

By:

Kanika Pasricha  
kanika.pasricha@unionbankofindia.bank

Akash Deb  
akash510@unionbankofindia.bank

Shreyas Bidarkar  
shreyas.bidarkar@unionbankofindia.bank

**Fig 1: 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

*US CPI and PPI remains sticky while labor market remains weak*

*Markets are pricing in total of 75bps rate cut in 2025 as against 200bps cut*

Last week was a data heavy week as we saw US CPI, PPI prints, both the data have cemented a December rate cut by FED, although the prospect that the FED may pause its policy easing in early 2025 is rising. In this regard, the FOMC rate decision and policy guidance due on 18<sup>th</sup> Dec'24 will be on close watch. (Refer monthly report: [Uni-FX: US exceptionalism, Trump trade may keep FX markets volatile next year](#))

In other G10 space, the Swiss National Bank (SNB) cuts its policy rate by 50bps which takes the bank's main rate to 0.5%, while markets were expecting a smaller rate cut. The ECB on expected lines also cut its policy rates by 25bps while Lagarde maintained her data dependent approach for future rate cuts. Monetary policy divergence is likely to remain key FX driver next year as well. This was evident from the fact that Brazil's central bank delivered a much hawkish monetary policy by raising its interest rate by 100bps to 12.25%.

In Asia, China's Politburo has announced that it will adopt a "moderately loose" stance for monetary policy in 2025, marking a major shift in its "prudent" stance since 2011. The Politburo has also signalled for looser fiscal policy, as it pledged to be "more proactive". While the Reserve bank of India (RBI) decided to keep its policy rates unchanged, it cut the cash reserve ratio (CRR) by 50bps to 4% to boost liquidity. This week is heavy in terms of central bank decisions with FOMC, BoJ & BoE policy outcomes in focus along with US PCE data. The key FX themes from this week are outlined below

- ♣ US CPI has cemented rate cut prospects in December FOMC meet
- ♣ ECB delivers another 25bps cut while offers dovish guidance; FX markets remained muted
- ♣ SNB surprises markets with aggressive rate cut of 50bps while RBA maintains status quo
- ♣ BoJ policy to become clear this week which will determine JPY's path
- ♣ Rupee slipped to all-time lows amid highest ever trade deficit recorded in Nov'24

**US CPI has cemented rate cut prospects in December FOMC meet**

US CPI inflation numbers came in on expected lines, with both headline and core CPI rising 0.3% MoM while on annual basis both the core and headline remained unchanged at 3.3% and 2.7% respective compared to previous month. The details showed some moderation in services inflation including in the shelter component, but core goods disinflation slowed with rise in apparel prices coupled with food sub component. Overall, the CPI inflation print has raised prospects for 25bps FED rate cut in December, but will likely push the FOMC to communicate a slower pace of easing into 2025, given that Trump's policies including on tariffs could certainly alter the trajectory of inflation. US PPI for Nov came in at 0.4% (expected 0.2%) vs 0.2% in Oct. From a year ago, PPI rose 3.0% (expected 2.6%) vs 2.4% in Oct. The 3.0% reading is the highest level since Feb 2023.

**Business sentiment improves in November**

While NFIB Small Business Optimism index surged from 93.7 in October to 101.7 in November, the highest level since June 2021 with the MoM increase at the largest since July 1980. The election results signal a major shift in economic policy, leading to a surge in optimism among small business owners.

**Labor market remains weak**

The release of the latest nonfarm payrolls report for November revealed that employment growth rebounded strongly by +227k after the weak reading of just +36k in October. Even after incorporating the +56k upward revision to prior month's employment, overall number remains weak. While the unemployment rate rose slightly from 4.1% to 4.2%, avg. hourly earnings picked up by 0.4% mom.

**US Dollar and bond markets consolidate while await new triggers**

After hitting a high of 2.4% on the day of the US election, the US10Y has since fallen back to 2.25% reflecting less concern over inflation. The US dollar initially weakened alongside US yields after the release of the nonfarm payrolls report but those losses proved to be short-lived and has recovered since the release of CPI data. After hitting a low of 105.42 on 6th December, the dollar index has since climbed

*PPI rose in November raising questions over progress in bringing down the inflation*

*ECB stance on future moves remains same those decision would be “data-dependent” and “meeting-by-meeting” with no pre-committed path ahead.*

*SNB cuts by 50bps an ongoing tussle with depressed inflation and a strong Swiss franc*

back around the 106.00-level. While the US 2-year and 10-year yields both hit fresh lows on Friday at 4.08% and 4.13%. A higher likelihood of the FED delivering another 25bps rate cut this month is not sufficient to trigger a sustained reversal of US dollar strength built on expectations that the incoming Trump administration will put in place policies including higher tariffs that will support a stronger US dollar next year.

