

FX Daily: More of the same to start the year

The first trading day of the year brought fresh pressure on European currencies. There is now a considerable risk premium being built into EUR/USD, and we suspect that both protectionism and the recent rise in gas prices are playing a role. A short-term dollar correction would be warranted by technical factors, but the overarching narrative should remain USD-positive



↓ USD: Entering favourable seasonality

In our first FX Daily of 2025, it's worth reiterating our core views for this year. We expect Trump's policy mix to trigger further dollar strengthening, with European currencies – and the euro in particular – coming under pressure from protectionism and monetary easing. Emerging market currencies should have a tough year too, as discussed in our [December FX Talking](#).

The dollar is seasonally strong in January and February. Interestingly, last month was also a strong one for DXY (+2.6%), breaking a seven-year losing streak in the month of December. That showed macro factors and expectations for Trump's policies were strong enough to counter the negative seasonal effect. Now that seasonality turns positive, we'd need a U-turn in that narrative that has

kept the dollar strong into year-end. Will it come from data? We are not expecting any rapid deterioration in the labour market, but rather a gradual one that is consistent with the Federal Reserve staying cautious on easing. A January cut would really require a slew of recession-sounding figures after the hawkish tilt in the December Dot Plot.

So will it come from Trump? The President-elect has already been quite vocal on some policy promises since his electoral triumph, and markets are pricing a good deal of macro implications ([USD/CAD being a case in point](#)). Unless he softens his tone on protectionism and/or fiscal stimulus into inauguration day (20 January), the dollar should count on a solid floor at the start of this month. The tail risk for USD remains any serious talk about a Plaza Accord 2.0 to artificially devalue the dollar. We don't expect that to happen and instead think Trump will have to stomach a structurally strong dollar, and only employ FX as a token for negotiation with trading partners with weak currencies.

Turning back to the US calendar, jobless claims surprisingly slowed to 211k in the last week of 2024. Meanwhile, the ISM releases its manufacturing index for December this afternoon. This gauge has been in contraction territory in every month but one since late 2022. Today's print will tell us whether the modest optimism from November's above-consensus 48.4 was justified or just a fluke. Consensus is leaning toward the latter (expecting 47.5 today).

The dollar was immune to the New Year's Eve rally in Treasuries and probably has some modest room to catch up on the downside once liquidity is fully reestablished. That said, growth concerns and rising gas prices remain a bearish argument for European FX – as discussed below – and we expect strong buying of the dollar on any dips in the event of a short-term correction. The macro and political story continues to point to 110.0 in DXY.

Francesco Pesole

EUR: Negatives piling up

The 4Q24 drop in EUR/USD was primarily driven by the widening in the short-dated swap rate differential due to diverging policy expectations between the Federal Reserve and the European Central Bank. Over the Christmas holiday period and in particular, in yesterday's trading session, the EUR/USD decline accelerated in spite of a re-tightening in the EUR:USD two-year swap rate gap from 200bp (on 12 December) to the current 185bp.

We estimate that EUR/USD is trading around 2.5% below its short-term fair value, therefore displaying a risk premium associated with growth concerns for the eurozone. Aside from the implications of expected US protectionism under Trump, we think pressure is being added by the rise in TTF gas prices to 50 EUR/MWh caused by Ukraine's pipeline shutdown. The pound was the worst performer yesterday, and it is probably not a coincidence that GBP is the most negatively correlated with gas in the G10.

If the technical picture is pointing to a EUR/USD short-term rebound, the euro remains a broadly unattractive currency in the longer run, and we cannot exclude another leg lower might be needed – perhaps to the 1.0200 mark – before a recovery.

Francesco Pesole

➔ CEE: FX hugs rates as the New Year approached

In the region today we will see the final 3Q GDP numbers in the Czech Republic which should be confirmed at 1.3% year-on-year. The central bank will also release minutes from the December meeting when it paused the cutting cycle. Two board members voted for a rate cut (we expect Frait and Prochazka) and today's minutes will show the vote split and discussion. Given the outcome of the meeting, we should see some hawkish arguments but given the hawkish market pricing, we see more of a possible surprise on the dovish side. Also in the Czech Republic, the state budget results for last year will be released. We expect a better result than MinFin had projected (deficit below CZK282bn), which should result in 2.4% of GDP, while we expect 1.9% of GDP this year. Next week, most likely on Monday, MinFin will also publish the financing strategy for this year and the first calendar of CZGBs issuance for January.

In Poland, December inflation will be published today, as always the first in the CEE region. We, in line with the market, expect an increase from 4.7% to 4.9% YoY. Although the range of estimates is wide, from 4.7-5.0%, the market is more inclined towards the upside risk.

In the FX market, we see PLN and CZK strongly following rates. While in Poland we think current market pricing is fair, in the Czech Republic we believe the market is too hawkish relative to the Czech National Bank's stance. While the CNB's next steps depend heavily on the January inflation number, we believe the probability of rate cuts in February is higher than the market implies. Given the low EUR/CZK levels, we are thus negative on Czech koruna and neutral on Poland's zloty.

EUR/HUF gained 0.5% yesterday, returning to higher levels, and we see the gap between rates and FX, which was created at the end of the year when the central bank increased FX implieds to stabilise the market, closing. However, we still see some room for HUF to weaken, and we remain negative on it.

Frantisek Taborsky

⬇ TRY: Lower-than-expected inflation after the start of the cutting cycle

December inflation in Turkey surprised to the downside with a drop from 47.1% to 44.4% YoY, below market expectations. Downside risk was indicated by inflation numbers from Istanbul yesterday. This is good news for the central bank after the start of the cutting cycle last week. The month-on-month rate fell from 2.2% to 1.0% MoM, while the market was expecting 1.6%. The central bank can thus continue the cycle at the January meeting.

Although the market reacted strongly to the first central bank rate cut last week, especially at the front of the OIS and bond curve, we believe the market still has room to price in more cuts, particularly in this segment of the curve. TRY stabilised yesterday and today after holiday volatility and is returning to the traditional weakening trajectory of previous weeks. Despite the start of the FX carry cutting cycle, it remains attractive, which should keep market attention strong this year.

Frantisek Taborsky

Author

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Chris Turner

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

chris.turner@ing.com

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