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

*Expect heightened volatility and more headline driven moves as markets await the next update from Trump administration*

*Fomc pause to keep supporting US dollar but trade tariffs hold key*

*After cutting rates at the past three meeting, the Fed may have reached a plateau*

Last week there were two major events which took place the first was Fomc meet which ended on expected lines as Fomc members unanimously left the Fed funds rate at 4.25-4.5%. The second event came over weekend where Trump administration fired the first shot of potential trade war as he announced that US will impose a 25% tariff on goods imported from Canada & Mexico and 10% on Chinese goods effective from 4<sup>th</sup> Feb'25. While Canada and Mexico have announced their own retaliation plans, the response from China was more measured, as China's Ministry of Commerce responded by saying that it will file a claim with the WTO as well as take necessary countermeasures to safeguard its interest. But the tariff impose on Canada and Mexico was delayed by one month by Trump after talking with respective country heads. The DXY is up c.1% since this tariff announcement while tariffs on Eurozone may be in pipeline, if implemented Euro which makes up large part of DXY will continue its weakness thereby strengthening the US dollar.

The recent announcement by Chinese start-up DeepSeek of a more affordable AI model to rival US tech giants has shaken highly valued US tech stocks and has raised concerns that whether US exceptionalism can continue?

Going forward the Bank of England (BOE) is the only G7 central bank with a monetary policy decision this week on Thursday (6 Feb). Markets expect the BOE to cut rates by 25 bps at the Feb meeting, largely on the back of a weak economy. Also, markets will be alert to Trump's announcement on tariffs. The key themes for this week.

**Key Themes:**

- ♣ Trump administration uses trade tariffs as negotiation tool to implement his policies
- ♣ ECB signal more rate cut to come while US dollar strength continues to weigh of Euro
- ♣ China succeeds to achieve 5% growth in 2024; while trade tariff threat looms
- ♣ India Rupee goes past 87/dollar mark after Trump's tariff announcement

**Trump administration uses trade tariffs as negotiation tool to implement his policies**

The DXY continues its strength on the backdrop of Trump announcing trade tariffs on Canada, Mexico and China to be implemented from 4<sup>th</sup> Feb'25 and on worries that the global growth may be lower. The dollar index was seen approaching the 110.0 level mark highest since Nov'22. The US dollar surged has led to Canadian dollar (low made on Mar'2003) and Mexican peso touched to multi year low as both these nations are top two trading partners of US. In response, Canadian Prime Minister Justin Trudeau and Mexican President Claudia Sheinbaum announced immediately over weekend that they also ordered retaliatory tariffs against the US. As per [US census report](#) Mexico accounts for 15.4% of US total trade while Canada accounts for 13.8% of US total trade followed by China 11.3%. While Mexico and Canada's export to the US accounts for approximately 78% and 77% respectively which represent 20% to 30% of Canada and Mexico's GDP. But later Trump delayed the 25% tariff on Canada and Mexico by at least 30 days which led to US dollar pare back its gains.

The predominant theme for the USD continues to revolve around Trump's approach to tariffs while next in line may be Eurozone and BRICS countries.

*In our view, US Dollar's recent dominant performance relative to its major currency peers may continue in near term. While US exceptionalism is expected to be the primary source, monetary policy divergence is also likely to play a role. Also slowing growth in Asia & Europe relative to the US, adds to the fundamental headwinds for major currencies.*

The global yields have been rising since last year thus increasing the global cost of funds. In US as the economy continues to grow stronger Fed maintains its hawkish stance of higher for longer and uncertainty around government spending and how the U.S. Treasury is going to fund those deficits may keep the yields at elevated levels. While during this trade tariff drama the bond markets reaction was muted.

*US GDP grew slightly lower than in Q4'24 but the overall economic condition remains strong*

*Monetary divergence between ECB and US to persist this year*

#### **Powell emphasized on patience while rules out March rate cut**

This week's Fomc meet was on expected lines as the policy rate was left unchanged at 4.50% and there was no change in balance sheet guidance. The recent minor adjustments in statements, signals from the FOMC press conference suggest that the March meeting is unlikely to bring additional easing measures. On inflation, Fomc stated that "inflation remains somewhat elevated" instead of previously saying "inflation has made progress toward 2% target but remains somewhat elevated." On jobs, Fomc stated that "the unemployment rate has stabilized at a low level in recent months, and labor market conditions remain solid" versus previously saying "since earlier in the year, labor market conditions have generally eased, and the unemployment rate has moved up but remains low."

