

By:

Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Akash Deb
akash510@unionbankofindia.bank

Shreyas Bidarkar
shreyas.bidarkar@unionbankofindia.bank

This week Euro continues to wobble as political turmoil in France and Germany has weighed on sentiment. The Korean won saw sharp volatility yet stabilised after the chaos that followed President Yoon Suk Yeol rescinded after declaring martial law. In the US, investor confidence of a rate cut on 18th December held firm despite less dovish comments from FED Chair Jerome Powell and a slate of economic data that showed services sector activity slowed in November after posting gains in recent months. [\(Refer our Uni-FX: US exceptionalism theme boosted by Trump trade effect\)](#). Meanwhile, Donald Trump continues to appoint China hawks in his team the recent one was Peter Navarro as his senior counsellor for trade and manufacturing.

In other G10 space, BoE Governor Andrew Bailey stated that he expects four interest rate cuts next year if the economic forecasts remain on course. Interestingly, the Yen continues to strengthen against the US Dollar as markets ponder whether the Bank of Japan will hike interest rates later this month.

This week, spotlight will be on US jobs data on Friday where the market expects NFP to rise to 202k in November vis-à-vis 12k in October and its subsequent revisions along with the unemployment rate, a deciding factor before FED's December FOMC meet along with the CPI on 11th December. The key FX themes from this week are outlined below.

- ♣ **DXY near the top of multi-year range while yields continues its roller coaster ride**
- ♣ **Eurozone gripped with political uncertainty in France and Germany**
- ♣ **Yen consolidates around 150 level against Dollar but lacks follow through ahead of policy**
- ♣ **Rupee hit fresh all-time lows but stabilizes as RBI MPC maintains status quo**

DXY near the top of multi-year range while yields continues its roller coaster ride

For US markets this was a very busy week with substantial data releases along with FED members speech just before the blackout period before the FOMC meet on 18th December. The DXY continues to trade sideways with positive bias against the G10 FX just above the 106 mark, the index has edged lower and fallen c.1.8% after making a high of 108.07 on 22nd November. **Even following its post-election rally, the U.S. dollar may strengthen going forward as less dovish FED, more dovish G10 central banks, trouble in China and uncertainty around U.S. economic policy should create an environment where the US dollar performs particularly well.**

The yields across the curve have also been consolidating in a narrow range of 10bps this week, probably waiting for the release of US labor market data on Friday (6th December) before making any significant move. The yield on shorter end of curve i.e. US2Y has fallen by c.35 bps after making a high of 4.28%. The bond markets are caught between FED's plan to cut interest rate and the risk of high inflation and federal debt level.

FED members maintain less dovish stance post US election

During the FOMC meet on 18th December the FED may deliver another 25bps rate cut, which could further lower the policy rate by 75bps in 2025, bringing the fed funds rate to the 3.50%-3.75% range. Indeed, the pace of rate cuts in 2025 could be slower, considering the potential inflationary policies that the incoming Trump administration could implement. Inflation expectations, as captured in the Treasury Inflation Protected Securities (TIPS) market, have moved higher. Although the FED enters a blackout period next week, **it will be alert to any surprises in the CPI data release on December 11.** Markets expects headline inflation to remain unchanged for a fifth month at 0.2% MoM in November and, core inflation, unmoved at 0.3% MoM for a fourth month.

FED's projection will also be closely watched and may be changed to reflect stronger than expected economic growth in recent months, as well as caution about potentially expansive fiscal policies. Although the statement from FED members this week seem to be divided on future rate cut path. For the December meeting, there is a 71% probability that the FED will reduce interest rates by 25 bps to 4.25%-4.50%, while the rest expect the FED to leave them unchanged, according to the CME FedWatch tool.

