

iFlow

MACRO MORNING BRIEFING

April 14, 2024

Special Briefing: Israel-Hamas-Iran & Markets

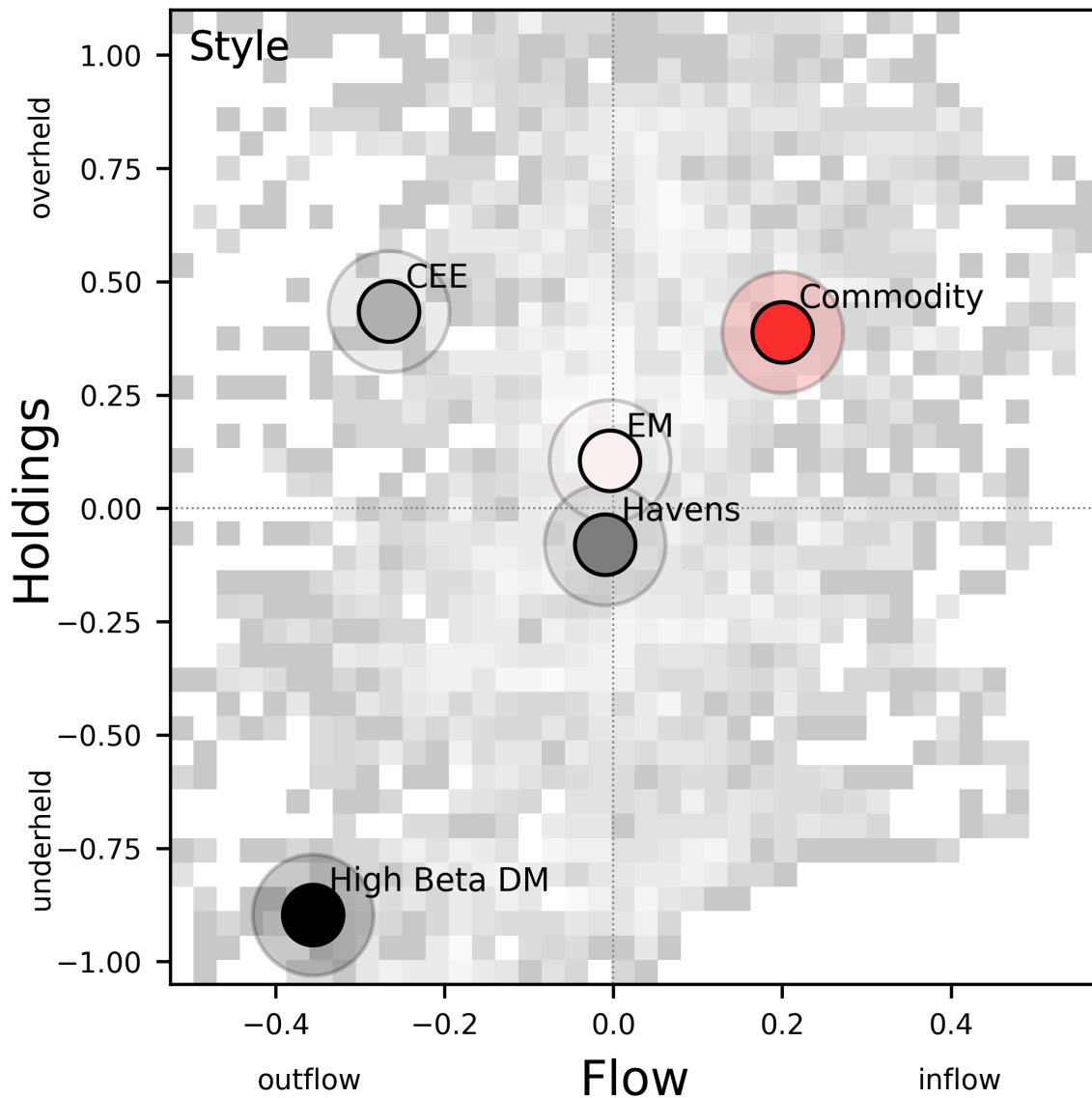
The Israel-Hamas war escalated on April 14 with Iran's direct attack on Israel. Analysis in the press can be condensed into: 1) this changes the nature of the conflict, as it opens the theater to Iran; and 2) much now hinges on how Israel responds. Our flows clearly indicate that the market was prepared for the attack, so a "surprise" reaction seems unlikely. Markets instead are more likely to focus on follow-on actions in the region and beyond, and on how risks can be de-escalated.

