FX weekly: US payroll will be in focus ahead of 20th January key event risk

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The US dollar continues to trade on a stronger footing as the new calendar year begins, with expectations that the policies to be implemented by Donald Trump in his second term as President will support further strength in the currency. Trump's inauguration as the 47th president of the US is set for January 20th and as per various media sources he is expected to enact 25 executive orders on his first day. Since the US presidential election on 5th November, the dollar index has surged c.5%. The dollar's gains have been broad based across DM & EM FX crosses since the election, reflecting optimism about the future direction of US economic policy under the incoming Trump 2.0 administration.

The US Dollar Index (DXY) trading at two-year highs close to 109, markets have priced in some form of trade tariffs may be imposed on US trade partners across 2025. In addition, safe haven demand for US dollar may be gaining momentum given sharp economic divergence in growth, America first on one hand while China stays under pressure with the new HPMV virus threat fuelling growth concern.

This week the US NFP data will give us insight about the condition of labor markets where as per market consensus it is expected to reduce to 154k vis-à-vis 227k in November while the unemployment rate to remain steady at 4.2% and wage growth is expected to come in at 0.3% m/m, 4.3% y/y. Also, a total of 8 Fed speakers' speech will also be closely watched. The key themes for this week are given below.

Key Themes:

- ♣ **US Dollar rally probably has more legs in near term as Trump joins office on 20th Jan**
- ♣ **Yen remains weak, while January hike is not a done deal, states Ueda**
- ♣ **EURUSD starts 2025 with downside moves and approaches closer to parity**
- ♣ **UK's economic worry to remain a drag on Pound, BoE policy remains on watch**
- ♣ **CNY bracing for 17 year low ahead of Trump's inauguration**
- ♣ **Rupee edging towards 86/$ threshold**

US Dollar rally probably has more legs in near term as Trump joins office on 20th Jan

The US dollar index (DXY) rose by 7.1% in 2024, driven by significant weakness in the euro (-6.2%) and the Japanese yen (-11.5%)

The US Dollar Index gained more than 2.5% in December'24 and close the third consecutive month in positive territory. Its best weekly performance in over a month on 3rd January, underpinned by expectations of fewer Fed rate cuts this year and the view that the U.S. economy will continue to outperform the rest of its peers globally as Trump imposes trade tariffs. The DXY began the new year on a strong note reaching more than two-year high of 109.54. The US Dollar Index (DXY) closed 2024 at a two-year high of 108.48. All G-10 currencies fell against the USD, led by NZD (-11.5%) while GBP was the most resilient, having fallen a modest 1.7%. The pricing of FED rate cut in 2025 has gone significantly up with markets expecting just 50bps rate cut this year for policy rate to reach at 3.85% as against 2.75% during the 18th September jumbo(50bps) rate cut.

The recent hawkish policy shift from the Fed provides another tailwind for US dollar strength at the start of this year.

US Treasuries had a mixed performance in 2024. The front-end of the curve, i.e. the 2-year yield closed the year marginally lower at 4.24%. The 10-year yield rose 69 bps to 4.57% as investors adjusted for term premium in the face of Trump's expansionary fiscal policies. The yields have been rising across all the tenor even after rate cuts by FED. The yield curve also steepened and finally ended its over two-year inversion in the 2s-10s bonds. In 2024 Fed had cut rates by 100 bps even then the yields on US10Y have risen by c.100bps.

The Fed is likely to leave rates on hold at the next FOMC meeting in January

The US labour market data came in better than expected with a drop in both initial jobless claims and continuing claims, NFP data remains on watch

Last month the FED concluded its final 2024 policy and on expected lines cut the FED fund rates by 0.25% to a range of 4.25%-4.50%. However, its economic and rate projections, the meeting statement and Mr. Powell's press conference were all more hawkish. The FED surprised markets as it now projects to cut rates next year, as opposed to the four times it had forecasted in September. As per Summary of Economic Projections (SEP), inflation is expected to accelerate in 2025 to 2.5% from 2.4% in 2024. The FOMC on 29th January markets are expecting the FED to hold the rates unchanged, as per CME FedWatch tool the probability of which stands at 88%.

Last week we received ISM PMI manufacturing data for the month of December, the manufacturing sector improved slightly but still in contraction zone, the index rose from 48.4 in October to 49.3. The index has been in contraction for the past nine-straight months. Uncertainty continues to hold back broad activity, though there are some signs of stabilizing demand amid industries as new orders improved to 52.5 compared to November reading of 51.3.

