

Deutsche Bank  
Research



# FX review and outlook

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Deutsche Bank, May 2022

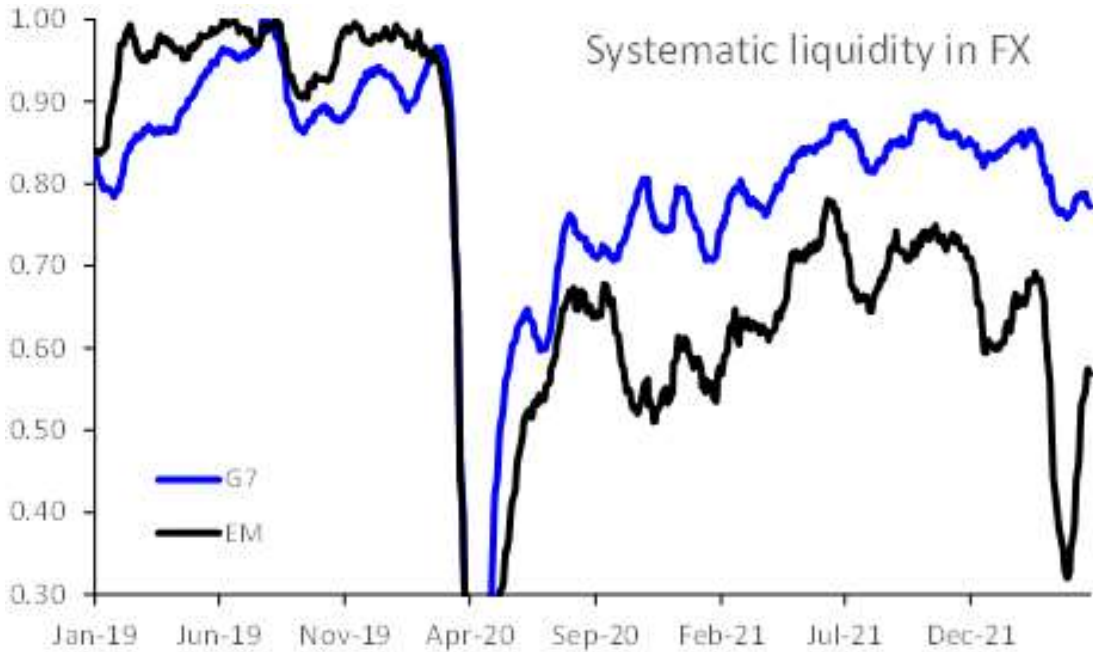
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All charts sourced from Deutsche Bank research / Bloomberg

# Market liquidity after the Russian invasion



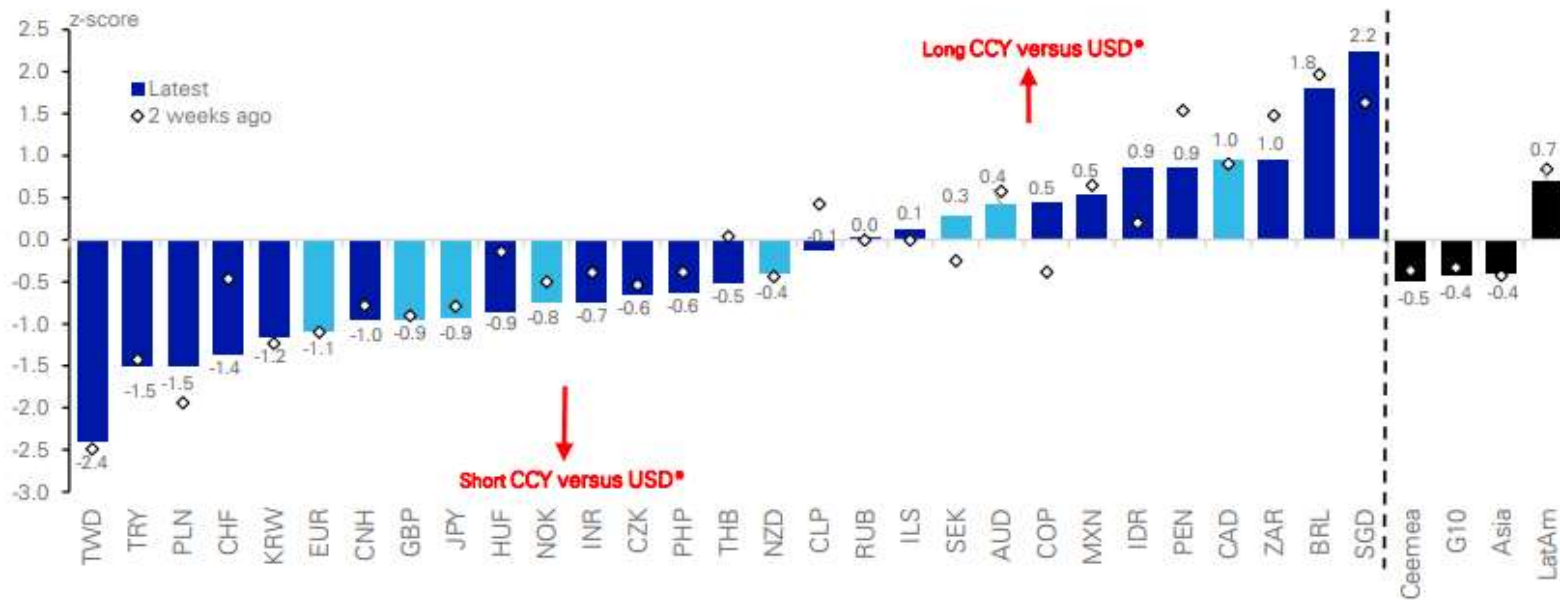
Liquidity has deteriorated, predominantly in Eastern Europe FX



# Market positioning after the Russian invasion



The market is generally short European and Asian currencies, versus long USD and Latin America



