FX weekly: US trade tariffs and Powell statements keep uphold on US dollar and yields

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Last week US jobs report and broadening of US tariffs led the US Dollar to recover some of its losses over the week. While US President Trump went ahead and announced 25% tariffs on all imports of steel and aluminium (including from Mexico and Canada with exemption for Australia). He also warned that the tariffs may go higher. Now, the markets will watch if Trump follows through with the other part of announcing reciprocal tariffs, either today or Wednesday. Meanwhile, a Bloomberg report stated, that US aluminium premiums jumped to the highest since 2022 as traders braced for metal tariffs while Canada is the biggest potential loser from Trump's steel tariffs. The report also warned that India may be flooded by cheap steel after the duties come into effect.

Powell in his testimony was hawkish in nature while stated that "policy stance now significantly less restrictive than it had been and the economy remains strong, we do not need to be in a hurry to adjust our policy stance as We're in a pretty good place with this economy. We want to make more progress on inflation. And we think our policy rate is in a good place, and we don't see any reason to be in a hurry to reduce it further. We know that reducing policy restraint too fast or too much could hinder progress on inflation. And at the same time, reducing policy restraint too slowly or too little could unduly weaken economic activity and employment."

US data this week will be CPI inflation (12 Feb, Bloomberg est. headline CPI at 0.3% m/m, 2.9% y/y from 0.4% m/m, 2.9% y/y in Dec), core CPI (Bloomberg est. at 0.3% m/m, 3.1% y/y from 0.2% m/m, 3.2% y/y in Dec) and retail sales (14 Feb) of which sticky inflation and robust retail sales may add to expectations for a prolonged Fed pause. Federal Reserve Chair Powell's semi-annual Congressional testimony will be closed watched.

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:

- ♣ **Trump reciprocal tariff threat and strong job will keep US dollar bid in near term**
- ♣ **BoE continues with its rate cut cycle while revised its inflation and GDP forecast**
- ♣ **₹ goes past two big figure change this year on Trump's tariff threat and domestic worries**

Trump reciprocal tariff threat and strong job will keep US dollar bid in near term

Persistent tariff threat from trump administration has kept US dollar in demand

The US dollar somewhat recovered its lost ground on Fri (7 Feb) and was broadly stronger against all of the G10 FX with the exception of JPY and CAD following disappointing US consumer sentiment and stronger wage growth leading investors to favour a further pause in the Fed cycle, while US President Trump's announcement for upcoming reciprocal tariffs this week, added to the dollar strength. For the last week, the DXY closed weaker by -0.3%.

The US Treasury yields were trading flat for almost a week but rose across the curve on Friday (7 Feb), after the hot wage growth in the January jobs report further added expectations for the Fed to hold rates for now. The 10-year UST yield closed the session up by 6.0 bps at 4.49%, and the 30-year UST yield closed up by 6 bps to 4.69%, while the UST 2-year yield jumped by 8 bps to 4.29%. As a result, the 2-year and 10-year yield spread narrowed by -1.5 bps to 21 bps.

January labor market data came in better than expected

January job creation with fewer than feared downward revisions to historical data may have cemented expectations that the Fed will not be cutting rates imminently

January non-farm payrolls came in at 143k, below the 175k consensus, but there were 100k of upward revisions to the past two months and the unemployment rate came in at 4% versus 4.1% previously and expected. The job revision, which the BLS does each year reduced the estimate from August which was for 818k of downward revisions over the 12 months to March 2024, but this is now reported as 598k. More significantly October, November and December jobs have been revised higher, so we have a stronger trend at the end of 2024 than previously thought. Wage growth provided the warning for the Fed's inclination to stay on pause as it accelerated above forecast at 0.5% m/m (the fastest sequential pace since Aug 2024), translation to a wage growth of 4.1% y/y in Jan (versus Bloomberg est. of 0.3% m/m, 3.8% y/y, and Dec's revised 0.3% m/m, 4.1% y/y).