### **ECB delivers another 25bps cut while offers dovish guidance; Fx markets remained muted**

The ECB did not surprise the markets and cut the rates by 25bp that has resulted in minor moves in FX and rates. The ECB in the policy statement dropped the reference to keeping the monetary stance “sufficiently restrictive for as long as necessary”. The ECB has cut rates four times totalling 100bps and markets expect a total of another 150bps cut next year.

#### **Key elements of ECB statement:**

- 1) The disinflation process is seen as well on track, and the central bank removed its reference to an expected rise of inflation in the coming months.
- 2) Domestic inflation has edged down but remains high, with wages and prices still adjusting to the past inflation surge with a substantial delay.
- 3) The central bank lowered its projections for underlying inflation (CPI excluding food and energy) slightly. The ECB now sees underlying inflation at 2.9% in 2024 and 2.3% in 2025 (both unchanged), 1.9% in 2026 (previously 2.0%) and 1.9% in 2027.
- 4) The ECB also lowered its GDP growth projections to 0.7% for 2024 (previously 0.8%), 1.1% for 2025 (previously 1.3%) and 1.3% for 2026 (previously 1.5%).

Although there was muted reaction in FX markets after the announcement of rate cut by ECB but the EURUSD pair broke the crucial level of 1.05. EURUSD pair has already been under pressure for the second half of 2024. The pair continues to wobble around the psychological figure of 1.05 after making a low of 1.0331 on 22nd November. The potential return of trade tariffs, as proposed by Donald Trump, could add complexity to the economic landscape. Such measures might push US inflation higher, forcing the FED to adopt a more aggressive policy stance. This could strengthen the USD further, placing additional pressure on EUR/USD in the coming months.

### **Swiss National bank surprises markets with aggressive rate cut of 50bps while RBA maintains status quo**

The Swiss National Bank (SNB) was the first major economy to loosen its monetary policy in March, implementing four reductions this year. The Swiss National Bank (SNB) surprised market participants by delivering a 50bps reduction in its policy rate to 0.50%, compared to the 25-bps reduction expected by the consensus while the policy rates remain at 0.50%.

In lowering interest rates, the central bank noted a decrease in underlying inflation pressures. With lower-than-expected food and energy inflation as well, the SNB lowered its CPI inflation projection for 2025 to 0.3% (previously 0.6%), while its inflation forecast for 2026 was little changed at 0.8% (previously 0.7%).

Meanwhile, the RBA this month has kept its policy rates unchanged at 4.35%. Markets have pared back expectations for a February rate cut by RBA after a stronger-than-expected jobs market. But more labour market data are available before the next policy decision. Potential weaker jobs data amid a slowing economy could still lead to an RBA pivot in February. Currently markets are pricing in 61% probability of rate cut on Feb 28th 2025 meet and a total of 75bps cut by end of 2025 for policy rate to reach at 3.50%.

### **BoJ policy this week to will determine JPY's path**

Market awaits BoJ policy this week and have priced in 76% probability that the BoJ will maintain status quo, while next year it is expected to hike rates by total of 45 bps for its policy rate to reach 0.68% in December 2025. The prevailing view among market participants for now is that the BoJ will hike at either the December or the January meeting.

*BoJ Governor Kazuo Ueda asserted we are “open for rate hike”*

*Rupee depreciating gradually compared to Asian peers*

*Subdued \$ flows in FII segment this week*

*BoP tracking negative numbers*

In November, Yen was the top performing G-10 currency strengthening by c.1.5% versus the US dollar. The USD/JPY opened last week at 149.86 but subsequently JPY lost momentum on the backdrop of US Dollar strength and trades around levels of ~153.5.