The yield on US10Y languishes near its lowest level since October 22

Concern that Trump's administration tariff policy could trigger the second wave of global trade wars may offer some support to safe-haven currency

The recent series of economic data and speeches by several FED members did little to alter market pricing of rate reduction this month

November jobs data report is critical to gauging the state of the US labor market and the FEDs' easing trajectory in coming months

US nonfarm payrolls expected to rebound in November after weak October print

Central bank outlook remains cautious

This week FED members provided a mix signal over the outcome of December FOMC meet but what was common was that all have adopted a cautious approach about rate cut in 2025. FED Chair Powell stated that the economy is in relatively good shape, and that the FED can afford to be a little more cautious as it tries to find the neutral interest rate.

While FED's Musalem was more cautious and noted that it may be appropriate to pause rate cuts as soon as Dec, emphasizing his decision will be guided by incoming data. FED's Daly was also more cautionary as she warned that a rate cut this month is possible but not a certainty, it remains on the table for policymakers though the timing is debated.

FED's Barkin stated that he is encouraged with where inflation is headed and sees the positives and risks on both sides of the FEDs mandates. While FED's Adriana Kugler expressed optimism about the US economy, saying inflation appears to be on a sustainable path to the FED's 2% goal. However, she did not say if she will vote for another cut in Dec FOMC meet.

FED's Bostic stated that he's undecided on whether an interest rate cut is needed in December FOMC meet. FED's Williams stated that more rate cuts likely needed over time. While Governor Waller stated that he is "leaning" toward supporting a rate cut this month (18 Dec), barring a negative surprise on inflation data.

Economic Data

The week started with release of ISM manufacturing data which provided a surprised move on the upside although remained in overall contraction territory. While the headline PMI fell to 52.1, undershooting the 55.5 expected and far below the 56 previously.

The US JOLTS jobs opening data picked up more than expected in November to 7744k from 7443k the previous month, with layoffs rates remaining low with some improvement in quit rates as well. While the ADP job change numbers for November came in a touch softer at 146k, below the 150k estimate and down from 233k in October although **historically ADP data and NFP data do not necessarily line up**. Initial jobless claims rose to 224k in the last week of November, from 215k in the prior week. This was still at historically low levels, suggesting the US labour market has remained resilient.

NFP data is expected to remain strong in November

This week NFP data will remain in focus, this data will influence market expectations for the FED's interest rate path. Currently the markets are expecting November payroll to rise by 202k. The October jobs report showed a modest increase of 12k in nonfarm payrolls, but this figure was overshadowed by temporary disruptions from Hurricanes Helene and Milton, as well as multiple strikes. As a result, the data was seen as "noisy" and less reliable. However, the report did reveal ongoing softening in the labor market, with revisions for August and September lowering job growth by a total of 112k.

Today's payrolls data may be lifted by the resumption of normal business operations in the Southeast after the disruptions caused by the hurricanes. This may lead to upward revision to previous month figures. Additionally, the unemployment rate rose by nearly 0.1%, reflecting broader labor market trends. While this time unemployment rate in November is expected to rise slightly towards 4.2%. vis-à-vis 4.1%, average hourly earnings m/m is expected to fall to 0.3% from 0.4%.

Political uncertainty in France persists. French President Macron now has to find a replacement for Prime Minister Michel Barnier

JPY remains volatile as market participant mull the third BoJ rate hike

US NFP data will lead to increased volatility in USDJPY pair

Eurozone crippled with political uncertainty in France and Germany

The EURUSD pair continues to wobble around the psychological figure of 1.05 after making a low of 1.0331 on 22nd November since then it has shown some recovery. The pair has fallen c.700pips after making a high of 1.12 on 25th September. The path for Euro going forwards looks difficult if Trump implements tariffs on goods from eurozone as vowed during his election campaign. The prospect of EURUSD reaching parity cannot be ruled out at this juncture. Also, markets are pricing in a total of 150bps rate cut by ECB by end of 2025 as compared with 75 bps by FED this interest rate differential is also likely to put more pressure on euro pairs.

French political turmoil has complicated the road ahead for the already troubled eurozone economy

French MPs decided on Wednesday evening to vote a motion of no confidence in the government led by Michel Barnier. MPs from the left and far right voted in unison, and the government fell, less than three months after it was set up. France is thus entering a new era of political instability. The 2025 budget has also not been passed. But for now, markets have not priced in greater political risk, with the spread between France's and Germany's 10-year yield narrowing to 78bps after nearly touching 90bps.

