Monthly Report

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Introduction – FX takes the Trump 2.0 path

Trump wins

The election presented the FX market with two very different paths: one of continuity with Harris, or one of radical shifts in economic policy with Trump. Trump 2.0 is the one it had to take. Not only did he sweep all the swing states and both chambers of Congress, but this time he will execute his mandate with loyalists installed in the key cabinet positions who are ready and prepared to implement his promises swiftly and aggressively.

A wave of dollar appreciation (its two-month gain is now above 6%) and a two-year high in DXY was the result. The binary nature meant that overnight implied volatilities were extremely elevated going into the event – even record highs for CNH – and by early morning Trump's decisive victory had turned G10 FX into a sea of red. Only the Canadian dollar escaped a greater than 1% loss on the day. There are two sides to the Trump trade coin that have lifted the dollar at the expense of Europe: in the US, the inflationary impacts of tax cuts and tariffs are expected to constrain the Fed's ability to cut rates, and fiscal stimulus should give the US economy a 'sugar high' growth boost. In Europe, meanwhile, trade uncertainty, tariffs, and inflammatory US foreign policy are assumed to dent confidence, hit growth, and force rates lower.

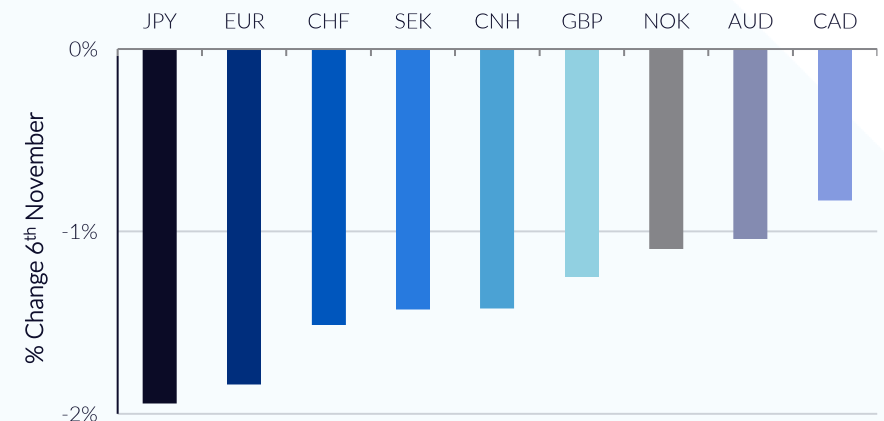
Trump's election win has clearly increased the downside risks for European FX. It is a regime change fin terms of how investors need to approach the markets. They must get used to market-moving social media posts at random intervals – this has already begun with Trump's threat to enact blanket 25% tariffs on Canada and Mexico, or 100% on the BRICS. These event hints at a new era of trade uncertainty, now that the use case for tariffs appears to have extended far beyond shrinking trade deficits and to a starting point for negotiations on any foreign policy issue, including drug and migrant flows. Open economies like Germany and China become particularly vulnerable in this context.

It also means that it is critical to accept the unknowability of which policy path will be realised. Given the focus on reducing federal expenditures through a Department of Government Efficiency, it cannot be guaranteed that the net fiscal impulse will ultimately be stimulative, and if it isn't, sentiment could deteriorate. And Trump likes to seek the market's approval – that may be a check on his radical promises.

Cyclical weakness abroad also supports the current direction

In Europe, further cyclical weakness has compounded the post-election downward momentum. Contractionary PMI indicators in both the eurozone and UK were responsible for a sharp drop in EUR/USD and GBP/USD to two-year and six-month lows respectively. The euro briefly broke below 1.04 for the first

The dollar rallied across the board as Trump won



time since the energy terms of trade crisis that sent it to parity in 2022. The ECB's policy path is has become closely tied to the growth outlook, and the softness in the macro indicators, as well as political crises in Germany and France, is behind bets on six further rate cuts over the next twelve months.