On the macro front, this month, wage growth figures, showed that October base pay grew 2.7% YoY, the fastest rate since November 1992. Also, preliminary report by the Bank of Japan revealed that Japan's Producer Price Index (PPI) increased by 0.3% MoM and 3.7% YoY. Meanwhile, core inflation in October held above the central bank's 2% target at 2.3% YoY.

Moreover, BoJ Governor Kazuo Ueda recently stated that the timing of the next rate hike was approaching as he asserted we are “*open for rate hike*”. Furthermore, BoJ's more dovish board member Toyoaki Nakamura stated that the central bank must move cautiously in raising rates, fuelling uncertainty about the BoJ's December policy decision. Going ahead if JPY does not hike rates this month the currency is likely to weaken further and will remain solely as US dollar play while awaits Trump administration policies once he resumes office on 20<sup>th</sup> January.

### **Rupee slipped to all-time lows amid highest ever trade deficit recorded in Nov'24**

INR slipped to fresh all-time low of 84.9325/\$ (17th Dec'24) after the merchandise trade data clocked highest ever deficit recorded in Nov'24 to \$37.84bln. In October, it was oil while in November, gold was the key driver of trade data shocker. Weak domestic data, CRR cut in the RBI policy and appointment of new RBI Governor Shri Sanjay Malhotra together have cherished hopes of rate cuts in the upcoming Feb'25 MPC thereby adding to depreciation bias in Rupee as it has been hitting fresh all-time lows. US FOMC interest rate decision today; soon followed by BoJ decision on 19th Dec'24 and BoE rate decision will be the key market movers in this week. Dollar has maintained an upward bias on US exceptionalism and uncertainty over Trump's policies.

Merchandise Trade Deficit clocked to all-time high levels of \$37.84bln in Nov'24 vis-a-vis our estimate of \$25.12bln (Market consensus: \$23.9bln). One-offs in Trade data have started to become frequent this year which is a cause for concern. In October, it was oil while in November, gold was the key driver of trade data shocker. 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. This is a positive surprise in a slowing global economy and is likely to have a salutary effect on FY25 C/A dynamics. While we expect the one-offs in trade deficit to correct in the coming months, yet the adverse impact seen FYTD leads to **revise our FY25 C/A deficit at 1.2% of GDP from 0.9% earlier.**

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 most of the emerging-market currencies depreciated against Dollar, Rupee has relatively been less affected among the Asian peers and depreciated (0.30%) last week. Despite this, **REER has seen an overvaluation bias reflecting pending depreciation pressure in the currency pair.**

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 \$3.06bln. Nevertheless, on a WoW basis equity markets crashed and outflows were to the tune of \$198.94mln vis-à-vis inflows \$2885.92mln a week ago. Also, the debt segment has witnessed negligible inflows to the tune of \$146.89mln vis-à-vis inflows of \$1218.75mln from the previous week. Moreover, the FAR related flows have turned positive at \$1053mln in Dec'24 vis-à-vis outflow of \$507mln in Nov'24. Going forward, Dollar inflows are also 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.

Our analysis shows that FYTD25 BoP is tracking negative c.\$1.05bln (Q1: \$6.37bln, Q2: \$27.65bln & Q3: -\$35.07bln) with sharp loss in BoP seen in last 2 ½ months. Historically, there is a close correlation between FX reserves (adjusted for valuation effects) and BoP.

