FX Daily: Here's why the dollar sell-off could stall

Conditions in global FX markets are a little calmer today. USD/JPY continues to retrace some of its heavy losses, but EUR/USD remains very bid. We do not see any triggers for big FX moves today, but take the view that the dollar could find support at the bottom of its 2025 trading range

After two days of heavy selling, the US dollar has started to find some stability

USD: Dollar licks its wounds

After two days of heavy selling, the dollar has started to find some stability. USD/JPY is drifting a little higher as investors gather their thoughts on what they have seen. Japanese money market data suggests that if the Bank of Japan did intervene on Friday above 159, it did so in negligible amounts. And the wall of silence coming out of Washington regarding Fed rate checks on Friday evening suggests the US administration is happy for the ambiguity to linger.

After Friday's shock, we see a decreasing marginal impact of this activity unless both Japan and the US formally confirm joint intervention – the first since 2011. USD/JPY has an upside gap to 155.60, which could be the direction of travel in the short term. Yen performance around the results of a 40-year JGB auction in early Asia tomorrow (poor auction equals weak yen) could be a catalyst here.

As for the broad dollar trend, we appreciate that strong flows into emerging markets are a mild dollar negative. But US data is holding up well and we can see tomorrow's FOMC meeting as a mildly dollar-positive event risk. Running into February, dollar seasonals turn more positive and again, we do not see the European buy-side as underhedged US assets as they were heading into 'Liberation Day' last April. Unlike last year, if foreigners were to start selling their underlying US assets, that would be different. Risks here are poor five or seven-year US Treasury auctions this week, or some big earnings miss from four of the Magnificent Seven, who report Wednesday and Thursday this week.

For today, the only US data of note is the weekly ADP jobs numbers. Barring a negative print here, we think DXY can work its way higher to fill Monday's gap to 97.42.

Chris Turner

EUR: 1.19 could be the range high

EUR/USD remains bid. Yesterday's release of German IFO business sentiment was not as strong as it could have been and is a missed opportunity for Europe to present the pull factor for portfolio capital away from the US. Remember this time last year, EUR/USD was doing well on the rotation of funds into Europe and then the game-changing decisions taken on fiscal stimulus in Germany.

Like other FX pairs, EUR/USD has some lively technical chart patterns this week. There is a downside gap to 1.1834 which should now act as support if EUR/USD is preparing to break above range highs at 1.1910/20. At present, we think those highs can hold and that EUR/USD can end the quarter somewhere near 1.17. But let's see. There seem to be plenty out there who are looking for a breakout and the fact that the 10 delta one-year EUR/USD butterfly option has gone very bid again – just like it did last April – suggests some investors want to be positioned for sizeable moves.

The eurozone calendar is light, with just a couple of ECB speakers today. The ADP jobs data looks to be the sole-scheduled catalyst for a move today.

Chris Turner

GBP: Short squeeze is back on

Sterling's outperformance this week may well be down to the fact that asset managers were very short GBP/USD positions, which have been left exposed by this week's dollar sell-off. As above, we are not big fans of chasing the dollar lower just yet and suspect these levels in GBP/USD – the high 1.36s/low 1.37s – could be the best levels of the quarter and perhaps of the year as well.

UK politics may well take its toll on sterling again over the coming months. The next big date here is a UK by-election on 26 February. Should Labour lose its seat to Reform, more pressure will be heaped on PM Starmer and speculation will grow about a change of leadership after the local election results in May.

Sterling is also vulnerable to any further bond market pressure emanating from Japan or the US. In short, we think sterling is near the top of multi-quarter ranges.

Chris Turner

HUF: Final thoughts before start of the cutting cycle

Today's meeting of the National Bank of Hungary should be a non-event from a rates perspective. No change at 6.50% is widely expected, but the meeting should be the last one, in our view, before the central bank starts cutting rates in February. The focus will be mainly on forward guidance.

The key for the February meeting will be January inflation. Our economists expect levels around 2.1-2.2%, close to the central bank's expectations. However, the question is where is the limit for the NBH to cut rates or wait longer. At the same time, the view on service prices, which remain elevated, will also be decisive.

The market has unwound dovish bets after December's inflation and at this point sees February as a 60/40 chance in favour of a rate cut and two 25bp steps for the next four meetings. The priced terminal rate has stabilised at 5.50% at the beginning of next year. For the next session, this seems like a fair expectation, but we see a terminal rate of 4.50% eventually and if the NBH starts cutting rates in February, we see more room for dovish pricing here.

However, for today, it seems that FX should not be too affected unless the central bank surprises significantly in one direction. We do however expect the NBH to cut rates at some point in 1Q and the market to go dovish, which should later pressure the forint. The market is maintaining a stable long carry positioning and the start of a cutting cycle should be a signal for markets to unwind. Therefore, we see EUR/HUF around 385.

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