- **This could be an inflection point in the conflict** as it moves from Iran-backed militias to the direct involvement of Iran's military. Hezbollah, in conjunction with the attack, launched 40-50 rockets at Israeli positions – though claimed this was part of their support for Palestinians more than for Iran. Also, Houthis in Yemen launched drone attacks at Israel. Iran told the UN mission that its attack concluded unless Israel “makes another mistake.”
- **The Iranian attack was communicated beforehand** via back-channels and was slow – Iran to Israel by drone takes five hours or longer depending on the type, cruise missiles take two hours, and ballistic missiles take 12 minutes. The IDF estimated that 170 drones, 30 cruise missiles and 120 ballistic missiles were launched. The attack appeared to have learned lessons from Ukraine, where such mixed drones/missiles combinations confuse and overwhelm “iron dome” systems. Iran claims this was a targeted and limited response just to the airfield that launched the April 1 attack in Syria that killed two of its generals. Israel and partners' air defenses reportedly shot down nearly all of the munitions – 99% is the number widely cited. Some see this attack as restrained and more testing of Israel's air defenses – “one and done” is the wish for many in the region.
- **The US role in defending Israel** from 300 plus drones and missiles was significant: 70 drones, 3 ballistic missiles intercepted, according to the US

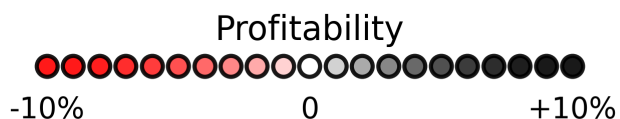
Defense Department. Jordan intercepted some missiles in defense of its population with multiple fragments in the nation. The UK and France also were involved in giving tech support, though no official details are released. The UK, US, France, Germany, the EU and Japan all condemned the Iran action.

- **Fallout from the attack in markets and economics so far:** **1) Airline flights** in the region have been disrupted and are likely remain so until we see the Israeli response; **2) Israeli stocks** rose 0.7% at the open Sunday but gave this back as Saudi Arabia said it “had deep concern over further escalation”; **3) Oil prices** rose Friday – jumping 2% at one point before closing up 0.75% – with futures set to open in 12 hours, focus is on \$100/bbl Brent, close last week \$90.45; **4) Gold** was off 1.2% on Friday at \$2343 – how it opens will be focused on \$2375 as a pivot.
- **On the peace front,** the US convened the G7 and will push diplomacy across the region to help shape any Israeli response. The UN Security Council will meet on Sunday at the request of Israel. Many see the attack rendering the goal of a Hamas ceasefire more difficult. Hamas leader Yahya Sinwar today rejected the deal to free dozens of hostages. The Israel war cabinet met and promised a response but didn’t spell out its options.

