FX Daily: Headwinds stiffening for the dollar

The dollar is under pressure at the start of European trading today. Risk assets are bid as US big tech came back from the brink last week and the Nikkei surged on an emphatic win for the LDP in Sunday's Japanese election. The narrative of diversification away from the US is also in play after Chinese regulators warned of concentration risk in Treasuries

The dollar is soft as overseas assets prove attractive and Chinese regulators warn about concentration risk in Treasuries

USD: Push and pull factors weigh on the dollar

The dollar is starting the week on the soft side, with both pull and push factors at work. On the pull side, we have a bid environment for risk assets, where US big tech pulled back from the brink last week (Nasdaq +2%), and global equity markets are performing well. Nowhere is that more apparent than in Japan, where the Nikkei was briefly up over 5% on the Liberal Democratic Party's landslide win. The consensus in FX markets has been that a large LDP win would trigger a large sell-off in both JGBs and the yen, as an unchecked LDP would push ahead with unfunded fiscal giveaways and lean on the Bank of Japan not to tighten.

So far, the LDP seems to have contained the fallout in the JGB market by arguing that the temporary tax cut on food would not require the issuance of fresh debt. And the risk to markets is that instead of this being a 'Sell Japan' story from the JGB side, it evolves into a 'Buy Japan' story on a government with a clean mandate to deliver growth. It may be too early to conclude the latter just yet, but we do note that the market is pricing a higher BoJ policy rate on this and given that the market will be bracing for intervention above the 158 area in USD/JPY.

If the negative pull factor for the dollar is the attractiveness of overseas asset markets, the push factor is what is going on at home. US labour market data surprised on the downside last week, and markets are now bracing for the Federal Reserve to potentially re-appraise its view of the jobs market. The focus this week will be on Wednesday's release of the January NFP jobs report and also benchmark revisions. Consensus expects a decent +70k increase, but the market will be more sensitive to a downside miss. Further US data this week includes December retail sales data tomorrow and the release of January CPI on Friday. Soft data can weigh on the dollar.

And earlier today Bloomberg reported that the Chinese state regulator had asked Chinese private sector banks to rein in their exposure to US Treasuries, from a market concentration risk perspective. Mainland China and Hong Kong together held $938bn of US Treasuries as of last November. Comments like these come at a vulnerable time for the dollar, when the dollar diversification theme is rife.

Barring a significant turn for the worse in risk appetite, it looks like we could see a down week for the dollar. DXY stalled at 98.00 last week, and 97.00/05 looks like an initial target.

Chris Turner

EUR: Trying to make Europe look more attractive

EUR/USD has enjoyed a bounce on the Chinese US Treasury story above. Despite being fragmented, Europe offers the best alternative in terms of depth and liquidity to the US Treasury market. We note this week that European leaders are meeting in Belgium on Thursday to discuss how to push ahead with key reforms such as the Savings and Investment Union. We discussed some of these themes in our 'Global euro – 100 day scorecard' released last September. Investors expect a glacial response from European leaders. The surprise would be that, similar to the new German fiscal stimulus announced last February, the very unsettled geopolitical environment pushes Europe into action. Let's see. Any significant progress to improve the European investment environment would be a euro-positive.

Stretched long positioning does look like the main barrier to a further EUR/USD advance. Friday's release of CFTC positioning data suggested that leverage fund net long positions are again approaching cyclical highs. But the short-term bias in EUR/USD looks to be towards 1.1900. And it will probably be Wednesday's NFP jobs data that determines where EUR/USD ends the week.

Chris Turner

GBP: PM Starmer remains under pressure

Pressure is building on UK Prime Minister Keir Starmer. His close ally, former chief of staff Morgan McSweeney, was forced to resign yesterday for his role in the appointment of Peter Mandelson as UK ambassador to the US last year. Questions over PM Starmer's judgement are likely to remain as the decision to appoint Mandelson faces further official scrutiny, and the Labour Party also faces a political reckoning at a by-election in late February and local elections in May. Expect pressure to remain on both sterling and Gilts as the market speculates over a change of personnel at numbers 10 and 11 Downing Street.

Combined with a dovish twist at last week's Bank of England meeting, sterling is under pressure. 0.8740/45 looks the initial target for EUR/GBP, with the risk to 0.8800 if it were to appear as though Starmer will step down.

Chris Turner

CEE: Trapped in the ranges

The beginning of this week will be quiet in the CEE region, and we will have to wait until Thursday for the first interesting data release. The Central Bank of Turkey will publish an inflation report, which could provide more insight into the bank's stance after higher-than-expected inflation in January. In Hungary, January inflation will be published, and we expect a sharp drop from 3.3% to 2.0% year-on-year – slightly below market expectations and the National Bank of Hungary's forecast (2.2%). This should be enough for a rate cut in February.

On Friday, Romania will publish GDP figures for the fourth quarter of 2025 and flash inflation for January in Poland. Here, we expect a drop from 2.4% to 1.9%, in line with market expectations. We will also see the breakdown of Czech inflation published last week at 1.6%, as well as the Czech National Bank minutes.

The CEE market remains in similar ranges to those we have seen since the beginning of the year. EUR/CZK and EUR/PLN remain firmly anchored at 24.200-400 and 4.200-230, while EUR/HUF is exploring new lows below 378. EUR/CZK is faithfully following hawkish repricing after the market was positioned for lower inflation numbers last week, and current levels by the lower end of the range seem fair to us. Similarly, we see EUR/PLN without much reason to break out of its current range. EUR/HUF is a different story, and we see a gradual slide down as the general elections in April approach. On Saturday, we will hear Prime Minister Viktor Orban's speech on the state of the country, where the market will be watching for any sign of changes in fiscal policy.

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