

FX Daily: A loss of confidence in the dollar?

It's early days, but we are on the lookout for any signs of a loss of confidence in the dollar. Could gold's ongoing rally be telling us something? And are there any signs that foreigners are starting to leave the US Treasury market? In theory, today should be a mildly positive day for the dollar if US core PCE inflation stays sticky, but pricing has been soft



Are foreigners starting to lose confidence in the US dollar?

➔ USD: Price action will be instructive

The value of currencies in FX markets is typically driven by interest rate differentials, with FX effectively being seen as an extension of monetary policy. That is why the dollar did so well from 2021 onwards on the back of relatively tight Federal Reserve policy and then the US exceptionalism story over the last couple of years. With so much uncertainty about the current US administration's policy, we in the market are on the lookout for new narratives. For example, could FX reserve managers who hold close to \$13tr in reserves be considering reducing their dollar composition? IMF data on FX reserve composition comes out with a lag; Monday will see the release of data ending December last year. But in the meantime, could the ongoing rally in gold be telling us something about investor preferences away from the dollar?

It will also be interesting to keep track of the weekly releases from the Fed in terms of the marketable holdings of US Treasuries that the central bank keeps in custody for foreign accounts. This data is released weekly on a Thursday evening. As of yet, there has not been a marked decrease in foreign official custody holdings, but we'll probably be keeping a closer eye on this data going forward.

We mention the above because dollar price action remains on the softish side. The announcement of auto tariffs on Wednesday has not given the dollar a material lift, and we want to see how the dollar trades today, when we should get some mildly positive dollar data. Here, the expectation is that today's US core PCE deflator remains at a sticky 0.3% or even 0.4% month-on-month, suggesting the Fed's pause in easing could extend further. Currently, the market prices 17bp of rate cuts in June – something which could be priced out should inflation remain sticky. In theory, that would help short-dated rates and the dollar – but as above, larger forces may be at play.

DXR risks an intra-day run-up to 104.70, and an outside risk to 104.90 on today's inflation data. But the mood music in the market is that unless reciprocal US tariffs really shock next Wednesday, investors look minded to sell the dollar.

Chris Turner

➔ EUR: Tariff fatigue

EUR/USD held in surprisingly well yesterday – as did European automakers. The Eurostoxx autos and parts index only fell 1% on the day, either because tariffs were priced in or the view that they would be negotiated away. Price action yesterday could be a precursor to next Wednesday, when the euro could take a hit once 20% across-the-board US tariffs are potentially levied on the EU.

Notably, we are seeing some longer-term EUR/USD bullishness in the FX options market. Despite the EUR/USD spot having come steadily lower over the last week, the FX options market has seen increasing demand for longer-term euro call options. For example, the one-year risk reversal skew – the price for a euro put option over a euro call option – has decreased to 0.34% from 0.66% over the last week. This one-year skew shifting in favour of euro calls was last seen in 2020 and would be a big talking point.

For today, we've got some French and Spanish inflation data early on, and then we have the European Central Bank survey on inflation expectations at 10am CET. Three-year CPI expectations are expected to remain stable at 2.4%. Any upside surprise could see a little more debate over whether the ECB pauses its easing cycle in April. The pendulum has certainly swung against that idea recently, with 19bp of easing now priced for April.

As above, EUR/USD in theory should look vulnerable to a sticky US inflation print today. But we suspect the 1.0730 area holds, and ending the day at 1.0830/50 would tell us something about declining appetite for dollars.

Chris Turner

⬆ GBP: Retail sales surprise on the upside

Our UK economist, James Smith, writes:

Another decent month for UK retail saw sales up 1%, having risen 1.4% last month (these are volume figures, so inflation adjusted). It's unusual to have two such strong months in a row, given this is a volatile data set – though it was equally strange to see four consecutive falls through the final months of 2024, given real-wage growth is so strong in the UK (6% wage growth, 2-3% inflation). So I think what we're seeing is a catch-up in the data to the probable underlying trend.

Sterling has strengthened a little further on today's retail sales figures. 0.8320 is clear support, below which it looks biased towards 0.8250. Next week will be dominated by the tariff story, and tariffs are EUR/GBP negative.

Chris Turner

📉 AUD: Suffering as the CNY proxy

Despite some ongoing reassessment of the dollar, AUD/USD has lagged. We think it could be vulnerable into next week's US reciprocal tariffs, where more tariffs on China look likely as Washington seeks to restructure global trade. A move back to 0.6200 is possible next week, while a cross rate like GBP/AUD could push up to the 2.08/2.09 area – levels last seen at the start of 2020.

Chris Turner

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

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