FX Daily: What to expect from another day of market mayhem

As markets continue to address the fallout of the SVB and Signature collapse and monitor US regional banks, a big question is emerging: will the Fed stop early? Markets are betting heavily it will, and this can mean a much weaker USD, but it's not worth looking any further than the very short term for now. US CPI today will obviously have a much smaller impact

HSBC has bought the embattled UK arm of Silicon Valley Bank

USD: Risks of another leg lower

The fallout of the collapse of Silicon Valley Bank and Signature Bank is still unfolding. Let's start by taking stock of has happened since markets reopened after the weekend:

- Depositors at SVB and Signature could access their funds on Monday thanks to intervention by US regulators, which aimed at preventing contagion
- The Fed's Bank Term Funding Programme came into action, offering advantageous conditions for banks that can get loans with collaterals valued at par – therefore avoiding to incurring in losses when selling securities that have lost in value. It remains to be seen to what degree this will ultimately be leveraged.

- The repricing in rate expectations has been titanic. In the US, markets now see only 50% chance of 25bp hike in March, and fully price in 67bp of cuts by year-end. US 2-year yields edged below 4.0%, over 100bp below Thursday's levels.
- US equities have steadied, but failed to rebound despite Fed's moves to calm investors
- In FX, the dollar drop has been quite contained: in this article, we explain why EUR/USD hasn't spiked on the huge Fed repricing.

So, what shall we expect today?

- Volatility is likely to remain the name of the game. US stock futures point at a marginally positive open this morning, but markets are constantly monitoring incoming news on the health of other financial institutions, in particular US regional banks. It's worth keeping an eye on the share price of First Republic Bank (another Californian institution) today, after a 62% drop in yesterday's trading session.
- Inflation data will be released in the US today: consensus is for a 0.4% MoM, 5.5% YoY read. Should we see some "orthodox" reaction in rates to a potential data surprise, this could be a signal that some degree of confidence has returned to the market.
- In FX, we think the balance of risks is tilted towards another leg lower in the dollar. The Fed and US regulators have taken decisive steps to restore market confidence and may be ready to do more (on the monetary side, when it comes to Fed) should financial risks fail to abate. While it is true that the move in rates appears overblown, there is ample room for a bounce in risk sentiment, and FX currently is much more sensitive to equities than rates. AUD and NZD still look attractive in a risk recovery. Should equities fail to rebound, CHF and JPY may emerge as outperformers.
- It will be interesting to follow where the political discussion goes when it comes to banking regulation. Clearly, this has now become a very central topic in Washington.

Francesco Pesole

EUR: Capped, for how long?

EUR/USD is holding up at 1.07 despite the huge move in US rates. Admittedly, EZ rates have also followed with a mammoth repricing, and markets are now even doubting the 50bp hike which was "promised" by Christine Lagarde for the March meeting. We teamed up with our rates colleagues and tried to give some clarity about the market impact of Thursday's ECB announcement in our ECB Cheat sheet.

Despite markets only pricing in 38bp of tightening this week, our economics team only expect the recent financial turmoil to impact the discussion on the rate path beyond the March meeting, and we therefore stick to our original 50bp call as the ECB remains – on paper – focused on fighting inflation.

From an FX perspective, this would be good news for the euro, but: a) a repricing higher in rate expectations would still require President Lagarde to convince markets at the press conference (which will prove exponentially more challenging given recent developments); b) rate differentials remain an absolute secondary driver of EUR/USD, and the direction for the pair is set to be determined almost solely by how the Fed reacts – or "overreacts" – to the SVB fallout.

For now, we target 1.08-1.09 by the end of this week.

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GBP: Upside despite potential hold by BoE

Market focus in the UK has been centred around HSBC's purchase of SVB UK, an operation which was championed by the UK government. It is hard to draw any obvious conclusions from an FX perspective, especially in the current market environment where we could see large daily swings in equities driving a pro-cyclical currency like the pound.

On the data front, data released this morning showed clear signs that wage growth might have finally peaked, as recent BoE surveys previously hinted. The 3M/3M annualised rate of growth - one of the better measures of momentum in the pay numbers - has slowed noticeably over recent months. This will be welcome news for the BoE, and does question whether the Bank will indeed hike by 25bp next week amid the SVB fallout.

Even if the BoE decides to hold, this should not prevent Cable to test the January 1.2450 highs if the Fed pivots to the dovish side and risk sentiment bounces back.

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CEE: This market leaders remain most sensitive

Today's calendar in the region does not have much to offer. This morning, we saw industrial production data from Romania, which posted a decline of 6.1% YoY for January. Later, retail sales for January in the Czech Republic will be released, which should confirm the sharp year-on-year decline.

In the FX market, the Hungarian forint and the Czech koruna remain the main focus again, failing to reverse further losses yesterday. On the other hand, the Polish zloty and Romanian leu have maintained admirable resilience to global turbulence. The Hungarian forint seems to be the most sensitive to market sentiment and energy prices in the region at the moment, with the koruna a close second. Both factors have pushed the forint and the koruna higher in recent days, but yesterday's US trading and the reversal in gas prices indicate that the sell-off should end today and both currencies should at least stabilize at current levels, supported by a higher EUR/USD.

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