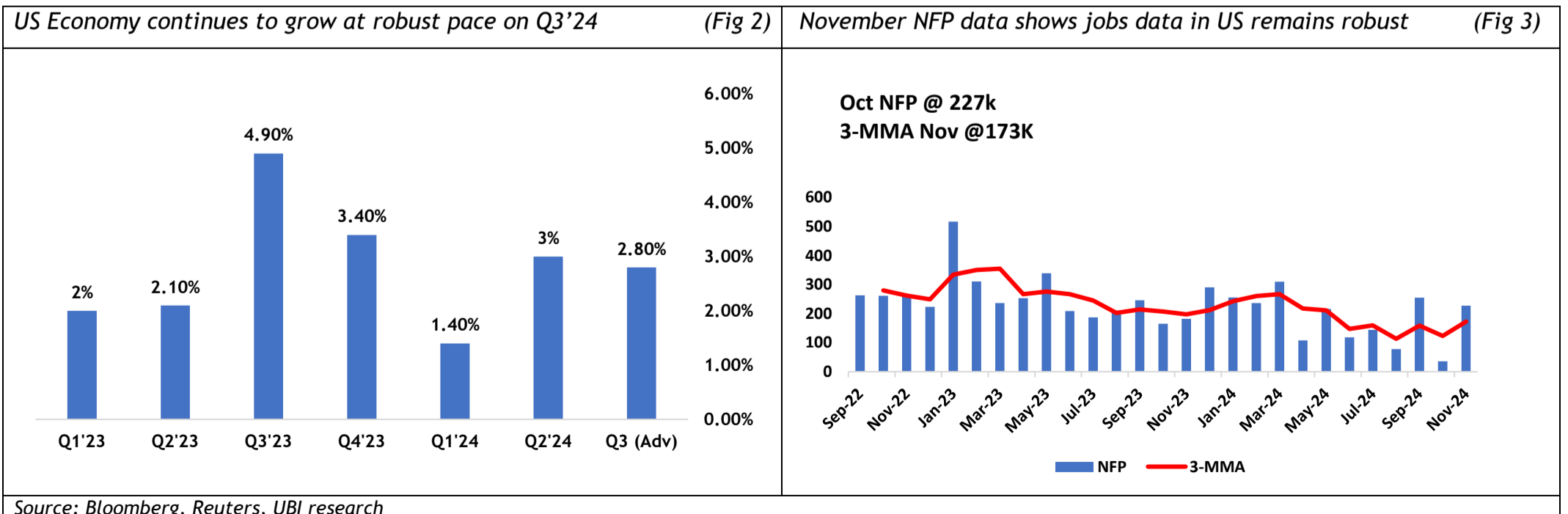
However, key factors may provide a salutary effect to Rupee moves: i) Subdued oil prices as favoured by Trump - Sensitivity of C/A deficit to oil prices stays high with every \$10/b move in oil price affecting annual C/A balance by close to \$15 bln. Hence, if average oil prices settle lower at c.\$75/b, C/A deficit may be closer to 0.5% of GDP in FY25 and may stay low in FY26 too; ii) Adequate FX reserve buffers may lead the RBI to continue to curb volatility - RBI ex-Governor Shaktikanta Das stated, “Our overall approach ensures that forex reserves act as shock absorbers, safeguarding the economy from external spill overs, while supporting competitive and orderly market conditions.

The latest RBI Special Data Dissemination Standards shows, 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.

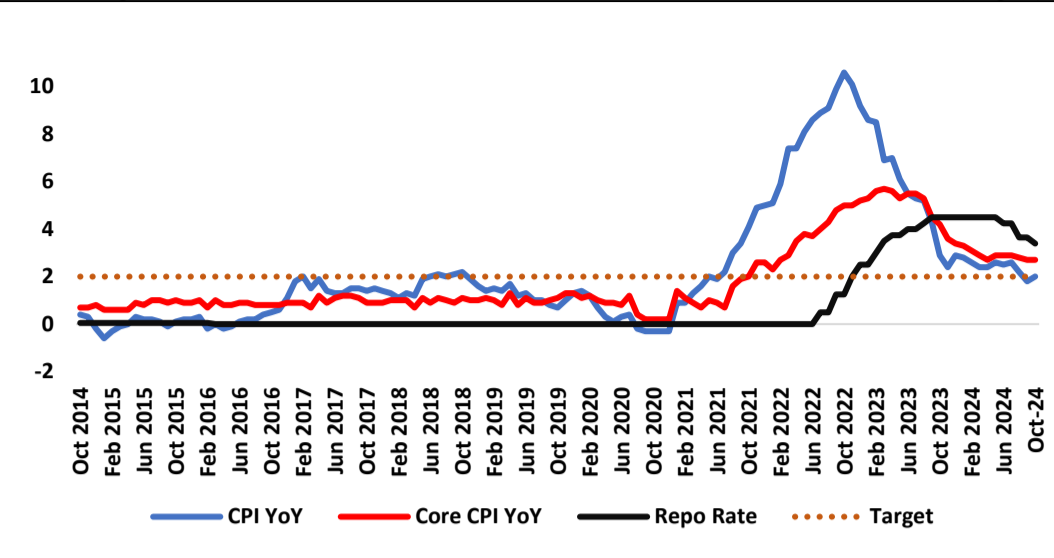
Additionally, spot FX reserves are at a near 5-month low to \$654.86bln for the week ended 06th Dec’24, though it is down by \$50.03bln from all-time highs of \$704.86 (\$35.07bln fall was adjusted after valuation effects). This shows central bank has persisted with its efforts to curb FX volatility.

