FX Daily: Euro welcomes German election result

Germany voted over the weekend, and the results are broadly in line with expectations. The euro got a small boost from the CDU/CSU being able to form a coalition only with the SPD, without any smaller third party. There's a lot on the table for markets this week, and we expect plenty of noise in FX

Chairman of Germany's Christian Democratic Union (CDU) Friedrich Merz (R) and State Premier of Bavaria and Christian Social Union (CSU) Chairman Markus Soeder (L)

USD: A week full of noise

A slew of soft data and renewed expectations that US President Donald Trump's tariffs will only be a short-lived transactional measure hurt the dollar last week. The direction of US protectionism will be the main driver beyond the short term, and we should see the discussion on Mexico and Canada tariffs return to centre stage as the deadline for the delayed tariffs is a week away. Canada is already disproportionately affected by US metals tariffs, and our working assumption is that Trump won't go ahead with 25% tariffs on his neighbours. However, a series of hawkish comments from Trump followed by a last-minute deal would be a familiar script, and we see downside risks for CAD and MXN before any reassurance on tariffs arrives.

The dollar has become more sensitive to US data (also non tier-one), and there are a few market moving releases in this week's calendar. Today, the Chicago and Dallas Fed indices should be overlooked, but tomorrow's Conference Board consumer sentiment indicator is key. We have seen indications – from both data and corporate earnings guidance – that the consumption story has deteriorated at the start of 2025. Later this week, the second fourth-quarter GDP print is expected to include a personal consumption revision down from 4.2% to 4.1% while confirming growth at 2.3% quarter-on-quarter annualised. Personal income and personal spending data for February is released on Friday, along with the Federal Reserve's favoured inflation measure, the core PCE index (for January), which is expected to show a reacceleration from 0.2% to 0.3% month-on-month.

We doubt we'll see one-way-traffic on the dollar this week. Markets are keen to close dollar longs on the back of softening US data, and a residual negative correction is still owed by the dollar should Russia and Ukraine agree on a peace deal. Yesterday, Ukrainian President Volodymyr Zelenskyy offered to step down in exchange for peace and NATO membership. At the same time, the looming Canada and Mexico tariff deadline and a 0.3% MoM core PCE can support the greenback.

There are many irons in the fire, and markets don't have the privilege of looking much beyond daily developments. We have a flat bias for the dollar today as the rebounding momentum from Friday has been tampered by a market-friendly German election result (more in the EUR section below). We continue to see upside risks to DXY beyond very short-term swings.

Francesco Pesole

EUR: Optimistic reaction to German vote

The German election results were broadly in line with opinion polls. The CDU/CSU is the leading party with 29%, followed by the far-right AfD at 21% and the SPD at 16%. While the CDU/CSU fared slightly worse than expected and the AfD's growing popularity was confirmed by the vote, incoming chancellor Friedrich Merz will benefit from two parties (the left-wing populist BSW and centre-right FDP) falling short of the 5% threshold to enter the parliament, meaning a CDU/CSU-SPD coalition would have a parliamentary majority.

The euro has reacted positively to the result as the rise of the AfD was largely in line with expectations and a two-party government is deemed more stable given the unsuccessful three-party experience of the outgoing government. The period of coalition talks starts now and we could see some residual euro sensitivity to the topic, especially for everything concerning the debt rule. That said, we see a high chance German politics will move back to being a small secondary factor for FX and EUR/USD will be driven primarily by US tariffs and US-Russia-Ukraine peace talks.

On the data side, Germany releases its Ifo surveys today. On Thursday and Friday, individual eurozone countries will start releasing flash CPI estimates for February, with the overall figure for the region due on Monday.

We remain reluctant to chase EUR/USD beyond 1.050 as a general rule, given the looming risk of US tariffs on the EU and the European Central Bank's resolutely dovish stance. Ultimately, we expect to see a return below 1.04 over the next four weeks.

Francesco Pesole

GBP: BoE speakers in focus

The UK published on Friday data showing a net public sector surplus of £15.4bn in January, which fell short of the £20bn estimated by the Office for Budget Responsibility in October alongside the Budget. That further raises the probability that Chancellor Rachel Reeves will need to scale back spending if she wants to avoid hiking taxes in her Spring Statement on 26 March. Remember that the fiscal headroom originally expected last autumn has been eroded by the rise in gilt yields.

We think sterling is going to suffer from the March Budget event, also as the Bank of England could see lower spending as a reason to unlock more cuts in line with the recent dovish shift in the MPC. While sterling is not as directly exposed to US tariffs as the euro, we expect the impact of upcoming broad-based US protectionist measures to weigh on all European currencies vis-à-vis the dollar. We expect a return below 1.25 in GBP/USD in March.

This week, the UK data calendar is empty, so all the domestic focus will be on BoE speakers. We'll hear from two doves today – Swati Dhingra and Dave Ramsden – as well as from hawkish-leaning Clare Lombardelli. Tomorrow, we'll hear from Chief Economist Huw Pill.

Francesco Pesole

CEE: Calendar can bring back local story

After a very quiet week, the local story is back in focus for markets. Today, we will see retail sales in Poland for January. Goods spending remains subdued, but has improved after a poor third quarter.

On Tuesday, the National Bank of Hungary will hold its last meeting under the current governor. While the rate decision is expected to be a non-event, the communication following January's surprisingly high inflation will have the market's attention. Also on Tuesday, we will see PPI in the Czech Republic, where agricultural prices in particular are being watched more and more by the central bank due to rising food inflation. Thursday and Friday, we will see the final fourth-quarter GDP numbers in Poland, Czech Republic and Turkey.

Markets in the CEE region are still focused on the Ukraine story – although the second half of last week showed that positive sentiment is gradually fading from the FX market. Over the last few weeks, the European stock market have been a good leading indicator for the PLN and HUF.

However, it has been showing some correction in the last few days, and in our opinion, we should see something similar for CEE FX. We already saw some signs on Friday in the HUF market and we think there is more to come. Positioning is clearly heavy long in these markets after the rally in recent weeks and the surprise risk is, in our view, more on the downside in the Ukraine story now given the transition to a rather bumpy stage. USD-crosses in particular therefore have good potential for some tactical long position building as the market takes profits in CEE on incoming headlines.

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