FX Tech Flash

EUR: Eyes on ECB and Versailles Summit

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2 Key Event Risks for EUR Today - Tomorrow

ECB Governing Council meeting coming up today will be of interest for any shift in policy leanings while the EU Emergency Summit in Versailles (today – tomorrow) will also take centre-stage.

ECB May Tweak APP Today but Defer on Rate Normalisation Plans

ECB should offer some hints of policy leaning. A reassessment of its APP is also eyed amidst chatters for earlier than expected end to APP (Aug instead of Oct). The set of macroeconomic projections, including inflation will also guide market expectations for rates trajectory. The Ukraine war is likely to have thrown a curveball at ECB policy normalization plans as recent ECB speaks suggest that policymakers may consider slowing policy normalisation process. Overall, we expect no major changes to ECB's policy stance, with deposit rate maintained at -0.5% but the APP could be made more flexible, or with pace of purchase reduced from planned EUR40bn starting Apr and/or end earlier in 3Q. Forward guidance on rate normalisation plan could be deferred but not derailed. We expect ECB to reinforce the message that policymakers will *do whatever it* takes to anchor stability in financial conditions.

EU Emergency Summit (10 – 11 Mar) – A Gamechanger for EUR?

There were reports earlier this week that EU may soon announce plans this week to jointly issue bonds to finance energy and defence spending. Though there is not much details at this stage, the focus is on the Emergency summit in Versailles on 10- 11 Mar (today – tomorrow) to confirm if the report has its merits. The size of the fund and timing will also be key. And potentially this can turn things around for the beleaguered EUR. We discuss this in the following page.

EUR Technicals - Long Term Trendline Support Intact

EUR was last at 1.1045 levels. Bearish momentum on weekly chart intact but RSI is showing tentative signs of turning from near oversold conditions. On daily chart, bearish momentum is fading while RSI rose from near oversold conditions. Intermittent bounces are not ruled out. Also we observed the upward sloping trendline support from the low in 2016, 2020 and 2022 remains intact and previous 2 occasions in 2016/17 and 2020 saw sharp rebound of 20% and 16% (respectively) off the upward trendline support. Fast forward this week, EUR traded a low 1.0806 and rebounded off the support. It remains to be seen if there will be a sizeable rebound (such as past episodes) but geopolitical unrest in Ukraine could keep trading choppy and price action volatile. We keep in view this technical picture and the potential levels. Support at 1.0865 (76.4% fibo retracement of 2016 low to 2018 high), 1.0806 (2022 low) and 1.0640 (2020 low). Resistance at 1.1190/1.12 levels (61.8% fibo, 21 DMA), 1.1285 (50 DMA) and 1.1450 (50% fibo).

EUR (Weekly Chart): Watch that Trendline Support

Source: Bloomberg, Maybank FX Research & Strategy

EUR Driven by Geopolitical Concerns, Stagflation Fears

Amongst the major FX, EUR is seen as one of the more vulnerable currency in light of Russian invasion of Ukraine, given EU's linkages with Russia via trade, energy, investments and sentiment channels. There is even a risk that Russia may turn off gas supplies to Europe (tit-for-tat response to sanctions imposed on Russia), in turn exacerbating Europe's energy shortage issues as the EU relies heavily on Russia for energy consumption (41% gas comes from Russia while 25% crude oil comes from Russia).

- Some EU countries like Portugal and Spain are less dependent on Russian energy but others like Germany, Italy and Poland are heavily reliant on Russia as it gets between 40% - 50% of natural gas from Russia.

The risk of a prolonged rise in energy and food prices could mean even higher price pressures adding constraints to growth, triggering stagflation concerns. Some European companies in industries like fertiliser, steel mill, especially those energy-intensive ones have reportedly cut production due to high input cost. We expect conditions to normalise when war situation defuses and commodity prices cool in response. Furthermore, there may be risks that policymakers may consider delaying policy normalization plans in order to better access Ukraine situation – which we opined should not be a case of ECB abandoning policy normalisation as inflation may run even hotter in Europe.

But Not All Is Lost

However, we indicated yesterday in our Daily and FX Insight (FX and Oil shocks) that **not all is lost and potentially there might even be a gamechanger for EUR.** There was a Bloomberg report earlier this week that EU may soon announce plans this week to jointly issue bonds to finance energy and defence spending.