Trump recently called for immediate interest rate cuts, and suggested other countries should follow suit. However, the Fed's December forecast indicated two potential rate cuts this year, but they remain cautious due to a mix of policies that could support growth (like tax cuts and deregulation) and potentially increase inflation (like tariffs and immigration controls). With economic indicators like GDP growth of 2.8%, unemployment around 4%, and core inflation at 3%, the Fed is expected to hold off on any immediate changes, as confirmed by Powell's statement that there's no need to rush adjustments.

The US GDP growth slowed to 2.3% annualized rate in 4Q'24, from 3.1% in 3Q'24. As a result, US economy clocked an annual growth rate of 2.8% for FY24, continuing its strong overall growth rate after registering 2.9% in FY23. Growth in the final quarter of this year was supported by strong personal consumption which grew at a robust 4.2% in 4Q'24, rising further from 3.7% in 3Q'24.

#### **ECB signal more rate cut to come while US dollar strength continues to weigh of Euro**

As widely expected, the European Central Bank (ECB) made another set of 25 bps cuts each to its deposit rate to 2.75%. This is the 5th set of rates cut since the easing cycle started in Jun'24. While not committing to future rate cuts, European Central Bank President Christine Lagarde continued to warn that Eurozone economy "remains weak in the near term" and added that "greater friction in global trade could weigh in on Euro area growth". She added that "we are facing significant and probably rising uncertainty at the moment". While Lagarde refused to discuss the prospect of the ECB having to lower rates to below whatever that neutral rate may be. Referring to the "meeting-by-meeting" approach included in the statement. The ECB did announce that the ECB staff on 7th Feb'25 will release a report on an updated analysis of the estimated neutral rate.

The euro slumped to low of \$1.0141, hitting its lowest level in three weeks, dragged by a stronger U.S. dollar after Donald Trump announced trade tariff on Mexico, Canada and China and also threatened tariffs against European union. While the European union has also warned that they would respond firmly if tariffs are imposed on European union. As given the euro-zone's trade deficit with US, expectations of tariffs in Europe has risen. This would increase the prospect of EURUSD pair touching the parity levels.

#### **China succeeds to achieve 5% growth in 2024; while trade tariff threat looms**

The game of tariffs has begun along with Mexico and Canada, China has also been at receiving end where US imposed 10% tariffs on goods imported from China which accounts for 11.3% of total trade into US but later was postponed by at least 30 days by Trump administration. While the offshore yuan did plunge to 7.36 per dollar, hitting a record low. Markets in China are closed due to Lunar new year holiday and will reopen on 05<sup>th</sup> Feb'25. The China's finance ministry has stated that it will impose additional tariff of 15% on coal and liquified natural gas imports from the U.S. and 10% higher duties on crude oil, farm equipment and certain cars, starting Feb. 10. Although Trump had during his election campaign stated to impose tariff on China as high as 60% so any further news from that perspective will be closely watched.

Economic growth in China accelerated from 4.6% YoY in Q3'24 to 5.4% in Q4'24, with sequential growth rising from 0.9% QoQ in Q3 to 1.6% in Q4. This improvement was driven by the impact of ongoing stimulus measures, which helped stabilize the economy. Industrial production also remained strong which grew from 5.4% YoY in Nov'24 to 6.2% in Dec'24, leading to a full-year increase of 5.8% in 2024.

*USDINR climbs on renewed US dollar demand, eyes on Trump's response towards China's imposing tariff on US goods*

*Flight to safe haven FX puts pressure on India rupee*

Consumer prices declined slightly, with a YoY drop from 0.2% in November to 0.1% in December, but core CPI (excluding food and energy) rose from 0.1% YoY in September to 0.4% in December. The People's Bank of China (PBOC) is expected to continue its easing policy, using tools like interest rate cuts and reserve ratio reductions to ensure market liquidity. Both 2-year and 10-year CGB yields have already fallen from 2.21% following the announcement of stimulus policy in September to 1.60% levels of late. The central bank may favour exchange rate stability at this juncture. In this direction the regulators have temporarily halted the government bond buying program.

### **India Rupee plunges past 87/dollar mark after Trump's tariff announcement**

The Indian rupee weakened past 87 per USD mark for the first time ever on 3<sup>rd</sup> Feb'25, hitting a record low of 87.29, after US President Donald Trump levied tariffs on Canada, Mexico, and China over the weekend also plunge in Asian currencies and stocks added to the weakness. Additionally, persistent foreign institutional investors (FII's) outflows, and risk-off sentiment contributed to the INR's downside.