French political turmoil has complicated the road ahead for the already-troubled Eurozone, which is facing severe downside risks to economic growth due to weak demand and potential tariffs once the new US administration of President-elect Donald Trump takes office.

ECB likely to cut rates in December yet Lagarde cautious about Trump 2.0 led policy uncertainty

ECB President Christine Lagarde also warned about growing risks to the trading bloc in her testimony before the Parliamentary Committee. She stated that "the medium-term economic outlook is uncertain, however, and dominated by downside risks,". "Geopolitical risks are elevated, with growing threats to international trade," she added.

On the interest rate outlook, Lagarde stuck to her data-dependent approach. However, traders expect that the ECB will cut its Deposit Facility Rate by 25 basis points (bps) to 3% at its December 12 meeting.

Yen consolidates around 150 level against Dollar but lacks follow through ahead of policy

The Japanese Yen continues to consolidate around crucial level of 150.00 this week and awaits BoJ policy this month on 19th December. Expectations that the Bank of Japan (BoJ) will deliver an interest rate hike this month, along with persistent geopolitical tensions and concerns about Donald Trump's tariff plans along with events in South Korea, has driven some safe haven flows towards the JPY. Furthermore, the recent decline in the US Treasury bond yields along with less dovish FED is also seen as another factor underpinning the JPY.

BoJ rate hike in December remains a close call

Bank of Japan (BoJ) board member Toyoaki Nakamura who is considered to be one of the dovish board members said on Thursday that "I am not against rate hikes but feel the decision should be data-dependent." Following his comment, the yen strengthen as market viewed this statement as potentially strengthening the case for another rate hike this month.

While earlier Governor Kazuo Ueda kept all options open with recent remarks that the timing for a hike is "nearing" as economic data have been in line with projections. The governor stopped short of offering specific hints pointing to a December move. While markets see about a 40% chance of a rate hike at the board meeting concluding on Dec. 19, down from 66% at the end of last week.

From a technical perspective, the swing low, around the 148.65 region, now seems to protect the immediate downside ahead of the 149.00 mark. On the flip side, attempted recovery might now confront some resistance near the 150.55 region. This is followed by hurdle around the 151.20-151.25 zone touched on Wednesday. A sustained move beyond the latter could lift the USD/JPY pair to the 152.00 mark.

RBI SDDS shows increased net short position in forwards highest in a decade

Rupee hit fresh all-time lows but stabilizes as RBI MPC maintains status Quo

The first week of Dec'24, witnessed a mere volatility in the FX global markets; DXY traded from lows of 105.70 to highs of 106.45. Despite US JOLTS data came in better than market expectations still DXY remained muted. The RBI MPC decided by a 4 to 2 majority to keep policy rate unchanged at 6.5% for 11th time in a row on dilemma for balancing inflation and growth amid growth shock. To ease the potential liquidity stress, the Cash Reserve Ratio (CRR) was reduced to 4% of NDTL in 2 equal tranches of 25bps each with effect from the fortnight beginning 14th Dec and 28th Dec, 2024 respectively; restoring to levels commencement of the policy tightening cycle in April 2022. As per the RBI, this reduction in the CRR is consistent with the neutral policy stance and would release primary liquidity of about ₹1.16 lakh crore to the banking system. (Refer our report: [FX weekly: Trump's Tariff, Treasury pick and Treasury yields remain in focus](#))

Since June'24, unlike Asian peers, Rupee was the worst performing currency and was hovering close to its then all-time lows. However, in recent weeks when all the emerging-market currencies appreciated against a stable Dollar, Rupee remained out of the league and depreciated (0.20%) after dismal domestic GDP data and ahead of RBI MPC outcome. India Q2FY25 GDP data came as a red flag for economic activity and hurt by a lingering depreciation bias made Rupee hit fresh all-time lows. (84.7425 on 04th Dec'24)

As per media reports, the central bank was likely conducting dollar-rupee buy/sell swaps in the mid-to-far tenors, which weighed down forward premiums. The 1-year dollar-rupee implied yield fell to a 4-month low of 1.95%, having declined nearly 30bps over 3 sessions. USD/INR buy-sell swaps offer the advantage of not adversely impacting forex reserves and also does not hurt rupee liquidity in the markets.