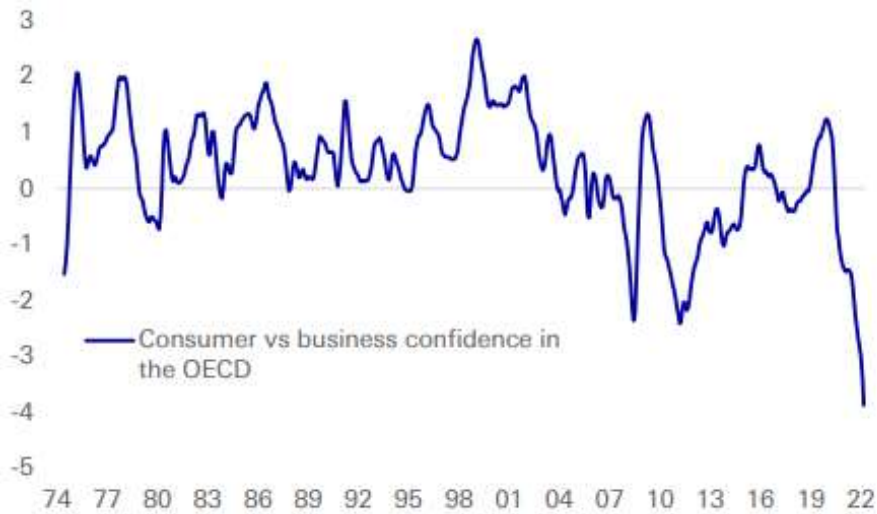
Source : Deutsche Bank, Bloomberg Finance LP, DTCC, EBS, Reuters, IMM, CORAX

Note: 1) \* Long (or short) versus EUR for CZK, HUF, PLN, CHF, NOK and SEK. 2) The black bars on the right-hand side are average positioning levels for G10, Asia, CEEMEA and LatAm. 3) The y-axis shows readings of positioning index in a z-score format, which is an average of rolling two years z-scores for individual sub-indicators. Thus, the long or short of each currency is relative to its two years' average instead of absolute level.

# Macroeconomic picture after the Russian invasion



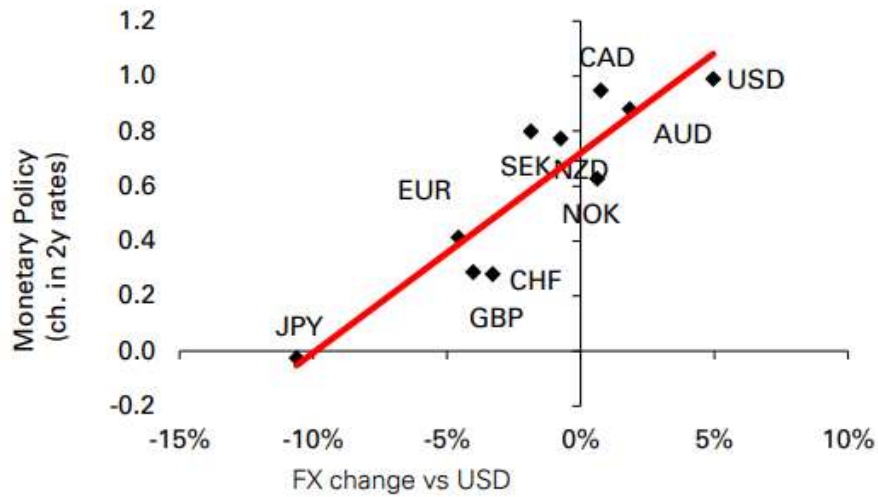
## Record high divergence between consumer and business confidence



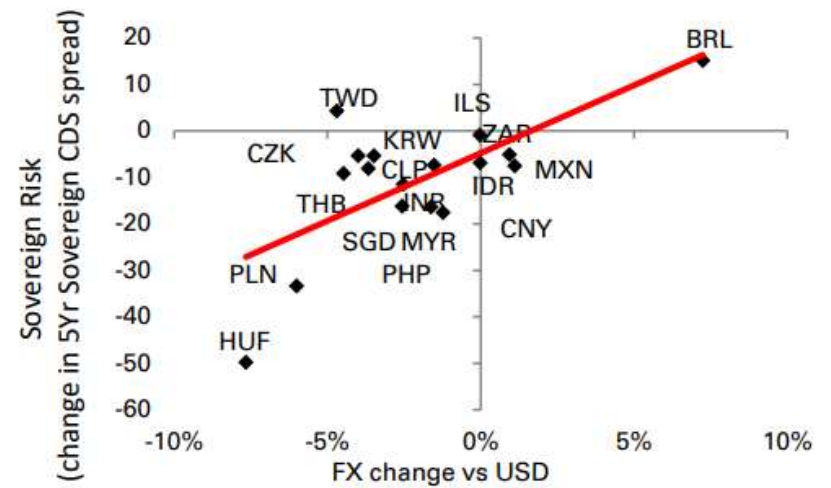
# FX performance since the Russian invasion