The Indian rupee has been on the depreciation path in the last few months due to factors domestic factors also such as widening trade deficit and India's sluggish growth in Q2FY25. After this tariff announcement the BRICS nation now awaits any further announcement regarding tariffs as Trump had already warned to implement 100% tariff on these nations which may continue to put pressure on the rupee.

The rupee weakness also continued in Jan'25 to c. 1.12% vis-à-vis c.1.06% in Dec'24. Last month the rupee came under selling pressure when [media reported](#) that the RBI governor Malhotra is open to more flexible rupee and will allow it to move freely in tandem with its local peers as against former RBI governor Das who favoured a very stable rupee against the US dollar.

As per the data released by RBI the central bank's aggregate negative position in FX forwards and futures hit \$68 billion in December. The last time its forward book was this big, whether positive or negative, was in March 2021.

While REER has seen an overvaluation, bias persists (107.20 in Dec'24 down from 108.13 in Nov'24 versus 5- yr. avg. of 103.99 levels) reflecting pending depreciation pressure in the currency pair. Pace of overvaluation has reduced in Dec vs Nov as Rupee move was relatively better aligned versus global peers. However, in Jan'25, the pace of fall in over-valuation would have increased as Rupee was one of the worst performing currencies amid global FX peers. (Ref fig 6,7,8)

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.\$24.32bln (Q1: \$6.37bln, Q2: \$27.65bln, Q3: -\$42.27bln & Q4 till date: -\$15.02bln) with sharp loss in BoP seen in Q3:FY25. Historically, there is a close correlation between FX reserves and BoP. Additionally, FX reserves halted its seven-week losing streak and rose by \$5.57 billion to \$629.56 for the week ending 24 Jan'25. This shows central bank has persisted with its efforts to curb FX volatility.

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 \$9.04bln. The debt segment has been positive; to the tune of \$38 million vis-à-vis inflows of \$1.27bln from the previous month. Moreover, the FAR related flows have turned flat as well to \$947mln in Jan'25 vis-à-vis inflow of \$1136mln in Dec'24.

Going forward while global factors are not entirely supportive for the rupee with the risk of tariffs from Trump 2.0 coupled with a more hawkish Fed. The Indian budget was an attempt to partly retrace growth led flows in the Indian economy via boost to demand (on income tax cuts) and development via focus on quality of spending with capex budget as percentage of GDP kept unchanged at 3.1% even as revenue spending brought down by 0.4% of GDP ([Refer to our report: FY'26 Budget](#)).

Local factors also point to a less benign growth-inflation trade-off for India, RBI monetary policy decision on 7<sup>th</sup> Feb'25 remains on watch with the RBI likely to initiate a shallow rate cut while rupee may react negatively, but in medium term growth supportive policy measures are likely to attract more capital flows and support rupee.

Technically USDINR may take support of 86.80 followed by 86.51 levels and will find resistance around 87.28 (all time high), breach of which will test 87.50 levels. However, going forward, we closely watch for a scenario of possible overshoot in DXY, probably a breach of current technical level.

