

## FX Daily: Sanctions bite, dollar liquidity in focus

Western leaders are escalating sanctions against Russia, with one of the most severe measures so far being to sanction the Central Bank of Russia (CBR) - limiting the CBR's ability to defend the rouble. USD/RUB is currently being quoted 25% higher than Friday's close. Expect the dollar to stay in demand globally and keep watch for USD funding stress



Russian rubles and US dollars

### USD: Flight to dollar quality/liquidity should continue

Measures to sanction the CBR are clearly having their intended consequences of weakening the rouble. Having suffered a variety of crises in recent decades, Russian residents are very sensitive to the USD/RUB exchange rate and clearly, the current rouble decline is hitting home. As we write this, we have just seen the CBR raise rates a staggering 10.5% to 20%. This looks like a package of measures to defend the rouble including new mandatory sales of 80% of FX revenues for Russian companies. This latter measure looks to prevent the kind of FX hoarding seen during the Crimea crisis of 2014, when Russian energy companies were alleged to have held onto FX earnings and contributed to heavy RUB losses during that period. Additionally, the CBR has temporarily suspended the sale of Russian assets by non-residents. This comes as companies like BP and the

Norwegian sovereign wealth fund announce plans to divest Russian assets.

With Western nations moving to extreme sanctions very quickly - e.g. measures to sanction the CBR are now starting to draw parallels with Iran - investors will be nervous that Western leaders bite the bullet and consider whether exposure to Russian oil and gas supplies comes into focus, too. What is clear is that commodity prices, (gas, oil, certain precious/industrial metals and softs such as wheat) will continue to rise and this supply shock should be a negative for activity and equities.

We are also a little concerned by any potential unintended consequences of the sanctions measures, e.g. whether the restrictions on hundreds of billions of dollars of hard currency assets will have some ramifications for global financial architecture - e.g. the use of any sanctioned assets as collateral in global repo markets. As such we will keep a close eye on the cross-currency basis swap market for any kinds of stress as well as seeing whether there is any increased demand for dollar liquidity at e.g. the ECB 7-day USD auction.

Suffice to say that the dollar should continue to be the preferred safe haven in these unprecedented times. The macro inputs of semi-annual testimony from Federal Reserve Chair Jerome Powell on Wednesday or Friday's February jobs report will definitely take a back seat to international developments.

DXY is heading back to the high at 97.70 and could break higher still.

## ⬇️ EUR: A risk premium for Europe

We [discussed on Friday](#) how central banks in Eastern Europe may be feeling about recent currency weakness. Euro losses have been relatively well contained so far, though we do believe that EUR/USD could fall further as investors fully assess the ramifications of weekend events. Given the seismic changes in German foreign/defence policy and e.g. the European embrace of the use of SWIFT sanctions, investors will wonder whether Western Europe will be prepared to curtail imports of Russian oil and gas, too. Indeed, there have already been some reports of Europe looking at quotas/limits on Russian energy. Clearly, Europe would have to pay a lot higher prices for its energy under such a scenario and growth forecasts would have to be downgraded.

It is a big macro week for the euro given the release of February eurozone CPI on Wednesday (French CPI has already surprised on the upside). But given events to the east, we doubt stronger eurozone CPI/potential for ECB hawkishness will be enough to turn around an otherwise bearish bias for EUR/USD.

EUR/USD briefly retested the 1.1110/1120 lows overnight and barring any surprise break-through in Ukraine-Russia talks, EUR/USD looks biased to 1.10 this week.

## ➡️ GBP: Volatility assured

GBP has been holding up surprisingly well - given that it is normally more sensitive to financial developments than others. Investors will be interested to see whether BP's planned sale of its stake in Rosneft has any FX implications, be it positive for the dollar or GBP - although huge uncertainty around how that sale happens remains.

As we have been saying recently, at least the Bank of England has set out its stall in reacting to stagflationary fears and today's surge in European natural gas will again edge the BoE towards

hawkish positioning. 0.8300-0.8400 looks the near term range for EUR/GBP, but a large leg lower in equities suggests 0.8400 could come under a lot of pressure.

## CNY: Renminbi again holding up well

As we discussed on Friday, the renminbi is holding up exceptionally well and its credentials as a reserve currency continue to grow. Notably, SWIFT payments denominated in CNY rose in January to a 3.2% share of global transactions - breaking out of a multi-year 1.5-2.5% range. Focus on Russia's ability to defend the rouble will also turn to China, given that Russia has 13% of its FX reserves in the renminbi - does the CBR sell those if they are still available? There will also be a focus on whether Russia tries to secure FX swap lines with China (backed perhaps by Russia's gold) although it remains very unclear that China would want to participate in such a venture given the risk of secondary sanctions.

For now, we continue to favour the renminbi as an alternative to the dollar and should focus return to macro, [China's Two Sessions](#) meeting later this week could re-focus the market on Chinese growth initiatives and a stronger renminbi.

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