

FX Daily: Don't rush to pick the EUR/USD top

EUR/USD is trading at 1.08 following gargantuan moves in European yields. At the current level, the pair is only 1.2% overvalued in our calculation, and we'd be cautious to pick a top before the ECB (today) and US payrolls (tomorrow) risk events are past us



➔ USD: Souring US sentiment continues to weigh

Yesterday, the FX market reacted to unprecedented moves in European rates. German yields spiked 30bp after the German fiscal announcement, the largest intraday move in 25 years. We discuss our view on the euro in the next section, but the implications for the dollar are not secondary. Even more surprising than the huge bund move was the total disconnect with US yields. Treasuries barely budged yesterday: another signal that markets are sinking their teeth into the repricing of US exceptionalism relative to Europe.

We have also seen some developments on US protectionism. The US has granted a USMCA exemption to autos, which have heavy cross-border supply chains with Canada and Mexico and has been identified as potentially the most vulnerable sector to the fresh 25% duties. Meanwhile, Canada's retaliation continues to appear more aggressive than Mexico's, reinforcing our perception that Mexico is closer to a deal to potentially pause tariffs than Canada, which could lead to MXN outperforming CAD. Anyway, both currencies are trading slightly stronger week-on-week as the

negative US rating continues to prevent the USD from reaping the benefits of US tariffs, and markets are not fully pricing in long-lasting tariffs.

In this sense, US data is more relevant than protectionism news this week. The whisper number for tomorrow's US payrolls is now close to 120k (consensus: 160k) following a soft ADP print (77k vs 140k consensus) yesterday. The ISM services actually bucked the trend of recent data disappointment yesterday, coming in stronger than expected at 53.5, with prices paid accelerating. But any positives for the dollar were likely offset by more negative expectations ahead of payrolls.

Today, the US calendar is lighter, aside from the release of January's trade deficit, which is expected to have widened further and could trigger a more hawkish response on tariffs by the US administration. We would resist the temptation to call for an immediate rebound in the dollar just yet given the upcoming payrolls risk event. But US longs have largely been obliterated so far in March, and our view is that the dollar move is overblown. The reality of prolonged US tariffs and their impact on Europe argues for a USD rebound in the coming weeks, but for now a stabilisation in 104-105 in DXY may be the best the dollar can hope for.

Francesco Pesole

➔ EUR: Some hawkish ECB risks after seismic event

Germany's new government announcement that it will loosen fiscal rules and deploy EUR 900bn in fiscal spending has generated a seismic shift in European markets. Yesterday's 40bp selloff in bunds was largely matched by other EU sovereigns on the view that deficits will increase, inflation may rise, and growth can improve. [Our rates team's impression](#) is that those moves should not be reversed, even if we could see some adjustments in the coming days following the oversized move. Beyond that, the risks are probably skewed to the 3% handle in 10-year bunds.

The implications for the euro are enormous. EUR/USD is trading at 1.08 following a 3%+ rally in the past two sessions. Interestingly, that level is embedding a relatively contained amount of risk premium (i.e. short-term valuation): around 1.2% in our calculations. That is because the key rates-FX transmission channel – the 2-year swap rate differential – has tightened significantly too. That means markets are repricing the ECB curve higher while repricing the Fed curve lower – a dramatic and highly unusual divergence. The EUR:USD two-year swap rate gap is at -145bp (it was -175bp a week ago) and – along with the move in equities and other parts of the yield curve – now returns a short-term fair value for EUR/USD at 1.067.

With these considerations in mind, we are reluctant to call for the peak in EUR/USD just yet. Crucially, we have two key events before the end of the week: the ECB meeting today and US payrolls tomorrow.

The ECB's widely-expected decision to cut rates by 25bp today should not be influenced by recent market swings. The communication in the statement and during the press conference will however take both fiscal and market developments into greater account. As discussed in our [ECB cheat sheet](#), we thought the main question today would be whether the ECB lifts the reference to monetary policy being “restrictive” after taking rates to 2.5% today. We originally thought it wouldn't, but the notion that fiscal spending is finally coming through – and that the risks to inflation are shifting higher as a consequence – could be giving Governing Council hawks some stronger backing. The repricing in the ECB curve has largely happened already, but President

Christine Lagarde can still give an extra boost to the euro should she signal a more cautious tone on further cuts.

An extension to 1.10 in the rally would be inconsistent with the prospect of US tariffs on the EU and rate differentials, and our model still shows at least a 1-1.5% correction is in store for EUR/USD in the short term. For today and tomorrow, volatility and major risk events argue against actively picking the peak in EUR/USD.

Francesco Pesole

➔ SEK: Hot inflation supports SEK rally

Sweden reported stronger-than-expected inflation figures for February this morning. CPIF accelerated more than consensus from 2.2% to 2.9%, with the core measure rising to 3.0% against a 2.7% consensus.

The data reinforces the view that the Riksbank may stay on pause at the next meeting and helped EUR/SEK move deeper below 11.00 after breaking crucial resistance overnight. This move is in line with our expectations, as discussed [in this note](#). We expect EUR/SEK to trade only temporarily below 11.0 as our model now shows almost 3% undervaluation – an indication that a lot of the positives are in the krona's price.

Our forecast for the remainder of the year still has EUR/SEK above 11.00 (mostly in the 11.0-11.30 range) as we expect US tariffs to temper with the strong European sentiment to which SEK has a higher beta than the euro itself, and there is also a possibility of some geopolitical risk being priced back in after a largely expected Ukraine-Russia peace deal.

Francesco Pesole

⬆️ TRY: CBT continues cutting cycle while interest in FX continues unabated

The central bank of Turkey will cut rates again by 250bp to 42.50% today, in line with market expectations. Monday's inflation confirmed the disinflationary trend with some downside surprise in February. Overall, both food and non-food groups were drivers of the lower-than-expected inflation after a large upside surprise in January. The downtrend in annual inflation has also continued. In a move aligning with disinflation efforts, the Ministry of Treasury and Finance reversed the hospital copayment hike, contributing to a benign reading last month.

While there are pricing pressures due to the recovery in domestic demand, leading producers to pass cost increases to consumers, disinflation is expected to continue as the CBT has signalled it will maintain its tight stance despite the start of interest rate cuts, ongoing real TRY appreciation, and improvement in services inflation. We expect inflation to fall below 30% by the end of 2025. This backdrop is supportive for the CBT to continue with rate cuts, ending this year with 29.0% in our forecast.

TRY continues to trend real appreciation and provides a fat carry despite the start of the CBT cutting cycle last December. Despite further rate cuts this year, TRY remains our favourite carry trade in the EM space. We expect USD/TRY to reach 38.10 by mid-year and 40.20 by the end of this year.

Frantisek Taborsky

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

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