Exhibit #1: Safe Havens Have Room To Move



20d Flows, Holdings,
and Profitability



Clouds: distributions over trailing 1,000 days

Data as of

Sources: Bank of New York Mellon, WM/Refinitiv

2024-04-11

Source: iflow, BNY Mellon

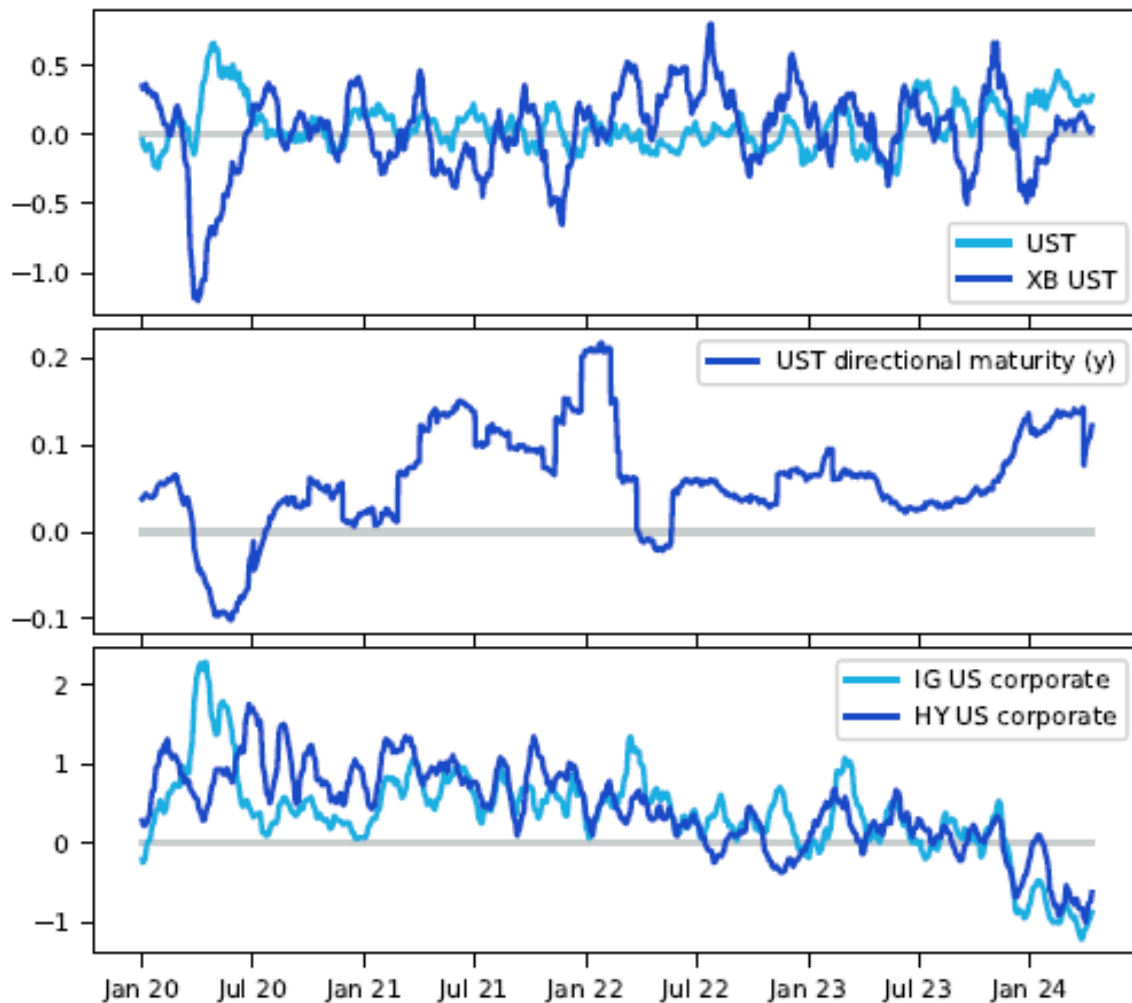
What we see in iFlow data in regard to this attack and escalation is helpful for understanding the risk ahead:

First is the focus on safe havens and what the market thinks will happen over the next few weeks. The JPY weakness story was contained in part by the anticipation of some Iran action all of last week. USDJPY 155 is likely the new line in the sand for Ministry of Finance intervention. Swiss franc outperformance on Friday highlighted the market anticipation of this development.

Second, commodity currencies have been overhyped and had positive flow most of the last week – yet remain unprofitable. So, without a significant move up in oil or other commodities, NOK, CAD and some EM stand to suffer.

Third, US bond holdings and flow show that clients are set up for yield curve flattening. Foreign appetite for US bonds has been flat, however. Notable also is room for more fixed income volatility ahead.