The University of Michigan consumer sentiment index eased more than expected to 67.8 for Feb (versus Bloomberg est. 71.8 and Jan's print of 71.7), lowest since Jul 2024 print of 66.4. The weaker print for Feb was due to a spike inflation expectation related to worries about tariffs. The 1-year inflation expectations jumped to 4.3% y/y (from last month's 3.3%) and the 5-10-year inflation expectations also edged higher to 3.3% (from last month's 3.3%). As consumers grew dramatically more worried about near term inflation as Trump pushed aggressive tariffs against major U.S. trading partners.

After this there is high probability that the FOMC is going to be on hold at the March 19th meeting. After the jobs report market expectations of Federal Reserve easing this year have pared back to just 35bp this year. As Fed Chair Powell has already stated in his January press conference that "We do not need to be in a hurry to adjust our policy stance". This week's inflation signals might inform the path thereafter, alongside other data and developments not least of which being policy shifts by the US administration.

Trump tariff threat continued to keep market on its toes

After the tariffs on Canada and Mexico gets extended by 30 days all eyes now on reciprocal tariffs

Over the weekend Trump continued its announcement of tariff threat while stated that he plans to announce reciprocal tariffs on many countries by this week. Although he did not identify which countries would be hit but suggested it would be a broad effort, and could also be done in place of the universal 10-20% tariffs mentioned previously. Meanwhile, Trump said that tariffs targeting automobiles were also under consideration. He also unveils plans for 25% tariffs on aluminium and steel to be effective form 4th March'25. According to Bloomberg, the new steel tariffs could ripple through US energy businesses, from wind developers to oil drillers that are reliant on specialty grades not made in the US. The report noted that some oil companies won exclusions from tariffs on the metal during Trump's first term, and that many steel and aluminium buyers and sellers had expected they would have at least until March to prepare for any tariff implementation.

Going forward when it comes to tariffs, it's hard to keep up with developments. We've had the threat of tariffs against Canada and Mexico seemingly for the strategic domestic agenda of fentanyl and immigration. Tariffs against China have already gone into place. Over the next couple of days, we might see the imposition of 'reciprocal' tariffs – i.e. trying to level the playing field on trade. ***If these reciprocal tariffs come in this week against those countries who have a higher tariff rate than the US, then it may be countries like India, Brazil and South Korea who are most exposed***.

BoE continues with its rate cut cycle while revised its inflation and GDP forecast

Last week the Bank of England (BoE) cuts its policy rates by 25bps to 4.50%. Seven policymakers voted for the move and two voted for a larger 50bps reduction, though Governor Andrew Bailey later cautioned market participants from reading too much into the dovish-seeming vote split. In the accompanying statement, officials noted substantial progress on disinflation over the past two years. That said, they suggested there might be some interruption to this encouraging trend in the coming quarters, with headline inflation expected to move higher through Q3-2025 before resuming a slowing trend thereafter. Officials touched on weaker-than-expected GDP growth since their last meeting as well as softer business and consumer confidence readings.

The two members vote for aggressive rate cut has caught markets off-guard

This meeting also included updated economic forecasts. The central bank lifted its forecasts for CPI inflation for 2025, 2026 and 2027 to 3.5%, 2.5% and 2%, respectively (from 2.75%, 2.25% and 1.75% previously), while it halved its GDP growth forecast for 2025 to 0.75% and bumped up slightly its 2026 and 2027 forecasts to 1.50%, both from 1.25% previously. The market reaction on monetary policy day was muted. Now the market is pricing four full rate cuts in 2025 one per quarter.

₹ goes past two big figure change this year on Trump's tariff threat and domestic worries

USDINR climbs on renewed US dollar demand on backdrop of tariffs threat

The Indian rupee continues its weakness this month as well and fell to all time low of 87.95 levels on 10th Feb'25. The daily dose of Trump tariff announcements is weighing on the Asian currency along with the rupee. The rupee started this year trading at 85.65 level and since then have seen two big figures change i.e. c.-2.61% weakness in span of just 29 trading days. Last week (3rd Feb'25) the USDINR pair opened with a gap higher, opening over 87.00 level following announcement of tariffs on Canada and Mexico the same story repeated this weekend as well where Trump announced reciprocal tariffs which lead the pair to touch lifetime low of 87.95. But this week on 11th Feb the rupee did phenomenal recovery of c.1% and recovered to levels of 86.8375, squeezing out speculative short position against the rupee, accompanied by a jump in short-term implied volumes, its strongest one-day rally since Nov'22.