Monetary policy dominant driver for G10



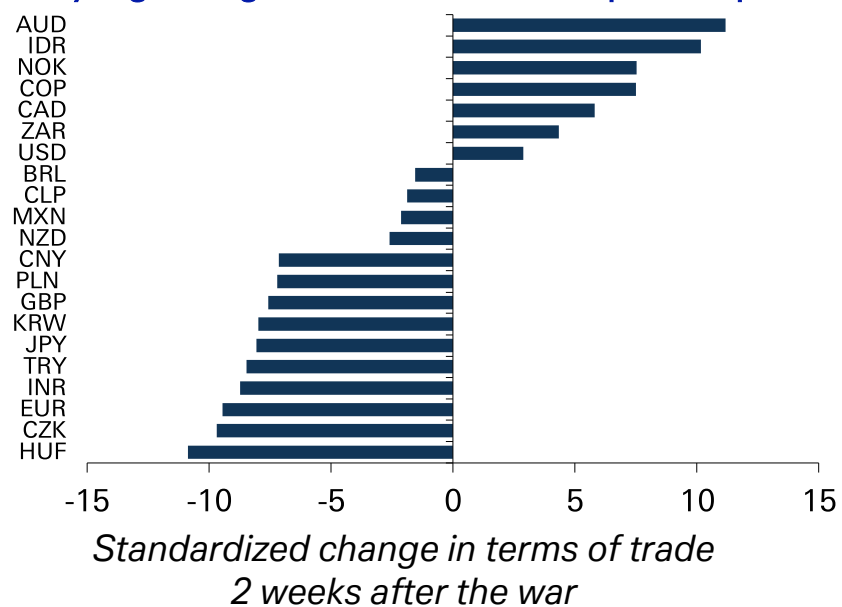
Sovereign risk dominant driver for EM



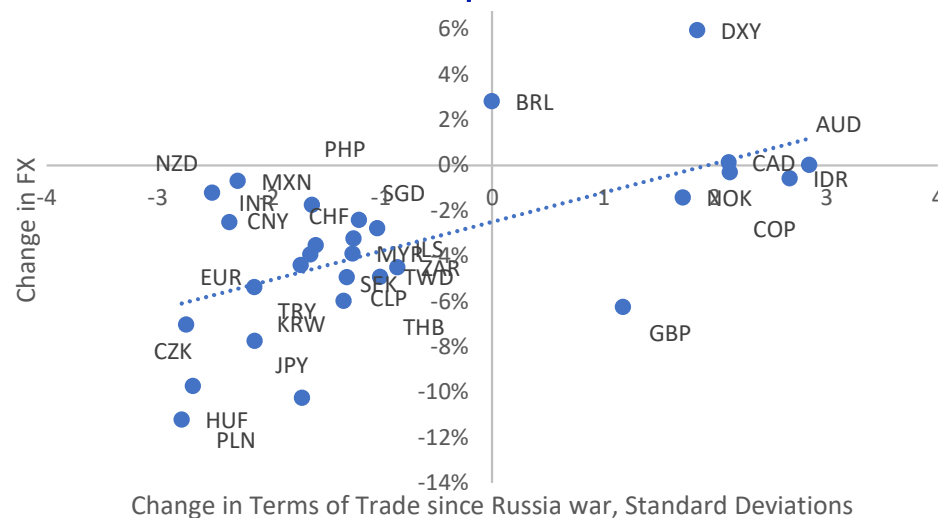
# The commodity impact on FX was short-lived



## Very big change in terms of trade at peak impact



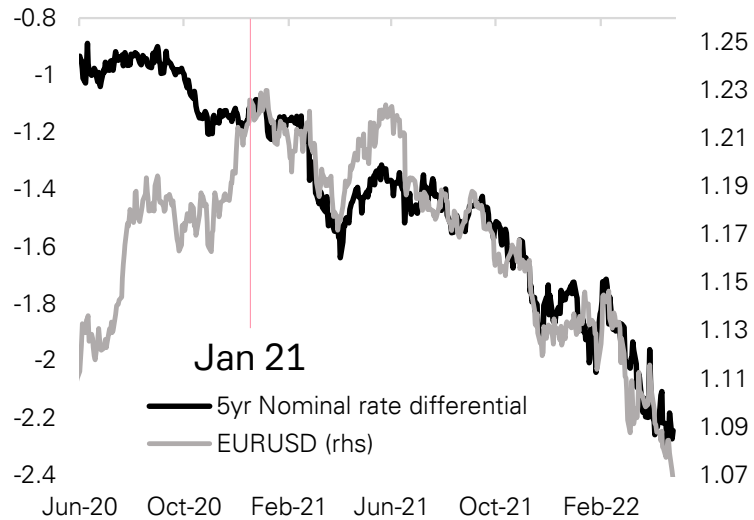
## Correlation between FX performance and commodities quite low



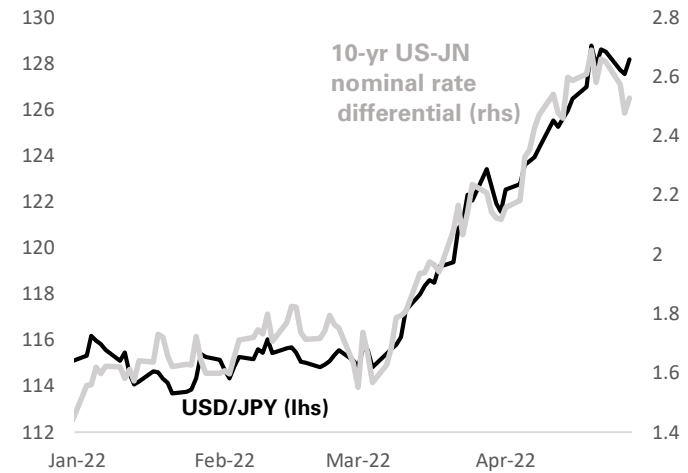
# Rate differentials have been dominating G10 FX market



### EURUSD correlation with rates high since 2021



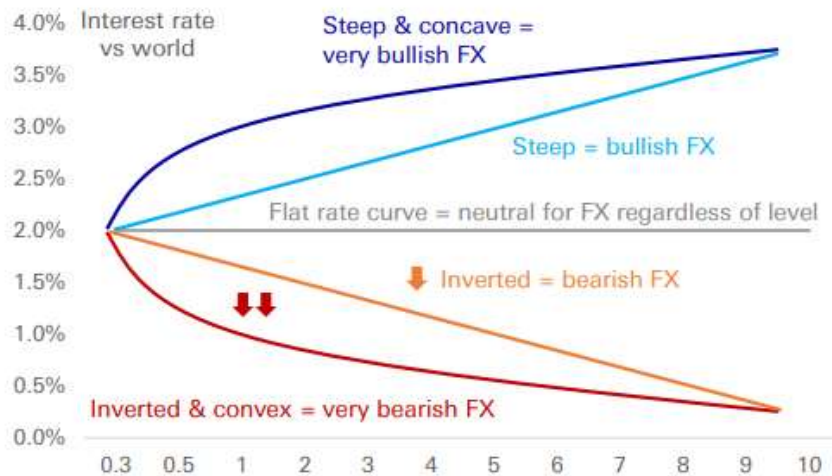
### USD/JPY correlation sharply picked up in 2022



