sold USD/JPY. Unilateral intervention from Japan now might buy Tokyo some time, but coordinated intervention in the US would still be very big news and hit USD/JPY hard. Unilateral intervention and USD/JPY bouncing around in a 155-160 range remains our base case.

Chris Turner

📌 CEE: Limited gas supplies will block the region's recovery

Regional currencies reacted, according to [our indication](#) yesterday, with the forint the most sensitive currency to global risk and higher energy prices, and the koruna the least exposed. In general, for CEE currencies, the global gas supply shortage seems to be a bigger story than higher oil prices. Indeed, Europe has had an above-average cold winter and gas storage is depleted to record lows in the Czech Republic, Hungary and Romania at around 30%, while Poland is somewhere around 50% and Germany only 20% filled. Therefore, the headlines from Qatar will weigh on CEE currencies for a long time unless we see a recovery in global supply.

Yesterday, CEE currencies traded very much in line with gas prices and this is unlikely to change in the coming days. The most affected EUR/HUF should see resistance somewhere around 380 levels until we see a headline about the recovery of supplies from Qatar. This should also keep market rates elevated in the expectation that higher energy prices would bring higher inflation in the future.

In Turkey, February inflation rose as expected by 3.00% MoM, translating into an increase from 30.7% to 31.5% YoY. This is the first increase in the year-on-year rate since September last year. At the same time, January inflation surprised upwards and the underlying momentum is uncomfortably accelerating. For the central bank, this is compounded by market pressure on the currency and higher oil prices on inflation following the outbreak of the US-Iran conflict, with the [highest pass-through of energy prices](#) to inflation in the region. This combination basically stops rate cuts at the March central bank meeting.

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