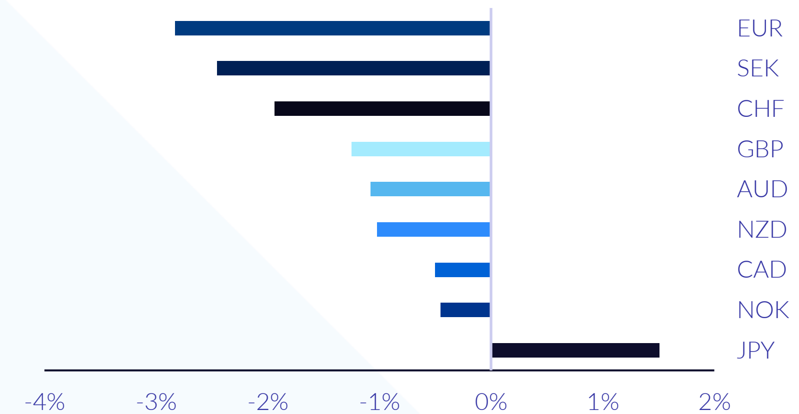
Risk appetite is steady, but vulnerabilities are growing

US risk appetite remains strong, with equities hitting successive record highs and credit spreads nearing all-time tights. And even in Europe, where some might assume that political and growth risks would weigh on European risk assets, the FTSE 100 and the DAX are trading either at or near record high levels. The post-election sentiment boom can also be seen in FX, where some of the most risk-sensitive currencies (NOK, AUD, NZD) comfortably outperformed the likes of CHF, GBP, and EUR both on election day and in November as a whole (JPY is another story).

But there are some intensifying pockets of vulnerability to look out for. While tensions have calmed in the Middle East, the UK and US decisions to allow the use of their long-range missiles by Ukraine in Russia triggered some escalation that involved a new nuclear doctrine and the use of ballistic missiles for the first time. European gas prices, while a long way below where they spiked two years ago, have doubled since February this year. Meanwhile, Trump's trade policy could quickly spiral into a global trade war that paralyses supply chains and knocks global growth, reversing the boost to risk assets that his win has provided so far. That would confront a European economy already troubled by sluggish growth and political crises.

Central banks are the focus in December.

November was mostly about the election, but macro trends are likely to dominate once again this month. Nine of the G10 central banks meet for the final time last year, with cuts expected from the Federal Reserve, the Bank of Canada, the ECB, the Riksbank, the Norges Bank, and the SNB, while the Bank of England should hold steady and the Bank of Japan may hike for a third time. In Switzerland and Canada, markets are favouring 50bp moves, while it is only recently that investors have come around to the idea of a 25bp cut from the Federal Reserve this time around.



FX Reviews

USD

Trump trade dominates

Politics was unsurprisingly the dominant driver in November and Trump's win extended the dollar index's meteoric autumn rally to 6%. There is a huge amount of uncertainty surrounding what Trump 2.0 really means, but the election result was about the most bullish possible scenario for the dollar. The Republicans took a full sweep of Congress, Trump loyalists have been installed in key positions, and the President-elect has taken every possible opportunity to reassure the world that he will be keeping his promises.

The number one concern for investors is that his policies – trade tariffs, tax cuts, immigration controls – are assumed to be inflationary. And since his polling averages began to pick up in October, there has been an enormously hawkish repricing of the Fed path. The end-Q1 2025 implied Fed funds rate has increased 80bps since September, from 3.4% to 4.2%. The ECB equivalent, meanwhile, has fallen 20bps. That divergence is what underpins the 6% drop in EUR/USD.

And Trump is only half the reason. Forget the jobs and growth panic that prompted a 50bp cut in September – the economy grew by 2.8% annualised in Q3, consumer spending rose by 3.4%, and the November services PMI touched a 2.5-year high. Progress on inflation also appears to have stalled, with YoY core PCE back up to 2.8%. That's not to say that the risks have disappeared, however - the October jobs report was severely weak, even accounting for one-time quirks. and the recent retightening in US yields could begin to weigh on activity once again.

The Fed has clearly begun to lean in the hawkish direction, with the likes of Kugler and Bostic suggesting that a pause would be appropriate, and Chair Powell urging caution, because 'the economy is not sending any signals that we need to be in a hurry to lower rates'.

