FX Daily: The calm can be deceptive

Central bank action has helped risk assets and cyclical currencies but it's still too soon to call a bottom

USD: Don’t get carried away

Risk assets and cyclical currencies gained overnight. While the latest central bank actions (European Central Bank and Bank of England quantitative easing) might have materially helped, it is still too early to call for a bottom. The dollar funding squeeze remains a dominant theme in FX markets (here, although EUR/USD basis corrected, USD/JPY basis remains- elevated at this point) and the global economic outlook remains highly uncertain, with clear downside risks. All monetary, fiscal as well as dollar liquidity provision polices need to go hand in hand and in a coordinated fashion to put a soft ceiling on indiscriminate or panic USD gains. In markets characterised by excessive volatility, the overnight gains of G10 currencies vs USD seem fairly muted compared to the significant losses these currencies experienced in past days and weeks. Hence, once should not get carried away.

EUR: Dollar funding squeeze apparent throughout the European FX complex

EUR/USD is partly reversing the collapse of the past two days, but unless market functioning returns to normal and USD funding concerns evaporate, cross upside should be fairly limited. The USD funding squeeze and its indiscriminate negative effect on markets manifested itself in

Denmark, where the up-to-now quasi safe haven (but low liquidity) Danish krone came under pressure and the central bank had to deliver a 15 basis point hike yesterday to defend the ERM II EUR/DKK trading band.

GBP: Markets taking the glass half full approach to BoE QE

After the Wednesday fall, sterling stabilised and rebounded in spite of the Bank of England rate cut and QE announcement. Although the BoE QE may be seen as larger than initial expectations, given the bazooka delivered by the ECB on Wednesday, in relative terms the BoE QE does not necessarily stand out as too negative for GBP vs EUR. Still, and as we mentioned in GBP: feeling the pressure point, the pound's outlook remains tricky in the current falling markets, which doesn't bode well for currencies with large funding needs.

RUB & CEE FX: CBR on hold and focusing on FX interventions

In Russia, we expect CBT to keep interest rates unchanged today. Despite the worsening economic and inflation outlooks, the rouble being under heavy pressure during recent days means a high bar for a cut. Defensive hikes are fairly unlikely too, with FX interventions being the preferred central bank tool to lean against RUB losses. As for FX interventions, we expect this to become a new theme in the Central and Eastern European FX space. With the National Bank of Romania already in its usual full intervention mode, we expect the Czech National Bank to join the chorus soon (CNB having the largest regional FX reserves fire power). Poland's central bank might follow while the bar for FX interventions in Hungary is high. The size and credibility of potential CNB FX intervention means we expect CZK to start outperform Hungary's forint and Poland's zloty, after heavy koruna losses in past weeks.

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