Monthly Report

February 2025

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Introduction – A tariff rollercoaster

Trump injects some volatility

The FX market was at the mercy of US tariff sentiment in January, as Trump began his second term. The dollar entered 2025 on a strong footing, thanks to a 7% rally in the final quarter, and began by extending gains as long-end yields rose globally, inflation concerns resurged, and markets priced in a tariff risk premium that pulled the likes of EUR/USD lower from levels suggested by rate differentials.

Then came inauguration week. In many respects, Trump hit the ground running with a raft of executive orders, particularly on immigration, deregulation, and pulling out of the likes of the WHO and the Paris Accord. But there was one area where he did not: tariffs. There were no day-one tariffs; instead, he only issued instructions to investigate the US' trade deficits. And markets never really bought the 25% tariff threat against Mexico and Canada that he floated in off-the-cuff comments. Instead, the consensus always appeared to be that the empty promises were negotiating tools that probably likely would not arrive in their proposed form. It was the dollar's worst weekly performance since 2023.

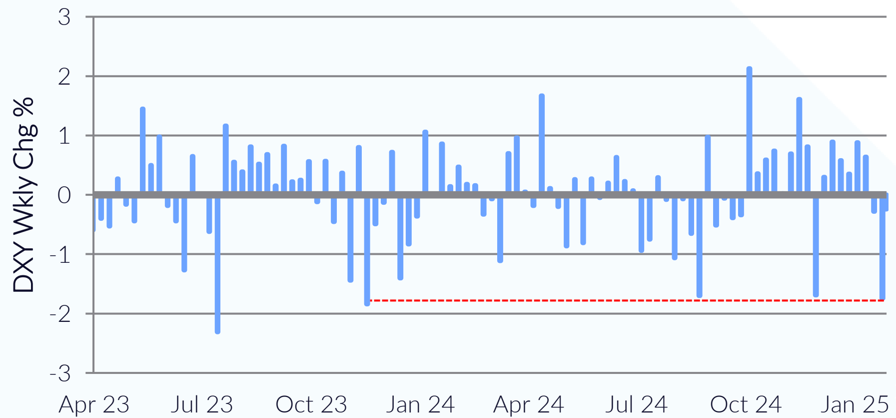
Tariffs matter to FX through several channels. The most direct is that import duties tend to generate a mechanical depreciation in the currency of the target country. Buy fewer (more expensive) Canadian exports, and the Canadian dollar will depreciate to offset some of the impact. Indirectly, traders then must weigh the inflationary impacts in the US, the hit to growth for exporters, trade frictions weakening economic efficiency, and the cascading effects of widespread trade wars if the target countries strike back.

The first evidence of a tariff-first-negotiate-later approach came against Colombia, where Trump used the threat of tariffs to coerce the Colombian government into accepting deportation flights. The Colombian President quickly backed down. Emboldened by his success, he announced that he would follow through on his threats against Mexico, Canada, and China – the US' three biggest trading partners, leveraging it to gain concessions on the border and leave a month to negotiate the nitty gritty.

A new era of unpredictability

The centrality of Trump's policy decisions led to a meaningful change in the most important market catalysts. Source articles, off-the-cuff comments, social media posts, and other unscheduled events now seem to matter as much as the key data – if not more. Unpredictability and uncertainty are deliberate hallmarks of Trump's dealmaking leadership style, often leaving markets clueless as how to accurately price the risks. This has been reflected in steadily rising volatilities since the middle of 2024.