Trade war intensification risks and unpredictability of US policy have spooked market sentiments, with the US Dollar soaring and EM investors paring back their positions. The Indian budget which was announced on 1st Feb'25, as an attempt to partly retrace growth led flows in the Indian economy via boost to demand (on income tax cuts) and development through 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. During the budget the government also announced to cut custom duties on higher profile items.

Flight to safe haven FX puts pressure on India rupee

Local factors also point to a less benign growth-inflation trade-off for India, while the RBI on 7th Feb'25 cut its policy rate by 25bps. On rupee, the Governor asserted that "our interventions in the forex market focus on smoothening excessive and disruptive volatility rather than targeting any specific exchange rate level or band. The exchange rate of the Indian Rupee is determined by market forces". The recent commentary from Governor Sanjay Malhotra was more or less same as former governor Shaktikanta Das but the rupee moves are slightly different. Whereas Governor Sanjay Malhotra said "day-to-day movements" in the exchange rate should not be focussed on so much and "may not be all that important", the Reserve Bank of India has used brute force to pull the rupee up by the scruff of its proverbial neck.

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)

Debt-FAR related flow has been strong this month till date

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 January at -$13.58. FYTD25 Balance of Payment (BoP) is tracking negative c.-$21.83bln (Q1: $6.37bln, Q2: $27.65bln, Q3: -$42.27bln & Q4 till date: -$13.58bln) with sharp loss in BoP seen in Q3:FY25. Historically, there is a close correlation between FX reserves and BoP. Additionally, foreign exchange reserves held by the Reserve Bank of India were at an equivalent of $630 billion in the last week of January, after hitting a 10-month low of $624 billion from two weeks ago ($13.58bln. fall was adjusted after valuation effects).

FPIs net withdrew $11.12bln (highest in a decade) in Oct'24, while there was inflow of $1.83bln in Dec'25. Followed by outflows to the tune of $9.04bln in Jan'25 and $0.99bln in Feb'25. The debt segment has been positive this month; to the tune of $2108 million vis-à-vis inflows of $38 million from the previous month. Moreover, the FAR related flows have risen to $1821mln. in Feb'25 (11th Feb'25) vis-à-vis inflow of $947mln. in Jan'25. Going ahead all eyes will on Trump's tariff plans and how Asian currency pairs react to it.

Central bank Policy Rates			
	Current	End of 2024	YTD Change 2025 in BPS
Advanced Economies			
Australia	4.35%	4.35%	0
Canada	3.00%	3.25%	-0.25
Euro-zone	2.90%	3.15%	-0.25
Japan	0.50%	0.25%	0.25
New Zealand	4.25%	4.25%	0
United Kingdom	4.50%	4.75%	-0.25
US	4.50%	4.50%	0
Developing Economies			
Brazil	13.25%	12.25%	100
China (1Y LPR)	3.10%	3.10%	0
India	6.25%	6.50%	-0.25
Indonesia	6%	6.00%	-0.25
Philippines	5.75%	5.75%	0
South Korea	3.00%	3.00%	0