Exhibit #2: US Curve Risk & Cross-Border Flows

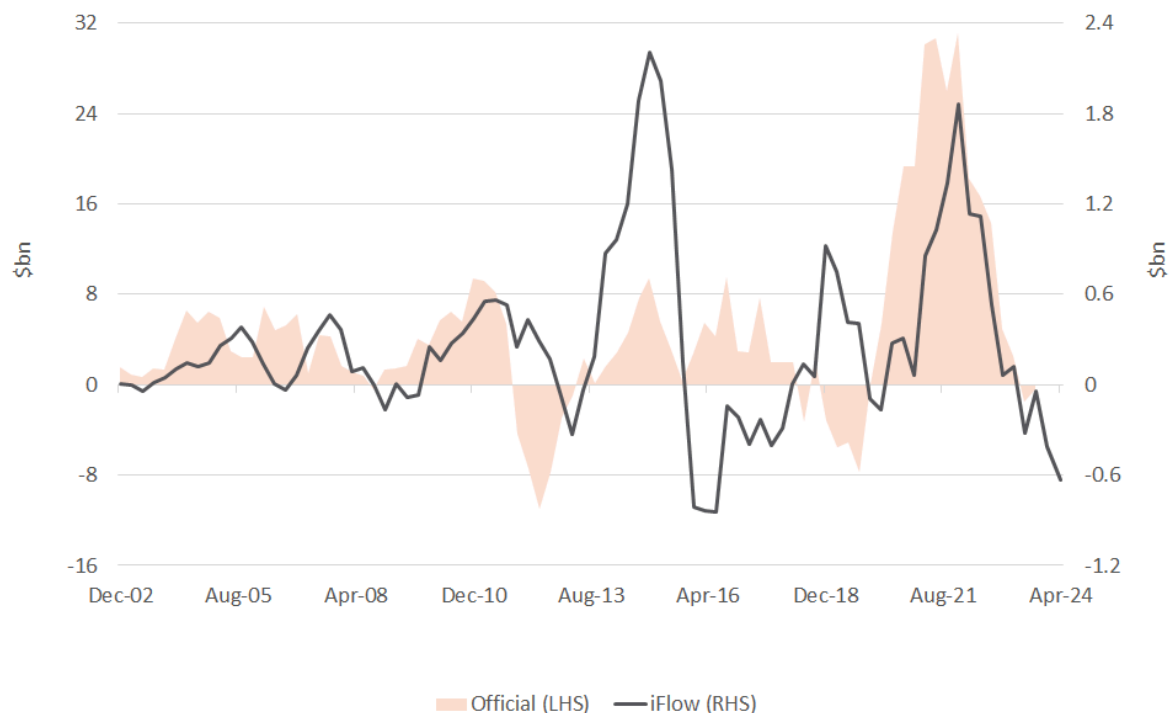


Source: iFlow, BNY Mellon

Fourth is the effect on Israel assets – modest ILS selling, significant equity selling, bonds nearly flat. Official data and iFlow EM for ILS indicate that Israel continues to face balance-of-payments pressures on the portfolio account. On a rolling 12-month sum basis, flows are the weakest since the middle of the last decade. According to official data, the Q4 drop of \$6.2bn was the second-worst quarter on record, close to the Q4 2018 outflow of \$6.6bn (situation same after currency translation). Some

improvement in Q1 is probably due, and these numbers seem more than manageable given reserves. However, the shift in flows – turnaround unlikely anytime soon – is another reason for Bank of Israel policy vigilance for now.

