

FX Daily: Dollar not out of the woods yet

The dollar has shown signs of stabilising, but has struggled to stay bid on Bessent's ruling out JPY intervention and a slightly hawkish Fed. The risks of another major leg lower in USD remain elevated, even if our bias is for a short-term recovery, given the overall supporting macro and rates picture. Elsewhere, expect few surprises by the Riksbank today



The US dollar is struggling to recover

➔ USD: Struggling to recover

The dollar took a breather yesterday after the early week collapse, but there are no clear signs of a mood shift yet. A slightly hawkish tone by the Fed yesterday had, however, a very limited effect on the greenback. While Steven Miran and Chris Waller voted for a cut (not surprising), the FOMC removed the line “downside risks to employment rose in recent months”, confirming a more upbeat view on the economy. Chair Powell said the Fed would take its time to assess new data, reinforcing the market's view of no cuts in March and April.

The modest USD reaction to the Fed confirms there is very little influence of short-term rates on USD-crosses at the moment. Interestingly, even comments by Secretary Bessent, in which he ruled out US intervention in JPY, only gave the dollar short-lived support. DXY initially recovered 1% from the 95.55 low yesterday, but has softened again overnight, while gold and silver's exceptional rally

signal USD debasement trades remain very much central.

In other words, there are no signs that markets are ready to unwind dollar pessimism just yet. We may well be in the middle of a round of significant increase in USD hedging as the USD's safe-haven value deteriorates, and it remains risky to pick a bottom when the moves are entirely detached from macro and rates. Our preference remains for a USD rebound, but at least strong US data is needed to start fuelling a USD recovery. Today, we'll watch jobless claims, which have been lower than expected of late.

Francesco Pesole

➔ EUR: Rate cuts to weaken the euro aren't a great idea

The debate about whether the euro's strength will affect ECB policy is intensifying. Last year, GC member De Guindos hinted that levels above 1.20 would be problematic, even though that was rebuked by Christine Lagarde on other occasions. The latest EUR/USD rally has already caused two members, Martin Kocher and Francois Villeroy, to express concerns that currency strength could prompt lower inflation and, in turn, looser policy.

For the moment, nothing is showing in ECB pricing. We suspect that markets will await any clarification in this sense by Lagarde at next Thursday's meeting before buying into this narrative.

So, while we are inclined to think the dollar can start a recovery, we don't see this threat of an ECB rate reaction as something that could significantly curb EUR/USD should the dollar instead enter another dive for now. The effectiveness of a potential ECB cut to weaken the euro is also rather doubtful, as the correlation between EUR/USD and short-term rate differentials has virtually disappeared. The past week of large USD losses has coincided with some widening of the USD short-term rate advantage over EUR to 115bp. That is the widest since mid-November when EUR/USD was trading around 1.16.

Another move past 1.20 today could trigger further upside volatility, with the 1.208 Monday high quite possibly being tested. We'll instead need to see a significant break below 1.190 before we can conclude the tide is turning on the pair.

Francesco Pesole

➔ SEK: No surprises by Riksbank

The Riksbank is almost guaranteed to keep rates on hold at 1.75% today. The latest inflation print was below consensus, both for headline and core CPIF. However, November growth was stronger than expected at 2.7% YoY.

Anyway, the Riksbank has been clear that only major deviations in data and/or serious external events can trigger rate adjustments in the near term. And while the euro's strength is already causing some protests in Frankfurt, the Riksbank has held a long-standing view that SEK is meaningfully undervalued. The latest moves are still too small to change that view or even to discuss any policy reaction.

We think the Riksbank will keep playing a very secondary role for SEK. Our assessment on EUR/SEK is that the recent drop has gone too far too fast, but until EURUSD goes decisively back lower, EURSEK will struggle to recover too. We suspect capital repatriation into Sweden has been a main

driver of the recent SEK strength, but that should start to fade if the US macro story keeps improving and markets rebuild some trust in the USD. We still think a return to 11.70+ in EURSEK is possible in the near term.

Francesco Pesole

➔ CEE: A weaker US dollar will further support the region

The calendar in the CEE region was rather muted yesterday and today, and the next important data is only Friday's GDP figures for 4Q25. However, the global story and the start of the CNB blackout period will keep us busy today. CEE FX yesterday saw some slight correction of previous gains following a weaker US dollar. It seems that the Fed meeting yesterday should not change much on this story and EUR/USD in the 1.190-200 range should be enough to keep CEE supported.

In the Czech Republic, the blackout period begins today before the CNB meeting next week on Thursday. Yesterday, Jan Prochazka, a member of the bank board, came with some hawkish pushback against previous statements by his colleagues. Although he sees the possibility of one or two rate cuts, at the moment he prefers to leave rates unchanged and wait longer for new data. This shows that a rate cut in February, as the deputy governor indicated on Tuesday, would be difficult to find a majority.

Still, everything will depend on the January inflation number and the market was clearly not too swayed by the relatively hawkish commentary compared to previous statements. Therefore, we think the koruna will be under pressure, and we expect EUR/CZK to head towards 24.350-400 due to the rising probability of rate cuts.

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