Key Market movers *(Fig 1)*

FX Performance

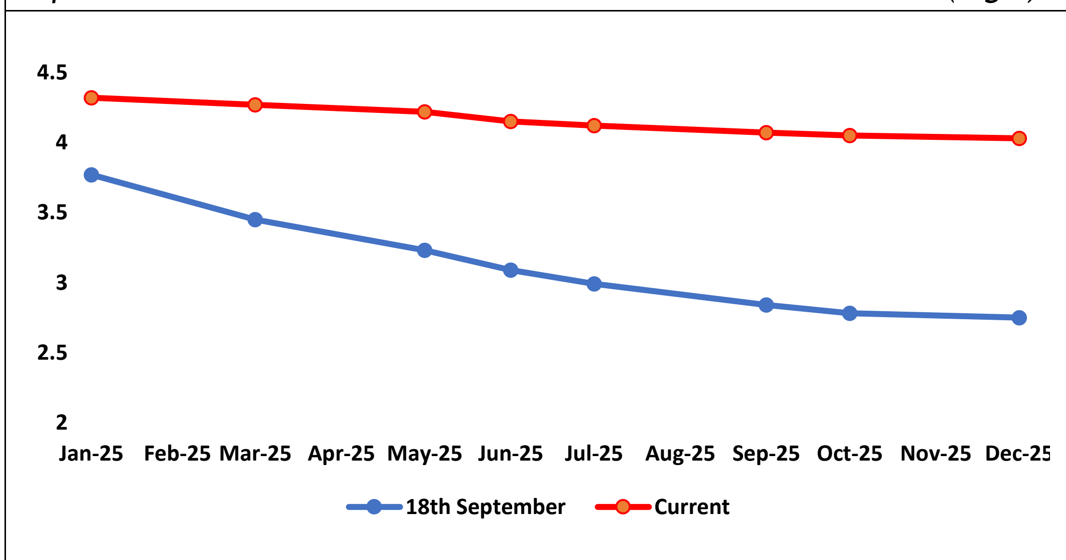
FX Pair	3M % Change	6M % Change	MTD % Change	YTD % Change
EURUSD	-2.81	-5.55	-0.36	-0.27
GBPUSD	-2.7	-2.82	0.11	-0.85
AUDUSD	-3.92	-4.68	1.06	1.45
NZDUSD	-4.5	-6	0.32	1.09
USDJPY	-1.49	3.71	-1.87	-2.89
USDCHF	3.22	5.18	-0.1	0.3
USDCAD	2.8	4.3	-1.32	-0.32
USDCNY	1.01	1.82	0.75	0.08
USDINR	3.61	4.16	1.03	2.19

Government Bond			
	1M Change BPS	3M Change BPS	YTD Change
10Y US Treasury	-29	19	-8
10Y JP JGB	10	31	22
10Y DE Bund	-21	5	1
10Y UK	-42	4	-10

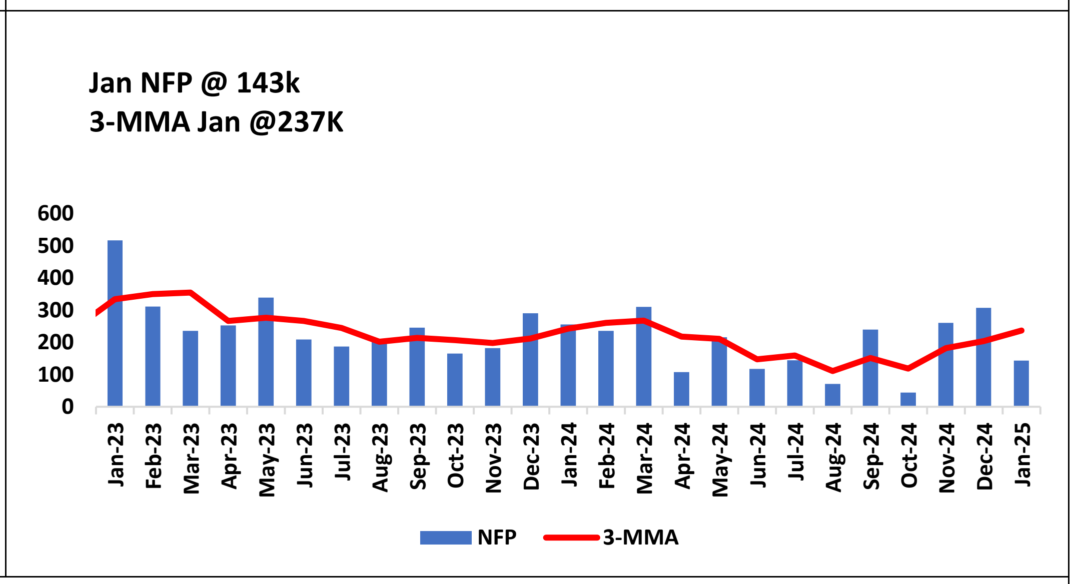
Commodity Price Performance			
	MTD % Change	3M % Change	YTD % Change
WTI Crude	-8	5	0
Gold	9	11	11
Silver	8	6	12
Copper	6.5	8.5	14.5