Looking ahead to December, there are a few critical points to consider. The predictive power of seasonality is strongest in December, and the dollar has fallen on the month for the last seven years. Notably, however, the last time it did not was at the time of Trump's first election win.

Next, the December FOMC meeting is a near binary event for markets, depending on whether policymakers opt to continue cutting at back-to-back meetings, an outcome which the market only prices at a 60% probability. That meeting also comes with a fresh set of projections and a new dot plot, where policymakers are unlikely to speculate too strongly on Trump but can't realistically ignore him (although they may try for one last time).

And finally, markets will need to get used to higher levels of volatility, particularly in relation to unscheduled events. Beginning with the tariff threats on Mexico and Canada, Trump's social media posts have once again become macro events. Simultaneously, however, investors have learned the perils of reacting too strongly, given that these threats were cooled after a phone call to Mexican President Sheinbaum only a few days later.

The key with trading Trump is the unknowability of his eventual policies, and that the outcomes will be nuanced. By all means the straightforward assumptions about higher growth and inflation could be correct, but we have to consider where markets may be getting it wrong. The DOGE, or Trump's desire to appease markets, for example, mean that the net fiscal impulse is ultimately unclear.

The dollar index has risen dramatically since September

GBP

Sentiment sours

The near 2% drop in sterling in November was primarily a dollar story and, while the 2025 outlook for the Bank of England remained largely unchanged, Reeves' budget continues to produce some lingering ill effects.

In the lead up to the announcement it was the uncertainty, and in the aftermath it was the choice to up business taxes that have weighed on spending, investment decisions, and growth. At 49.9, the November PMIs slipped into contraction for the first time in over a year, as services sentiment slipped to the weakest level since December 2022. Q3 GDP growth also slowed more than expected, to only 0.1% from 0.5% in the second quarter.

The impact of the budget was given a lot of attention in the November Bank of England meeting. The new MPR projections put inflation 0.5% higher at the peak next year due to the short-term 'positive demand shock' to come from the increased government spending and borrowing plans. Yet policymakers generally argued that they would mostly look through the budget impact, meaning that a different rate path was unlikely.

Investors disagree. Since the day before the budget announcement, the swaps market has priced out two of the five rate cuts that were previously expected in 2025. The consensus for a continued quarterly pace of rate cuts has kept the BoE rate profile much closer to the Fed's than the ECB's, which explains the bulk of the 5% rise in GBP/EUR in 2024.

It is also supported by services inflation holding at the 5.0% mark in October, something which policymakers have consistently emphasised as the main obstacle to a return to sustainable 2% inflation. It is worth noting that the BoE inflation projections were conditioned on the pre-budget implied cutting path, which suggests that the projected boost to inflation will be smaller, if the market is right on the pace of further easing.

The rate-driven rally in GBP/EUR in November is in large part because sterling is comparatively quite shielded to the Trump trade. The US believes that it has a trade surplus with the UK, so Trump is unlikely to complain about Britain not buying enough American imports. At the same time, more than half of UK exports to the US are services, while the focus for tariffs is on goods. And Trump's fondness for the UK and his Scottish heritage should make him less likely to go after the British economy.

Even if UK growth were to suffer as much as the eurozone under Trump, the BoE is much less sensitive to changes in the cyclical outlook. Inflationary persistence and still sticky price growth in services the main roadblock to quicker easing. And while eurozone growth outperformed the UK in Q3, Britain is generally seen as having stronger momentum in the medium run and the political turmoil on the continent is far greater.

The key question for BoE watchers this month is the meaning of the word 'gradual', which has so far been ambiguous at best. Alan Taylor, the newest MPC member and the only one so far to put a number on it, says it means 100bps over the next year. The market thinks it is closer to 80bps – only three cuts in the next eight meetings. An unwind in this hawkish pricing is likely sterling's biggest downside risk heading into 2025, if growth fades or services inflation begins to fall more quicky than expected.