**Key Market movers**

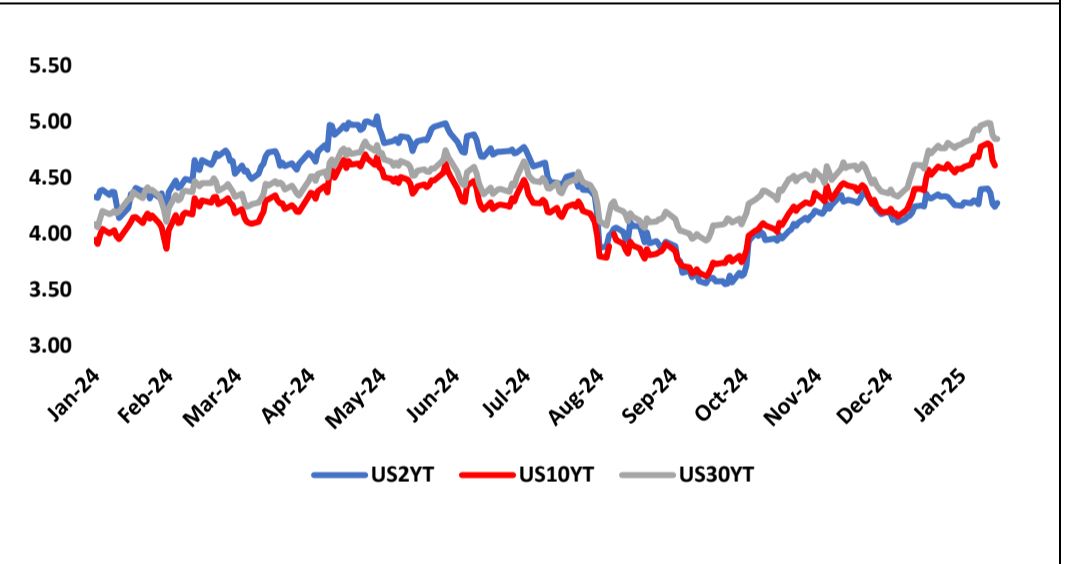
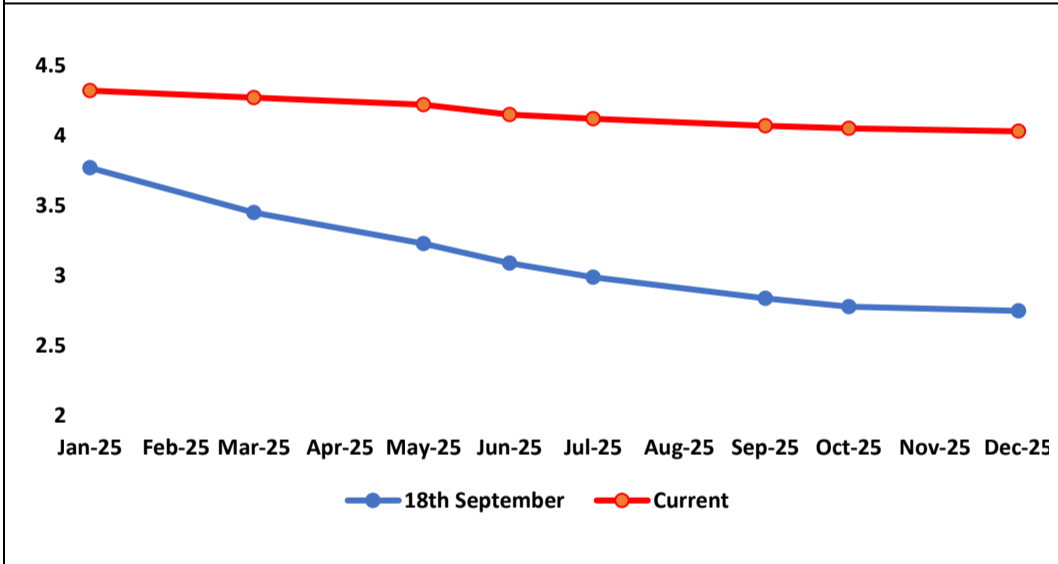
(Fig 1)

FX Performance					Government Bond			
FX Pair	3M % Change	6M % Change	MTD % Change	YTD % Change		1M Change BPS	3M Change BPS	YTD Change
EURUSD	-4.46	-3.94	0.43	0.43	10Y US Treasury	-9.1	25	-3
GBPUSD	-3.62	-3.31	-0.65	-0.65	10Y JP JGB	15	30	15
AUDUSD	-5.35	-4.79	0.65	0.65	10Y DE Bund	11	12	17
NZDUSD	-5.46	-5	1.02	1.01	10Y UK	-3	14	0
USDJPY	1.74	3.12	-1.4	-1.4				
USDCHF	5.36	3.67	0.3	0.3				
USDCAD	3.71	4.65	0.48	0.48				
USDCNY	1.87	0.43	-0.67	-0.67				
USDINR	3.05	3.5	1.25	1.25				