Source: Bloomberg, Reuters, UBI research

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

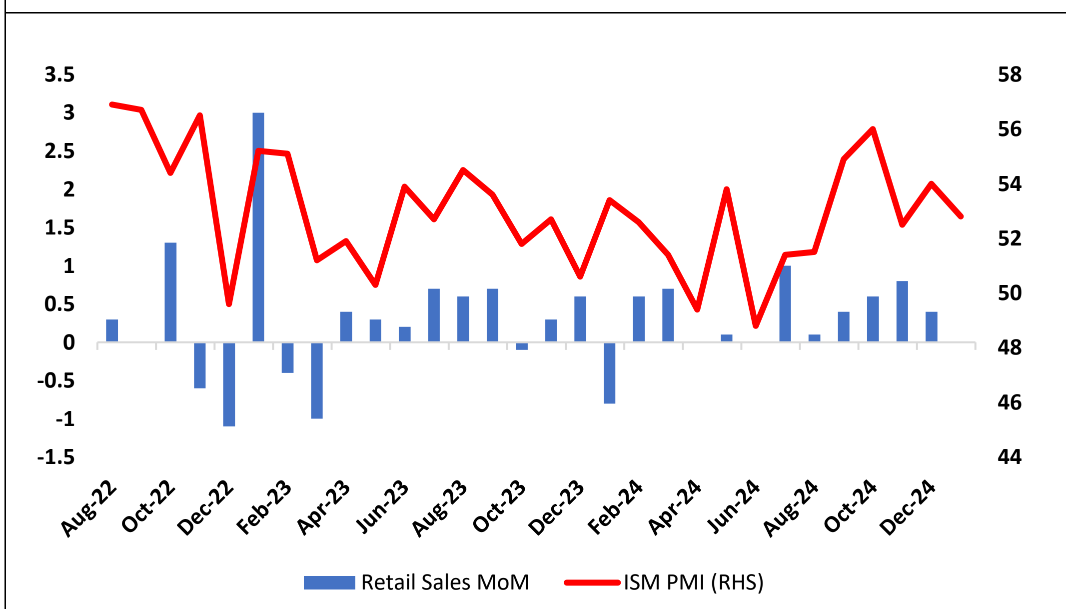


Job creation in Jan'25 (US NFP) was lower than expectation *(Fig 3)*

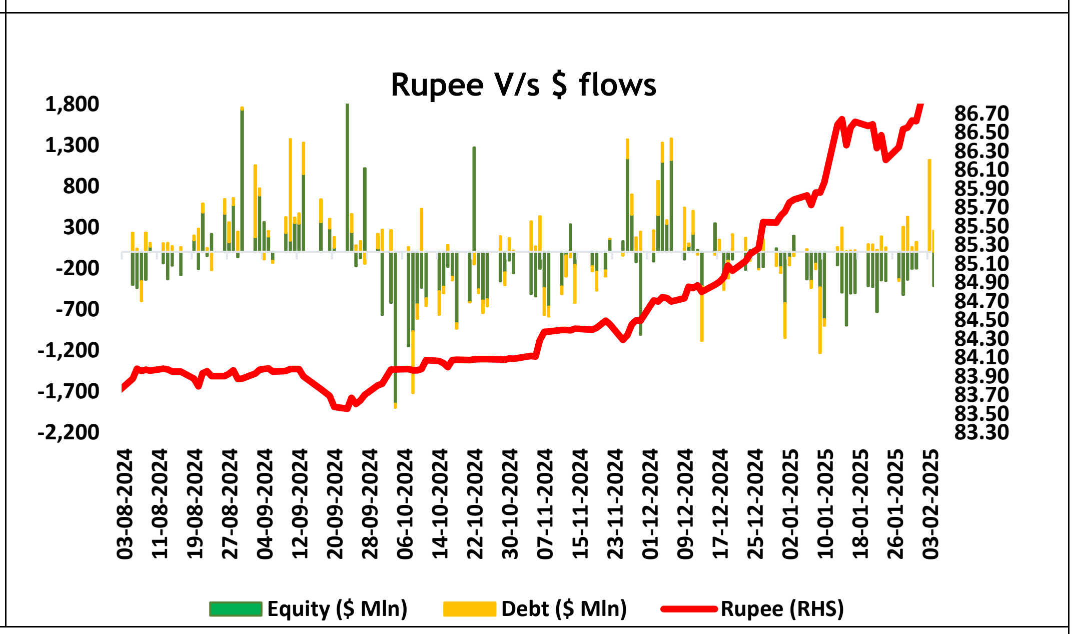


