

FX Daily: Washington flexes the tariff muscle

The dollar has so far retraced about a quarter of its 10% run-up from late September. That has largely been a function of investors reducing the tariff risk premium embedded into the currencies of key trading partners. The threat of tariffs against Mexico and Canada this coming weekend may prevent more of a dollar correction this week, and attention will turn to key rate meetings and last year's fourth quarter GDP data in many parts of the world



➔ USD: Learning to live with the tariff threat

The weekend saw the US successfully use the threat of import tariffs against Colombia to secure its policy aim of returning illegal immigrants. The use of tariffs as a policy lever now looks well understood by the market and perhaps will be worth decreasing marginal volatility. That said, the FX market is still operating off a potential 1 February deadline for tariffs against Mexico, Canada and China – and that may prevent the dollar from correcting too much further this week.

Instead, focus could shift back to the macro side given a whole host of central bank rate meetings, fourth quarter GDP data and some key inflation prints around the world. James Smith previews a

lot of those [here](#). On balance, we think that Wednesday's FOMC meeting should not prove a negative event risk for the dollar in that US activity data has been pretty strong. The bigger risk to the dollar could come from Friday's release of December's core PCE inflation reading. Here, a 0.2% month-on-month reading could suggest inflation is less worrisome than some have feared and see market pricing for this year's Federal Reserve easing cycle shift to 50bp from the current 43bp.

We suspect investors are reasonably comfortable running long dollar positions at the moment and would not be surprised if DXY drifted back to the 108.50/108.80 area in quiet markets.

Expect lots of focus on US equity markets this week, too. A lot of the big tech stocks are releasing fourth-quarter earnings results at a time when Chinese AI firm Deepseek is starting to question whether such a huge amount of investment is required to achieve the same results. This questions the barriers to entry currently being enjoyed by the US tech stocks.

Chris Turner

➔ EUR: German IFO in focus

EUR/USD briefly nudged above 1.05 on Friday on news that Washington may potentially not be as aggressive on China tariffs as first thought. Euro short-dated swap rates rose on the view that the European Central Bank may not have to cut as deeply. US short-dated swap rates fell on the news that tariffs might not be as inflationary and that the Fed could ease more. Consequently, the two-year EUR:USD swap differential narrowed in close to 165bp – the tightest since early November.

We view the above as corrective, and our quarterly profile of EUR/USD gradually trending towards the 1.01 area by year-end is partially built on the assumption that the above rate differential widens back out to 200bp. Let's see.

For today, the focus will be on the Germany Ifo business sentiment data, where a modest tick higher is expected. This follows a small rise in the eurozone PMI flash releases on Friday.

Expect EUR/USD probably to be contained in a 1.0400-1.0500 range for the near term, with the next catalysts for a move being the FOMC and ECB meetings on Wednesday and Thursday respectively.

Chris Turner

➔ GBP: Short squeeze should not last

Friday's price action – particularly in GBP/USD – had all the hallmarks of a short squeeze. Short GBP/USD had been the conviction call for many at the start of the year given the UK's fiscal travails, but lower bond yields have taken the pressure off UK asset markets. And the (probably misplaced) prospect of a softer US tariff regime has now softened the dollar as well.

However, for UK corporates short the dollar, we see GBP/USD in the 1.25/26 area as an interesting area to consider USD hedge ratios. We think there is a good case for GBP/USD to be trading 1.19/20 later this year as the Bank of England picks up the pace of its easing cycle and the chancellor may have to come back to the table with more fiscal tightening later this year.

In terms of the UK calendar this week, Wednesday could be the most interesting. BoE Governor Andrew Bailey testifies to the Treasury Select Committee on Financial Stability. On the same day,

UK Chancellor Rachel Reeves tries to shift the narrative back to the growth agenda in a speech at Oxford.

Chris Turner

➔ CEE: Temporary strength in the region

With a busy global story, the CEE region doesn't have much to offer this week. The National Bank of Hungary is scheduled to meet tomorrow, but this should be a copy-paste of previous meetings. FX has seen significant relief in the last two weeks, but inflation did surprise to the upside in December. In line with expectations, we expect rates to remain unchanged at 6.50%.

On Thursday and Friday we will see GDP numbers in Poland, Hungary and the Czech Republic for the fourth quarter of 2024. While data from Hungary should show the end of the technical recession, we should see confirmation of a continued economic recovery in Poland and the Czech Republic.

The Czech National Bank's blackout period begins on Thursday, and we will likely hear from the board members today and tomorrow on their views on rates. For now, we have heard from Eva Zamrazilova and Jan Prochazka that, after lower than expected inflation, a rate cut will be discussed at the February meeting – which is also our baseline view. We expect a dovish tone this week as well, which should push EUR/CZK higher. Due to the rebound in EUR/USD, EUR/CZK has returned to pre-inflation print levels, but rates still point to levels around 25.350-400, which is our direction for the next two weeks.

Elsewhere in the region, we will be watching EUR/HUF and Tuesday's NBH meeting. The currency pair dropped below 408 on Friday, the lowest this year, allowing for some rally in fixed income as well. If the NBH repeats its previously cautious tone, which is our baseline view, this should be confirmation for EUR/HUF to stabilise and potentially test lower levels. On the other hand, a pullback in the US dollar should put pressure back on EM currencies and therefore we believe the current EUR/HUF lower levels are only temporary.

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