Going forward, the first jobs report of the year comes on 10th January along with average hourly earnings. As per market consensus NFP data for month of December is expected to decline to 154k as against 227k in November. Also, Trump will join office on 20th January and as per various media sources he is expected to enact 25 executive orders on his first day. These orders may target immigration, energy and education polices and intends to undo many Biden's actions. Markets will be watchful of his action due to uncertainty over his plans for hefty import tariffs on China which he has stated to impose 60% tariff on Chinese imports also his stance on war between Russia and Ukraine as he being a war dove.

Yen remains weak, while January hike is not a done deal, states Ueda

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

Then Japanese yen remained weak during 2024 and lost c.11.5% against the US dollar despite various efforts by Japanese MoF to intervene. The USDJPY pair touched high on 161.96 on 3rd July since then have made low of 139.57 on 16th September but was unable to maintain the downward momentum and is trading below the 160 levels. The yen has been recovering some lost ground at the start of the new calendar year resulting in USD/JPY dropping back towards 156.50 after hitting a high of 158.08 on 26th December. However, the uncertainty surrounding the Bank of Japan's (BoJ) policy outlook might cap the JPY's upside.

While the USD may be underpinned by tariff uncertainties in the near term, further gains in USD/JPY may be held back by the persistent monetary policy divergence between the Fed and the Bank of Japan (BOJ) which may hike again in 2025.

In its December policy the BoJ held its interest rates at 0.25% for the third time in a row. As per the Bank of Japan's policy statement, it assessed that the economy is likely to continue growing at a pace above its potential growth rate, with underlying CPI expected to rise gradually. However, the BoJ reiterated the uncertainty surrounding both growth and inflation, which, in our view, was the key factor behind its decision to maintain interest rates at current levels.

The next BoJ meeting, scheduled for 24 January, will take place just four days after Trump joins the office. The probability of no change by BoJ in its 24th January meeting currently stands at 58%, while market expect BoJ to hike rate by 47 bps this year for policy rate to reach +0.7025%. Technically we expect USDJPY to trade in the range of 154.00 to 160.50 in the near term.

EURUSD starts 2025 with downside moves and approaches closer to parity

More negatives piling up for Euro

EUR/USD fell for a third straight month in December, by c.1.5%. Underscoring the weakness was the wide monetary policy divergence between the Fed and the ECB. The technical along with fundamental outlook suggests that the near-term bias remains bearish, the pair has weakened c.6.20% in 2024. While markets scaled back expectations for Fed rate cuts due to the inflation spill over of Trump's tariff policy, interest rate swaps indicate more aggressive easing (120 bps of rate cuts in 2025) from the ECB to bolster the region's economy. Political crises in Germany and France exacerbate the manufacturing slowdown in both of Eurozone's largest economies and will also weigh down further on the EUR. *The multitude of headwinds acting against the EUR is likely to persist in the near term and it seems highly possible that EUR/USD would test the well-watched parity level in the coming months.*

ECB President Christine Lagarde has stated that the central bank aims to achieve its 2% inflation target by 2025. Lagarde remarked, "We made significant progress in 2024 in bringing down inflation, and we are hopeful that 2025 will be the year we reach our target, as expected and aligned with our strategy." 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. Technically we expect EURUSD to trade in the range of 1.0215 to 1.0380 in near term.

UK's economic worry to remain a drag on Pound, BoE policy remains on watch

The pound was the worst performing G10 currency on the opening day of 2025, falling by 1.06% over fears of growth while fell 1.22% against the US dollar last week. Those fears were reinforced by the UK PMI manufacturing index which dropped more than estimated to 47.0 levels the lowest level since January 2024 it was the fourth consecutive month of decline.

The disappointing PMI data and the increased fears over the economic impact of a renewed rise in natural gas prices saw the probability of a BoE rate cut in February increase modestly, by 3bps to 18bps. *Going forward, the GBP is likely to face lesser headwinds compared to other major FX peers such as the EUR. Most importantly, the monetary policy differential between the Fed and the BoE remains reasonably small.*

GBP pushed down by growth concerns

The pricing for BoE rate cuts this year seems too cautious and markets expects the BoE to cut by 75bps by end of 2025 for policy rates to reach 4.11%. The next policy is due on 6th February where markets are pricing in 65% probability of rate cut by BoE.

