FX weekly: Dollar powers ahead on heightened chance of Fed pause

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Last week's better than expected US December jobs data, highest print in nine months drove the dollar and rates higher across the board. This feeds into the narrative of US exceptionalism and has now pared back expectations of the Fed's easing cycle to barely one 25bp rate cut this year (post Sept'25). Lack of synergy in Trumps promises may drive "economics to trump politics" eventually and is evident from recent media reports as his economic team is said to be discussing about ramping up tariffs to avoid an inflation spike, with one scenario involving a gradual increase by about 2% to 5% a month. Also, as per Wall Street Journal report, Trump is preparing executive orders aimed at boosting American fossil fuels and undoing his predecessor's push for the US to adopt electric vehicles.

Trump 2.0 is likely to be positive for both Dollar and US rates. US10Y has jumped c.120bps since 18th September'24, while Fed has cut rates by 100bps and is slowly inching towards 5% mark on prospect of lingering inflation and widening fiscal deficit. Shift in expectations of Fed policy path that the neutral rate to remain higher has led to the US10Y term premium to move higher and may continue to do so this year (fig3).

As per our last FX weekly, we have stated that US Dollar rally has more legs in near term the same trend continued last week while Euro, JPY and INR remained weak and the pair have respected the levels as stated in our report.

The US calendar this week looks unlikely to challenge the dollar strength narrative. The key data to watch out is US CPI data for December. The month on month readings is likely to be 0.3% in both, and this would mark the fifth consecutive month of a 0.3% MoM reading on core CPI. The key themes for this week.

Our key views for 2025

FX Crosses	View in 2025	Key Risk for FX crosses
EURUSD	↓	Trump less agrresive on trade tariffs towards Eurozone
GBPUSD	→	UK economy detoriates to put pressure on BoE to cut aggresively
USDJPY	↓	BoJ maintain its Dovish tone
USDINR	↑	FII inflows
USDCNY	↑	PBoC intervenes in its FX markets

Key Themes:

- ♣ **US jobs report heightens chances of a Fed pause this year**
- ♣ **US dollar gains adds to pressure on BoJ to hike rates**
- ♣ **Euro continues to remain weak while inflation in eurozone picks up mildly**
- ♣ **Pound extends it loses as soaring UK yields weigh on economic outlook**
- ♣ **Rupee's breaks 86/$ handle amid strong DXY after US NFP data print**

US jobs report heightens chances of a Fed pause this year

Strong US jobs report backs Fed rate cut pause

The US Dollar index (DXY) for the week rose by c.0.64% and is likely to remain volatile till Trump resumes his office on 20th January a key risk event to watch out for this month. ***The widening monetary policy differential acts in favour of the USD. Also risks of Trump signing off trade tariffs post 20th January will likely keep the USD bid in the near term.*** In this regard the recent comment's that his economic team is discussing of ramping up the tariff to avoid spike in inflation may sooth market sentiment and market volatility.

The highlight of last week was the December US jobs data which closed the year with a strong gain. The US jobs report shows payrolls rose by 256k in December versus the 165k consensus figure. Revisions to the past two months were -8k. The unemployment rate has fallen to 4.1% from 4.2% – the consensus was for it to hold at 4.2%. Wage growth was 0.3% mom with the YoY rate slowing to 3.9% from 4%.

As stated above on Sept. 17 2024, the yield on US10Y was 3.65%. The next day, the FOMC announced that it was reducing the federal funds rate by 50 bps, the first rate cut by the central bank since 2020. Since then, the FOMC has cut the fed funds rate by 100 bps, but the 10-year Treasury yield is roughly 120 bps higher at c.4.80%. ***In 2025 if inflation remains sticky, growth continues to surge and/or fiscal policy remains loose then a 5% yield on 10-year US Treasuries is certainly within the realm of possibility.*** The uncertainty over Trumps' policies and US exceptionalism to continue this year as strong macro data continue to led markets to pare back Fed rate cuts this year. In January 29 FOMC meet no change decision from the Fed looks highly possible, while the market is pricing less than 3% probability of a 25bp rate cut and the risk of an extended pause has increased with the market no longer fully discounting a rate cut until September.

The key US data this week will be CPI inflation (15 Jan) and retail sales (16 Jan) of which sticky inflation and robust retail sales are likely to expectations for a prolonged Fed pause. There are several Fed officials speaking this week ahead of the FOMC blackout period starting Sat (18 Jan).