Trump's first week was the dollar's worst since 2023



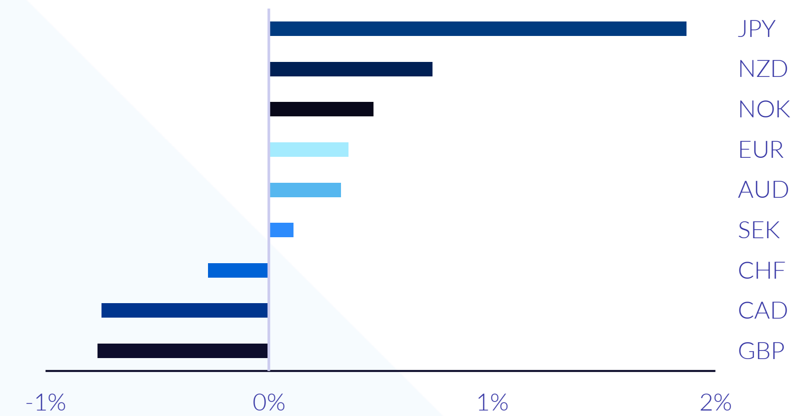
This dynamic became a familiar theme in January's central bank decisions. The Bank of Canada, the Federal Reserve, and the ECB gave perhaps the most boring central bank meetings of the past year, because policymakers were simply too reluctant to give any concrete forward guidance in the face of severe US policy uncertainty. The BoC was explicit in saying that its forecasts were potentially all but useless, because they used a baseline in which no tariffs were levied. ECB President Lagarde suggested only that conversations around where rates would level off were around the corner, but that surprised precisely no-one. And Fed Chair Powell confirmed that he is not 'in a hurry', reinforcing current expectations for only one or two rate cuts this year.

Japan was an exception, and the yen was the clear outperformer as the BoJ hiked rates for the third time and retained its confidence in being able to do so further. And the Riksbank became the first to call a likely end to its cutting cycle, suggesting that 2.25% is where rates will stay, though the market is not so convinced.

Vulnerabilities

A couple of vulnerabilities emerged. The first was reflationary concerns, particularly in the US, that drove a spike in longer-dated yields globally in the first few weeks of 2025. At the epicentre of the bond rout was the UK, where depressed sentiment around the most recent fiscal decisions was intensified by the Treasury's budget rules closing in as interest costs surged.

In the equity market, a selloff episode emerged as investors began to seriously question the sky-high tech valuations in the US. For a short time, the release of Chinese AI chatbot DeepSeek sent markets into a tailspin, with the model said to produce ChatGPT-like results with only a fraction of the cost, negating the need for vast amounts of hardware. Nerves have calmed since, but a material correction in the US equity market could spread quickly to Europe and to FX, with the immediate selloff prompting a surge in the non-US safe havens (CHF, JPY). The large jump in wealth in the US has played a big part in keeping consumer spending – take that away, and things could begin to fall apart.



FX Reviews

USD

Tariffs, tariffs, tariffs
The dollar entered 2025 at its strongest real trade-weighted level since the 1980s, shortly after the Plaza Accord when the G5 agreed to devalue the dollar. The nominal dollar index (DXY) also peaked at a two-year high early in the month.

For a while, it looked as if the greenback would end lower as Trump failed to hit the ground running on his tariff agenda. At the beginning of February, however, the imposition of 25% tariffs on Canada and Mexico, plus 10% on China, led to a sharp upward correction.

There was a direct and clear correlation between the dollar and the consensus on tariff severity. That meant a lot of whipsawing as conflicting clues kept markets on a Trump guessing game. Through a Washington Post article suggesting tariffs would only be levied on 'critical imports', Trump's rebuke to said article, sources from Bloomberg and the FT suggesting tariffs would be implemented in monthly increments, and the WSJ leaking that there would be no day-one measures, the market retained its scepticism that tariffs would ever come through before any negotiations.

But he eventually came through on the promise to slap steep tariffs on the US' biggest trade partners, under the guise of stemming fentanyl flows and halting the US' 'subsidising' of its allies through trade deficits. Canada quickly followed with retaliatory measures, threatening a protracted trade war. The risk sensitive G10 (EUR, CAD, AUD, NOK, SEK) plunged, before recovering as Canada and Mexico struck eleventh-hour deal to trade border concessions for a 30-day reprieve.

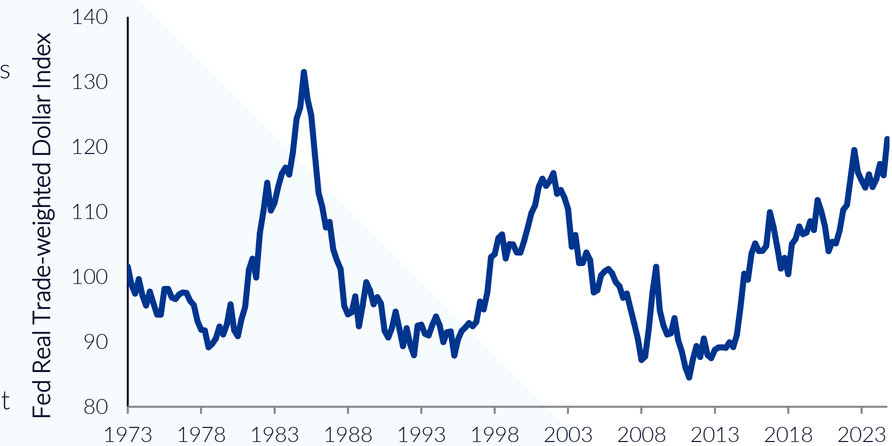
So, maybe the market was appropriately pricing the risks after all, and concessions can avert trade wars - it is impossible to know. A tariff premium is likely to remain for as long as Trump keeps talking about them, and another wave of dollar strength is possible if a trade war does materialise.