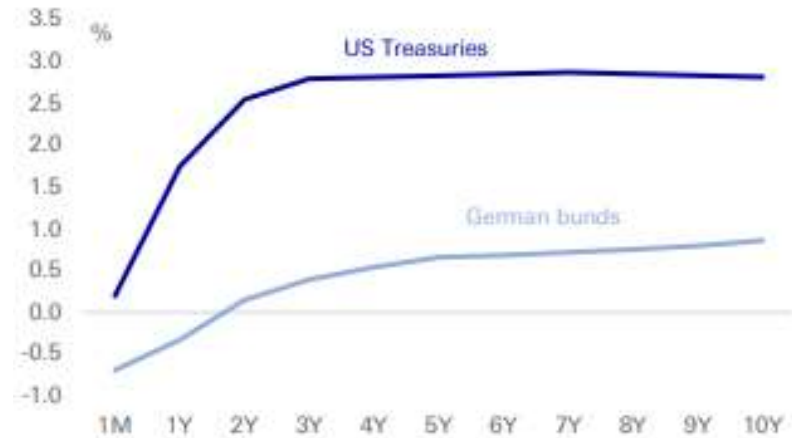
# The shape of the yield curve is very important for G10 FX



## Shape of curve and impact on FX



## Current US curve shape supportive of USD

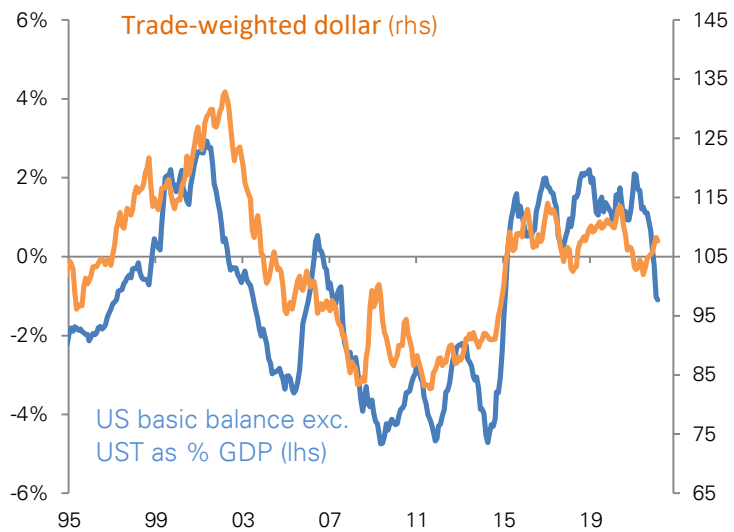




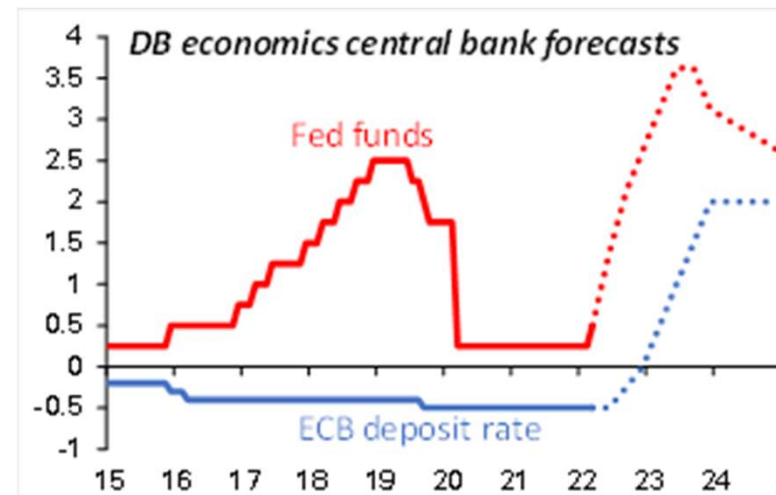
# USD outlook: peaking and significant weakness coming



The underlying US flow picture is rapidly deteriorating



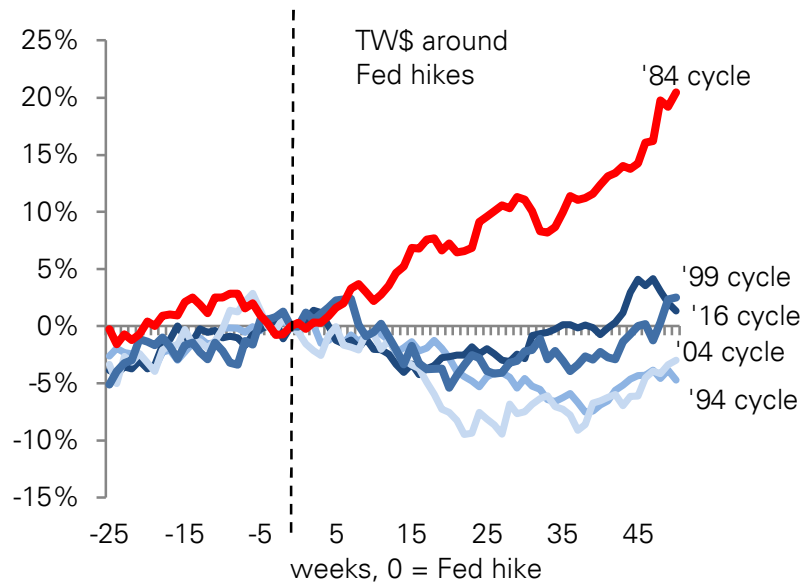
We see Fed pricing approaching peak and a US recession



