FX Daily: Tentative tariff optimism keeps dollar under pressure

Markets have continued to unwind USD longs as US Treasuries had another strong session, and a delay in tariff announcements is fuelling some tentative optimism. That said, we could start to see growing pressure on CAD and MXN, which are facing the most tangible tariff threat at the moment. Today, expect more of the same from ECB speakers in Davos

It's tricky to draw conclusions on how tangible tariff threats are at the minute, and that's adding another layer of uncertainty to the mix for markets

USD: Corporate tax discussion in focus

Trump's day two in office was dominated by the threat to reshape tax systems for multinational companies. As part of a memorandum originally published on Monday, the president is tasking the US Treasury with investigating discriminatory taxes on US citizens or corporations. Along with the floated possibility of withdrawing from the OECD agreement on a minimum corporate tax, the US is considering double taxation on some foreign individuals and companies established in the US. It is admittedly hard to draw conclusions on how tangible this threat is, or the implications for US and foreign corporations for now. It is likely another layer of uncertainty to which markets are getting accustomed.

On the hot tariff topic, the focus has remained on Canada and Mexico after Monday's threat to impose 25% tariffs. After another round of dollar weakness in yesterday's US session, CAD and MXN are now trading around 1% stronger compared to Friday. We read that as a signal that markets are still reluctant to price in the full extent of the tariff impact, and perhaps still hanging on to hopes that tariffs will be delayed further on the back of some cooperation on migration. For now, Canada has pledged to retaliate but outgoing Prime Minister Justin Trudeau has equally stressed that avoiding tariffs is the priority. Downside risks for both CAD and MXN remain elevated.

Today's US calendar only includes the Leading Index and MBA mortgage applications, which in the week ending 10 January (published last week) jumped 33%, the highest since March 2020. We'll see whether markets have the will take 10-year Treasury yields back to 4.50%, which can add to the dollar's soft momentum. Our rates team remains bearish on UST beyond the very near term, and that fits our view that the dollar can withstand temporary positioning squeezes.

Francesco Pesole

EUR: 1.050 would be stretch

For a second day in a row, EUR/USD got support from a dollar decline but fell short of the 1.0440 mark. There still seems to be some resistance to take the pair back to the 1.0450-1.050 mark, which would close the gap with its short-term fair value, that we currently estimate at 1.0580. In fact, 1.050 would mark a shift to essentially pricing out most of the Trump tariff risk on the eurozone. That is probably premature.

On domestic eurozone news, a number of European Central Bank members are speaking in Davos, including President Christine Lagarde, Francois Villeroy, Klaas Knot and Olli Rehn. Yesterday, Bundesbank governor Joachim Nagel confirmed the ECB should cut rates by 25bp next week and reiterated the widely shared view that more cuts can follow. He is generally considered among the most hawkish Governing Council members, and that was another signal there is no resistance left to the dovish front.

We expect today's comments to follow the same line and markets to consolidate their expectations for four rate cuts by the ECB this year.

Francesco Pesole

NZD: Inflation data paves the way for half-point cut

New Zealand released fourth quarter inflation figures overnight. Headline CPI was flat at 2.2% versus expectations for 2.1%, while the closely monitored non-tradable index slowed slightly faster than expected from 4.9% to 4.5%, the lowest level since the fourth quarter of 2021 and 0.2% below the Reserve Bank of New Zealand's November projections.

This set of figures paves the way for a 50bp RBNZ cut at the 19 February meeting, which markets are now fully pricing in. We expect that 50bp move to be followed by at least two more 25bp cuts to take rates to 3.25%, as the RBNZ is following the widespread shift in central banks to growth concerns and should be keen to frontload some easing.

In the short term, NZD/USD can find some support beyond the 0.570 mark as markets see the risks of US tariffs on China as tentatively lower. NZD was the biggest short in G10 according to latest CFTC positioning data, so the technical picture is supportive despite the recent rebound. Ultimately, Trump's trade agenda will determine how far NZD/USD can recover. From a domestic perspective, the RBNZ should give little support to its currency.

Francesco Pesole

CEE: Risk-on mood supports regional currencies

Today we will see the first data in the CEE region this week. In Poland, labour market and industrial production data for December will be published, and tomorrow we will see retail sales. December's set of real economy data should point to a continued, albeit gradual, recovery in the Polish economy. The year-on-year change in industrial production and retail sales is expected to be slightly stronger than in November amid a more favourable calendar (number of working days).

The EM market continues to rally after tariff headlines and switch to risk-on mode. CEE in particular had another good day yesterday, with the CZK outperforming its peers this time. EUR/CZK erased most of the gains after surprisingly low inflation last week and closed below 25.150, well below the Czech National Bank's forecast. We could hear from central bankers later this week ahead of the start of the blackout period on Thursday next week. We expect a dovish tone due to lower inflation, which should again push EUR/CZK higher. The current low levels could be attractive to the market ahead of the CNB meeting in February, where we expect a rate cut. Still, valuations point to a higher EUR/CZK around 25.350-400. We therefore see the current move as noise from the global environment and remain negative on the CZK.

EUR/PLN successfully closed yesterday below the key 4.250 level. Contrary to the CNB story, National Bank of Poland hawkishness should keep PLN supported as we discussed here earlier. While we also still see some dispersion between rates and FX here, we see current levels more fair compared to EUR/CZK. On the other hand, for a bigger move further down we would likely need to see more hawkish repricing in the rates market. Meanwhile, the market has resisted outpricing more cuts after the NBP press conference last week.

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