

FX Daily: Dollar corrections should have short legs

The dollar could lose some momentum this week as a return of normal market conditions allows for some reconciliation with slightly lower rates. However, the proximity to Trump's inauguration and the strong underlying narrative of a hawkish Fed may well keep any USD correction short-lived. In Canada, Trudeau may resign soon, but CAD's risks remain unchanged



We think a material rotation away from the dollar looks unlikely at this stage

⬇️ USD: Rally may lose some steam

The Christmas holiday period was not particularly eventful for FX markets, but it was again remarkable how the dollar kept finding support, defying both seasonal negative pressure and a brief rally in US Treasuries at the end of December. The new year started with a new dollar rally and European currencies coming under pressure.

This week will see a return of normal market conditions and a pick-up in FX liquidity. That may lead to some softening in the dollar's momentum, as the greenback could reconnect with the slight deterioration in its rate advantage over the holiday period. But while technical factors signal that the dollar rally at the start of the year is overdone, the proximity to Donald Trump's presidential inauguration should prevent a substantial rotation away from defensive dollar longs. Incidentally, January and February are two seasonally strong months for the dollar.

This will also be the week where data retakes centrality. The hawkish December FOMC has, in our view, set the bar higher for any data disappointments to hurt the dollar, as pricing for a rate cut in March (January looks implausible) may prove sticky. There's currently 12bp priced in for March, 17bp for May and 25bp for June. Adding to the hawkish narrative, we heard two FOMC members (Mary Daly and Adriana Kugler) revamping inflation concerns. An effective re-focus of the Federal Reserve on the price side of its mandate would provide a fresh bullish narrative for the dollar.

On Friday, December jobs data will be published in the US. Our economists project payrolls at 140k and unemployment unchanged at 4.2%, close to the consensus figures – 160k and 4.2%. That would be consistent with the gradual cooling in the jobs market that the Fed was likely factoring in when it revised the Dot Plot to only two cuts in 2025, and should leave the underlying macro story broadly supportive for the dollar. Other key releases this week are the JOLTS job openings, the ISM service (the manufacturing index came in [stronger than expected](#) last week) and the FOMC minutes.

Our tactical view in FX remains unchanged from last week. Technical factors argue for some correction or at least loss of momentum for the dollar, but we expect strong buying interest in the dips. Ultimately, the 110.0 target remains very much at reach for DXY in the coming weeks.

Francesco Pesole

EUR: Looking for a lifeline

EUR/USD recovered some ground on Friday, in line with our expectations. From a valuation standpoint, there is still short-term upside potential for the pair, which at current levels embeds a risk premium of around 1.5-2.0%.

The effect of the moderately re-tightened EUR:USD short-term swap spread may, however, prove insufficient to drive the euro back to the 1.040 mark sustainably. We suspect that unless there are some tentatively positive developments in the eurozone growth narrative, any EUR/USD rebound is destined to be quite short-lived, and risks over the coming weeks remain skewed towards the 1.02 area.

The recent rise in gas prices after the Ukraine pipeline shutdown is currently pairing with protectionism fears, and any lifeline to the euro at this point would likely need to come from data. The focus this week will be on December's inflation figures, with eurozone CPI expected to have accelerated from 2.2% to 2.4% and core to have flattened at 2.7%. Any material upside surprise might dent markets confidence on four European Central Bank rate cuts this year and help the euro stabilise.

Francesco Pesole

CAD: Trudeau reportedly about to resign

A media report is suggesting the Canada's prime minister Justin Trudeau will resign as leader of the Liberal Party this week. That would not necessarily lead to early elections, as a leadership contest would take place to select a new prime minister. Anyway, elections will be held in October at the latest, and the opposition Conservative Party has a vast lead in the polls.

The Canadian dollar reacted positively to the report and USD/CAD has reversed Friday's rally. The move was quite small compared to the magnitude of the loonie's depreciation in December,

signalling only very cautious optimism that this development can lower the risk of Canada being hit by US tariffs.

We discuss the outlook for CAD in light of Trump's protectionism threat [in this note](#), and our bottom line remains that upside risks for USD/CAD could extend to 1.50 in the event of a fully-fledged North American trade war. In the coming days, expect CAD to be very sensitive to any political news and the potential implications for US-Canada trade relationships. Canada's jobs figures are also released on Friday, but that is now a secondary input for the Bank of Canada compared to the risk of US tariffs.

Francesco Pesole

➔ CEE: Ignoring the strong US dollar

This week we start in the Czech Republic, where the state budget result for last year will be published today. The Ministry of Finance is also likely to publish the funding strategy for this year and the bond issuance calendar for January. We expect a roughly similar gross supply of CZGBs as last year and lower in net terms. On Thursday we will see hard data from Hungary and the Czech Republic with industrial production and retail sales. We will also see final GDP data and retail sales in Romania on Friday.

In the FX market, PLN and CZK remain unimpressed by the new lows in EUR/USD from the past two days and both currencies maintain current strong levels, while HUF has come back under pressure. As we discussed on Friday, we maintain a negative bias for HUF – but at current levels, it seems that the gap between FX and rates has been closed and EUR/HUF could stabilise at current levels. EUR/CZK and EUR/PLN are still following a strong rates differential, which suggests stability for both currencies. However, in the medium-term we believe the CZK market is too hawkish, while we may see PLN pricing grow even more hawkish if anything. Therefore, we have a slight negative bias on CZK and a positive one for PLN. Overall, however, we do not expect higher volatility in the current environment.

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