As per latest data, the RBI's net outstanding short positions in dollar/rupee forward contracts rose by a whopping \$34.60bln to \$49.18bln at the end of Oct'24, the highest in at-least in a decade. However, market participants believe that the central bank has further stepped up in the non-deliverable forwards market on the back of its ballooning aggregate short position, which likely climbed to \$65bln-\$70bln in Nov'24.

FPIs net withdrew \$11.12bln (highest in a decade) in Oct'24 while outflows moderated to \$2.56bln in Nov'24. However, flows turned positive in Dec'24 to \$1.77bln. Nevertheless, on a WoW basis equity markets received inflows to the tune of \$2005.92mln vis-à-vis \$586.45mln a week ago. Also, the debt segment has witnessed inflows to the tune of \$1218.75mln vis-à-vis \$850.14mln from the previous week. Moreover, the FAR related flows have turned positive at \$1233mln in Dec'24 vis-à-vis outflow of \$507mln in Nov'24.

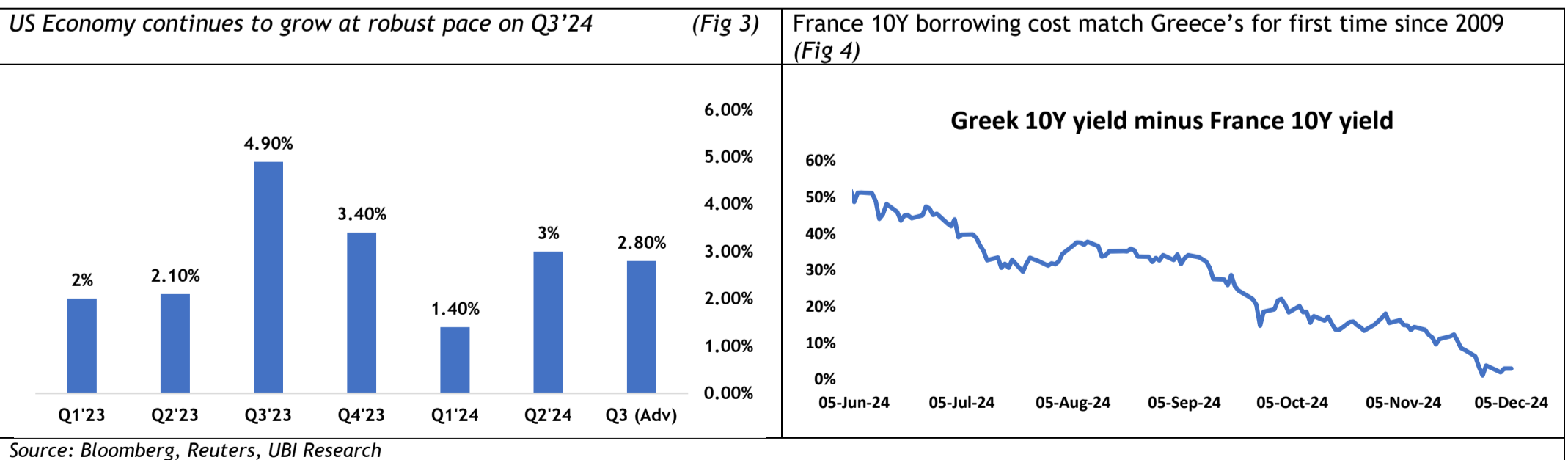
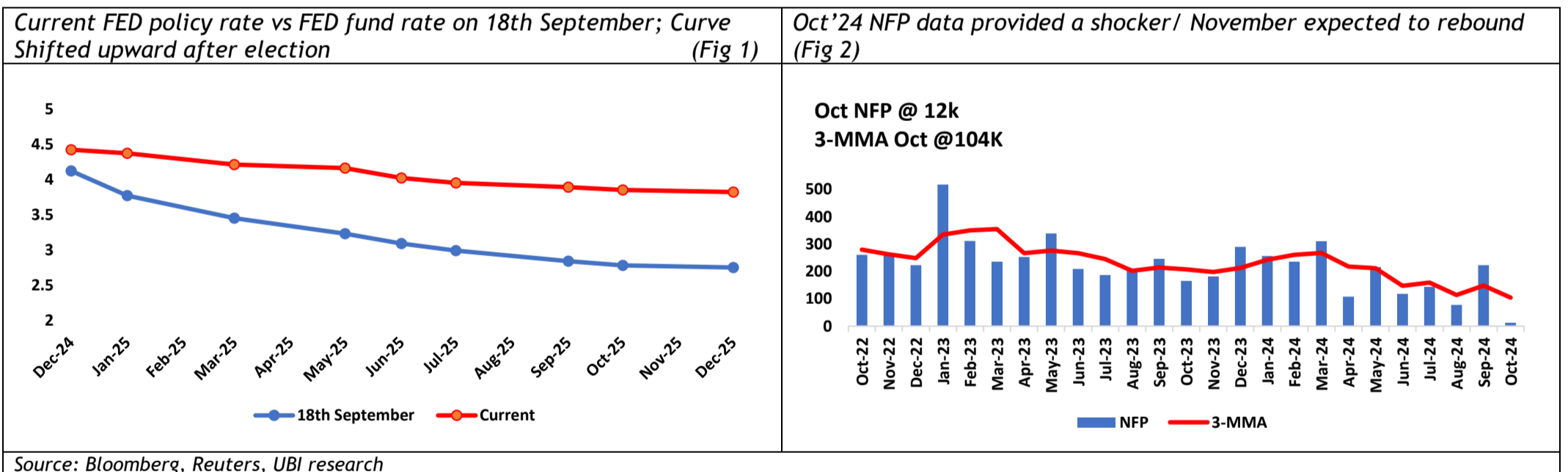
Our analysis shows that in this month, the record high forex reserves kitty has slipped by \$46.99bln to \$657.89bln from all-time highs of \$704.86 (\$33.09bln fall was adjusted after valuation effects), signalling that the Central Bank has taken appropriate measures to curb volatility in the local currency. The strategy to beef up its accumulation buffer its reserves, it helps to avoid any unforeseen future volatility in the domestic currency.

