

FX Daily: Attack on Fed carries big USD downside risks

The dollar sold off across the board as the Fed received DoJ subpoenas, reigniting both independence risks and a brief return of 'sell-America' trade. It's wait-and-see mode now as markets try to assess the effective implications of all this. We'll watch the bond market for any signs of concerning curve steepening. The risks for USD are significant



Markets are in wait-and-see mode in the wake of the DoJ opening a criminal investigation into the Federal Reserve

⬇️ USD: DoJ vs the Fed is potentially explosive for USD

The dollar's smooth appreciation trend was abruptly interrupted overnight after Federal Reserve Chair Jerome Powell said the Fed had been handed grand jury subpoenas from the Justice Department, threatening a criminal indictment over his testimony about renovation works at the central bank's headquarters. Powell has explicitly characterised this as an attack on the Fed's independence from the Trump administration. Markets' initial reaction agreed with that view. The combined drop in the dollar, equities and Treasuries was a reminiscence of the "sell America" days of last spring.

However, Treasury futures have steadied this morning, and that is the most important signal

markets aren't ready to price in a loss of Fed independence just yet, either on the view that Powell will indeed remain firm in his policy views (as he's pledged to), the FOMC won't be heavily affected, or that the DoJ subpoenas aren't likely to lead to an indictment. S&P500 futures are still down 0.4%, though, and DXY -0.3%.

Expect developments on this story to take over other macro drivers for the dollar, at least for today. The downside risks for the dollar from any indications of further determination to interfere with the Fed's independence are substantial. Again, the bond market will be the most important barometer, both on the short end of the curve if markets price back in more rate cuts, or in the long end with potential stress signs on independence risks. A sharp steepening of the curve could take the dollar on a fall.

We would have had a moderately bullish view on the dollar this week as we expect tomorrow's US core CPI to come in above consensus at 0.4% month-on-month, and markets are more relaxed about the jobs market after Friday's drop in unemployment to 4.4% (even [if the details tell a different story](#)). Another event that we thought could have also helped the dollar this week was the Supreme Court's presumably unfavourable ruling on Trump's tariffs, which could materialise on Tuesday, Wednesday or Thursday this week. We shared [our thoughts](#) on this on Friday, and will be holding a [live webinar](#) on the details this afternoon.

But markets need to have a clearer view on this explosive Fed development before re-entering dollar longs. A combination of hot inflation and more bets on the Fed's loss of independence would feed real rate concerns that could cause major USD depreciation.

Francesco Pesole

EUR: Pick your Fed hedge

The Swiss franc is the best-performing G10 currency this morning, confirming its role as a preferred hedge against Fed independence risk. However, based on 2025 moves, the euro and Swedish krona could also be major beneficiaries. It's clear markets are in wait-and-see mode, expecting to learn more about the effective implications of these Fed subpoenas.

On the downside, the US threat of forcefully annexing Greenland remains the big frontier risk for European currencies. We analysed the latest movements in EUR/DKK in this [note](#). While possible FX intervention by the central bank may be having a knock-on effect on liquidity, the latest unusual moves in Danish krone forwards suggest some hedging/speculation may be underway.

There will instead be little to no domestic data input for the euro this week. And while there are some scheduled European Central Bank speakers, we've heard very limited dissent of late, and markets will remain reluctant to change their ECB pricing.

We still think EUR/USD can eye 1.1600 in the near term if Fed risk is priced out. But markets may require quite a bit of reassurance first, and we'd rather have a bullish bias to 1.170-1.1750 for today.

Francesco Pesole

JPY: Political risk back on

Picking a bottom on the Japanese yen remains hard. Speculation that Prime Minister Sanae

Takaichi will dissolve the parliament and call snap elections has continued to rise over the weekend. In theory, such a move would be aimed at securing a stronger majority, which, if achieved, is often appreciated by the domestic currency. But for now, political uncertainty fuelled more speculative USD/JPY buying on Friday, with the Finance Minister's tolerance band continuing to be tested. Interestingly, the yen is the only currency in G10 not gaining from the Fed's news.

Based on Japan's latest FX interventions in July 2024, we still suspect there may be a preference to wait for a USD-negative market event (previously a cool US CPI report) to intervene. The spot also traded at almost 162 when intervention started, around 2.5% above the current 157.9.

If Fed risk abates, USD/JPY continues to face upside risks that could extend to 160 – a level that should see some resistance as some identify it as the line in the sand for the Bank of Japan.

Francesco Pesole

➔ CEE: More space for cuts but also weaker FX

This week will be the first of this year that the CEE region returns to full trading and a more interesting calendar. This morning, industrial production in Hungary will be published, but tomorrow's inflation for December will gain more attention. Our economists expect another drop from 3.8% to 3.0% year-on-year, below market expectations but in line with the NBH forecast.

On Tuesday, we will also see details of Czech inflation, which brought a downward surprise last week. On Wednesday, inflation data will follow in Romania, where we expect an unchanged 9.8% YoY reading.

The National Bank of Poland will decide on rates as the first central bank in the region to do so in 2026. December's downside inflation surprise increases the chance of a rate cut from the current 4.00%, but in our view, the baseline rates will remain unchanged. On Thursday, the NBP governor will hold a press conference and could indicate how many more rate cuts we can expect. The market is pricing in a terminal rate of 3.37% currently.

Several data releases are also due across the region on Thursday and Friday, including retail sales in the Czech Republic, core inflation in Poland and inflation expectations in Turkey.

The region saw a correction of previous gains last week, in line with our bearish view based on dovish pricing in the rates market. We believe there is still room for this to go further, and the pressure on CEE FX is likely to continue. EUR/USD is heading towards 1.160, and the local market is receiving an increasing number of signals that central banks may deliver more rate cuts this year.

Tomorrow's inflation data in Hungary should cement rate cut expectations and restart the cutting cycle in February. This should put pressure back on the forint, where carry trade positioning has just resumed. In turn, we see EUR/HUF heading higher this week, closer to 388. For EUR/CZK, we maintain a view of 24.350-400. EUR/PLN seems more fairly priced, and we do not expect much activity here despite the NBP meeting.

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