CNY bracing for 17 year low ahead of Trump's inauguration

USDCNY rose beyond 7.3000 level last week after authorities had defended that level for weeks. It is likely to be yet another challenging year for the CNY in 2025. Trump's tariffs are likely to exacerbate the existing concerns about China's economic slowdown. On top of a weaker domestic growth outlook, the CNY may be dragged by a shift in monetary policy stance (announced in December's CEWC) to "moderately loose" from the previous "prudent" approach. Externally, the USD may also draw strength from a shorter and shallower Fed rate-cut cycle. Overall, USD/CNY may trade higher in the coming few quarters.

Rupee edging towards 86/$ threshold

Rupee depreciating trend continues for 9th straight week

INR closely tracking weakening CNY

The rupee slipped around 3% in CY24 and last Friday ended at a record closing low at 85.7825/$ pressured by a strong Dollar and decline in the Chinese Yuan, and logged a 9th straight week of losses. However, the domestic currency was largely protected near to all-time lows levels of 85.82/$ (27th Dec'24). 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. Already, the local currency sentiment was weak after the dismal trade data shocker for Nov'24 followed by frail Balance of Payment dynamics in FY26 contingent on FPI trends while C/A deficit may remain flat with downward bias numbers, data showed CAD slipped to 1.2% of GDP in Q2:FY25 up from 0.9% of GDP in Q1:FY25.

Merchandise Trade Deficit clocked to all-time high levels of $37.84bln in Nov'24, however as per our estimates it is expected to normalize in Dec'24 to $26.85bln on account of lower gold imports after festivals & wedding seasons demands. Interestingly, while goods deficit was at record highs, services trade surplus also clocked record levels (for 2nd consecutive month) at USD 17.99bln in Nov'24 vis-à-vis $17.22bln a month ago. We expect this positive trend to continue in the last month. While we expect the one-offs in trade deficit to correct in the coming months, yet the adverse impact seen FYTD led to **revise our FY25 C/A deficit at 1.2% of GDP from 0.9% earlier**.

(Refer our report: Trade deficit shocks to $38bln; we revise FY25 C/A deficit to 1.2% vs 0.9%)

Volatility increased in Dec'24 post New RBI MPC chief

Since June'24, unlike Asian peers, Rupee was the worst performing currency and was hovering close to its then all-time lows. However, 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 where market expectation rises for rate cut in the upcoming MPC. Despite this, ***REER has seen an overvaluation bias (108.14 in Nov'24 up from 107.20 in Oct'24) reflecting pending depreciation pressure in the currency pair***. Also, Chinese Yuan has breached a key psychological level of 7.30/$ and is approaching 17-year lows of 7.35, levels last seen in Nov'23.

FPIs turned negative in Jan'25 again

FPIs net withdrew $11.12bln (highest in a decade) in Oct'24, while outflows moderated to $2.56bln in Nov'24. However, in equity segment flows turned positive in Dec'24 to $2.37bln but turned negative again in Jan'25 to $501mln. Nevertheless, on a WoW basis equity markets outflows have been consistent to the tune of $644.55mln vis-à-vis outflows of $600.35mln a week ago. Also, the debt segment has turned negative; outflows to the tune of $809.89mln vis-à-vis inflows of $211.64mln from the previous week. Moreover, the FAR related flows have reduced to $448mln 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.

BoP tracking negative in Q3:FY25

Our analysis adjusted for valuation effects shows that shows that FYTD25 Balance of Payment (BoP) is tracking **negative c.$8.25bln** (Q1: $6.37bln, Q2: $27.65bln & Q3: -$42.27bln) with sharp loss in BoP seen in Q3:FY25. Historically, there is a close correlation between FX reserves (adjusted for valuation effects) and BoP.

However, key factors may provide a salutary effect to Rupee moves: i) Subdued oil prices as favoured by Trump - 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 $15 bln.

FX reserves at 8-month low

Additionally, spot FX reserves are at a near 8-month low to $640.28bln for the week ended 27th Dec'24, though it is down by $64.61bln from all-time highs of $704.86 ($42.27bln fall was adjusted after valuation effects). This shows central bank has persisted with its efforts to curb FX volatility. Also, RBI's forward position has spiked to record levels of USD 59bn as of end Nov'24.