Indian Rupee (₹ - Rupee): View

INR depreciating momentum continued & traded with bouts from lows of 84.5850 to retesting all-time lows of 84.7425. Rupee move was broadly linked to the Dollar's strength & weakening Chinese Yuan. Considering the present scenario, we may expect dollar to consolidate till Trump takes charge of the White House. Another 25bps rate cut by FED (72% probability for a 25bps cut in 18th Dec'24) will lead support to the domestic currency along with Dollar inflows which are expected from Dec'24 on inclusion of India FAR bonds in the Bloomberg Emerging Market (EM) Local Currency Government Index and related indices, starting 31st Jan'25. Still, the central bank will remain vigilant using all the levers to contain the currency volatility.

Despite global headwinds, the USD/INR pair has outperformed other FX peers on continuous dollar sales by PSBs. Given US Dollar exceptionalism may persist in the near term at least till Trump joins office on 20th Jan'25, we are of the view that there is a case for further drift in USDINR. Fundamentally as well, Rupee is a depreciating currency with an average annual FX move of 2-3% clocked to align with US-India long term inflation differentials. Interestingly, during Mar'20-Mar'23, while INR was nearly flat from Mar'20 to Mar'22, a one-off depreciation of 9-10% was seen in FY'23 to align with fundamentals. Thereafter, INR depreciated c.1% in FY24 and also in this year there is a very tight movement of c.2%. Hence, there is a pending depreciation in FX from a fundamental perspective as well, which is already reflected in the RBI REER over valuation. These shows concern that the Indian rupee may still have more room to depreciate, however the RBI firmly focused on FX volatility may allow it to depreciate gradually.