Moving on to the Fed, January's rate decision was probably the most boring in recent memory. In a familiar theme of late, Powell gave very little away, stressing the uncertainty around US policy and their inability to act on it until concrete actions come into play. The strength of the economy meant that they are 'not in a hurry' to cut rates further, but he also suggested that some progress was made in the intermeeting period.

The labour market remains strong and continues to stabilise, but it is not reaccelerating. The blowout 254K payrolls report jolted markets and briefly saw only a singular rate cut from the Fed priced in this year, but the downward trend is still intact when looking at the six-month averages. Most brushed off the uptick in job openings, too, given its divergence with other data sources that continue to point to a softening, Meanwhile, the stability in the unemployment rate and a concerningly hot ISM prices paid index reminded markets that the Fed is going to be on an extended pause for the first half of the year.

If there was progress on inflation, it takes a deep look to find it. Core CPI held at 3.3% and core PCE at 2.8%. Powell pointed to a cooling in the Owner's Equivalent Rent component, and the 0.2% m/m core PCE figure suggests that inflationary pressure on the Fed's preferred gauge has subsided for the near term. Some further progress can be expected in the coming months as the price surge in Q1 2024 fades out of the comparison.

The real trade-weighted dollar hit the strongest since the 80s



GBP

Gilt mania

For Sterling, January brought both a 14-month low and its best weekly performance versus the dollar since 2022. Disruption in the gilt markets led to heavy losses early on, but cooling yields and a resilience to US tariff threats helped it to recover.

In short, idiosyncratic fiscal challenges and a reliance on foreign investors translated into the pound being the central victim of a global surge in long-dated borrowing costs. The 30-year and 10-year yields jumped 30bps in a week, with the former touching the highest since 1998. The pound typically benefits from higher yields, because it attracts investors seeking better returns. Instead, it sold off. Naturally, that generated comparisons to the Truss mini-budget crisis, and it led Ray Dalio to suggest that the UK risks a 'debt death spiral'. It was nowhere near this scale, however, and the excess yield move in the UK was relatively contained. CDSs also held in recent ranges, so default probabilities were quite stable.

The problem is that the Chancellor's fiscal rules force her to act if rising interest costs steer the Treasury away from these rules. The squeeze on fiscal 'headroom' necessitates either tax hikes or spending cuts to restore it, and these actions risk slowing growth even further. For investors, the attractiveness of higher-yielding debt then must compete with the unattractive prospect of those higher yields further weakening economic activity. For a while, this gave sterling a less predictable, EM-like dynamic when it came to data releases – lower-than-expected inflation should have weakened the pound, for example, but the drop in yields was a relief instead. Fortunately, longer-dated yields did eventually come down, and sterling was able to regain some ground.

But stagflation remains a widespread concern, and sterling continues to underperform levels implied by its strong yield position. The January PMIs indicated that companies are shedding jobs at rates not seen since the financial crisis or the pandemic, owing to rising cost pressures, the employers' tax hike, and the post-budget sentiment slump. Sainsburys, for example, have announced plans to cut 3% of its workforce. 75% of the voting public are 'not confident' in the government's growth plans, and consumer confidence has fallen to a one-year low. Meanwhile, GDP growth has completely fizzled out since the summer, and it is unclear how this slump gets resolved at this juncture. Short-term Bank of England rate cut expectations rose, helped by the weak growth picture and a mild downside surprise on the December CPI, at 2.5%. A February cut is almost fully priced, as are three cuts for 2025 in total.