US dollar gains adds to pressure on BoJ to hike rates

Upward momentum for USD/JPY slows as the pair moves closer to 160.00-level

The only currency withstanding the dollar strength last week was the Japanese yen recording 0.26% appreciation. The threat of MoF FX intervention in the 158.50/160.50 area plus the chances of a BoJ 25bp rate hike on 24 January now priced at 49% are providing the yen with some support. In our last published weekly report, we highlighted that USDJPY pair to move within 154.00 to 160.50 range the same has been evident in last week movement while we expect the pair to move in same range even this week.

Last week, Japan's Economy Minister Ryosei Akazawa noted that the economy is at a "critical stage" in overcoming the public's deflationary mindset, but did not provide a clear timeline for when the BOJ might act. The next BoJ meeting, scheduled for 24 January, will take place just four days after Trump joins the office. Japan's 40-year government bond yield reached an all-time high, amid a global bond selloff and speculation that the Bank of Japan will hike interest rates soon. The yield rose as much as 3 bps to 2.755%, the highest since 2007. Overnight index swaps are pricing in a 60% chance of a rate hike at next week's meeting, and 83% by March. That compares with about 46% and 79% odds respectively a week earlier. Yen traders will be watching Bank of Japan policy expectations, U.S. inflation data and the Trump administration as it takes shape.

Euro continues to remain weak while inflation in eurozone picks up mildly

Last week the EUR/USD pair declined and traded in a range of 1.0214 and 1.0437 before closing the session lower at 1.0244. As highlighted in our last weekly report we expected the pair to remain weak and get support around the 1.0215 mark the same has been evident last week the pair made a low of 1.0214 levels and has taken support at this level.

Eurozone inflation picks up slightly while 25bps rate cut by ECB in January to keep Euro weak

In December, Eurozone CPI inflation came in as expected, with the headline rate rising to 2.4% YoY and core inflation remaining steady at 2.7%, same as November. Services inflation, important to ECB policymakers, increased to 4.0%. While these readings show some acceleration in price growth, the overall outlook supports the expectation of gradual ECB rate cuts in 2025. This is due to a weaker growth environment in the region and inflation continuing its return to the 2% target.

ECB's Lane highlighted deed to ensure interest rates follow a middle path; he don't want rates to remain too high for too long while inflation pressure to continue to ease this year. Furthermore, the central banker pointed out that there are many concerns regarding geopolitical developments, adding that the European Union Europe should not be unprepared for a trade war if Donald Trump's intention to impose import tariffs comes to fruition.

The ECB monetary policy on 30th January will be key event to watch out for this month where the market expects the central bank to cut its policy rate by 25bps for which the probability stands at 90% at the current juncture and a total of 92 bps cut this year. Technically we expect EURUSD to trade in the range of 1.0125 to 1.0325 in near term.

Pound extends it loses as soaring UK yields weigh on economic outlook

Rate cut probability by BoE currently stands at 68% in its Feb meeting

The GBP has weakened sharply over the last couple of trading days resulting in cable to touch 1.2200 level. The main trigger has heightened investor concerns over the ongoing sell-off in the Gilt market. Yields on 10-year and 30-year Gilts have risen to their highest levels since July 2008 and July 1998 respectively while yields have increased by c.60 to 65bps respectively since the end of November. The pound continues to sell off as rising borrowing costs for the UK government could force the administration to cut public spending. Sterling remains weak and could continue to decline this week, with 15th Jan being a key day due to the release of December's UK CPI data. Regardless of the outcome, sterling may face pressure. Persistent inflation could signal trouble for the BoE's policy and the UK gilt market. On the other hand, a softer CPI number could lead to a drop in short-term GBP interest rates as markets anticipate more BoE easing. In either case, sterling may continue to struggle.

Rupee's breaks 86/$ handle amid strong DXY after US NFP data print

The rupee slipped around c.0.40% after the robust US NFP data print on first Friday of 2025; which dragged the major global FX peers and INR to a record closing low at 86.64/$ pressured by a strong Dollar and decline in the Chinese Yuan past 7.36 levels, and logged a 10th consecutive weekly losses. However, the domestic currency was largely protected near to all-time lows levels of 86.71/$ (14th Jan'25). Dollar has maintained an upward bias on US exceptionalism and uncertainty over Trump's policies. This in turn has strengthened Dollar and all the major global currencies took a hit.

