FX Daily: Short-term fix to a long-term issue

The US potentially releasing one million barrels of oil per day is unlikely to make up for the lost Russian supply, and should fail to drive prices sustainably lower. Commodity FX should not see much more downside after absorbing the initial shock. EUR/USD may hold on to gains after strong eurozone inflation readings. Elsewhere, the CNB should hike by 75bp

USD: US release of oil reserves no game changer

Markets were forced to rethink their optimism on Russia-Ukraine peace talks yesterday after Russia said there were no major breakthroughs in negotiations and Nato members warned that a withdrawal of Russian troops is still not on the cards. At the same time, developments in the commodity market have offset the hit to risk sentiment, as the Biden administration is reportedly weighing the option of releasing one million barrels a day of crude from the US reserves to counter the rise in prices. Coincidentally, the US is seeking some agreement among allies to join with similar measures. It is undeniable that should the plan go ahead, the release would cause a positive supply shock – but one million barrels per day are simply not enough to offset Russian losses, and this appears to be a short-term fix to a long-term issue.

While it is reasonable for oil futures to trade some 5-6% weaker on the back of the news, it does not seem likely that US reserves will be able to drive oil prices structurally lower. For the currency market, this means that commodity currencies – and especially the very oil-sensitive Norwegian krone and Canadian dollar – may not be looking at much more downside after having absorbed the initial shock. At the same time, we expect the commodity FX bloc to remain on the backfoot today as the OPEC+ meeting should continue to see a push for increasing supply to make up for lost Russian crude, possibly keeping oil prices pressured.

The dollar has recovered some ground, although the heavily euro-weighted DXY has remained mostly flat in overnight trading as the euro enjoyed some idiosyncratic support. We continue to doubt there is much more downside for the dollar from these levels, and markets may rebuild more long-dollar positions ahead of tomorrow's nonfarm payrolls which may well endorse the recent hawkish re-pricing of Federal Reserve tightening expectations. Today, markets will keep an eye on US personal spending figures for February and a speech by the Fed's John Williams.

EUR: Holding on to gains

German CPI data surprised once again to the upside yesterday, with headline inflation jumping to 7.3% in March from February's 5.1%. Spanish inflation, also released yesterday, nearly reached 10%. All that translated into a stronger euro, which has been able to hold on to gains despite the market's optimism on peace talks (originally behind the big EUR/USD rally this week) somewhat fading.

Undoubtedly, the news of US oil possibly being released is also a positive for the euro, given the eurozone's dependence on energy exports, but – as highlighted above – it is still unlikely to drive crude prices sustainably lower, keeping the prospect of a material recovery in the battered eurozone's terms of trade as quite remote. As we have repeatedly highlighted in recent publications, we continue to see the terms of trade shock as likely to keep EUR/USD upside limited in the medium-term.

Today, we'll see the CPI numbers from France and Italy, while eurozone-wide data will be released tomorrow. Naturally, the bar for an upside surprise is now set very high. On the European Central Bank side, we'll hear from vice president Luis de Guindos and chief economist Philip Lane.

We think that high eurozone inflation readings and the benign external environment – albeit still highly reliant on Russia-Ukraine peace negotiations – can keep EUR/USD in the 1.11/1.12 area for today.

GBP: EUR/GBP can hold around 0.85 for now

It's all very quiet in the UK today, both on the data side and in terms of Bank of England communication. Yesterday's EUR strength helped EUR/GBP extend gains and break through the 0.8500 resistance overnight.

We see mostly downside risks from this point for the pair, but that should be a story for the coming weeks, as the euro's good momentum could keep a floor under the pair for now.

CZK: CNB meeting may lead to market disappointment and weaker koruna

The first monetary policy meeting of the Czech National Bank since the outbreak of the Ukrainian conflict will take place today. A rate hike in the 50-100bp range is likely to be on the table today. Our main scenario calls for a 75bp hike in line with market expectations. Surveys prefer a 50bp hike.

In any event, despite the hawkish decision, we can expect a dovish press conference highlighting stagflation and geopolitical risks. We expect that, as in February, Governor Rusnok will mention that this rate hike may be the last, which we believe may lead to market disappointment. Given the rate moves over the past two days, we see the risk of a larger correction lower since we released our CNB preview.

EUR/CZK has moved to the lowest levels in a month on optimism over a de-escalation in the Ukraine war, making the pair vulnerable to any dovish CNB outcome.

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