On tariffs, the UK's trade deficit with the US (at least according to US statistocs), the high weighting of services trade, and Trump's fondness for the UK puts it low on the list of targets. That allowed sterling to strengthen against the currencies likely to have the biggest direct impacts (EUR, CAD, CNH).

Put into context, the gilt selloff looks much less scary

EUR

Trump's next target

There was very little domestic news to move the euro, and markets were fixated on the US instead. At the peak of tariff fears, the euro came the closest to parity since 2022. But it ended January marginally stronger once these concerns had cooled.

So far, Trump has left the EU out of his current threats, largely because they have been centred around the fentanyl trade. His reasoning for applying tariffs to Europe is likely to rest on ameliorating more longstanding concerns – the US trade deficit – and for that, we may have to wait until the investigative reports come out on 1st April. In the meantime, he has assured markets that EU tariffs will 'definitely happen' and that 'it's an atrocity what they've done'.

By now, it goes without saying that the eurozone is in a poor place in terms of growth already, and that a trade war could weaken already depressed demand and plunge the bloc into recession. Policymakers often disagree on the net directional impact on inflation - weaker demand has to be weighed with supply disruptions and import duties - although most would expect sustained tariffs to give the ECB extra encouragement to take rates to stimulative levels.

It is impossible to guess at this stage how severe or persistent a trade war will be, if one happens at all. While ECB President Lagarde has urged EU leaders to negotiate with Trump, most warn of retaliation. The most likely way out of a confrontation might be to give the US the appearance of a victory by, for example, promising to buy more US oil and gas. That would be best-case outcome for the euro.

The ECB inched closer to the end point of the cutting cycle in January with another 25bps cut. No significant new information came out of the meeting itself, but sources later told Reuters and Bloomberg that the 'restrictive' label may be dropped from the March policy statement, and that the debate is soon going to heat up about where 'neutral' monetary policy lies and whether it is necessary to cut rates to below those levels.

While services inflation has been stuck around the 4% mark for over a year, Lagarde is adamant that further moderation in wage gains will drive services disinflation this year. Combined with weak demand, some reckon risks are growing an inflationary undershoot. Consumer confidence fell to the lowest since 2023 in January, and the French and German economies are crying out for some help. There is a limit to what the ECB can do for countries plagued by structural economic and political issues, but it can ease the cyclical pain, and there is an argument to be made to take rates to lower than the 2% terminal rate currently assumed by markets.

Of course, however, the hawks that have moved to the sidelines recently are going to become much louder voices with each rate cut. They will be concerned that cutting too far might let inflation run riot again and could slow down the final stages of the easing cycle.

The German elections will be a key event for the euro in February. The CDU are almost certain to gain the biggest vote share, and so the euro will move largely based on the extent to which the incoming government might be able to reform the debt brake and allow for some stimulus spending. A boost to the German economy would be an obvious positive.

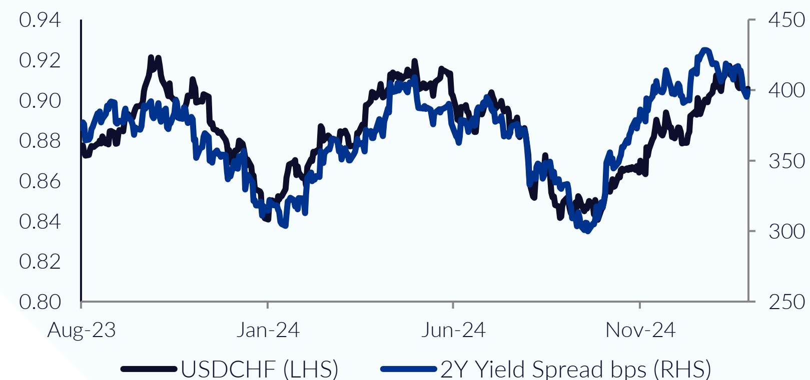
CHF

Haven in Europe

While many have suffered from a trade risk premium since the US election, the franc's haven appeal has given it a purer anchor to the US short-term yield cycle. Having weakened considerably in Q4, some extra easing bets in the US allowed CHF to claw back some losses in January. For EUR/CHF, an unwinding of that risk premium in the euro meant that the franc shed a small proportion of the 7% gains that it won through the final eight months of 2024. We also learned that a selloff in US tech stocks favours the franc over the dollar as a haven currency, which is an upside risk for those concerned that equity multiples might come crashing down.