Rupee depreciating trend continues for 10th straight week

In Nov'24, when most of the major global-market currencies depreciated against Dollar, Rupee has relatively been less affected among the Asian peers and depreciated marginally until US elections outcome. But, in Dec'24 rupee sell-off gained momentum which was mostly due to the change in reign in the central bank. The depreciation trend continues in jan'25 which shows INR took a major hit and was the worst performing currencies among Asian peers but largely better than compared to the global major FX peers. ***The rupee came under further pressure after media reported RBI Governor Sanjay Malhotra indicated an openness to a more flexible rupee***.

INR closely tracking weakening CNY after it breaches crucial 7.36/$ levels

REER has seen an overvaluation bias (108.14 in Nov'24 up from 107.20 in Oct'24 versus 5-yr. avg. of 103.94 levels) reflecting pending depreciation pressure in the currency pair. Since the currency has depreciated by 2.25% since end November already, we believe the FX overvaluation has reduced yet some further weakening pressure might still persist looking at REER levels.

REER overvaluation to reduce after major depreciation already hit

The local currency sentiment was weak after the dismal trade data shocker for Nov'24; though it was revised later to $31.83bln, where Gold was adjusted to $9.84bln vis-à-vis $14.86bln. However, the latest trade numbers for Dec'24 show sharp narrowing to $21.94bln. Despite this, our analysis shows that BoP dynamics stayed under pressure in December at $9.89. FYTD25 Balance of Payment (BoP) is tracking **negative c.$12.89bln** (Q1: $6.37bln, Q2: $27.65bln, Q3: -$42.27bln & Q4: -$4.64) with sharp loss in BoP seen in Q3:FY25. Historically, there is a close correlation between FX reserves (adjusted for valuation effects) and BoP. Additionally, spot FX reserves are at a near 8-month low to $634.59bln for the week ended 03rd Jan'25, though it is down by $70.30bln from all-time highs of $704.86 ($46.91bln fall was adjusted after valuation effects). This shows central bank has persisted with its efforts to curb FX volatility. (Refer our report: 2025: A year to stay "nimble and humble" amid global volatility)

Revised Trade deficit numbers to recalibrate the BoP numbers annually

BoP tracking negative even in Q4:FY25

FX reserves at 8-month low

FPIs net withdrew $11.12bln (highest in a decade) in Oct'24, while outflows moderated to $2.56bln in Nov'24. In equity segment flows turned positive in Dec'24 to $2.37bln but turned negative again in Jan'25 to $2587mln. However, on a WoW basis equity markets outflows have surged to the tune of $2086.45mln vis-à-vis outflows of $644.55mln a week ago. Also, the debt segment has turned negative; outflows to the tune of $999.02mln vis-à-vis of $809.89mln from the previous week. Moreover, the FAR related flows have turned negative as well to $188mln in Jan'25 vis-à-vis inflow of $1136mln in Dec'24. Going forward, Dollar inflows are also expected from Jan'24 on inclusion of India FAR bonds in the Bloomberg Emerging Market (EM) Local Currency Government Index and related indices, starting 31st Jan'25.

FPIs turned negative in Jan'25 again

Another key factor that gave a negative effect to Rupee moves was the outburst in oil prices (touched a high of $81.68/bbl on 13th Jan'25; levels last seen in Aug'24) as U.S. under the Biden administration imposed fresh sanctions to squeeze Russia's Energy Sector will be impacting India's oil trade deficit to a great extent - Sensitivity of C/A deficit to oil prices stays high with every $10/b move in oil price affecting annual C/A balance by close to $15bln.

As per media sources, the premium on the dollar/rupee forward contracts fell across most tenures as major PSBs are likely to have sold forward dollars for maturity in March. June & December. These Buy-Sell swaps are used to replenish liquidity, as the net liquidity conditions have deteriorated sharply in recent weeks (₹ 209,199 crore/- as on 14th Jan'25).