EUR

The spectre of 2022

The two-year yield gap between the euro and the dollar widened dramatically in November – nearly 40bps. As expectations for the Federal Reserve became more hawkish, markets piled in on dovish bets for the ECB. At one point, a severe disappointment on the November PMIs took EUR/USD to the lowest since the parity episode triggered by the energy crisis in 2022.

The main external shock to the ECB's rate path was naturally Trump's election victory. The main assumption for next year is this: because of the eurozone's high exposure and trade surplus with the US, and evidenced by Trump's promise to 'make them pay', it is likely to be one of the worst hit by US tariffs. These tariffs represent a growth shock to the euro area as businesses lose competitiveness in US markets and potentially domestic markets, with cheap Chinese exports to the US finding their way to Europe. This negative growth shock comes at a time when the eurozone is suffering already, owing to long-term structural shifts, political turmoil, and restrictive monetary policy. As a result, the ECB reckons that it needs to act to save growth, and that means more than six rate cuts are priced in by the end of 2025.

So while higher inflation expectations drove US yields higher, eurozone yields grinded lower. It is impossible to foresee the exact economic impact of Trump, but the ECB's Stournaras has suggested a recession, and Nagel sees a 1% hit to GDP. This is alongside rising risks from the geopolitical situation in Ukraine and continued poor growth in China.

Meanwhile, domestic headwinds continue to worsen. Consumers simply aren't spending wage gains as the ECB had

hoped, and growth is suffering. The 10-month low in the composite PMI index for November, driven by weakness in France and Germany, triggered a brief meltdown in EUR/USD as bets on a 50bp rate cut surged.

It is no coincidence that these main culprits are also where political uncertainty is ballooning and structural issues are putting the handbrake on economic policy. In France, the three-way gridlock in the National Assembly has meant that the interim government faces an ousting, after resorting to a constitutional loophole to put through spending cuts. OAT-Bund spreads surged to their highest since the debt crisis in 2012 as hopes of a material contraction in the deficit crumbled. Meanwhile, the inability to agree on fiscal stimulus measures led to the downfall of Germany's fragile coalition, although the silver lining here is that a new government could finally get some economic support through.

However, the euro clawed back some losses as ECB hawk Schnabel's commentary wiped out bets on a 50bp move. She expressed a strong preference for a more gradual approach, arguing that there was limited room for further cuts and that the PMIs have been unreliable in recent months. Contrary to the market's assumptions, she also reckoned that deglobalisation and trade fragmentation would increase inflationary pressures rather than easing them in the eurozone next year.

At 2.7%, core inflation remains sticky. While a 25bp move this month is a certainty and the likes of Villeroy want 50bps to be an option, the market is now only pricing an 18% chance of a jumbo move, although at least one is priced in at a 95% certainty over the next four meetings.

CHF

Haven status to come in handy

Against most majors, the franc simply mirrored its short-term yield differentials in November. That meant a near 2% loss against the dollar as US inflation expectations rose and the Fed path was repriced. EUR/CHF, however, dropped to the lowest level since the floor removal in 2015, thanks to an increasingly bleak cyclical outlook in the eurozone.

In Switzerland, markets added to easing expectations a touch, with a return to zero interest rates now all but priced in. There was another unsurprising surprise to the downside on inflation which, at 0.6% YoY, remains on a firm downward trajectory. The picture is even softer on a month-on-month basis, where prices have been going *down* for some time now – the price level is now 0.6% lower than it was in June.

The dovish rhetoric from the SNB continues to intensify, with Chairman Schlegel emphasising his willingness to return to negative rates, and to do so before returning to FX intervention as a policy tool. The market is leaning towards a 50bp rate cut at the December decision, which would put the policy rate at 0.5% before the year is out.

The other side of the coin for weak inflation, of course, is the support to nominal CHF rates based on purchasing power – an effect that is becoming increasingly powerful as inflation differentials widen.

Turning to Trump, the franc's haven status could prove to be a valuable asset in the coming quarters. The franc is often seen as a safer way to play Europe, and capital allocation to Swiss assets could certainly help to strengthen it if the situation in Ukraine escalates further, or the eurozone is hit hard by US tariffs.