Source: Bloomberg, Reuters, UBI research

US retail sales is expected to remain weak for Jan'25 *(Fig 4)*

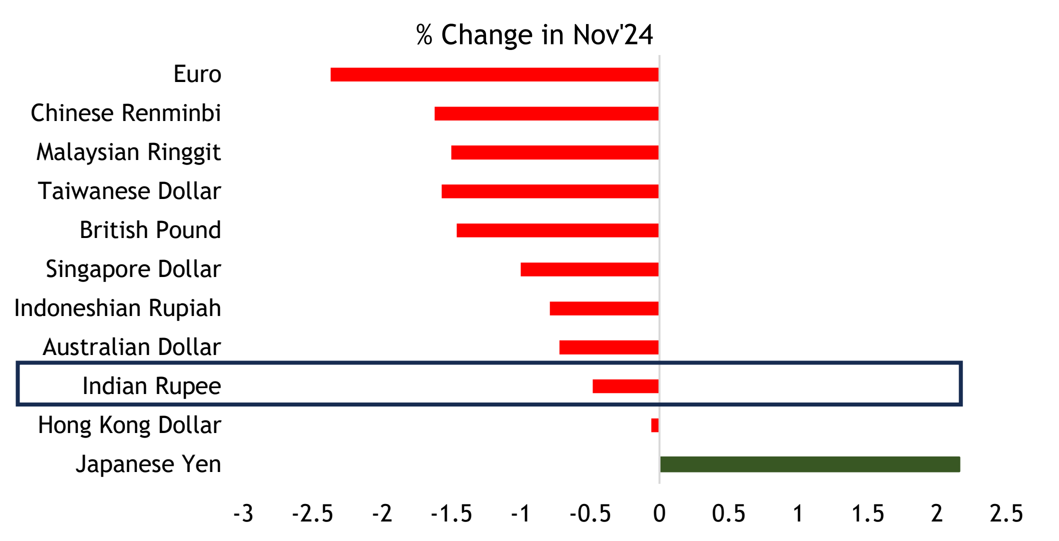


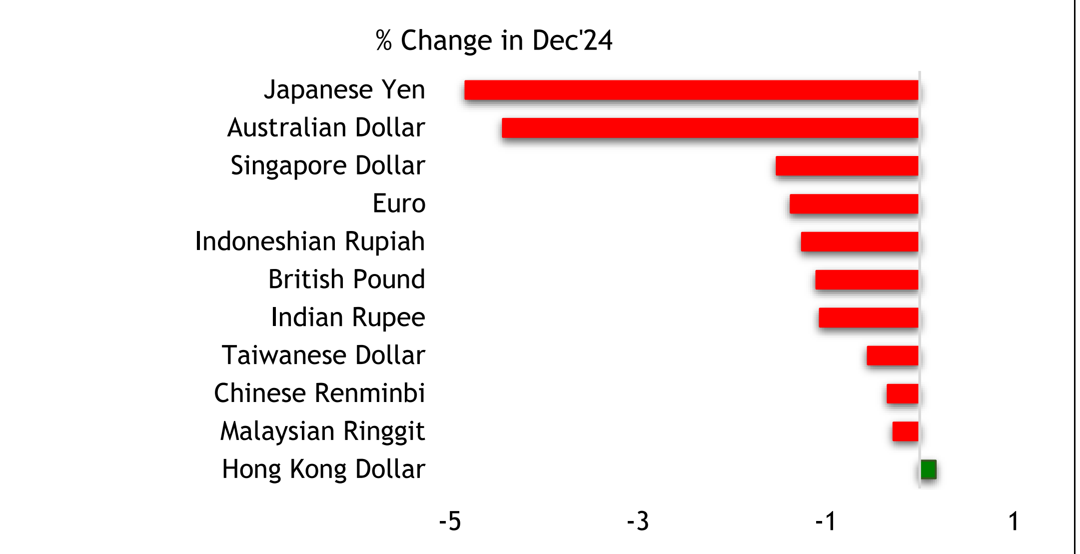
Outflows from equity markets continue to weigh on rupee *(Fig 5)*