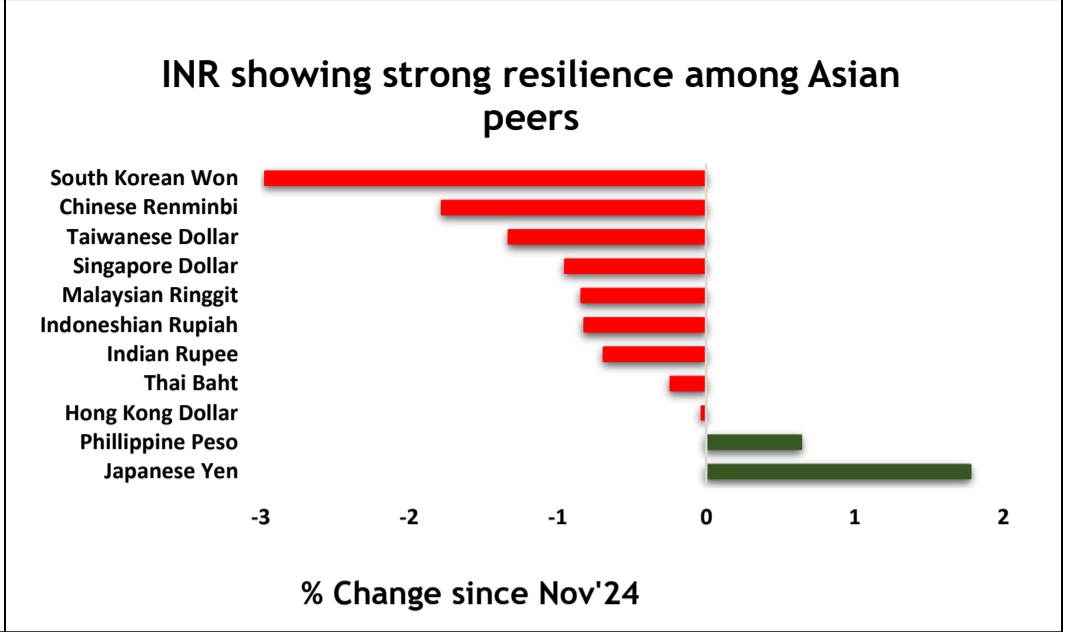
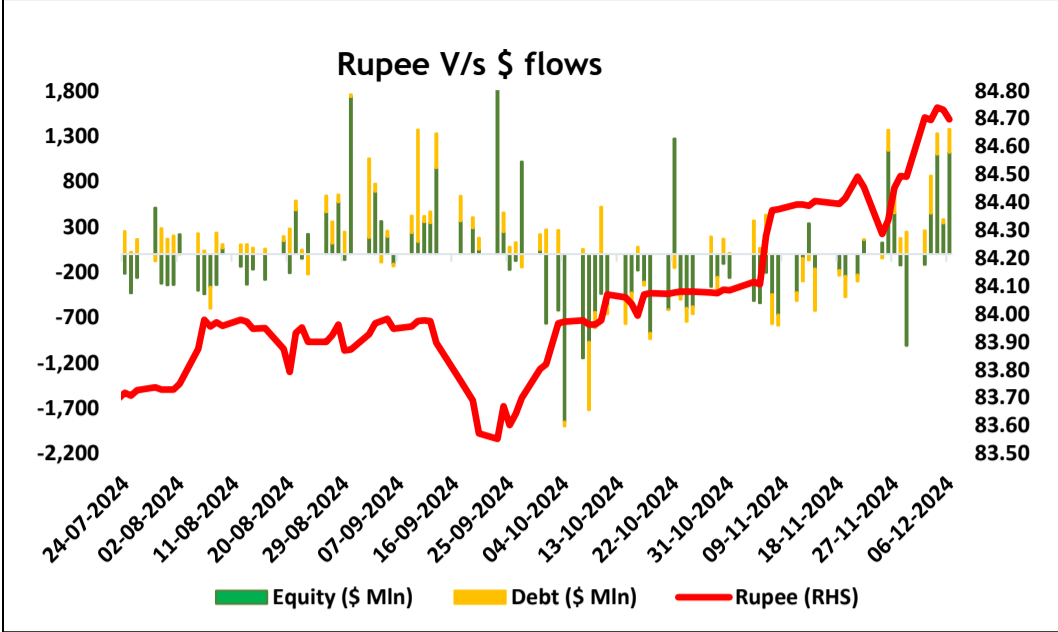
In order to attract more Dollar inflows, RBI decided to increase the interest rate ceilings on FCNR(B) deposits. Accordingly, effective from today, banks are permitted to raise fresh FCNR(B) deposits of 1Y to less than 3Y maturity at rates not exceeding the ceiling of overnight Alternative Reference Rate (ARR) plus 400bps as against 250bps at present. Similarly, for deposits of 3Y to 5Y maturity, the ceiling has been increased to overnight ARR plus 500 bps as against 350 bps at present. This relaxation will be available till March 31, 2025. Currently, FCNR rates are already prevailing way below the ceiling of ARR plus 250bps which indicates that we may probably need more policy levers to incentivise banks to attract FCNR flows. However, going forward, we closely watch for a scenario of possible overshoot in DXY, probably a breach of current technical level. (Refer our monthly report: [Uni-FX: US exceptionalism theme boosted by Trump trade effects](#))