Based on the current global scenario, volatility to reign on uncertainties till Trump joins White House on 20th Jan'25 and thereafter we can expect cooling down. The Dollar Rupee pair has respected our previous technical levels where the short-term objective of 86.50 is done and now technically we feel INR should take support of 86.20 followed by 85.90 levels and will find resistance around 86.80, breach of which will test 87.20 levels. However, going forward, we closely watch for a scenario of possible overshoot in DXY, probably a breach of current technical level. (Refer our weekly report: [FX weekly: US payroll will be in focus ahead of 20thJanuary key event risk])

Key Market movers *(Fig 1)*

FX Performance

FX Pair	3M % Change	6M % Change	MTD % Change	YTD % Change
EURUSD	-5.84	-5.87	-0.96	-0.96
GBPUSD	-6.5	-5.81	-2.4	-2.4
AUDUSD	-7.5	-8.3	0.08	0.08
NZDUSD	-7.6	-7.4	0.41	0.41
USDJPY	5.56	-0.54	0.41	0.41
USDCHF	6.24	2.19	0.88	0.87
USDCAD	4.38	5.08	-0.02	-0.02
DXY	6.05	3.99	0.95	0.95
USDCNY	3.69	0.69	0.28	0.28
USDINR	3	3.61	1.19	1.19

Government Bond

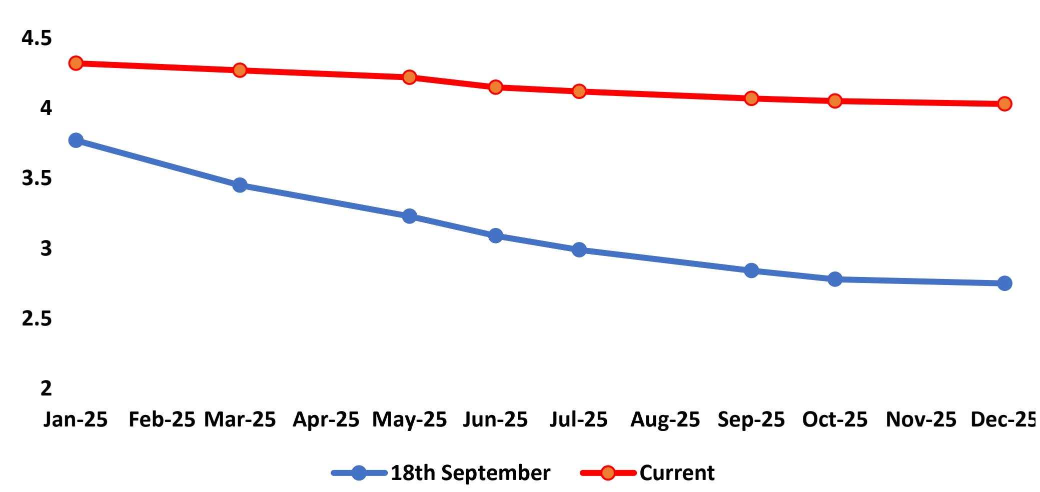
	1M Change BPS	3M Change BPS	YTD Change
10Y US Treasury	34	71	17
10Y JP JGB	16	26	15
10Y DE Bund	33	34	30
10Y UK	36	72	109

Commodity Price Performance

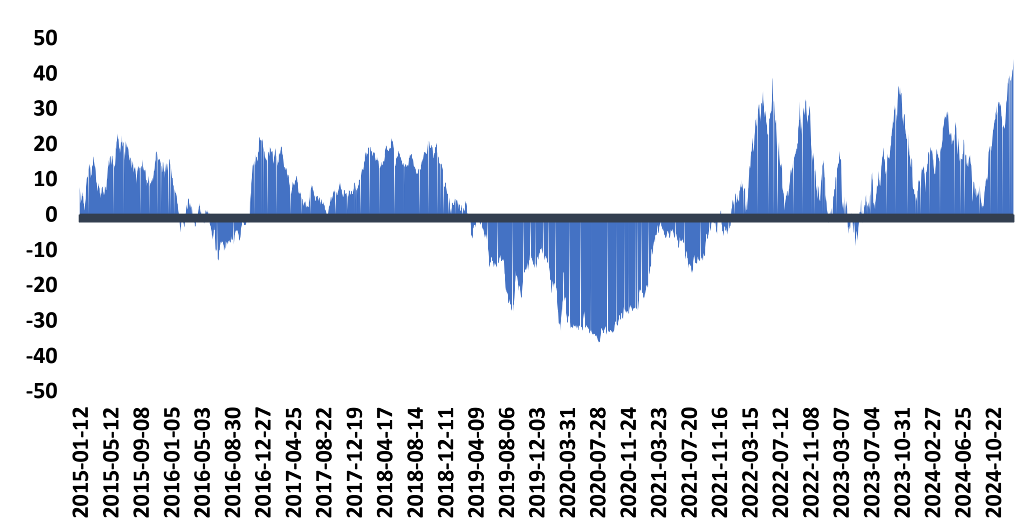
	MTD % Change	3M % Change	YTD % Change
WTI Crude	11.47	10.25	8.97
Gold	0.48	0.65	1.66
Silver	-2.16	-3.28	3.69
Copper	3.2	-1.52	7.78

