

FX Daily: Settling in with the long diplomatic game

We'll likely enter the weekend with more questions than answers on the Russia-Ukraine tensions, with the diplomatic game set to extend well into next week and likely beyond. In a very quiet day data-wise, we continue to see the dollar (and other safe-haven) downside as contained given the still highly volatile geopolitical situation



Source: Shutterstock

➔ USD: Still likely to find a floor soon

This week has not given enough indications that Russia-Ukraine tensions are heading towards a de-escalation, as US authorities have continued to doubt Moscow's claims around a troop withdrawal while Ukrainian forces and Russian separatists have repeatedly accused each other of violating a cease-fire.

There is a very high probability that we'll get into the weekend with a still very blurry picture on geopolitical tensions, with next week's meeting between the US Secretary of State, Antony Blinken and his Russian counterpart Sergei Lavrov now perceived as the pivotal event in the Ukraine saga. We think lingering uncertainty around current diplomatic developments should help put a floor

under the dollar as safe-haven demand is unlikely to dissipate in the very near term.

When it comes to the second big driver for the dollar – Fed rate expectations – we'll hear from Charles Evans, Christopher Waller, John Williams and Lael Brainard today, after James Bullard continued to advocate in favour of front-loading rate hikes yesterday. Any sign from today's speakers that they would also favour faster tightening could see markets go back to speculating on a 50bp March hike, a prospect that has been partially and gradually priced out in the past few days.

We continue to see any dollar weakness as being quite short-lived, and struggle to see DXY break decisively below 95.50 for now. The US data calendar today is very light and only includes some housing data.

➔ EUR: Stuck between contrasting forces

EUR/USD volatility has dropped significantly since yesterday morning, with the current tight trading range (1.1350-80) factoring in some modest degree of geopolitical risk (which is preventing a decisive break above 1.1400) and the market's reluctance to fully price out expectations on ECB tightening this summer preventing a fall below 1.1300.

These conflicting forces may continue to keep the pair around current levels into the weekend, with the eurozone's consumer confidence data later today unlikely to generate much reaction in FX.

➔ GBP: Growth momentum continues to help the pound

As expected, UK retail sales (data released this morning) rebounded fiercely in January, as the Omicron-induced slump dissipated. This is yet another indication of how the British economy has started the year with some good momentum, which is ultimately keeping the market comfortable with its aggressive pricing for Bank of England tightening.

GBP/USD broke above 1.3600 yesterday likely on the back of the recent positive data flow and solid BoE rate hike expectations, while the pound also appears relatively less exposed than other European currencies to the adverse swings in geopolitical sentiment. Cable could hold above 1.3600 today.

⬇ SEK: Inflation impact to proved short-lived

The January inflation report released this morning in Sweden showed some resilience in both CPI and CPIF inflation, which declined only marginally (to 3.7% and 3.9%, respectively) at the start of the year. A closely-monitored core measure – CPIF excluding energy – unexpectedly jumped from 1.7% to 2.5% year-on-year: this is likely behind the positive reaction of the Swedish krona after the release.

Still, the FX impact of inflation figures should be very short-lived both because the Prospera inflation expectation survey continued to show how CPIF inflation expectations remained anchored below 2.5% for the next year – therefore implying a significant easing of price pressures later in 2022 and no Riksbank tightening – and because geopolitical risks are too big of a driver for SEK at the moment. As noted in our recent FX commentaries, the krona has all the characteristics of being a preferred proxy benchmark, outside of the rouble and Ukrainian hryvnia,

for Russia-Ukraine tensions: a high beta to risk sentiment, geographical vicinity, and lack of buffers that other European currencies can count on: i.e. sensitivity to oil prices for Norway's krone or hawkish bets on its domestic central bank for the euro.

Given the still quite volatile situation in Ukraine, expect some support at 9.25 in USD/SEK and around 10.50 in EUR/SEK today.

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