JPY

The next hike approaches

A last-ditch rally meant that the yen became the only currency in the G10 to strengthen against the dollar in November. Markets became increasingly convinced of the possibility for another Bank of Japan rate hike in December, and the resulting rise in JGB yields squeezed the dollar's 10-year rate advantage, which continues to be the predominant driver for USD/JPY.

Inflation has been surprising to the upside. Tokyo core CPI landed higher than expectations and year-on-year PPI surged to 3.1%, hinting inflationary pressures building in the pipeline. An expectation among policymakers that supply chain issues and trade fragmentation under Trump would be broadly inflationary also increases the chance of a pre-emptive hike, or at least improves confidence that the neutral rate is higher.

At the same time, markets are growing increasingly confident in a positive cycle in the labour market, with President Ishiba calling upon firms and unions to keep the momentum on wage hikes in the upcoming round of negotiations. A hike is coming and a 25bp move is fully priced by the March meeting, alongside a 60% chance that it comes in December. The consensus appears to be for a hike every six months until we reach the 0.75-1.00% range.

Overall, USD/JPY closed out November slightly below the 150 threshold, despite peaking as high as 156.5 post-election. That puts the yen well clear of the possibility of intervention. Japan's currency diplomat Mimura gave a few threats about 'one-sided and drastic' moves, but we know that 160 is probably the lowest threshold at which the MoF would consider stepping back into the market.

SEK

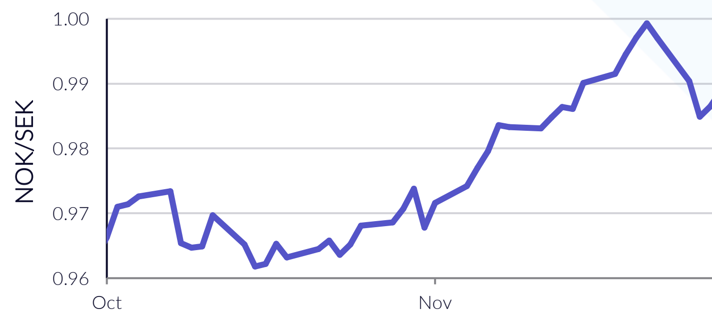
Growing contrast with Norway

The krona was one of the big losers of November, as the Riksbank and the data rang alarm bells on growth. Rate setters took another dovish step, as they sought to speed up an economy recovery with a 50bp rate cut.

0.3% growth in Q3 meant that the Swedish economy did manage to avoid a technical recession this year, defying consensus estimates. But consumption growth remains weak and full-year growth is likely to be well below 1.0%, so officials remain concerned about inflation settling below the 2% target without further cuts. While Deputy Governor Seim estimated the neutral rate to still be in the pre-pandemic region of 1.5-3%, she also hinted that policy may need to be cut lower than that to pull Sweden out of its cyclical downturn. Markets see rates below 2% as soon as Q1, although through 25bp increments.

The pre-existing weakness in Sweden likely makes the krona more exposed to US tariffs than Norway's krone. And given that the Norges Bank is still some months away from cutting even the first time, NOK/SEK's test of parity was hardly surprising.

Policy divergence helped NOK/SEK to test parity again



CAD

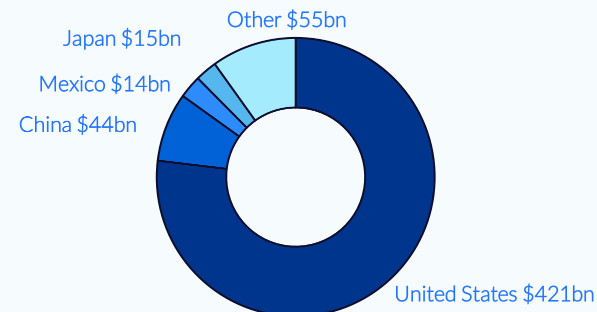
Tariff threats begin

Despite Trump's tariff threats on social media returning the loonie to a four-year low in a brief meltdown, the markets eventually found calm, and the Canadian dollar finished as one of the most shielded currencies to the US dollar Trump trade, even as domestic fundamentals continue to worsen.