Source: Bloomberg, Reuters, UBI research

Pricing of FED rate cut has gone up since Jumbo rate cut (50bps) on 18th September *(Fig 2)*

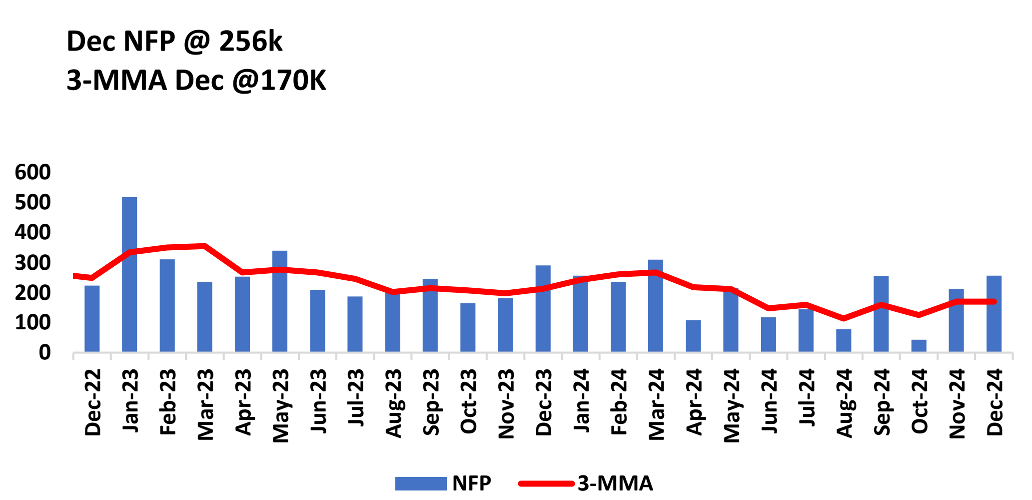


US 10Y Term Premium highest since 2015 (Model based) *(Fig 3)*

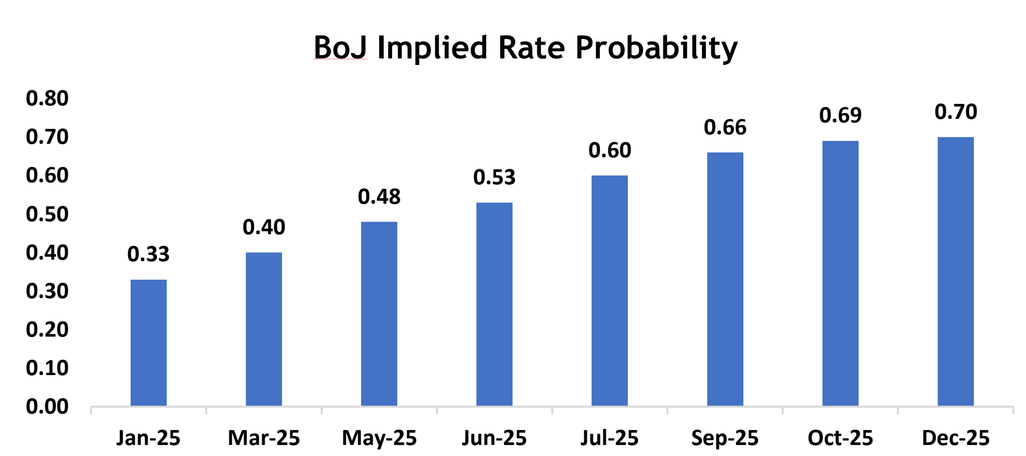


