FX Daily: Another tariff cliffhanger

As markets assess the implications of the Zelenskyy-Trump clash on Friday, the focus today is whether US tariffs on Mexico and Canada will go ahead. The FX market is not pricing in 25% duties as a base case, and still leans in favour of either smaller tariffs or another last minute deal. Downside risks for CAD and MXN are therefore sizeable

After US-Ukraine discussions turned sour on Friday, the key focus today is whether US tariffs on Mexico and Canada will go ahead

USD: Highly binary outcomes from tariff event

US-Ukraine talks fell through on Friday after a heated exchange in the Oval Office between US President Donald Trump and Ukrainian President Volodymyr Zelenskyy. While the mineral deal is off the table at the moment and the US has taken a step back from brokering a peace deal, markets are not pricing out the chance of a Ukraine-Russia truce. A summit with Zelenskyy and European leaders in London yielded a pledge to end the war, but also recognised the US remains instrumental in bringing Russia to the negotiating table. We still think exposed currencies (EUR, Scandies) are due a rally if and when a peace deal is agreed, but increased confrontation from the US towards Europe and Ukraine might reduce the security guarantees for Kyiv and ultimately leave some residual geopolitical risk in asset prices.

But the biggest market driver today will be any updates on US tariffs on Mexico and Canada, as 25% duties are due to come into effect tomorrow. Canadian and Mexican officials are attempting to strike another last-minute deal, and US officials have also floated the idea of imposing smaller than 25% tariffs. One possibility is that – alongside increased commitment to fighting illegal drug traffic – Trump will require both countries to replicate US tariffs on China, which may be hiked from 10% to 20%.

CAD and MXN depreciated at the back end of last week, but are still not pricing 25% tariffs as the baseline. The FX market saw Mexico as more likely to avert tariffs over Canada a month ago and appears to have a similar feeling now, having penalised the loonie more than the peso in the past week. Today's events will be inevitably binary for FX, but given that markets are still leaning towards another delay in tariffs, there are more downside risks than upside risks for CAD and MXN today. USD/CAD and USD/MXN are currently trading 2.5% and 3.5% off their 3 February highs. We'll be looking for moves above 1.460 and 21.0 as key indicators of a pessimistic shift in sentiment today. Our base case remains that 25% tariffs will be averted, although we admit it remains a very close call.

The US calendar will also be watched closely this week, as some soft data recently dented the notion of US exceptionalism and contributed to the dollar's partial retreat. We expect ISM surveys to reaffirm that the US has started the year on a soft tone, and see some risk that today's manufacturing index will drop back below 50.0. On Friday, we expect a slightly below-consensus 140k payroll figure, with unemployment inching higher to 4.1%.

We remain bullish on the dollar ahead of next month's round of tariffs, but if we are right with our baseline calls for a tariff delay and softish US data, this should not be a good week for the greenback.

Francesco Pesole

EUR: Inflation to favour dovish ECB stance

The euro's outlook remains tied to developments on US tariffs and on Ukraine peace talks. EUR/USD took a hit late Friday after the Trump-Zelenskyy incident, but has rebounded since trading resumed on Sunday evening – perhaps on the news that Ukraine remains open to a mineral deal with the US and that the EU is actively trying to bring the US back to the negotiating table with Ukraine.

Today, the eurozone releases inflation estimates for February after regional prints provided some tentatively dovish signals. Spanish and Italian CPI undershot, German's inflation was unchanged, but the core measure declined. Consensus is for a deceleration to 2.3% in eurozone headline CPI and to 2.5% in core. As discussed here, we expect this CPI report to endorse a still-dovish tone by the European Central Bank as it delivers a highly anticipated cut this Thursday.

Still, with markets pricing in three cuts by year-end in the eurozone, the euro's downside risks ahead of Thursday are limited. In our baseline USD-negative scenario for this week, we can see EUR/USD moving back to 1.050.

Francesco Pesole

GBP: Bailey's testimony in focus this week

The UK data calendar is quiet this week, and the pound will primarily be driven by external input. The major domestic event is probably the Treasury Committee questioning of Bank of England Governor Andrew Bailey and other MPC members on Wednesday.

The February BoE cut was accompanied by a dovish vote split, but data has since pointed to more caution on easing. Fourth-quarter growth, December wages and January CPI all came in stronger than expected, and the risks are that we could see some hawkish adjustment in Bailey's stance.

We remain of the view that GBP/USD rallies won't prove sustainable beyond the very near term as we expect the UK budget event at the end of March to trigger fresh pressure on the pound also by potentially unnerving the fragile gilt market. We expect a decisive break below 1.25 in Cable in the coming weeks, but this week the pair may remain supported.

Francesco Pesole

CEE: Collapse in Ukrainian negotiations leaves region exposed

As we move into March, the CEE region is starting to grow busy again. February inflation numbers for Turkey were released this morning, and the month-on-month pace slowed after January's stronger-than-expected repricing from 5.0% to 2.3%, translating into a decline from 42.1% to 39.1% year-on-year. Later today, February PMIs across the region will be released, which should show some improvement in industrial sentiment.

Tomorrow we will see the final GDP numbers for last year's fourth quarter in Hungary. On Wednesday, February inflation in the Czech Republic will be released, which we estimate slowed past 2.8% to 2.7% YoY, in line with market expectations. Thursday will be followed by the Central Bank of Turkey meeting, where we expect another 250bp rate cut to 42.5%. In Hungary, we'll see industrial production and retail sales numbers for January, as well as wage growth in the Czech Republic.

Friday's collapse in negotiations between Ukraine and the US resulted in an unwinding of the previous optimism in Central and Eastern Europe and we are likely to see more bearishness coming into the region today.

As we discussed previously, the rally in rates over the past two weeks has led to widening rate differentials across the board. The main driver has been positive sentiment, which is now gone. Rates will therefore be free to set the next direction, which is weaker FX in CEE. PLN and HUF in particular may be exposed due to positioning from previous days.

On the other hand, Friday's move was significant, and today we should see more of a stabilisation at weaker levels while waiting for further developments in the Ukrainian negotiations. What is clear, though, is that it will be more of a bumpy road for FX from this point onwards. However, hawkish central banks should provide some support to weakening FX and limit larger moves.

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