Based on the current global scenario, technically INR should take support of 85.50 followed by 85.10 levels and will find resistance around 85.90, breach of which will test 86.50 levels. However, going forward, we closely watch for a scenario of possible overshoot in DXY, probably a breach of current technical level, 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: Hawkish FED leads to sharp spike in DXY & Rates in muted markets)

Key Market movers *(Fig 1)*

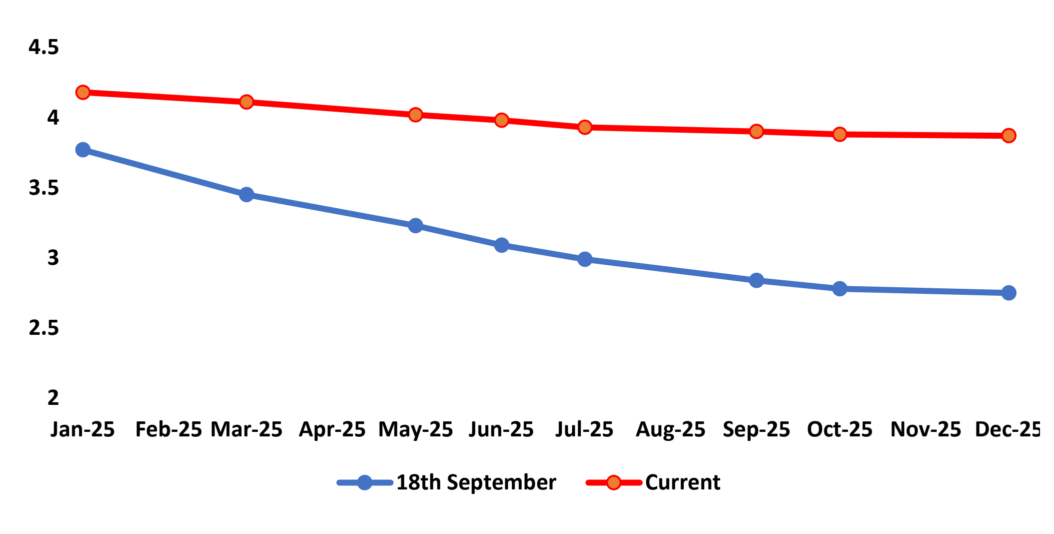
FX Performance				
FX Pair	3M % Change	6M % Change	MTD % Change	YTD % Change
EURUSD	-6.55	-4.43	-0.43	-0.43
GBPUSD	-5.36	-2.51	-0.73	-0.73
AUDUSD	-9.17	-7.43	0.4	0.4
NZDUSD	-9.67	-8.05	0.32	0.32
USDJPY	7.04	-2.73	0.28	0.28
USDCHF	6.48	0.75	0.11	0.11
USDCAD	6.6	5.93	0.47	0.47
DXY	6.24	0.87	2.7	0.4
USDCNY	3.69	0.69	0.28	0.28
USDINR	2.11	2.68	0.24	0.24

Government Bond			
	1M Change BPS	3M Change BPS	YTD Change
10Y US Treasury	43.2	64	2.6
10Y JP JGB	4	20	0
10Y DE Bund	31	21	6
10Y UK	32	46	3

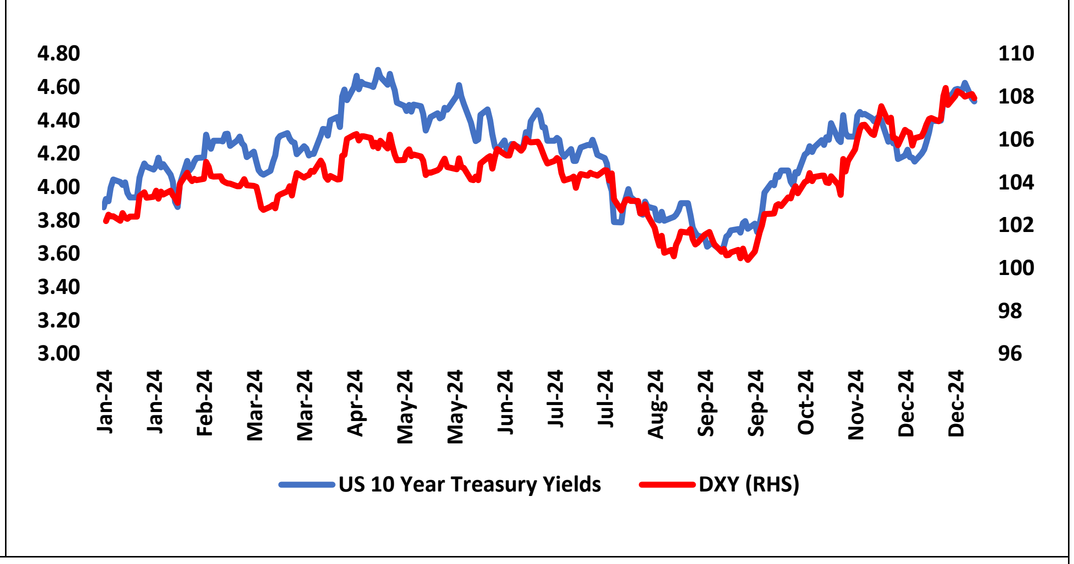
	Commodity Price Performance		
	MTD % Change	3M % Change	YTD % Change
WTI Crude	10.27	-0.51	3.06
Gold	-0.81	-1.03	0.51
Silver	-5.43	-6.27	2.77
Copper	-2.91	-12.59	1.32