Source: Bloomberg, Reuters, UBI research

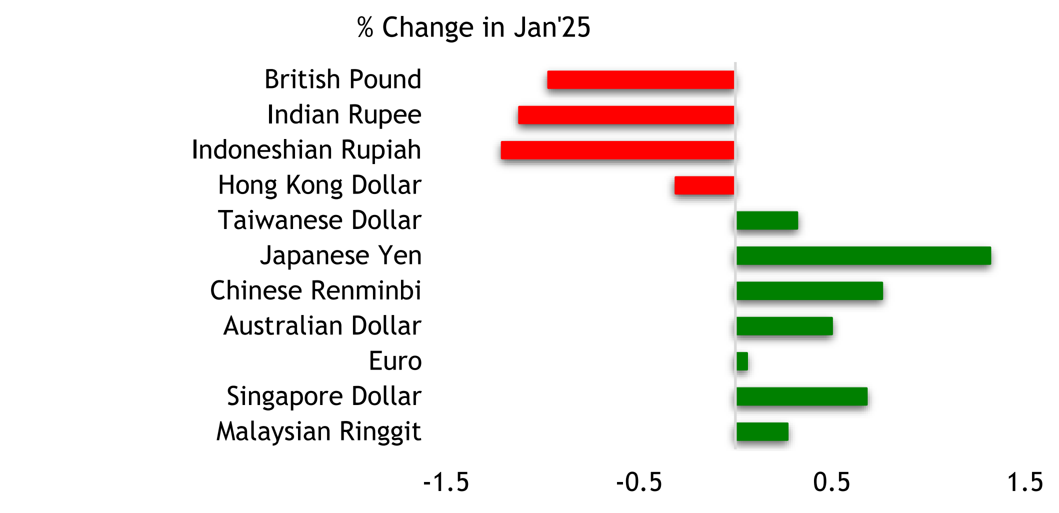
After US election INR showing strong resilience *(Fig 6)*	INR selloff gained momentum in Dec'24 *(Fig 7)*

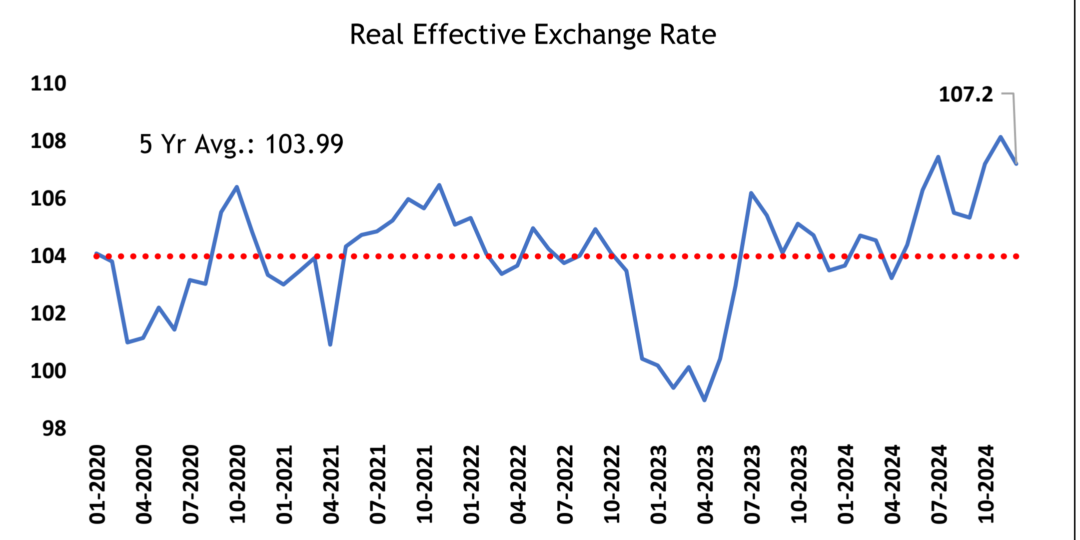




Source: Bloomberg, Reuters, UBI Research

Rupee seen sharp depreciation in Jan'25, remains worst performing currency after Indonesian Rupiah *(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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