Based on the current global scenario, technically INR should take support of 84.50 followed by 84.16 levels and will find resistance around 84.90 (NDF highs), breach of which will test 85.30 levels. However, going forward, we closely watch for a scenario of possible overshoot in DXY, probably a breach of current technical level. 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 labour market data to impact FX markets](#))

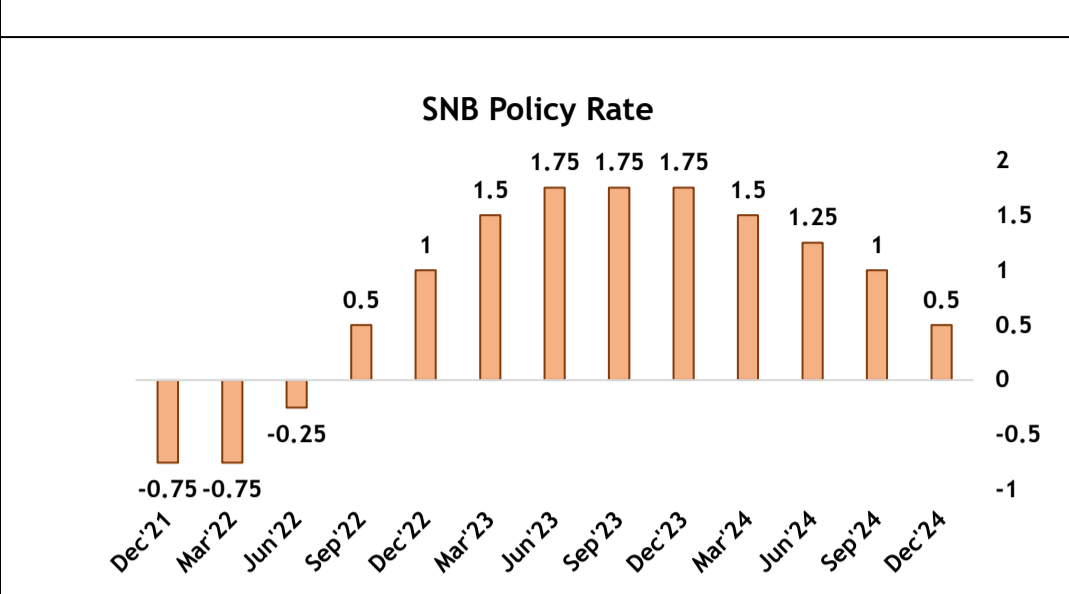


Eurozone inflation spiked to 2% in October, while core remains unchanged (Fig 4)