Source: Bloomberg, Reuters, UBI research

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

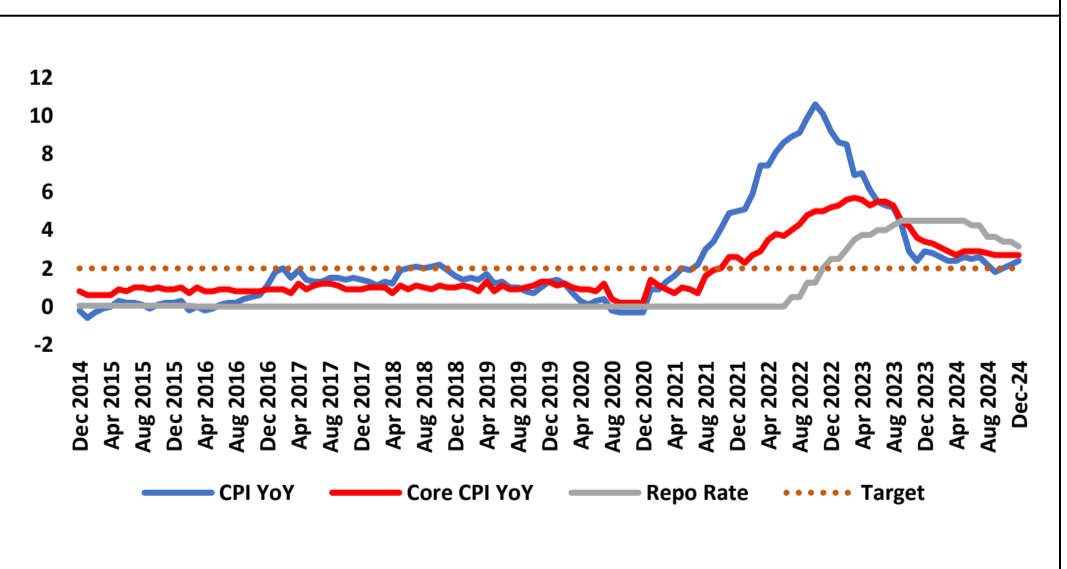
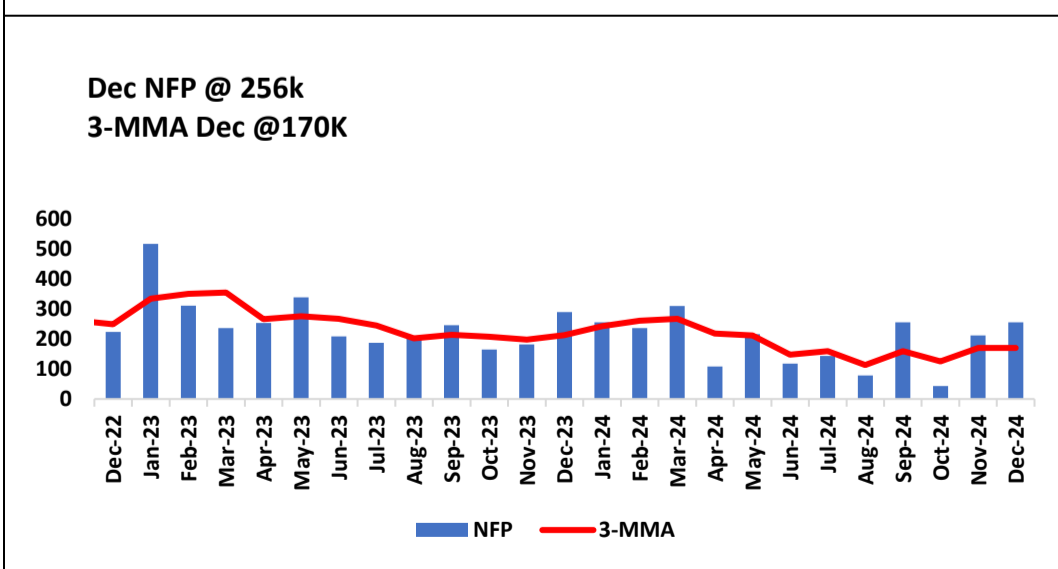
10Y yield has risen C. 100 bps since Sept 18th jumbo Fed rate cut (Fig 3)