CPI was weak again, at 0.6%, and the consensus is still on rates reaching zero but not moving into negative territory this year. Negative rates remain on the table, but the SNB appears keen to avoid that situation. US rates should remain the dominant driver for USD/CHF.

For USDCHF, it is all about rates



JPY

Hawkish momentum grows

The yen's strong rebound in January was the result of a narrowing long-end yield spread. Softer inflation and some extra easing bets in the US brought down the 10-year Treasury yield, while another hike and a hawkish shift from the Bank of Japan lifted the 10-year JGB yield to the highest in over 13 years.

After taking one more month to be sure of the data, and with another round of robust wage hikes in hand, the rate increase that markets had originally looked for in December ultimately came in January instead. Trump's inauguration had been a potential obstacle, but Japan had escaped without any immediate tariffs.

The key point for Japanese yields is that guidance remained fixed on hiking rates further, provided that the data meets expectations. Officials expressed increased confidence that the BoJ's outlook for price and wage gains would continue to be achieved, and that even with the most conservative estimates, there is still some way to go until rates hit a neutral level.

That suggests that slow adjustments higher will keep rates steadily rising. The market consensus is for another move in July or September, and then something like a six-monthly pace thereafter.

USD/JPY's movement closer to 150 removes the near-term risk of any FX intervention from Tokyo, but, as always, further yen strength depends more on the US economy than on the BoJ. Even with the current strength of the US economy, yen bulls will be banking on the Fed moving more quickly to cut rates.

SEK

The final cut?

With the global trade backdrop front of mind for investors, and the outlook for much of Europe at the mercy of Donald Trump, the krona largely moved in lockstep with the euro through January. USD/SEK peaked above the 11.2 handle but eventually settled closer to 11.1.

That is despite the Riksbank and the ECB beginning to considerably diverge. While another three cuts are looking likely in the eurozone, the Riksbank's lead on policy easing means that it is much closer to the end of the cutting cycle. When cutting again to 2.25%, policymakers said that the December forecasts still hold. In other words, they reckon they are done. Gov Thedeen suggested that is best assessment is that the Riksbank stays at 2.25%.

At the very least, the back-to-back cutting cycle is likely over. But the market is not convinced that this is the end, and the swaps market points to another by May or June, after holding steady in March. While the positive signs are building for a recovery in consumption and housing activity, unemployment is still rising and inflation continues to undershoot the target, having fallen to 1.5% in December. Policymakers have been hoping that a quick passthrough of the impact of the original hikes will be mirrored by some fast relief on the other side, but few are convinced that we are at neutral just yet.

Either way, an early finish to the rate cutting cycle suggests that the krona could benefit from an improving yield differential over the coming year. As always with SEK, however, that is heavily dependent on risk conditions remaining positive and, in 2025, Trump not disrupting the global economy too heavily.

CAD

BoC: who knows?

The BoC threw out forward guidance when it cut rates in January, arguing that the tariff story makes it impossible to guess the rate path this year. That was probably a fair assessment, given that Trump handed out 25% tariffs later that week and USD/CAD rocketed to a 22-year high. And that an eleventh-hour deal helped to delay them soon after,

The read for many was that the BoC's forecasts were a waste of time; they simply do not know how US tariff threats will play out, and even if they did, the consequences would be unknowable. Undoubtedly, a trade war would be devastating if it eventually comes around. US exports represent 20% of Canadian GDP, and most of Canada's imports come from the US. Canada's swift retaliation was targeted to inflict pain on the US at as little cost as possible for the Canadian consumer, but growth would certainly take a large hit. In a hypothetical scenario where half of the 25% tariffs are passed through into consumer prices over three years, BoC modelling suggests a 2.2% hit to GDP growth in the first year.

