

FX Daily: Spreads and tariffs keep dollar in demand

The combination of wider interest rate differentials and broadening US tariffs are providing continued support to the dollar. We can't see that changing this week



Continued uncertainty over the nature, timing and magnitude of tariffs looks likely to keep the dollar supported this week

USD: More tariffs are coming

Friday's [relatively strong](#) US job report numbers and the broadening of US tariffs are keeping the dollar supported. On the former, the jobs report has seen expectations of Federal Reserve easing this year pared back to just 35bp. Those Fed easing expectations could narrow even further this week. Another 0.3% core month-on-month CPI reading on Wednesday will not help the disinflation story and we'll also get to hear from Fed Chair Jerome Powell in his semi-annual monetary policy testimony to Congress on Tuesday and Wednesday. It is hard to see why Powell would want to push a more dovish narrative right now.

When it comes to tariffs, it's hard to keep up with developments. We've had the threat of tariffs against Canada and Mexico seemingly for the strategic domestic agenda of fentanyl and immigration. Tariffs against China have already gone into place. Over the weekend a new set of 25% tariffs were announced on steel and aluminium tariffs. In the frame here again are Canada, Mexico, and China plus Brazil, South Korea and Germany too. These tariffs could be seen to fall

under the category of protecting critical industries.

But it also seems that, over the next couple of days, we might see the imposition of 'reciprocal' tariffs – i.e., trying to level the playing field on trade. We had thought that these might come in during the second quarter after the Commerce Department delivers its report on why the US runs perennial trade deficits. If these reciprocal tariffs come in this week against those countries who have a higher tariff rate than the US, then it may be countries like Brazil, India and Korea who are most exposed. That said, reports have also suggested that reciprocal tariffs could impact everyone, and the auto sector has been highlighted as well.

Needless to say, much uncertainty about the nature, timing and magnitude of these tariffs looks likely to keep the dollar supported this week. The main threat to long dollar positions could be a re-assessment of European prospects should any expectations of a Russia-Ukraine ceasefire grow later this week.

However, for the time being, we doubt investors will want to let go of overweight positions in the dollar and we can see DXY edging towards the top of a 108-109 trading range through the early part of this week.

Chris Turner

⬇️ EUR: Weighted by tariffs and spreads

The repricing of the Fed cycle after the strong US jobs data has seen EUR:USD two-year swap rate differentials widen back out beyond 190bp. We expect those differentials to stay near 200bp for most of the year and to keep EUR/USD under pressure. Equally, Friday's release of the European Central Bank's [staff paper into the neutral interest rate](#) had little impact on the pricing of the ECB cycle.

The threat of tariffs coming to Europe this week has seen EUR/USD drop close to 1.03 again. A move back to 1.0225 is possible if the 'reciprocal' tariffs claw in the EU or some of the major European countries. And Wednesday's US CPI release is another negative event risk for EUR/USD. If it can survive the tariff risk and the CPI, the run-up into Friday could look a little better for EUR/USD as investors turn their attention to the Munich security conference. Here we are expecting to hear more about the US proposed ceasefire deal in the Russia-Ukraine conflict. A surprise deal would certainly be a positive for the European currency complex.

The data calendar is light today – just ECB President Christine Lagarde in parliament at 3:00pm CET.

Chris Turner

➡️ GBP: Tariffs versus BoE

EUR/GBP is offered again this morning as the market is dominated once more by the tariff story. Here, the market expects the EU to have more to lose than the UK on tariffs. We cannot rule out another drop in EUR/GBP to the 0.8250 area should tariffs hit Europe in the early part of this week. However, tomorrow could see the focus flip back to the Bank of England easing cycle. Here, former arch-hawk – potentially now arch-dove – Catherine Mann delivers a speech on the UK outlook. Understanding why she [voted for a 50bp rate cut](#) last week could shed light on whether others will want to follow suit. A soft fourth quarter UK GDP figure out on Thursday could also add to a dovish

narrative.

GBP/USD should be the focus for any sterling downside, however. We favour GBP/USD heading down towards the lower end of a 1.2250-2500 trading range.

Chris Turner

CEE: Ukraine deal talks support the region

After a busy week with central bank decisions in [Poland](#) and [the Czech Republic](#), this week should be a bit calmer. Tomorrow, we will see January inflation in Hungary. We expect a rise from 4.6% to 4.8% year-on-year, in line with market expectations, and core inflation should also be higher from 4.7% to 4.9%.

On Wednesday, the Czech Republic will release its final inflation estimate, which should confirm last week's 2.8% YoY reading and reveal weaker core inflation as indicated by the flash estimate. On Thursday we will have 2024's fourth quarter GDP in Poland, though we have already seen the full-year estimate implying 3.4% YoY. On Friday, the calendar concentrates on final inflation numbers in Poland and Romania, inflation expectations in Turkey for February, and Czech National Bank minutes from last week's meeting. We'll also see the decision by the National Bank of Romania, which is likely to leave rates unchanged at 6.50%.

Last week, CEE FX saw decent gains across the board supported by hawkish central banks and the Ukraine deal talks. Nothing is likely to change here this week and we may see some details of the deal from the US administration – potentially at the Munich security conference this Friday. Overall, all CEE currencies look fairly priced to us matching their interest rate levels. Positive news from the geopolitical space could support further gains in CEE this week. Otherwise, the focus will be more on US data.

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