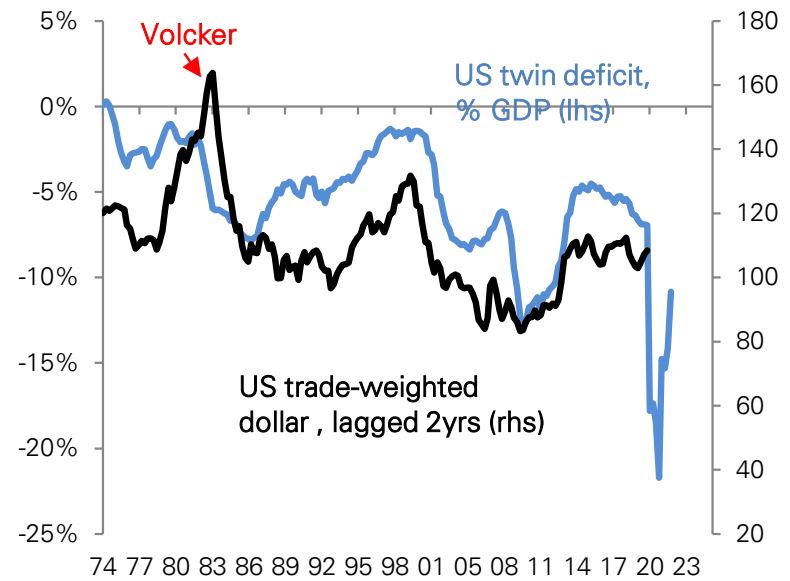
# The 1984 Volcker experience



Dollar rallied as the Fed was hiking



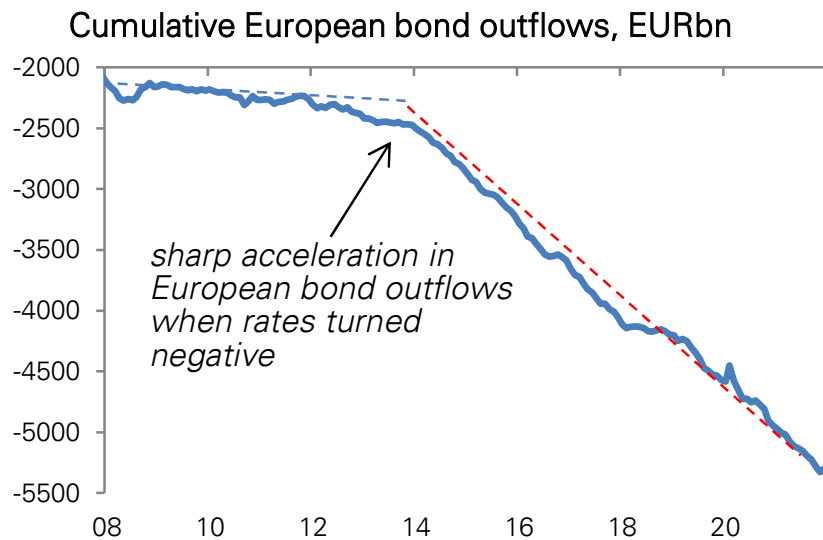
But sharp reversal



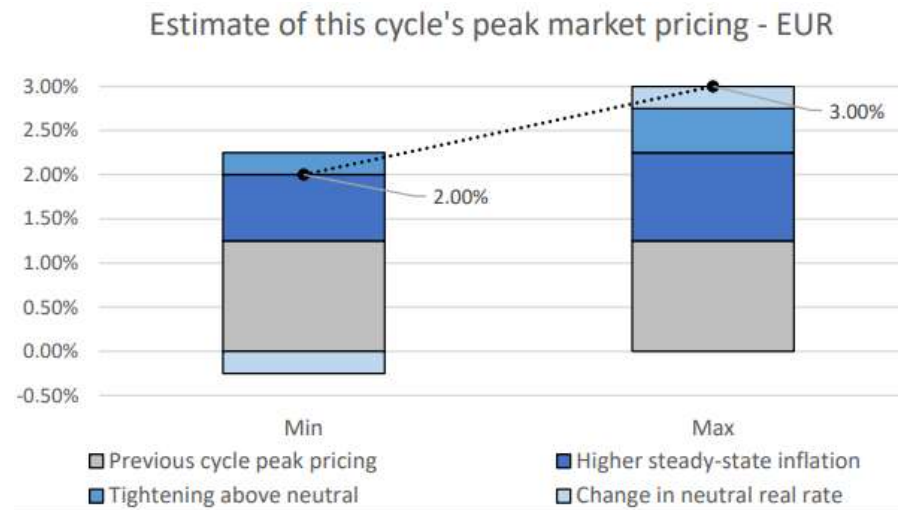
# EUR/USD considerations



## Strong non-linearities around negative rates



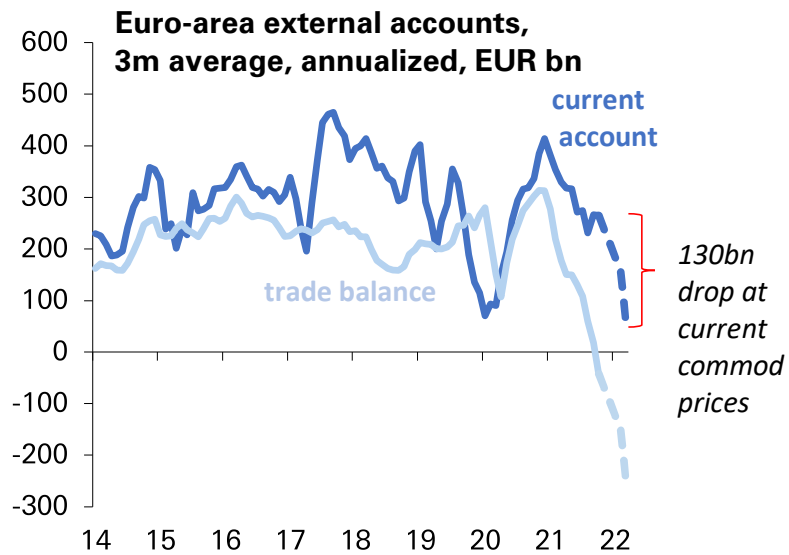
## We estimate ECB terminal in 2%-3% range, above market pricing