Source: Bloomberg, Reuters, Fred.stlouisfed.org, UBI research

December NFP data has pared back rate cut by Fed in 2025 *(Fig 4)*

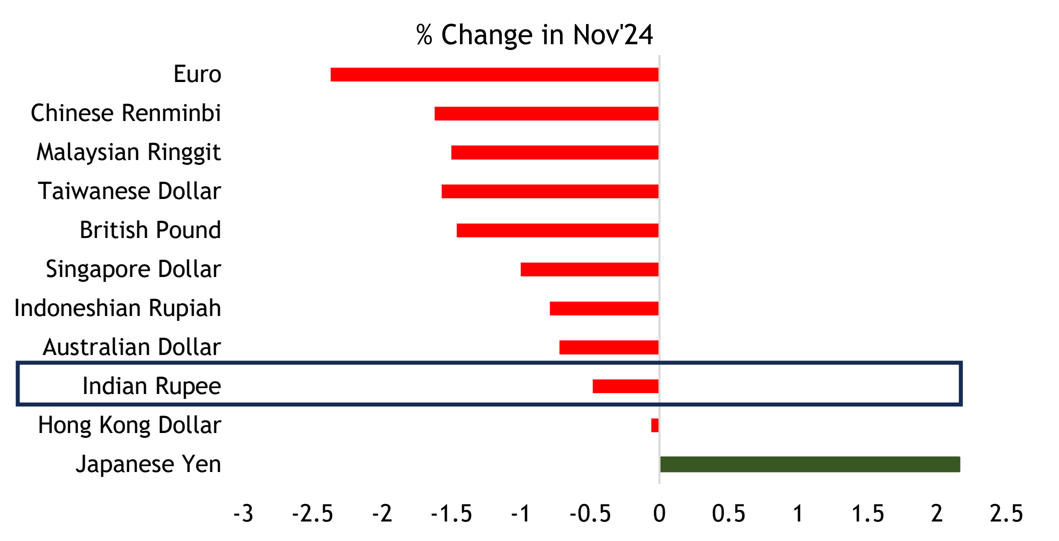


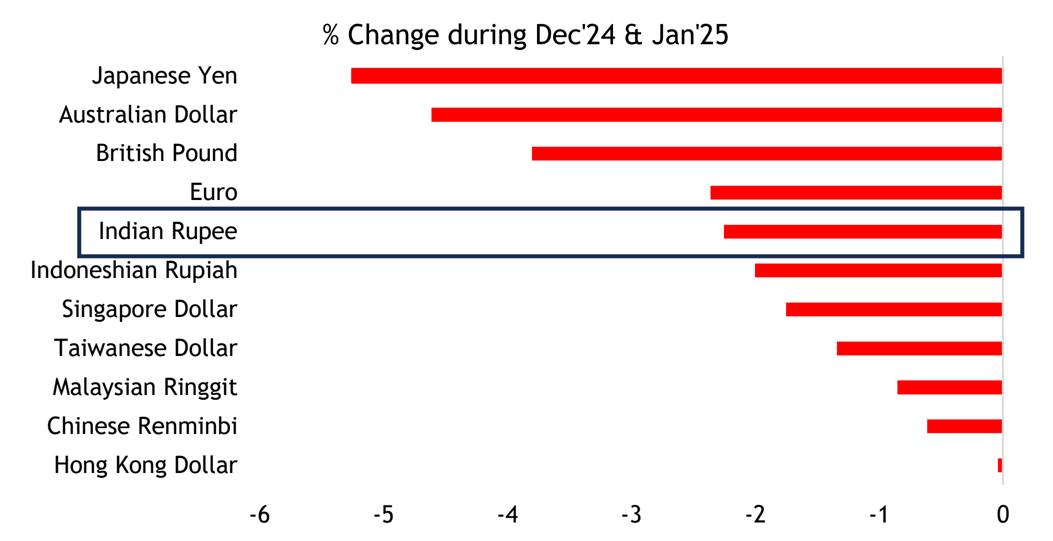
Markets expect BoJ to hike rates by 50bps in 2025 *(Fig 5)*