Source: Bloomberg, Reuters, UBI research

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

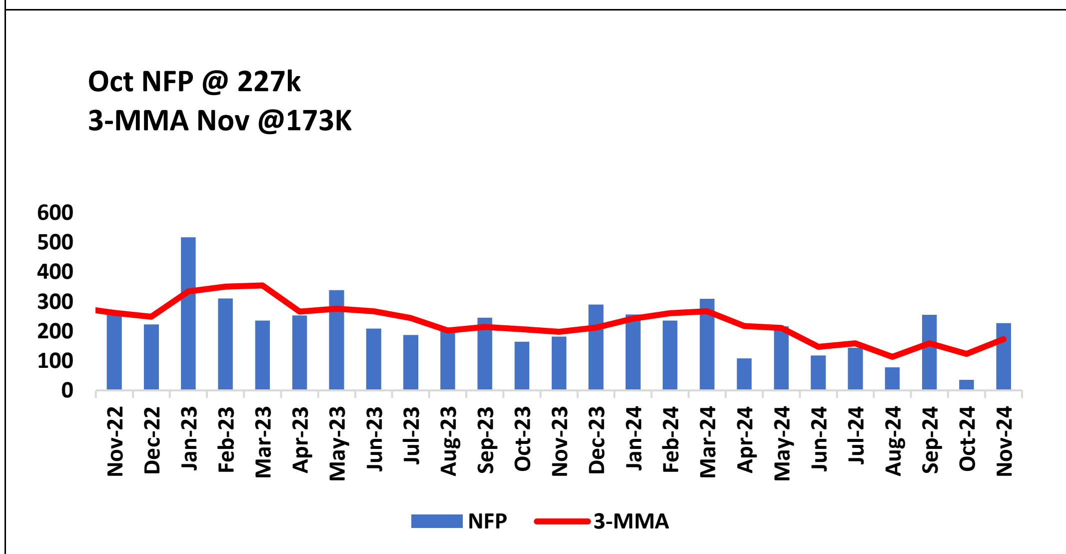


US Dollar, yields rose despite rate cut by FED (100bps in 2024) (Fig 3)