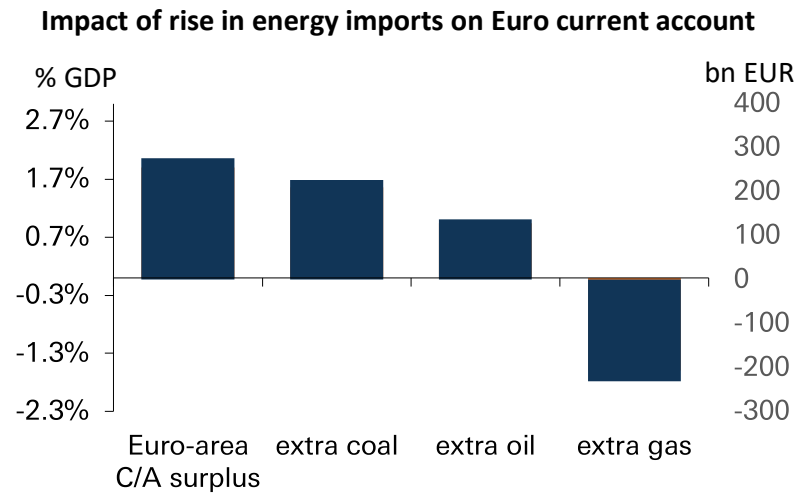
# EUR/USD considerations



An energy embargo remains the biggest concern



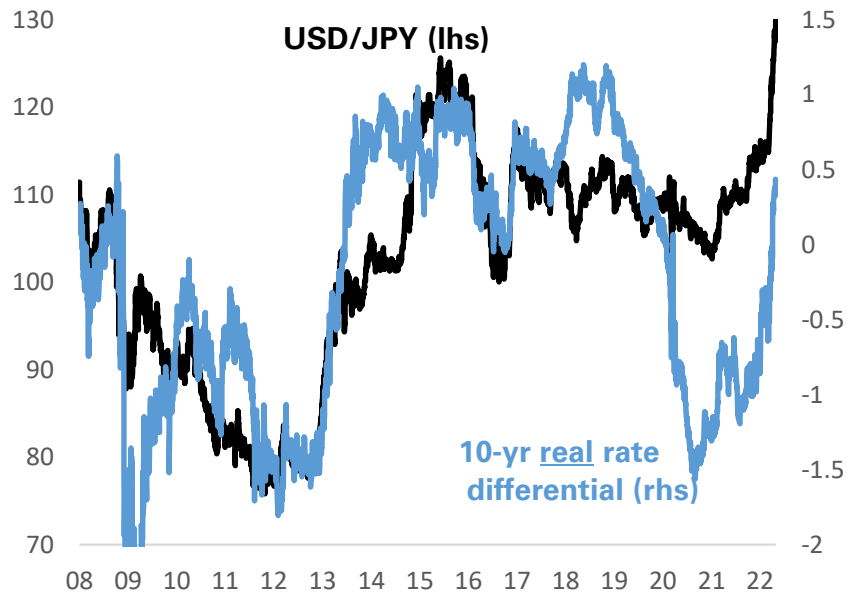
At peak commodity stress, we estimated a 400bn higher energy bill for Europe



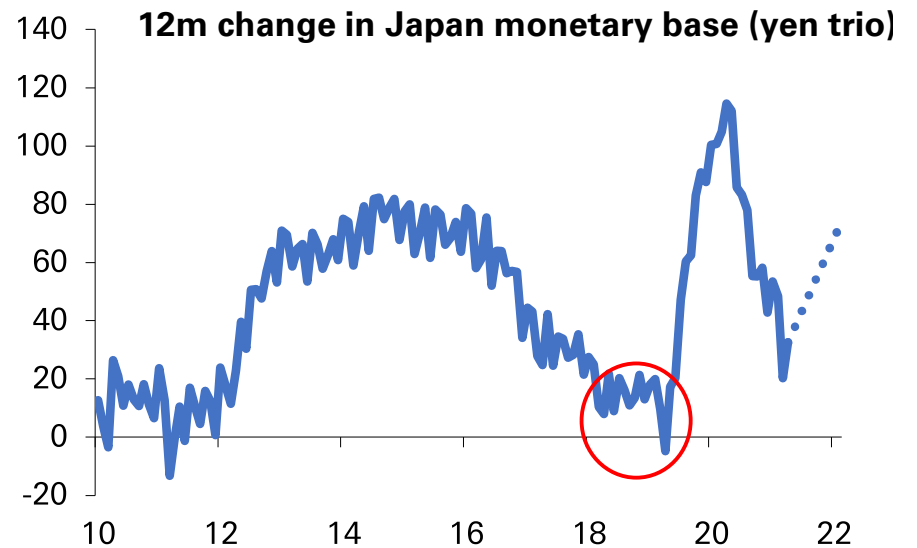
# USD/JPY considerations



USD/JPY is “too high” versus rates



However the BoJ is now expanding its balance sheet



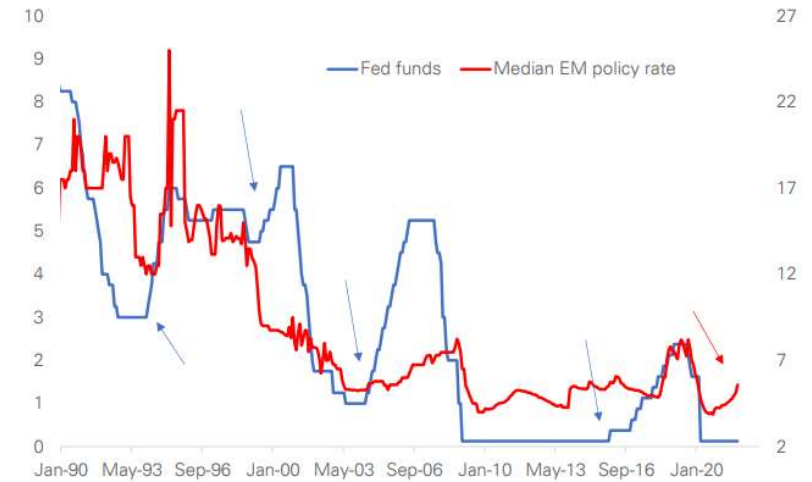
# Emerging Markets FX – growth the major driver, at risk



