# FX Daily: Not trusting the dollar sell-off

We are taking the view that the dollar has some room to recover today. Japanese bonds have rebounded, and US Treasuries and equities are on track to follow higher later today. And with Trump headed to Davos, we see some scope for de-escalation on the Greenland risk and fears of European dumping of US assets. EUR/USD can return below 1.1700 in this environment

US President Trump departing the White House for Davos on Tuesday 20 January

## USD: Stabilisation can help the dollar recover

Yesterday's dollar sell-off seemed to reflect a combination of spillover from JGB volatility and concerns about Europeans reducing their Treasury holdings. The volatility imported from Japanese bonds affected global fixed income across the board, but the FX reaction was not uniform. Higher bond yields – even when driven by foreign markets – tend to weigh on a currency when investors are already sensitive to that country's fiscal sustainability.

Over the past year, the three developed market currencies that have at times shown a negative correlation with their long dated yields (10Y–30Y) have been USD, GBP and JPY – the three worst-performing G10 currencies yesterday. To us, it was particularly striking how GBP underperformed even against high beta currencies such as NOK and NZD, which suggests that the fiscal factor is a bigger discriminator of FX moves than risk sentiment.

Our view is, however, that this is not a sell-off worth chasing in USD. Long-dated Japanese bonds rebounded sharply overnight, lifting one source of USD downside risk for today's European-US session. Incidentally, S&P500 futures are up 0.4% while European equities seem to be struggling to recover.

Greenland will be the dominant theme today and there may be scope for de-escalation, offering the dollar some support. Trump is meeting EU leaders in Davos today, and if the past year has shown anything, it's that face to face engagement tends to provide the best opportunity for tensions with the US president to ease. Before departing for Davos, Trump said: "We'll probably be able to work something out."

There are no market-moving data releases in the US today. Market pricing for a Fed cut has remained untouched despite the bond and equity sell-off (only 6bp for March) which reinforces our view that the dollar faces upside risks today amid broader stabilisation.

*Francesco Pesole*

## EUR: Return below 1.1700 possible today

A headline about Danish pension fund AkademinerPension exiting US Treasuries yesterday briefly fuelled extra concerns about a European exodus from US assets, despite the actual size of the fund's holdings being very small in December ($100m). Markets aren't following through on these concerns this morning, and if Davos brings some geopolitical de-escalation, the associated EUR gains may start to be trimmed today.

Our view is that unless bond volatility spikes again – not our baseline – EUR/USD belongs below 1.170 in a seasonally strong period for USD and in light of the recent hawkish repricing of front-end USD yields.

In the rest of Europe, we are also wary of chasing the rally in SEK much further for now. EUR/SEK is trading at over 2% short-term undervaluation and may be due to an upward correction – we believe to 10.80 – before re-establishing a medium-term depreciation trend.

*Francesco Pesole*

## GBP: No surprises in UK inflation

As discussed in the USD section, sterling's underperformance yesterday was, in our view, primarily mirroring the risks of importing bond volatility for a currency that recently experienced periods of negative correlation with back-end yields on fiscal worries. Calmer markets this morning mean EUR/GBP may face some downward pressure and return below 0.870.

On the data side, there was nothing in the UK inflation report for December – released this morning – that is likely to move the needle for the February Bank of England meeting. Our UK economist, James Smith, notes that the BoE's preferred gauge of "core services", which excludes volatile and indexed items, came in at 4.0% for the third consecutive month. Headline inflation accelerating slightly more than consensus to 3.4% was partly due to food prices accelerating to 4.5%. Food is something MPC members are monitoring closely, even though it remains well below the 5.3% BoE forecast.

*Francesco Pesole*

## CEE: Keeping bearish bias

While the CEE calendar remains muted today, and we will see the first data tomorrow and Friday, the global story is keeping the region busy. Yesterday, we saw a full hit of the risk-off environment coming from the US tariff headlines, which CEE rates followed in expected fashion with steepening curves across the board. However, EUR rates at the front of the curve were heading in the same direction and the rate differential did not change much. At the same time, the jump in EUR/USD is somehow offsetting the risk-off mood and at the end of the day we did not see much movement in FX.

We maintain a bearish bias for the next few days, but mainly due to local reasons and pricing in more rate cuts than the global story. However, both sides point to weaker FX in the region. Today, attention will still be on the global story and Davos talks, but we can expect some defusing of the risk-off mood and calming of the markets, which should keep the region at least stable, and only in the next few days should they shift the focus back to the regional story.

*Frantisek Taborsky*

## Author

**Francesco Pesole**
FX Strategist
francesco.pesole@ing.com

**Frantisek Taborsky**
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

**Chris Turner**
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com