

FX Daily: Markets temporarily shake off reciprocal tariff threat

If Thursday was the 'Big Day' for US reciprocal tariffs, you wouldn't have known it by looking at the global equity rally or the slightly softer dollar. The benign impact on markets of yesterday's tariff announcement owes largely to the tariff measures being incredibly complex and not coming in until after April - allowing plenty of time for negotiation



Trump signed the reciprocal tariffs executive order and remarked, "Tariffs are good, tariffs are great actually."

📉 USD: Reciprocal tariffs seen as 'unworkable'

The dollar is a little weaker in Europe today on the back of slightly lower US interest rates, ongoing optimism about an end to the war in Ukraine, and a US reciprocal tariff package which was hard to decipher.

Firstly, the market knew that the Commerce Department was due to deliver a big report on trade in April and had expected tariffs thereafter. But it had also feared that this week's reciprocal tariffs announcement would be a separate workstream and be more immediate. News yesterday effectively laying the groundwork for the April report has therefore been seen as a relief.

And investors have a pretty clear idea of what President Trump is trying to achieve with these reciprocal tariffs. This is laid out quite clearly in this [factsheet](#). But reading through the details of the basis on which reciprocal tariffs will be delivered is mind-blowing. Each country's reciprocal tariff will be based on a relative analysis of: import tariffs, VAT rates, subsidies, regulatory burdens, FX misalignment, and 'any other practice that.. imposes any unfair limitation on market access or any structural impediment to fair competition with the market economy of the United States'.

In theory, the White House has tasked the Commerce Department and others with producing a comprehensive report on each trading partner by April. How this is physically possible remains to be seen given DOGE's efforts to reduce the government workforce.

However, the outcome is likely to be perhaps some eye-wateringly large tariffs against some of the key countries with which the US runs a goods deficit. The EU will certainly be in the cross-hairs since it looks like Trump is using the threat of tariffs as leverage against the EU's digital service tax.

Fortunately, we have already been using the assumption of peak trade pressure in the second quarter of this year. The above looks consistent with that and it's why we think the dollar will move a little stronger into the second quarter. This means the current dollar dip should be a correction rather than a meaningful new trend.

For today, we think the dollar can stay soft as the focus switches to the security conference in Munich and what it means for any ceasefire in Ukraine. Speculation is building that representatives from the US, Russia, Ukraine and perhaps Europe, too, could meet in Saudi Arabia at some stage. A soft, weather-related January US retail sales figure today does not need to hit the dollar too hard. But we think short-term momentum could carry DXY below 106.95/107.00 to the 106.35 area.

Chris Turner

EUR: A little more room to correct

The components of yesterday's US January PPI release which read over to the core PCE deflator came in quite benign yesterday. Hence the drop in US rates and the firmer EUR/USD ahead of the tariff story. As above, the market senses some relief that tariffs were not immediate and allows a couple of months for trading partners to fine-tune strategies - be they buying a lot of US LNG, cutting their own trade barriers, or standing and fighting.

Our best guess on EUR/USD is that this current correction might extend to the 1.0535/75 area - but that should be the extent of it. And we have a baseline forecast that EUR/USD will be pressing 1.00 in the second quarter.

As an aside, we have been discussing the outperformance of eurozone equities and whether global rotation into Europe could help the euro. Yet when looking at flows into a popular eurozone equity ETF - the iShares MSCI Eurozone - there have not been any strong signs of that rotation. This is perhaps another reason why the EUR/USD correction will peter out above 1.05.

Chris Turner

CEE: Busy end to the week

The end of the week in the region offers a very heavy data calendar:

- This morning saw the release of inflation numbers in Romania for January. The headline number fell from 5.1% to 5.0% year-on-year, while the market was expecting 4.9%. At the same time, GDP in 4Q24 shows some recovery in the economy from the previous quarter's stagnation to 0.8% quarter-on-quarter, above expectations.
- Inflation expectations in Turkey, closely monitored by the central bank, fell only slightly in February but continued the trend of previous months. However, given the surprise in January inflation, year-end expectations rose slightly to 28.3%.
- Later this morning, Poland's inflation for January will also be released. Our economists are expecting an increase from 4.7% to 5.0% YoY in line with the market. However, the upside surprise in the Czech Republic and Hungary earlier creates some upside risk.
- And in the Czech Republic, the central bank will release the minutes of last week's meeting when it resumed the cutting cycle.
- Lastly, the National Bank of Romania is expected to leave rates unchanged at 6.50% (see below).

As expected, CEE markets were in good spirits yesterday after headlines about the Ukraine negotiations. We saw a strong rally especially in the rates market, while FX was rather muted or corrected slightly some gains from the previous days. Thus, the initial picture would suggest tighter rate differentials may signal the end of the FX rally and perhaps some correction ahead of the weekend. However, if we look at our simple valuation framework, the weight of rates has dropped and the weight of sentiment as the main driver has increased significantly, especially in the case of Hungary's forint and Poland's zloty. This implies that the Ukraine story is the main driver and the future direction will depend on the evolution of this story. Today we should continue on a positive note and after the weekend conference in Munich, we will have more clarity on the future direction for CEE FX.

Frantisek Taborsky

➔ RON: Rates stay on hold amid persistent inflation and fiscal uncertainty

We expect National Bank of Romania policymakers to keep the key rate at 6.50% at today's meeting, as is widely anticipated by the market. Romania's overall inflationary trend has been slowing down throughout 2024, but the disinflationary pace has been clearly diminishing and could even come to a halt in 2025.

Given the persistent inflationary pressures, the uncertain fiscal policy path, and mixed signals from economic activity, we expect that the central bank will opt to keep the policy rate unchanged at 6.50% at its upcoming meeting but also throughout the first half of 2025. We still envisage two 25bp rate cuts in the second part of 2025, though there are quite a few conditions that will need to be met to get there.

The Romanian government bond market (ROMGBs) somehow stabilised in February after a sell-off and rally in January. Still, political uncertainty remains in the market given the presidential election in May and complicated government negotiations. In our view, the market is struggling to regain confidence in the fiscal consolidation plan, so we will likely need to see some further action from the government – which seems unlikely before the election – or an improvement in monthly budget numbers, which will take several months. The overall story has stabilised but we are missing more positive news to see another leg of the rally from current levels.

FX remains unchanged, fully under central bank control. As with rates, we believe the central bank has no reason to make any changes here in the first half of the year. If the situation calms down globally and locally on the fiscal and political side, we believe there may be room to devalue the RON in the second half of the year.

Frantisek Taborsky

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