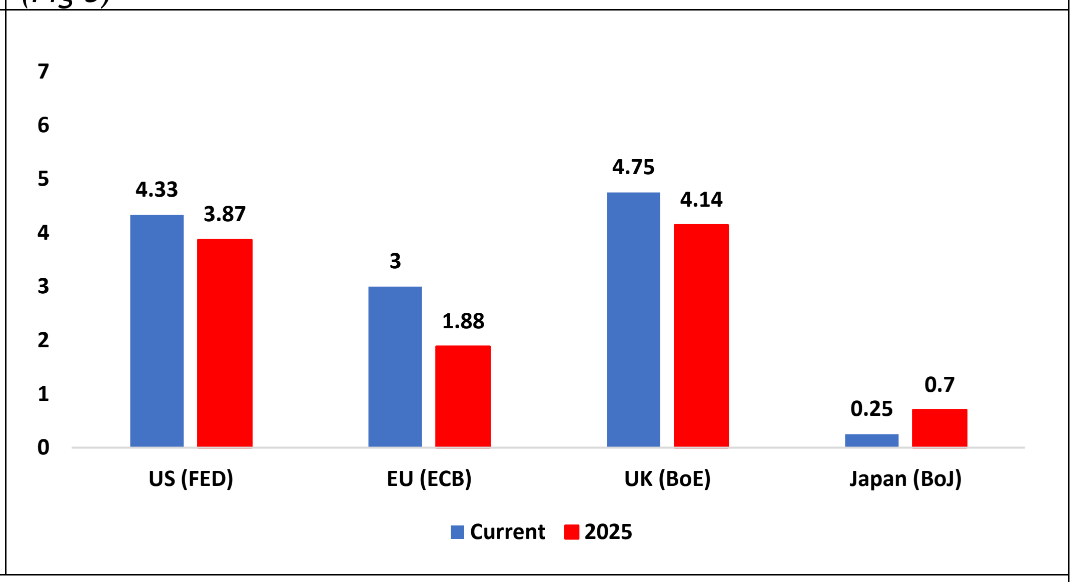


Source: Bloomberg, Reuters, UBI research

Market awaits Dec NFP data which will show the labor market condition (Fig 4)

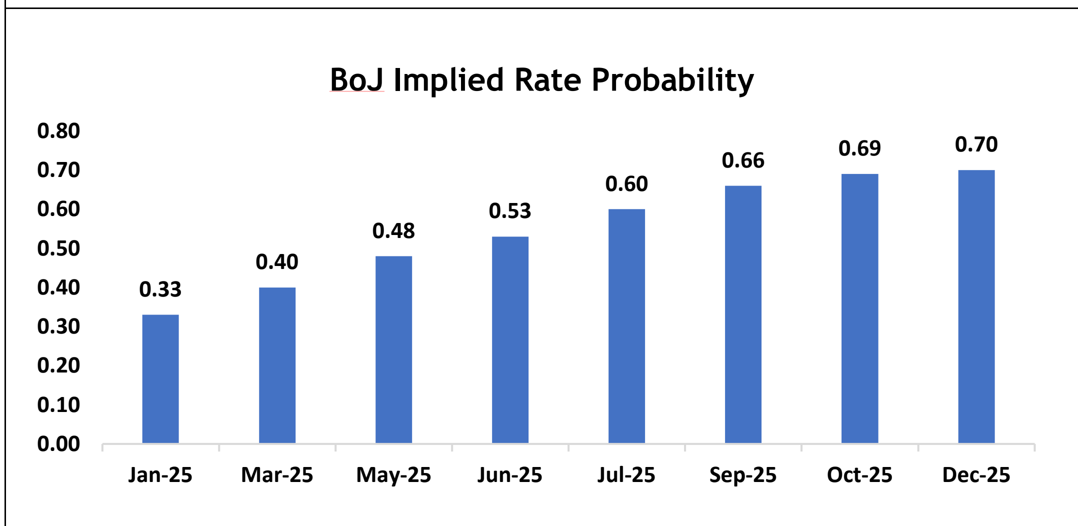


Monetary policy divergence to remain key theme in 2025 where Fed is expected to cut rate by 50bps, ECB by 100bps and BoJ to hike by 50bps (Fig 5)

