# FX Markets: Pressure switches to Europe

Fast-moving financial markets have today seen attention switch from the (ongoing) banking crisis in the US towards Europe. Credit Suisse shares have fallen 23% and the Eurostoxx Banks Index is off 8%. Stress in money markets is moving back to Monday's levels and the euro is softening

## Markets remain nervous

Earlier today we had described a 'nervous calm' returning to financial markets. That has not lasted long at all as attention has switched to Europe and the pressure on Credit Suisse's (CS) share price after The Saudi National Bank, one of CS's top investors, said it was not open to a further capital injection into CS. Heavy losses in CS have un-nerved European bank stocks in general at a time when the failure of SVB, formerly the United States' 16th largest bank, is still being assessed.

Heavy losses in European banks have raised stress levels in money markets. The 3-month USD FRA-OIS spread has widened back out to +57bp (near Monday's peak) and the 3m EUR cross-currency basis swap has widened to 38bp from 15bp at the start of European trading. Remember that the cross-currency swap represents the extra cost the interbank market is prepared to pay to secure USD funding using the EUR swaps market. It was a key measure of stress both during the 2008 financial crisis and again during the start of the pandemic in March 2020.

## FX markets switch mode

Having traded for many quarters off the macro influences of the US inflation/Fed tightening story, FX markets are now trading off financial stress. EUR/USD is selling off today as the dollar benefits from the extreme (market dislocation) end of its smile curve. The pressure on European banks has also sparked a repricing of tomorrow's European Central Bank meeting. What was seen as a solid 50bp hike from the ECB has today been cut to a 35bp hike.

Standout FX performers remain the Japanese yen (global interest rates are now converging on those in Japan) and to a lesser degree the Swiss franc – although USD/CHF is now higher today as money market stress is leading to broader dollar strength. As we discussed last week, it seems investors are still unravelling some of their favourite trades in the Mexican peso and the Hungarian forint (both off 2%+ today).

Renewed financial stress is clearly not good news for commodity currencies either, where the Norwegian krone, which along with the Swedish krona trades at the highest volatility in the G10 space, is also off close to 2% against the dollar today.

## What next?

Clearly, it looks like it will take some time for financial conditions to settle. The Fed announcing greater oversight for mid-sized US banks may not be enough and investors may want to hear of more support from monetary and regulatory authorities. Investors will also be looking out for the take-up of the Fed's new liquidity scheme, data on which should be available tomorrow evening.

With the US MOVE index for US Treasury volatility now spiking above March 2020 levels and the VIX (US equity volatility) heading back to 30%, now is not the time to be looking for carry/yield in FX markets. Instead, a safety-first approach will dominate until developments in the banking system become clearer. That should mean the JPY continues to outperform on the crosses and may even continue to outperform the dollar, too.

But a re-pricing lower of the Fed curve will not take the dollar lower until money market conditions smooth out and some confidence is restored to the bank sector. In short, do not be too quick to resell the dollar.

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