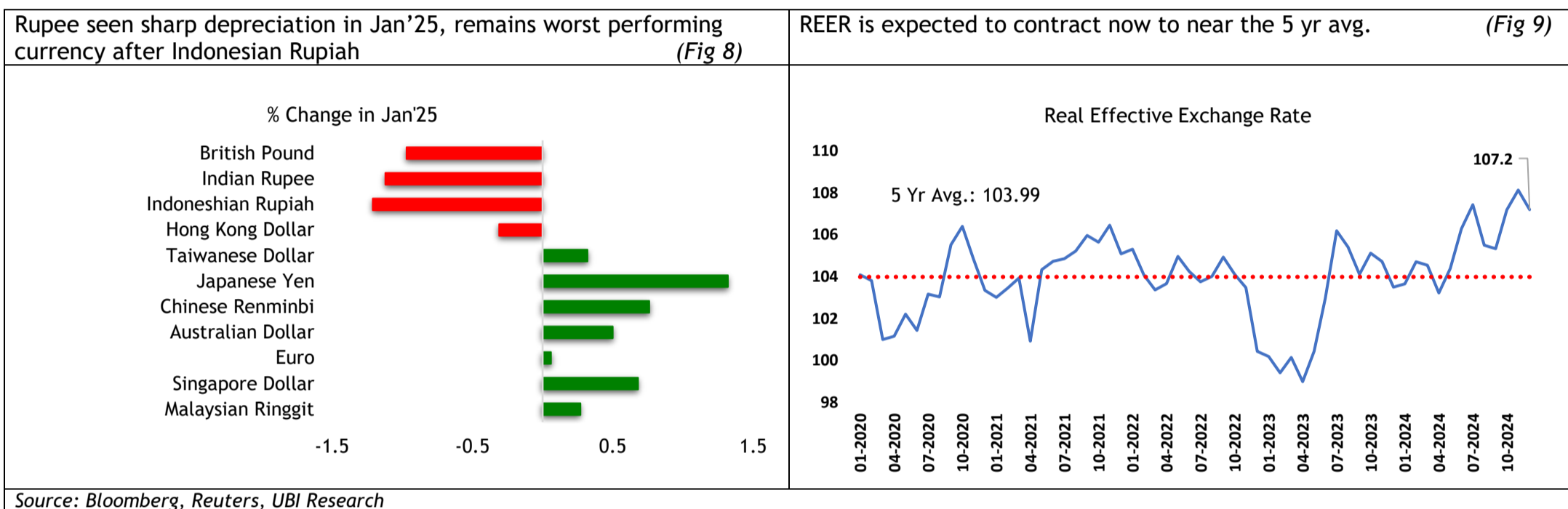
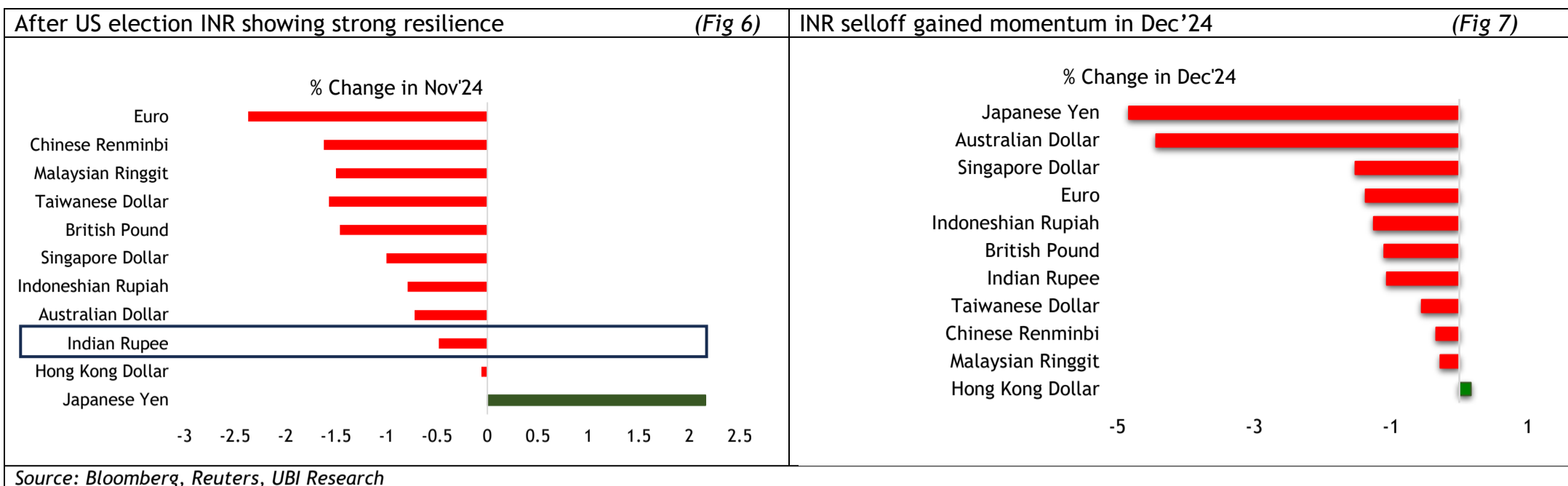
Source: Bloomberg, Reuters, UBI research

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

Eurozone inflation remains sticky at lower end (Fig 5)



Source: Bloomberg, Reuters, UBI research



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