Source: Bloomberg, Reuters, UBI research

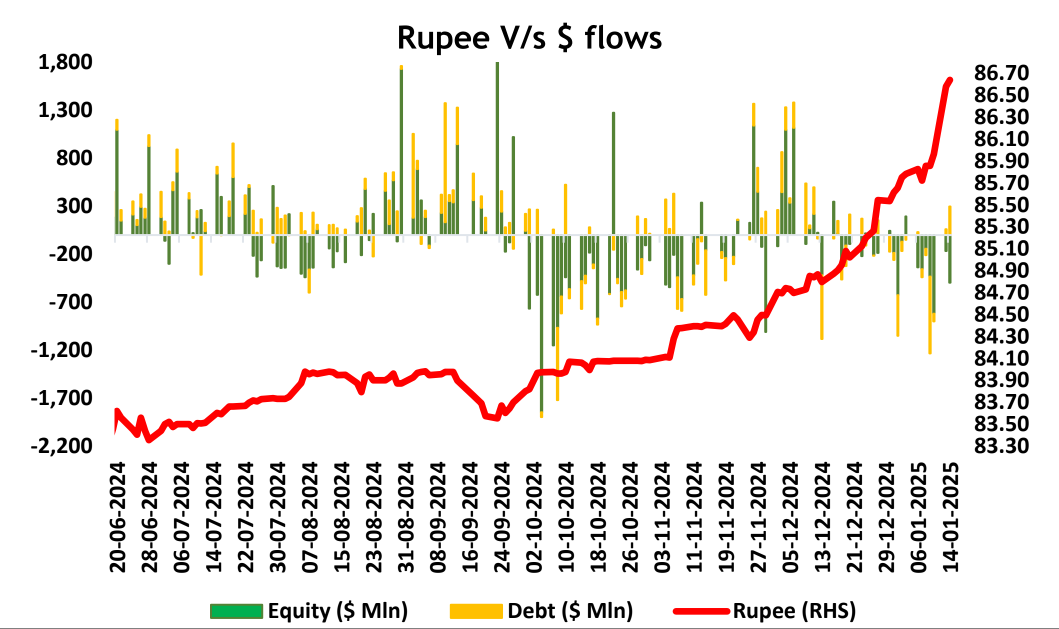
After US election INR showing strong resilience *(Fig 6)*	INR selloff gained momentum in Dec'24 & continued in Jan'25 *(Fig 7)*

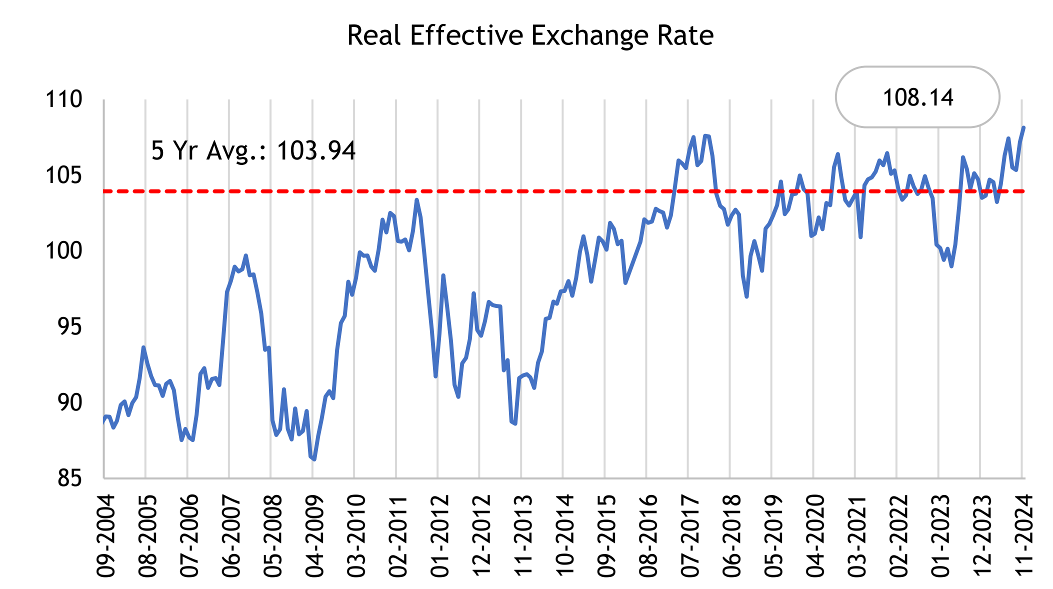




Source: Bloomberg, Reuters, UBI Research

Rupee seen sharp depreciation pressure after US NFP data *(Fig 8)*	REER is expected to contract now to near the 5 yr avg. *(Fig 9)*





Source: Bloomberg, Reuters, UBI Research

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