Trump's 25% tariff threat, ostensibly to force Canada into action on illegal immigration and drug flows, initially scared the life out of investors. The majority of Canadian exports go to the US – with per capita GDP already falling, these huge tariffs are something the Canadian economy can ill afford. Calm eventually prevailed, however, and most consider it to be a starting point for negotiations.

At the Bank of Canada, we got the 50bps cut in October and a second in December is now priced at 60%, after another round of soft data. Per capita GDP fell 0.4% in Q3, employment disappointed again, and inflation remained soft, despite inching up to 2%. Markets are pricing the terminal rate at around the 2.6% mark, having peaked at 3.1% in the middle of the month.

More than ¾ of Canadian exports went to the US in 2023



AUD

Core inflation keeps RBA steady

The Aussie dollar continues to find some support from the most hawkish rates outlook in the G10, but its strong yield differential is ultimately outweighed by Trump's election win and its proximity to China.

The AUD:USD two-year yield differential is in the same place as it was in early October, but AUD is down 5% since then. There are several factors we can point to: a) as something of a yuan proxy, Trump's targeting of China inevitably spills over into AUD/USD, b) commodity prices have declined significantly since the early summer, and c) general risk appetite outside of the US has been shaky.

For the RBA, the markets are still looking at April for a first move. Headline CPI is virtually at target, but concerns remain about an uptick in the core measure to 3.5%.

Economic Calendar – December 2024

Central banks dominate the calendar this month, with no less than nine decisions within the G10.

Date	Time (CET)	Currency	Event	Previous
Wed 4th	8:30am	CHF	CPI y/y	0.8%
Fri 6th	2:30pm	CAD	Employment Change m/m	14.5K
Fri 6th	2:30pm	USD	Non-Farm Payrolls m/m	12K
Tue 10th	**4:30am**	**AUD**	**Reserve Bank of Australia Policy Decision**	**4.35%**
Wed 11th	2:30pm	USD	CPI y/y	2.6%
Wed 11th	**3:45pm**	**CAD**	**Bank of Canada Policy Decision**	**3.75%**
Thu 12th	8:00am	GBP	GDP m/m	-0.1%
Thu 12th	**9:30am**	**CHF**	**Swiss National Bank Policy Decision**	**1.00%**
Thu 12th	**2:15pm**	**EUR**	**ECB Policy Decision**	**3.25%**
Thu 12th	2:30pm	USD	PPI m/m	0.2%
Mon 16th	10:00am	EUR	Flash Manufacturing PMI Flash Services PMI	45.2 49.2
Mon 16th	10:30am	GBP	Flash Manufacturing PMI Flash Services PMI	48.6 50.0
Mon 16th	3:45pm	USD	Flash Manufacturing PMI Flash Services PMI	48.8 57.0
Tue 17th	8:00am	GBP	Average Earnings Index 3m/y	4.3%
Tue 17th	2:30pm	CAD	CPI y/y	2.0%
Tue 17th	2:30pm	USD	Retail Sales m/m	0.4%
Wed 18th	8:00am	GBP	CPI y/y	2.3%
Wed 18th	**8:00pm**	**USD**	**Federal Reserve Policy Decision**	**4.50-4.75%**
Thu 19th	**5:30am**	**JPY**	**Bank of Japan Policy Decision**	**0.25%**
Thu 19th	**8:30am**	**SEK**	**Riksbank Policy Decision**	**2.75%**
Thu 19th	**9:00am**	**NOK**	**Norges Bank Policy Decision**	**4.50%**
Thu 19th	**1:00pm**	**GBP**	**Bank of England Policy Decision**	**4.75%**
Fri 20th	8:00am	GBP	Retail Sales m/m	-0.7%
Fri 20th	2:30pm	USD	Core PCE Price Index m/m	0.3%
Mon 23rd	2:30pm	CAD	GDP m/m	0.1%

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