Rupee depreciated after dismal GDP data (Fig 5)

(Fig 5)

Rupee volatility & depreciation contained despite USD strength (Fig 6)



Source: Bloomberg, NSDL, UBI Research, Refinitiv

Fig 7: Dashboard for key global market moves

Central bank Policy Rates			
	Current	End of 2023	YTD Change 2024 in BPS
Advanced Economies			
Australia	4.35%	4.35%	0
Canada	3.75%	5%	-125
Euro-zone	3.40%	4.50%	-110
Japan	0.25%	-0.10%	35
New Zealand	4.25%	5.50%	-125
United Kingdom	4.75%	5.25%	-50
US	4.75%	5.50%	-75
Developing Economies			
Brazil	11.25%	11.75%	-50
China (1Y LPR)	3.10%	3.45%	-35
India	6.50%	6.50%	0
Indonesia	6%	6.00%	0
Philippines	6%	6.50%	-50
South Korea	3.25%	3.50%	-25

FX Performance				
FX Pair	3M % Change	6M % Change	MTD % Change	YTD % Change
EURUSD	-4.6	-2.89	-0.02	-4.2
GBPUSD	-2.9	-0.36	0.03	0.1
AUDUSD	-3.66	-3.59	-1.29	-5.62
NZDUSD	-5.17	-5.52	-1.1	-7.42
USDJPY	5.34	-3.68	0.1	6.26
USDCHF	4.31	-1.12	-0.18	4.48
USDCAD	3.41	2.69	0.22	5.95
DX	4.57	0.87	0.06	4.41
USDCNY	2.41	0.19	0.22	2.26
USDINR	0.8	1.44	0.13	1.77

Source: Refinitiv, UBI Research

Government Bond			
	1M Change BPS	3M Change BPS	YTD Change
10Y US Treasury	-13	46	29
10Y JP JGB	4	20	42
10Y DE Bund	-25	-6	11
10Y UK	-21	36	74

Source: Refinitiv, UBI research

Banking Research Team	
Kanika Pasricha Chief Economic Advisor	kanika.pasricha@unionbankofindia.bank
Suneesh K	suneeshk@unionbankofindia.bank
R Gunaseelan	gunaseelan@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank

Disclaimer:

The views expressed in this report are personal views of the author(s) and do not necessarily reflect the views of Union Bank of India. Nothing contained in this publication shall constitute or be deemed to constitute an offer to sell/ purchase or as an invitation or solicitation to do so for any securities of any entity. Union Bank of India and/ or its Affiliates and its subsidiaries make no representation as to the accuracy; completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability regarding the same.