A joint recovery fund demonstrates EU solidarity, debt mutualisation and could serve to mitigate against any supply-side fallout on growth, prevents risks of any contagion and/or credit blow-up and in turn, boost EUR sentiments. This may even be similar to the EU's recovery fund (dubbed the Next Generation EU Fund) that was launched in Jul 2020 (size worth up to EUR750bn) and was widely regarded as a success in terms of stabilising sentiment, and providing support for business and jobs. S&P did highlight that the Euro-area's supranational response combining QE and pooling of fiscal resources has buttressed the creditworthiness of all member states. 23 out of 30 EU developed sovereigns are rated by S&P as stable while 5 including Italy were upgraded to positive and 2 (Guernsey and Spain) are negative. It may take a while more to assess if the situation borne out of Ukraine war will create growth concerns beyond the short term and if they warrant any massive outlook revision. The risk is if the conflict drags on further.

Recent geopolitical developments are also supportive of sentiments and had aided EUR's rebound. Ukraine said that it is open to discuss Russia's demand for neutrality as long as it is given security guarantees. Earlier, Ukraine also said it is no longer insisting on NATO membership. Russia also demands that Ukraine recognise Crimea as part of Russia and that the Donbas region are independent amongst other demands (Ukraine to demilitarise, etc.). While it is early to conclude that tensions have de-escalated, the recent development is a small but positive step forward. We continue to monitor developments if there are indeed compromises or concessions made during Ukraine-Russia negotiations. On Tue, China President Xi spoke with French President Macron, German Chancellor Scholz and suggested that China would be willing to work with Germany and France to mediate a solution. A diplomatic solution to Russia-Ukraine will further support sentiment, if it materialises.

Near Term Direction to Take Cues from Geopolitical Developments

In summary, on one hand, geopolitical risks, stagflation concerns may weigh on EUR but on a more positive note, the potential for an EU joint fund and hopes of de-escalation in tensions could help to stabilise EUR. It is important to note that the Ukraine development remains very fluid and geopolitical tensions are always 2-way risks for markets (as much as tensions can escalate, they can also de-escalate). We cannot predict how long the conflict will last but we can draw on experience from past events (e.g., 9-11 attack, Crimea annexation in 2014 and Turkish offensive into Syria in 2009), in that troughs for most FX took varied durations to materialize, most losses had been reversed on average after several weeks, if conflict remained localized.

The risk is that sanctions and military conflicts broaden and escalate further, and that we get an oil-driven recession or that stagflation fears materialise. This scenario would then usher in more bearish outlook on growth and would warrant a revision of our FX forecasts.

EURMYR: Choppy Moves Owing to Geopolitics and Oil

Since mid-Feb, EURMYR started to decline from above 4.76 levels to an intra-day low of below 4.5244 (7 Mar). Military conflict in Ukraine is a negative for EUR (as described above) while for MYR, the gains in oil price, palm oil prices (during the similar period) are supportive of MYR. Furthermore, our Economist also noted that every USD10/bbl increase in crude oil price raises results in net positive fiscal impact of MYR1.4b or 0.4% of GDP. M'sia budget for 2022 then assumed oil prices at $66-67/bbl. Based on our house view forecast for oil to average $100/bbl for 2022, there will be a net positive fiscal impact of MYR4.8b (0.3% of GDP).

The subsequent rebound in EURMYR this week from sub-4.53 to 4.6270 was due to tentative hopes of de-escalation in Ukraine tensions and hopes of joint-bond issuance. So, in asset markets, equities rebounded while oil prices eased from highs (-13% overnight). On net, the short-term story remains driven by geopolitical factor. Ukraine development remains fluid and **geopolitical tensions are 2-way risks for EURMYR.** If tensions worsen from here. Then EURMYR could be skewed to the downside but if reconciliation happens. We can expect EURMYR to trade higher from current levels of 4.6270. Weekly momentum remains bearish but there are early signs of turnaround in RSI and potential bullish divergence there. Resistance at 4.7050 (61.8% fibo retracement of 2020 low to 2021 high), 4.7770 levels (50% fibo). Support at 4.5240 (recent low) and 4.4720 (2020 low).

EURMYR (Weekly Chart): Potential Bullish Divergence on RSI

Source: Bloomberg, Maybank FX Research & Strategy

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