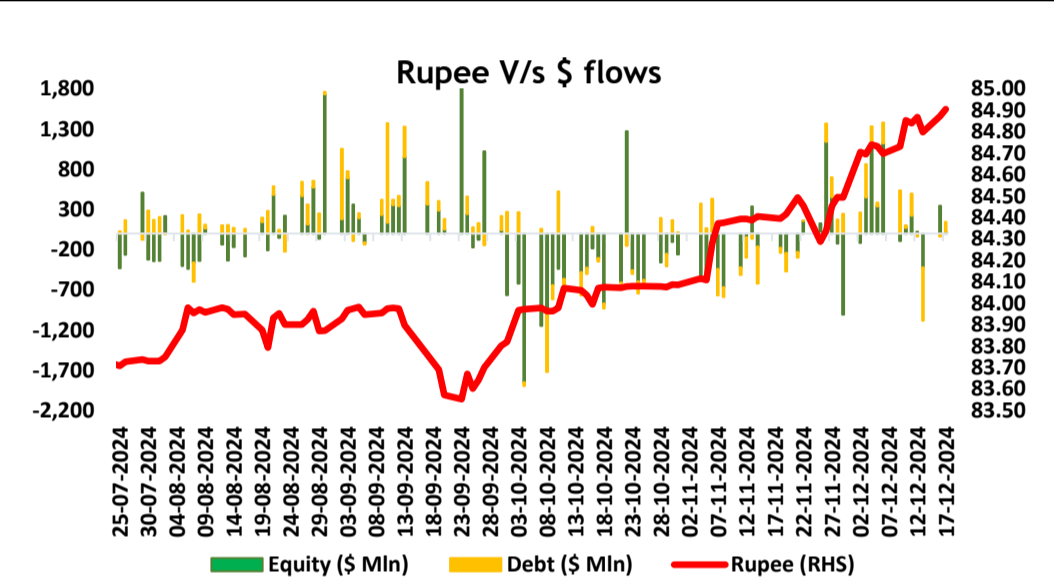


Source: Bloomberg, Reuters, UBI Research

SNB cut its policy rates by 50bps in its December policy (Fig 5)

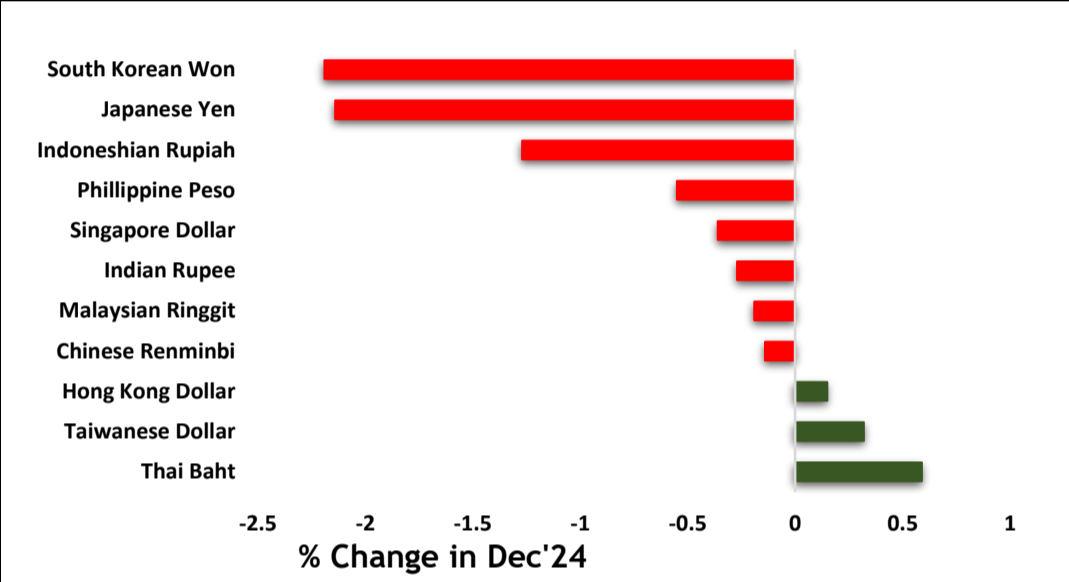


Rupee gradually depreciating amid subdued \$ inflows (Fig 6)



Source: Bloomberg, Reuters, UBI Research

INR showing strong resilience among Asian peers (Fig 7)



**Key Market Movers** (Fig 8)

Government Bond			
	1M Change BPS	3M Change BPS	YTD Change
10Y US Treasury	-15	63	40
10Y JP JGB	2	21	40
10Y DE Bund	-26	2	12
10Y UK	-20	55	78

Commodity Price Performance			
	MTD % Change	3M % Change	YTD % Change
WTI Crude	-4	-6.6	-6.4
Gold	-2.78	5.26	28.84
Silver	-4	7	30
Copper	-6.84	-1.4	6.68

Source: Reuter, UBI research, Bloomberg

FX Performance				
FX Pair	3M % Change	6M % Change	MTD % Change	YTD % Change
EURUSD	-5.45	-2.45	-0.97	-5.11
GBPUSD	-3.76	-1.03	-0.86	-0.8
AUDUSD	-5.07	-4.11	-2.26	-6.56
NZDUSD	-6.13	-6.18	-1.89	-8.22
USDJPY	8.91	-2.32	2.43	8.74
USDCHF	5.3	0.04	1.5	6.23
USDCAD	4.18	3.1	1.04	6.18
DXY	5.11	0.87	0.06	5.14
USDCNY	2.08	0.38	0.32	2.36
USDINR	1.1	1.69	0.33	1.99

## Banking & Economic 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
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Shreyas Bidarkar	shreyas.bidarkar@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@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.*