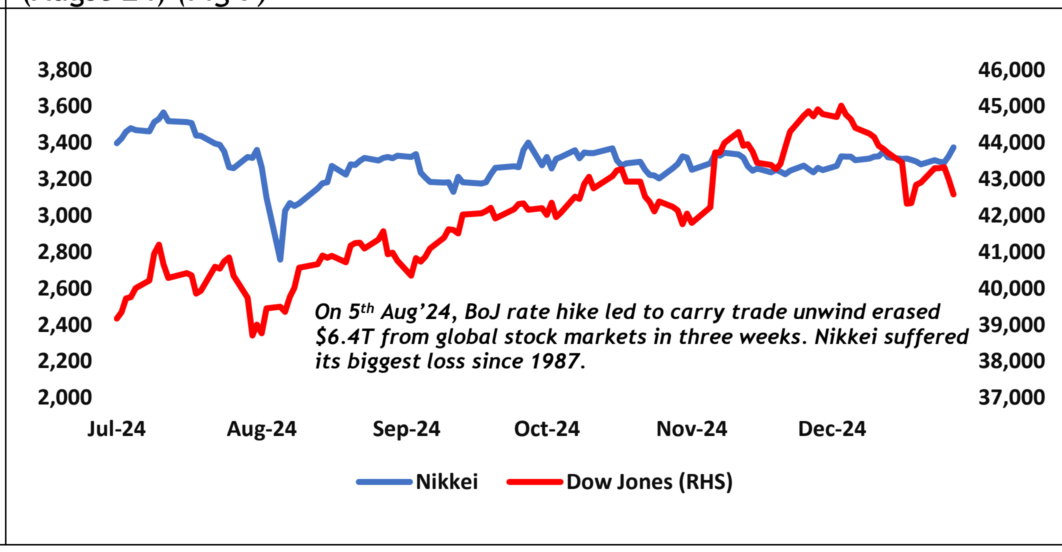


Source: Bloomberg, Reuters, UBI research

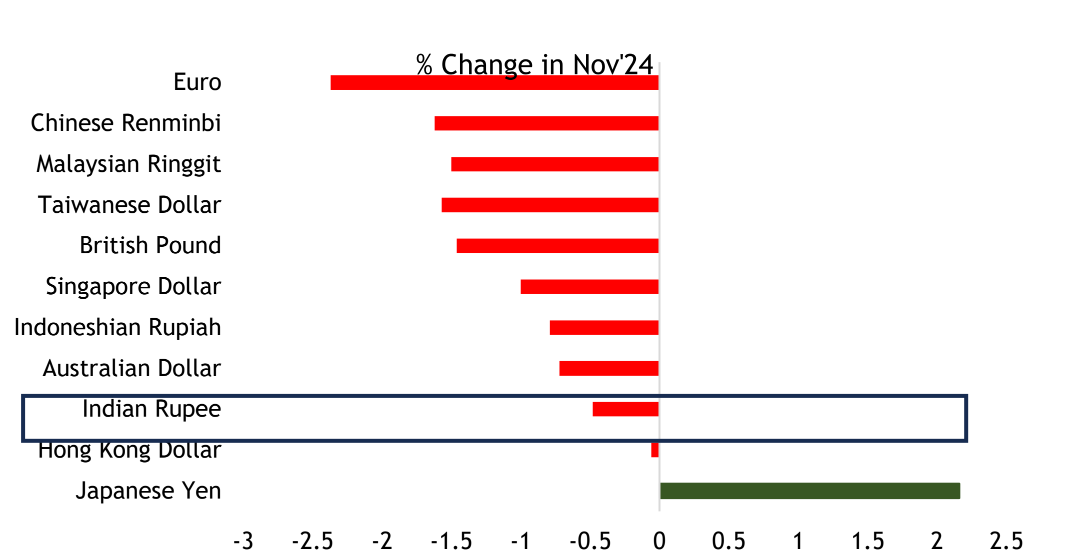
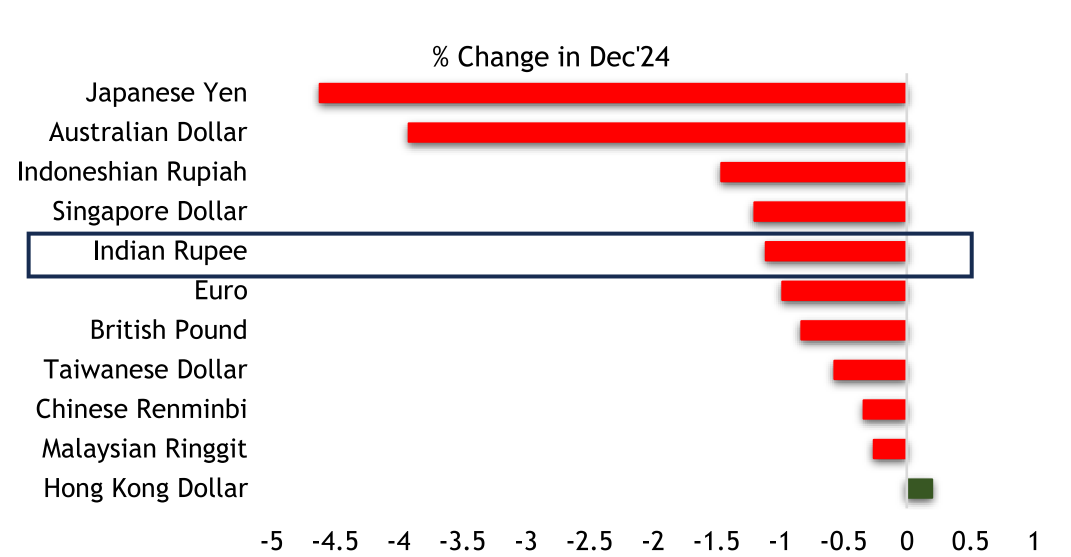
Markets expect BoJ to hike rates by 50bps in 2025 *(Fig 6)*