The centrality of the tariff story makes it much harder to get excited about the possible bullish drivers. Trudeau's resignation paves the way for an accelerated election timeline, with Pierre Poilievre and the Conservatives almost certain to get into power. Poilievre is market-friendly and wants tax cuts and deregulation. He also loathes dovish monetary policy, and has suggested in the past that he would fire Gov Macklem and replace him with someone more hawkish,

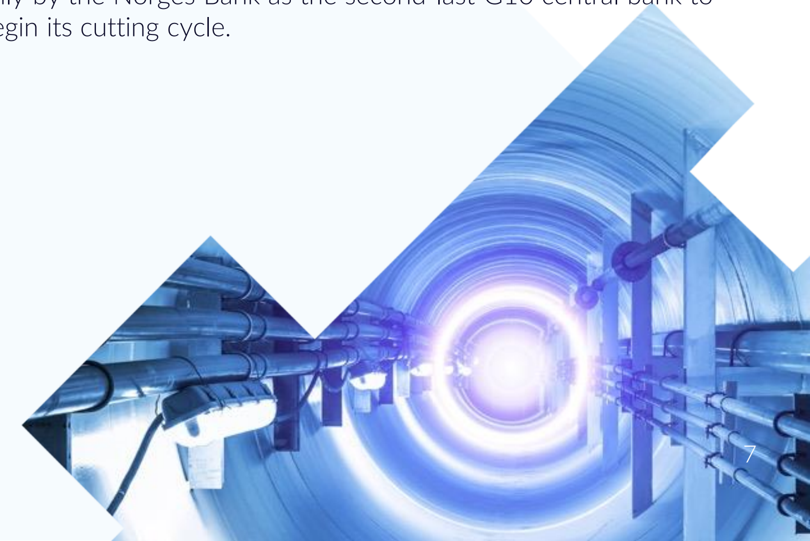
Data-wise, the economic picture was stable. CPI inflation remained subdued, falling to 1.8%, largely thanks to a sales tax holiday. A healthy 91K jobs were added in December, but the labour market cooling trend still looks intact.

AUD

RBA nears first cut

The Australian dollar halted its decline in January and steered clear of a break below the 0.60 level. A large part of its relatively solid performance came from the relief surrounding a US-China trade war. Rather than the 60% tariffs that Trump floated last year, he labelled his call with Xi Jinping 'very good' and expressed his desire to strike a deal and to avoid tariffs at all. Of course, however, China did get 10% tariffs after all, giving AUD a poor start to February.

Meanwhile, the RBA is closing in on its first rate cut. A February cut is priced at 90% and markets expect a second by the May meeting. Core CPI dropped from 3.5% to 3.2% and is now within touching distance of the 2-3% target range, where the headline figure has been since August. Rates have been at 4.35% since November 2023, and the RBA is likely to be beaten only by the Norges Bank as the second-last G10 central bank to begin its cutting cycle.



Economic Calendar – February 2025

German federal elections and a Bank of England decision are the key events for February.

Date	Time (CET)	Currency	Event	Previous
Tue 3rd	11:00am	EUR	CPI y/y	2.7%
Tue 4th	8:30am	CHF	CPI y/y	0.6%
Thu 6th	**1:00pm**	**GBP**	**Bank of England Policy Decision**	**4.75%**
Fri 7th	2:30pm	CAD	Employment Change m/m	90.9K
Fri 7th	2:30pm	USD	Non-Farm Payrolls m/m	256K
Mon 10th	2:30pm	USD	CPI y/y	2.9%
Thu 13th	8:00am	GBP	GDP m/m	0.1%
Thu 13th	2:30pm	USD	PPI m/m	0.2%
Fri 14th	2:30pm	USD	Retail Sales m/m	0.4%
Tue 18th	**4:30am**	**AUD**	**Reserve Bank of Australia Policy Decision**	**4.35%**
Tue 18th	8:00am	GBP	Average Earnings Index 3m/y	5.6%
Tue 18th	2:30pm	CAD	CPI y/y	1.9%
Wed 19th	**2:00am**	**NZD**	**Reserve Bank of New Zealand Policy Decision**	**4.25%**
Wed 19th	8:00am	GBP	CPI y/y	2.5%
Fri 21st	10:00am	EUR	Flash Manufacturing PMI Flash Services PMI	46.1 51.4
Fri 21st	10:30am	GBP	Flash Manufacturing PMI Flash Services PMI	48.2 51.2
Fri 21st	3:45pm	USD	Flash Manufacturing PMI Flash Services PMI	50.1 52.8
Sun 23rd	All Day	EUR	German Federal Elections	
Fri 28th	2:30pm	CAD	GDP m/m	-0.2%
Fri 28th	2:30pm	USD	Core PCE Price Index m/m	0.2%

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