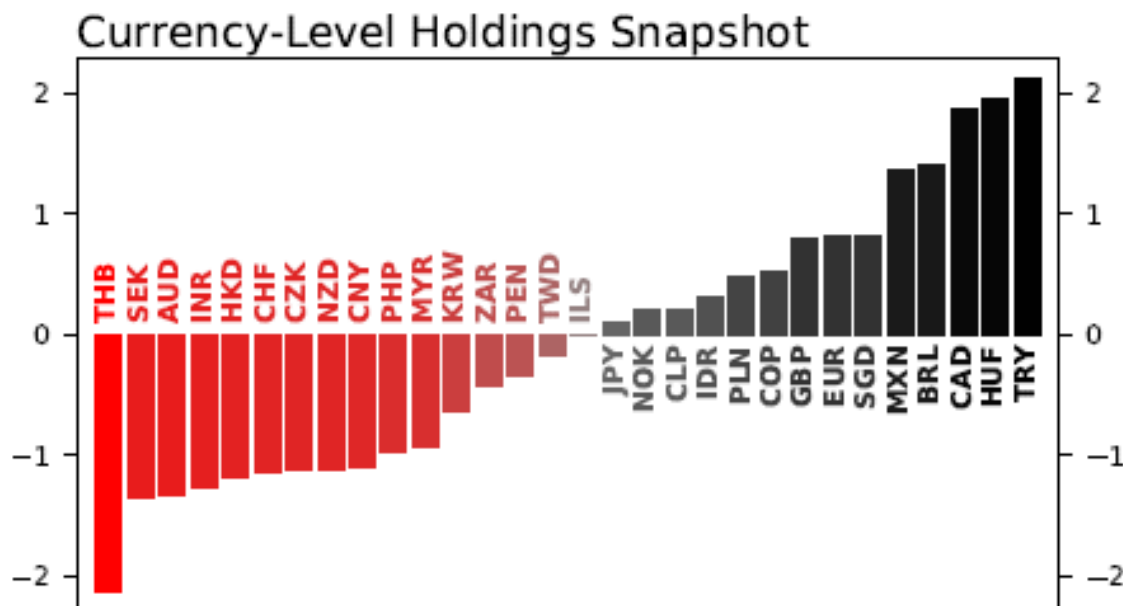
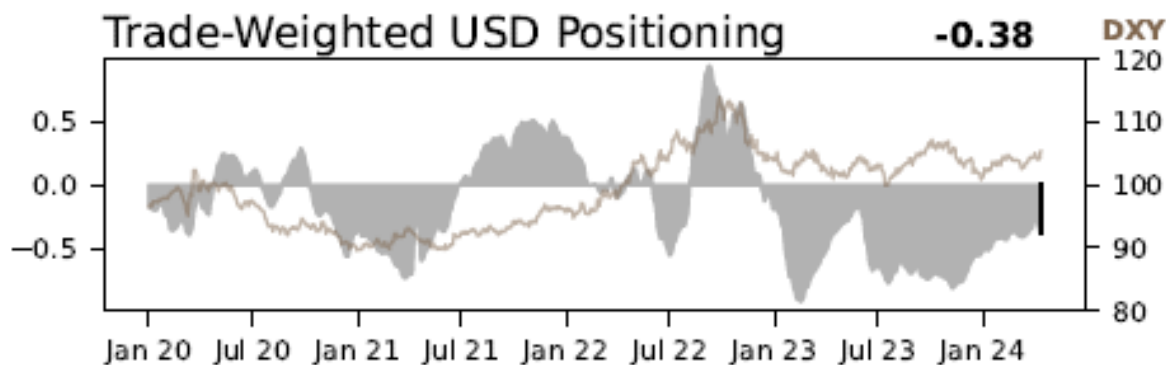
Exhibit #3: Israel's Portfolio Account Under Pressure



Source: iFlow, BNY Mellon

There is scope for further accumulation of USD, even with the recent buying after the CPI data. Our clients remain overweight EUR, CAD and some high-carry currencies such as MXN, so this is where we would watch for rotation in the greenback's favor. At present, these dollar pairs continue to anchor USD underheld positions, while the dollar is favourably positioned against APAC currencies. Another form of cross-border demand could come in the form of dollar purchases associated with fixed income flow, especially if hedge ratios are lower due to extraordinary circumstances. As noted above, iFlow indicates that cross-border demand for US Treasuries has been lackluster compared to domestic demand. Safety demand will likely outweigh concerns over short-term steepening and potential fiscal pressures.

Exhibit #4: USD Has Room To Move Higher



Source: iFlow, BNY Mellon

Bottom Line: The rise of oil prices and safe havens, particularly gold, will be the focus this week amid hope that this attack is just a “one-off.” Focus on USD may be in that rates pivot as the key driver and its safe-haven status gets tested. USD short position remains notable – EUR, CAD and MXN most at risk for bigger reversals.

Disclaimer & Disclosures

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