## The growth differential with DM explains medium-term performance



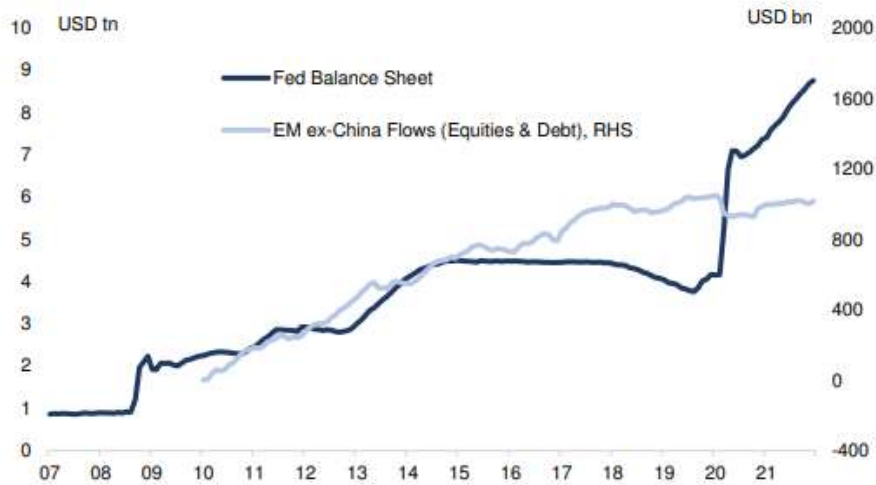
## Pre-emptive EM hikes have provided Fed buffer



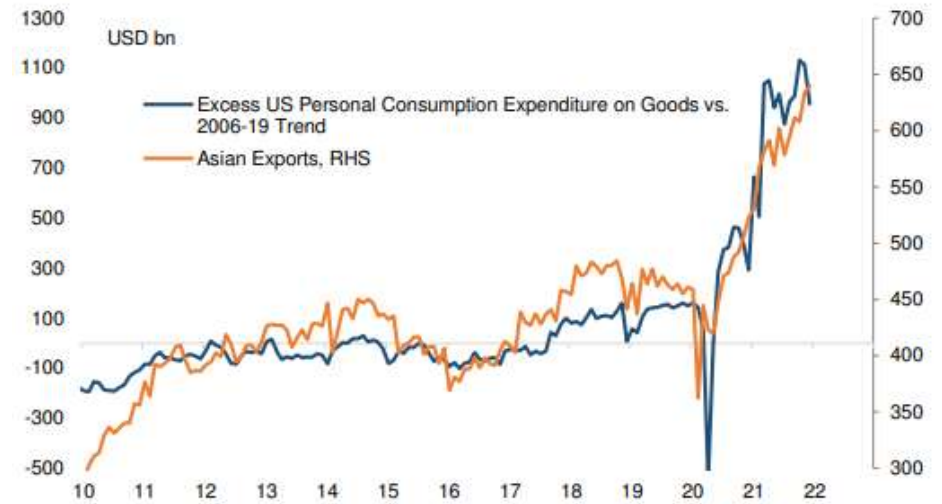
# Impact of Fed tightening on EM FX likely largest in Asia



## Outside of China, no capital flows to unwind



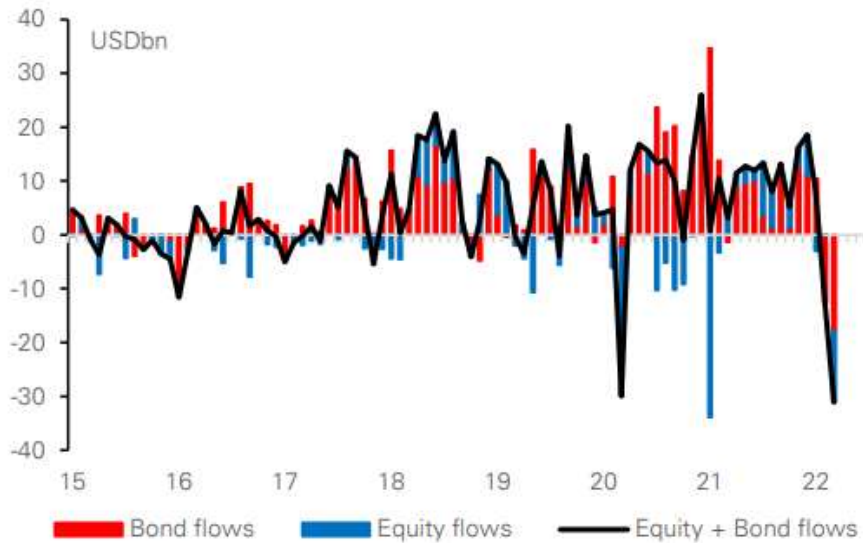
## The main transmission of policy was via trade channel



