FX Markets: Moving to a war footing

War in Europe has understandably taken its toll on currencies in the region and the implementation of Russian sanctions now questions the rouble's deliverability. Both the US dollar and the Chinese renminbi have proved beneficiaries

A currency exchange in Moscow showing just how far the rouble has fallen

European FX: In harm's way

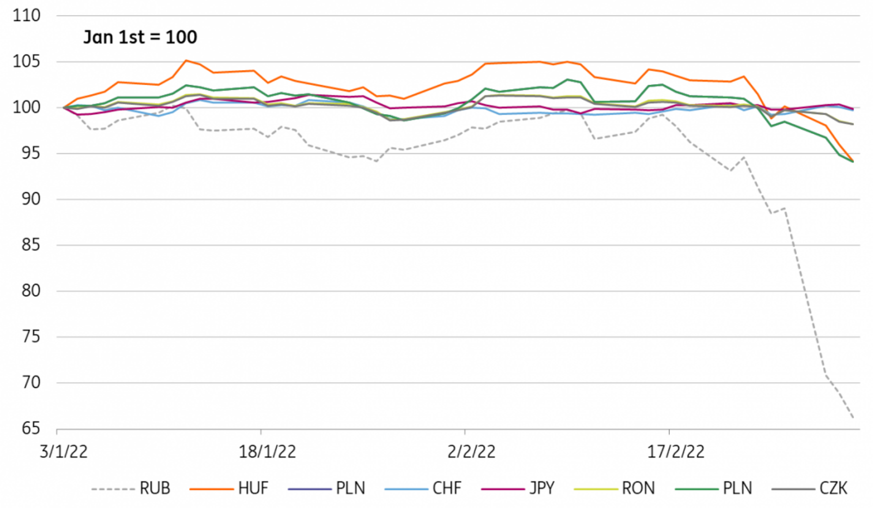
President Putin's surprise invasion of Ukraine has hit European FX hard. The Russian rouble, quoted offshore, has fallen around 35%. Most of that decline was driven by the announcement that the Central Bank of Russia (CBR) would face western sanctions, making a large part of its FX reserves unusable for a defence of the rouble. Instead, Russia has resorted to rate hikes and capital controls to protect its currency.

The path for the rouble looks very uncertain but likely lower. There is substantial foreign cash trapped in rouble assets that is looking for an exit. And what seems more clear is that full rouble deliverability (the ability to swap currency balances internationally) has been compromised. Based on sanctioned counterparty risk, we have seen the emergence of a two-tier rouble market: onshore trading with onshore names, offshore with offshore. The development of a Non-Deliverable Forward market seems just a matter of time.

Understandably, European currencies have been hit hard – especially those with borders on Ukraine. In the G10 space, liquidity, geography and the energy independence of the US all make the dollar a preferred safe haven – also backed by a strong economy and central bank justifiably ready to tighten. Expect the dollar to stay bid over the coming months.

In addition to the other traditional safe havens of the Japanese yen and the Swiss franc, the Chinese renminbi is also performing well. Local policymakers no doubt welcome the strong renminbi performance – worthy of a currency that is a privileged member of the IMF's Special Drawing Rights. But trade and portfolio flows – perhaps including some Russian activity as well - may also be helping here.

FX performance against the dollar since 1 Jan 2022



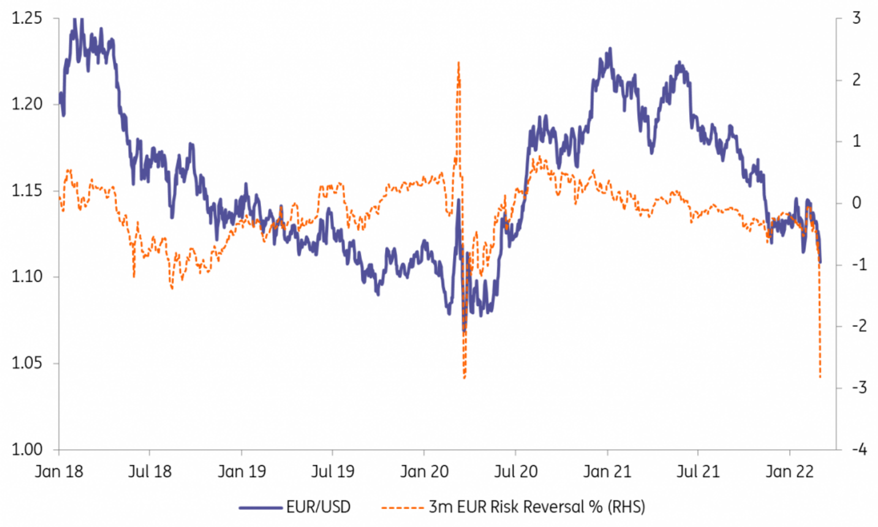
Source: Refinitiv, ING

EUR/USD: The hedge against a European war

The decline in EUR/USD has been relatively modest so far – just around 3% over the last month. The drop will have been restrained by lingering expectations of a hawkish European Central Bank on 10 March. Yet activity in the FX options market has been far more dramatic. The buying of downside protection in EUR/USD and the cost of a euro put option (right to sell) over an equivalent euro call option (right to buy) is the most one-sided since March 2020. That is when EUR/USD briefly traded down to 1.0650.

We cannot know how far this war will escalate, but what we can say is that pressure is building for a sizeable break in EUR/USD below 1.10 this spring.

EUR/USD: FX options market braces for a move sub 1.10



Source: Refinitiv, ING

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Disclaimer