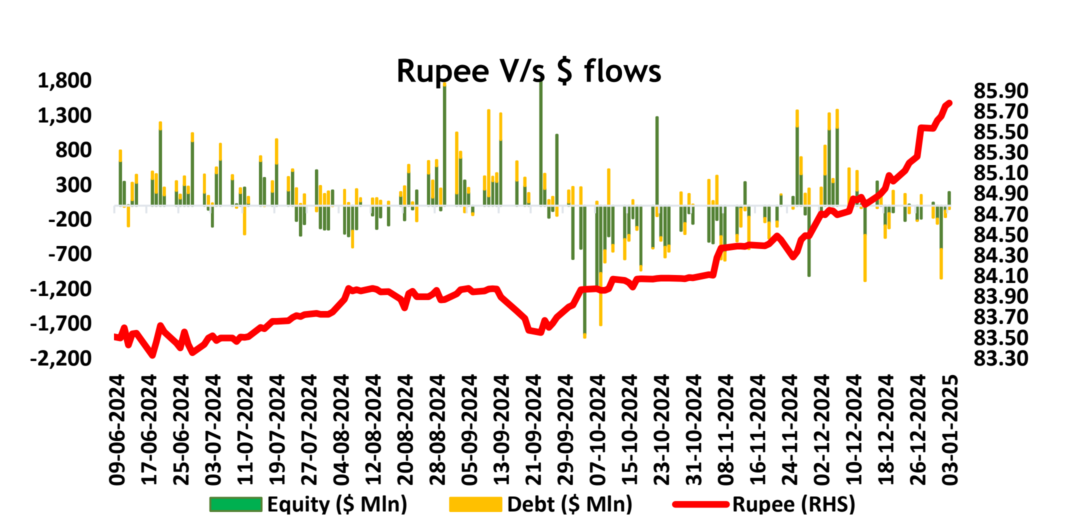
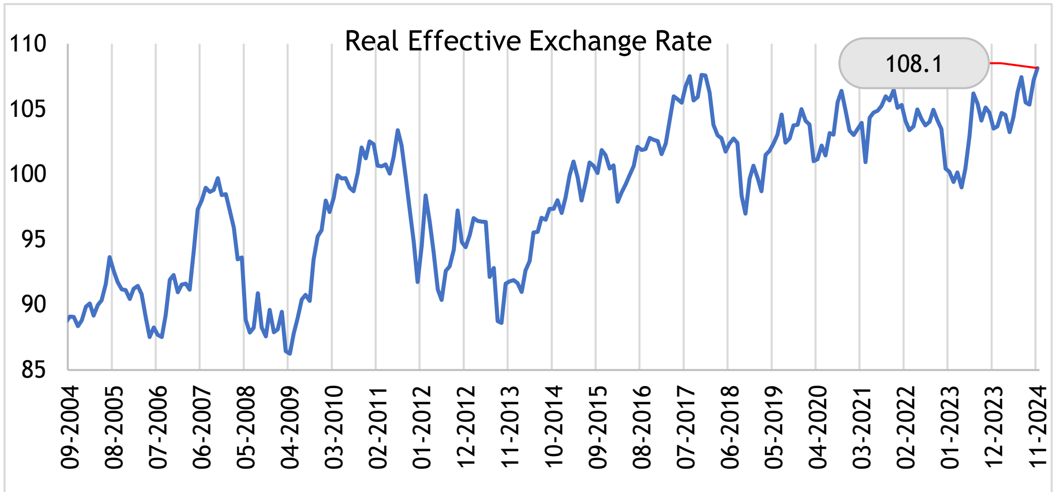
Nikkei and Dow Jones have recovered since Black Monday of 5th (Augst'24) *(Fig 7)*



Source: Bloomberg, Reuters, UBI Research

After US election INR showing strong resilience *(Fig 8)*	INR losses momentum in December post regime change in RBI *(Fig 9)*
	

Source: Bloomberg, Reuters, UBI Research

Rupee seen sharp depreciation amid Trump's victory *(Fig 10)*	Rupee REER value clocked highest since Apr'04 showing high over-valuation *(Fig11)*
	

Source: Bloomberg, Reuters, UBI Research

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