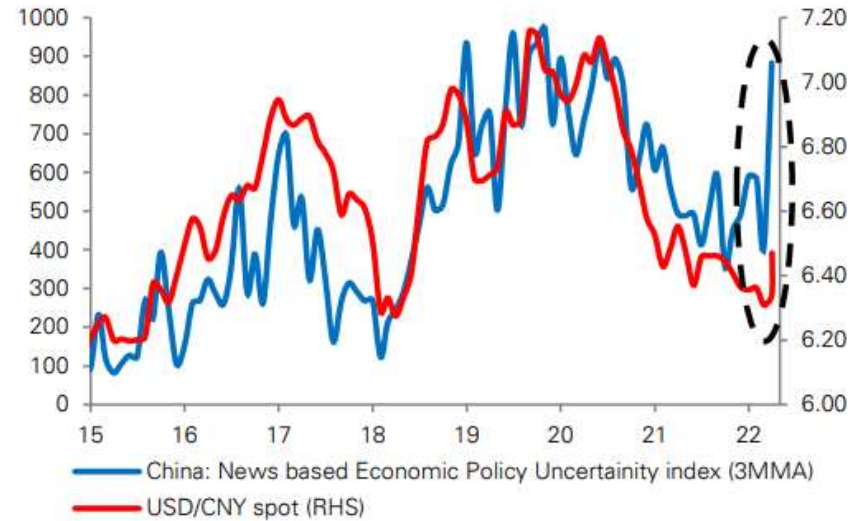
# In China, there are capital flow and domestic growth risks



### Very large China capital outflows in Q1

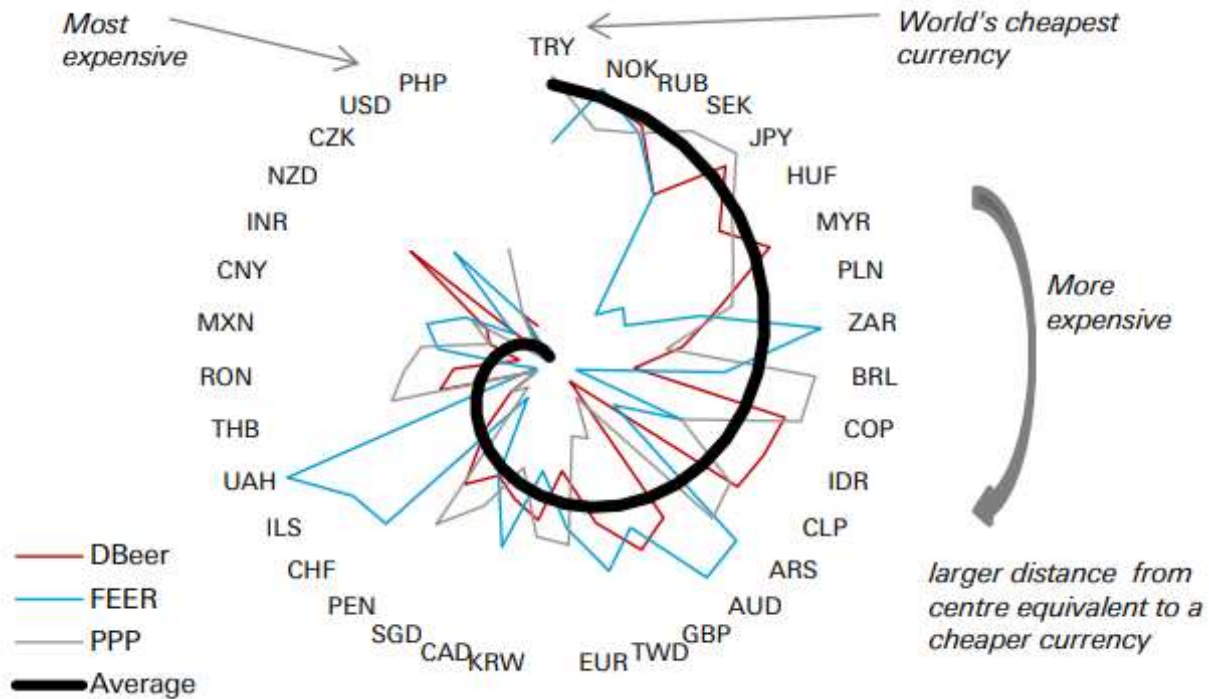


### Growth (COVID) uncertainty not helping





# Latest currency valuations



# Summary



1. Monetary policy has been the dominant driver of G10 FX both before, and after the Russia invasion. We expect this to continue.
2. Front-loaded Fed hikes are providing material support to the dollar. We see Fed pricing peaking and a greater repricing in the rest of G10 so the dollar should peak later in the year.
3. A gas embargo is the biggest downside risk to EUR/USD.
4. Growth dominates as a driver of EM FX. Downside growth risks – especially out of China – will continue to be a major headwind.
5. Front-loaded monetary tightening and the absence of significant capital inflows (excluding China) is however providing insulation to many EMs.

# Appendix 1

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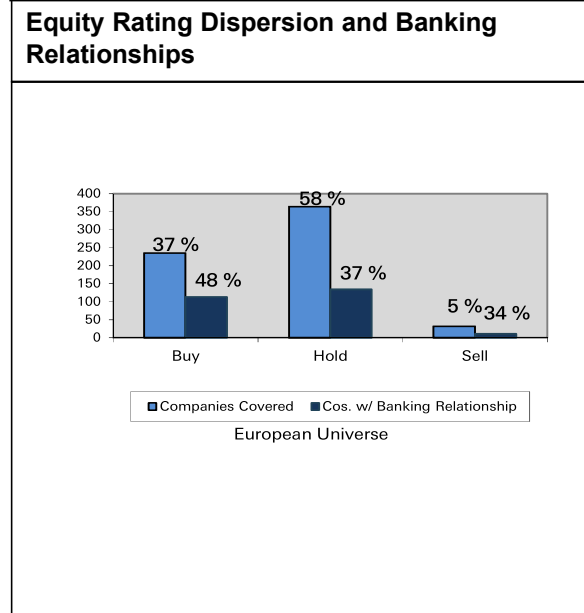
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