

FX Daily: Unwinding the spurious dollar rally

The dollar strengthened across the board yesterday with no clear catalyst. We suspect that in an environment that keeps pricing large Fed cuts, USD rallies aren't very sustainable. We'll be awaiting the next leap higher in short-term USD rates to endorse a dollar rebound. Today, the focus is on PMIs and the Bank of Canada, which may disappoint dovish bets



⬇️ USD: Sticky Fed cut bets hinder USD rebound

The dollar rebounded sharply yesterday as the risk-on mood generated by Beijing's reported stock support package evaporated during London trading hours. The Hang Seng is having another good day today, even though Beijing's measures appear an emergency and temporary solution, more a symptomatic treatment rather than addressing fundamental economic concerns.

European and US equities failed to follow the Hang Seng's gains yesterday but also showed broad resilience. The rise in US rates did not look large enough to justify the rotation from European FX (EUR and GBP) back into the dollar. In all, we admit the dollar jump was quite surprising, and without a clear catalyst, and therefore see room for the dollar correction initiated overnight to

extend today.

One dynamic to keep an eye on – however – is the impact on markets of US Republican Primaries. The underperformance of the Mexican peso since the start of the week may be indicating markets are pricing in a larger chance of Donald Trump winning the presidency after Ron DeSantis endorsed him. Trump won the New Hampshire primary yesterday, securing 55% of votes and casting serious doubt on the future of Nikki Haley's campaign. It all seems rather premature, but Banxico is also on the brink of a rate cutting cycle – [as discussed here by our rates team](#) – which can compound to keeping the peso soft. This should not translate into a one-way direction for the peso though, we still expect to see high demand in the dips, not least due to the preserved carry attractiveness and our view of a US dollar decline.

Today, the focus will be on S&P Global PMIs across developed countries. Markets have become gradually more sensitive to this US survey, even though the ISM remains the main reference. Expectations are for a tiny decline in manufacturing PMIs (already in contraction area) and a stabilisation in services. We don't have a strong bearish view on the dollar in the short-term, but yesterday's moves did appear overdone in an environment where Fed funds futures still price in 130/140bp of cuts this year. We'll be more convinced of the sustainability of a near-term dollar rebound once short-term Treasury yields take another leap higher (two-year rates are down nearly 10bp since yesterday). Revamped rate hike bets in Japan are pushing USD/JPY lower this morning, favouring a broader dollar correction which could have legs today.

Francesco Pesole

EUR: A new PMI test

EUR/USD is around 1.0% cheaper compared to its short-term financial fair value at current levels. Normally, only deviations beyond the 1.5 standard deviation band (+/- 1.5% for EUR/USD) are followed by rapid convergences to the fair value. However, we believe the dollar rallied a bit too far yesterday, and there is some room for EUR/USD to tick back above 1.0900 into tomorrow's European Central Bank announcement ([here is our preview](#)).

At the same time, much of today's price action in the pair will depend on PMIs. French and German figures are published ahead of the eurozone-wide numbers this morning. Expectations are modestly optimistic, with the eurozone composite PMIs seen rising from 47.6 to 48.0, led by marginal gains in both services and manufacturing.

PMIs are often assessed in comparison with other countries. In the case of the eurozone, against the US and the UK. The consensus for UK PMIs is for a flat 52.1 (composite) reading. Barring a material surprise in the eurozone print, the lingering divergence between contractionary (EZ) and expansionary (UK) PMIs will keep EUR/GBP pressured today.

Francesco Pesole

CAD: BoC to make dovish shift more gradually than the Fed

The Bank of Canada announces monetary policy today and will almost surely keep rates on hold. As discussed in our [BoC preview](#), the focus is on whether the Bank is ready to deliver a Fed-like dovish pivot.

We think it may be too early for a radical shift in the policy message. December's core inflation

figures were hotter than expected, with the trim measure rising from 3.5% to 3.7% and the median measure holding at a revised 3.6%. That may well be enough to outweigh concerns about a cooling off in the jobs market: full-time employment declined by 25k in December.

While the hawkish bias should be softened and the discussion on rate cuts opened, we think the BoC will fall short of the dovish stance expressed by the Federal Reserve in December. Expect the policy message to include concerns about the path of inflation and readiness to keep policy restrictive for longer if necessary. Markets are pricing in around 110bp of easing by the BoC in the next 12 months: we suspect today's meeting will fail to endorse those expectations, and CAD can find some moderate support. Still, we expect USD/CAD to find good demand below the 1.34 mark.

Francesco Pesole

NZD: Non-tradeable inflation offers RBNZ a hawkish "loophole"

New Zealand's inflation matched estimates at 0.5% quarter-on-quarter and 4.7% YoY in the 4Q print published overnight. This is a touch higher than our forecast (4.6%), but well below the 5.0% projected by the Reserve Bank of New Zealand for the period. However, non-tradeable CPI did come in hotter than expected at 1.1% QoQ, which has led to a move higher in short-term NZD rates. In FX, NZD/USD broke back above 0.6100 on the release, even though it quickly defaulted to being traded by external factors.

The stronger non-tradeable CPI may offer an excuse for the RBNZ to stick to some hawkish narrative on 28 February, although they will need to admit that general inflation pressures have declined and the economy underperformed, making any promise of higher-for-longer a harder sell to markets.

The next key release in New Zealand is the 4Q jobs report on 6 February. Until then, expect volatile Chinese sentiment and USD dynamics to drive NZD performance. Even in the case of an RBNZ dovish shift, we like the chances of a higher NZD/USD beyond the short term as the Kiwi dollar benefits from a broader USD decline and Fed rate cuts. Our year-end target is 0.64.

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