FX Daily: US inflation concerns return

The dollar is receiving some fresh support from data, particularly from the spike in the ISM services prices paid sub-index in December. Should we see a re-focus of the Fed on inflation concerns, the dollar could enjoy a new rally on the back of continued Treasuries softness. Today, the key highlights are the FOMC minutes, ADP payrolls and a speech by Chris Waller

USD: Re-strengthening

Markets have been tempted in the past couple of days to believe there is some truth behind the *Washington Post's* report – quickly rebuked by Trump – that US tariffs will be only on selected products. We are also looking with interest at the timeline for the US Congress' plan to pass a three-in-one bill for taxes, border and energy. Speaker Mike Johnson has set a rather ambitious April deadline, and that could suggest the new administration will have to focus efforts on domestic policies and at least delay a large-scale protectionism programme. Remember that in his first term, Trump waited for the fiscal stimulus to go through before embarking on his protectionism campaign.

For now, markets have been left guessing on tariffs, which allowed the US macro story to take over and unmistakenly offer support to the dollar. Yesterday's US data releases were hawkish for the

Fed, and the implied probability of a March rate cut has now dropped below 40%. Treasuries had another soft session yesterday, and stocks slipped, adding support to the safe-haven dollar.

Aside from the stronger-than-expected JOLTS job market opening and the headline ISM services index, the most remarkable print was the ISM prices paid subcomponent, which spiked to the highest level since January 2023. If a generally resilient economy was already accounted for when the Fed met in December, a resurgence in inflation concerns could drive an even further hawkish tuning in the policy message.

The details of December's FOMC will be released in today's minutes, which could throw a bit more support behind the dollar. Expect also some reaction to the ADP payrolls, even if they seldom predict official payrolls. Maybe more importantly, there is a planned speech by Chris Waller at 1400 CET: let's see if he joins other members in flagging lingering inflation risks.

We could see opposing forces on the dollar today, as the technical/positioning picture still points to correction risk, but the Fed/macro picture may well continue to attract dollar bulls. We could see a consolidation just below the 109.0 mark in DXY.

Francesco Pesole

EUR: Still embedding some risk premium

Eurozone inflation re-accelerated from 2.2% to 2.4% in December, a largely base-effect-driven move that was fully expected. The core rate was unchanged at 2.7%. The ECB's survey of inflation expectations showed a significant rebound from 2.1% to 2.4% for three years ahead, but we doubt any of yesterday's numbers will be enough to make the ECB tweak its dovish narrative at this stage. Markets agree and are still pricing in four cuts this year.

Our short-term fair value model still returns a 1.3-1.5% risk premium in EUR/USD, which is above the 1.5 standard deviation and in theory a buy signal. But as discussed in the USD section above, the strong US macro story is fighting technical short-term bullish factors on the pair. Incidentally, markets won't necessarily need to completely close that risk premium anytime soon, as part of it is still generally justified by downside risks to the eurozone on the back of Trump's protectionism threats.

There is only a speech by French central bank governor Villeroy to watch in the eurozone calendar today. EUR/USD may find decent support at 1.0300 for now.

Francesco Pesole

SEK: Slower inflation consolidates case for cuts

Sweden's inflation figures released this morning came in less hot than expected, with headline CPIF slowing down to 1.5% and the key core measure (CPIF excluding energy) decelerating from 2.4% to 2.1% in December.

That further endorses our view that the Riksbank will take rates to the 2.0% mark with two back-to-back 25bp reductions on 29 January and 20 March. Markets are broadly pricing in a similar scenario, meaning the impact on the currency should not be material. Three-month historical volatility on EUR/SEK has plummeted of late and is at the lowest since 2021, a quite welcome development for the Riksbank which is likely to tolerate the pair trading around 11.50 while still flagging the krona's rebound potential.

Sweden's sounder economic prospects compared to the eurozone means that in the event of Trump's tariff threat materialising, the Riksbank should not have to cut rates as much as the ECB. That explains our view of a stable or modestly lower EUR/SEK in the 11.30-11.50 range for most of this year.

Francesco Pesole

CEE: No interest in catching up with US dollar

Like yesterday, the calendar in the CEE region is empty and we will have to wait for Thursday and Friday for the first releases this week. Poland opened yesterday after the holidays and today we will see the return of Romania. PLN rates did not catch up with the previous sell-off in CEE rates in the previous days and some upward momentum was given by core rates only at the end of trading. The rates differential remained lower and EUR/PLN returned to the 4.260-280 range as we discussed here yesterday.

For now, EUR/PLN and EUR/CZK seem to have no intention of catching up with the EUR/USD slide from late last year and in recent days. We are thus becoming more convinced that the focus will remain on the local story regardless of the global context. Rates and monetary policy play a major role for now and a hawkish shift by both central banks will keep currencies supported going forward.

We still believe the risk on CNB is now on the dovish side versus market pricing and any hint of a return to rate cuts by the central bank should lead to a weakening of the CZK. In Poland, the situation seems more balanced from a market pricing perspective, which may be more hawkish from current levels in our view. Therefore, EUR/PLN may retest 4.250 soon with the NBP meeting next week, where the governor may confirm the hawkish view presented in December.

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