FX Daily: Policymakers move to limit SVB fallout

Over the weekend US policymakers have taken measures to restore confidence and halt the deposit run in parts of the US banking system. Expect a nervous market to closely track US banking stocks today. The dramatic re-pricing of the Fed curve and the bullish disinversion of the US curve is a dollar negative. Expect the Swiss franc and Japanese yen to stay bid

USD: Policymakers move swiftly to restore confidence

US policymakers have acted quickly to restore confidence in the US banking system after Friday's second-largest bank failure in history. The Federal Reserve, US Treasury, and Federal Deposit Insurance Corporation have together announced two key measures. The first is that all uninsured depositors of SVB will be made whole. This addresses the fear that uninsured depositors (in this case in the venture capital/tech sector) would lose deposits and would pull funds from other banks with high ratios of uninsured deposits (reports suggest 96% of SVB's deposits were uninsured). The second key measure has been the Fed announcing a new liquidity programme - the Bank Term Funding Program (BTFP). This will allow eligible financial institutions to access dollar liquidity in return placing US Treasuries, Agencies, or Mortgage-Backed Securities as collateral. Importantly the collateral values will be taken at par, meaning no write-downs. This addresses SVB's problem of the need to meet deposit outflows with sales of securities - a move that forced SVB to realise losses and burn through equity capital. Read our article for more.

For today, investors will watch US banking stocks carefully to gauge whether the above measures have been enough to restore confidence. Worryingly over the weekend another bank, Signature Bank in New York, was also taken into administration by US authorities. One clear read for the market is that the Fed is not going to be able to deliver a 50bp hike on 22 March if, at the same time, it is introducing new liquidity measures for the US banking system. The market has now scaled back expectations for this month's FOMC to +25bp, with some high-profile names now calling unchanged rates. Indeed, the pricing of the December 2023 FOMC meeting is now 75bp lower than in the middle of last week.

For FX this means the following. The first major US financial crisis since 2008 has seen a significant bullish disinversion of the US yield curve - which is dollar bearish. We have been arguing for some that time that bullish disinversion would be required to send the dollar lower - but had felt that it would be US disinflation or weak activity data - not a financial crisis - which would be the trigger. Expect investors to remain wary this week and continue to prefer the CHF and JPY over the dollar. In a way, we are going back to former periods of risk aversion - when selling the dollar and buying US two-year Treasury notes was the key strategy in a crisis.

DXY to probably trade alongside the US KBW banking index - particularly the Regional banking Index - today. Risks lie to the 103.50 area and potentially 102.50 this week.

Chris Turner

EUR: Spreads narrow markedly in favour of EUR/USD

The dramatic re-pricing of the Fed policy curve has seen two-year EUR:USD swap rate differentials narrow inside 100bp - the narrowest since October 2021. This is EUR/USD positive. Unless there is a massive rally in US banking stocks today which suggested that US authorities had been incredibly successful in putting the genie of US banking sector risk back in the bottle, we would say EUR/USD is biased to the 1.0780/1.0800 area.

On Thursday this week, the European Central Bank policy meeting will be challenging. Presumably, it will have to push ahead with a 50bp hike for fear of adding even more volatility to the markets.

Chris Turner

GBP: Bailouts and budgets

Sterling did a lot better than we were thinking on Friday. We very much struggle to buy into sterling as a safe-haven currency, given the UK's large current account deficit and large financial sector exposure. Instead, we suspect deleveraging and the unwinding of short sterling positioning played a role.

Today the focus will be on the UK's support of the tech sector in response to SVB's UK arm. As in the US, depositors in the UK are being made whole and the government is looking to address the working capital needs of those exposed. The market still expects the Bank of England to push ahead with a 25bp hike on 23 March. This still may be at risk of being priced out, given the BoE was not far away from a pause anyway.

We could easily see EUR/GBP retracing back up to 0.8900, while we would not chase GBP/USD over 1.22.

Chris Turner

CEE: Forint and koruna should reverse losses

The second half of the month in the Central and Eastern Europe (CEE) region traditionally offers a weaker economic calendar and given the global story, we assume that regional factors will not be the driver this week. Romania's inflation for February was released this morning and rose by 15.52% year-on-year, slightly above market expectations. Tomorrow, we will see in Romania, industrial production and on Wednesday we will see labour market data. Also, on Wednesday we will see this week's highlight, Poland's inflation number. We expect an increase from 17.4% to 18.7% YoY, above market expectations, which should be the peak inflation this year in our view. However, the number has a lot of uncertainty due to the consumer basket weight update. Then, on Thursday, we will see the current account results across the region and on Friday, core inflation will be published in Poland.

In FX markets, given the global story, it will be difficult for the CEE region to find its way. However, risk aversion seems to be declining and a higher EUR/USD should help the region correct some of the losses from the end of the last week. Moreover, in the case of the Czech koruna and Hungarian forint, which faced the biggest losses, the biggest jump in gas prices since June last year played a role as well, making room for new gains. In our view, these two currencies should see a positive start to the week. In the case of the koruna, however, the falling interest rate differential will play against it. Thus, we expect the koruna to move lower to 23.60 EUR/CZK and for the forint to 380 EUR/HUF.

Frantisek Taborsky

Authors

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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