Monthly Report

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Introduction – 'Trump trade' loses its shine

Peak dollar?

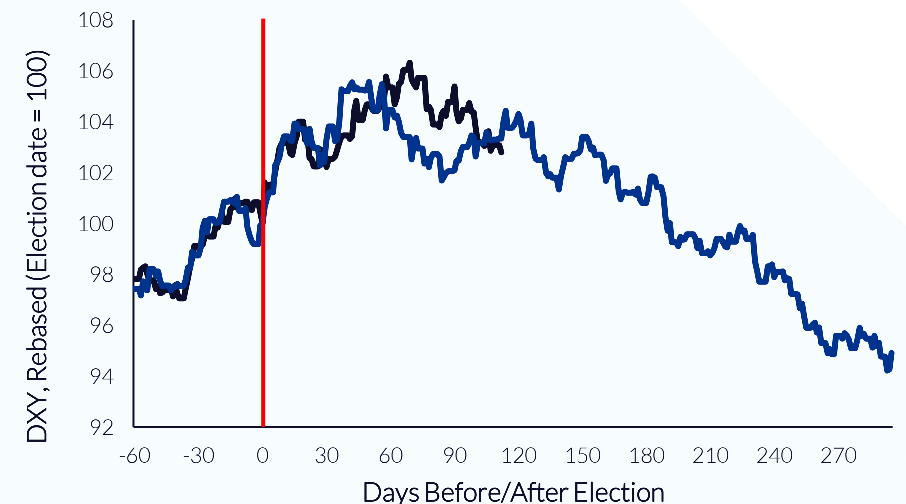
Most of the chief beneficiaries of the 'Trump trade' – the dollar, stocks, bond yields, crypto, and the rest – are now reversing as markets question their underpinnings. From their peaks ahead of the inauguration, the Magnificent 7 are down 15%, the dollar index is over 3% lower, and the 10-year Treasury yield has plunged by 70bps.

Initially, this was because tariff promises began to lose their bite. His threats were vague, imprecise, and usually delayed, and he had shown a preference for dealmaking wins as opposed to tariffs as an end in themselves. It often feels like he is making policy up as he goes, and the confusion has made the market less sensitive to the headlines.

The eventual implementation of 25% tariffs on Mexico and Canada and 10% on China would have been expected to send the dollar back to its highs. But it didn't, and the dollar remains broadly weaker. That is because in the background there has been a building pile of evidence that the US economy is slowing down. It also comes at a time when European sentiment is improving and equity indexes there have outperformed the US.

The hard US data has mostly been solid, but a string of disappointments across retail sales, the PMIs, the regional surveys, and consumer confidence has encouraged investors to wonder whether US exceptionalism is fading. Trump's fast-paced policy changes (DOGE, immigration, Ukraine, tariffs, tax cuts etc) have left heads spinning, and the uncertainty accounts for much of the weakness in sentiment and consumer spending. If a slowdown gets confirmed, the next question becomes whether it is purely down to this uncertainty, or whether the new administration is simply aggravating a pre-existing weakening trend. If the first, one would expect the impact to fade as concrete policy is realised, and if the second, we could be looking at a more sustained downturn in the dollar.

The dollar index is still following the 2016/17 playbook



Europe at a fiscal crossroads

Europe faces a long list of challenges, among which there is stagnant productivity growth, high fiscal deficits, the rise of competition from China, the prospect of a trade war, and political instability. Trump's geopolitical interventions have added another. US and Russia have squeezed Europe (including Ukraine) out from talks on ending the worst conflict on the continent since WW2. He labelled Zelenskyy a 'dictator' while refusing to call Putin the same, and a now-infamous exchange

in the Oval Office has dented hopes for peace. US officials have also been quite clear that Europe should no longer solely rely on a US security guarantee.

This has forced a reckoning for European defence spending and upended the international security order. Recognising that Europe needs to rearm quickly, newly-elected German Chancellor Merz is already trying to push through perhaps €400bn in defence spending using the old parliament, while UK PM Starmer has pledged to increase spending to 2.5% of GDP by 2027.

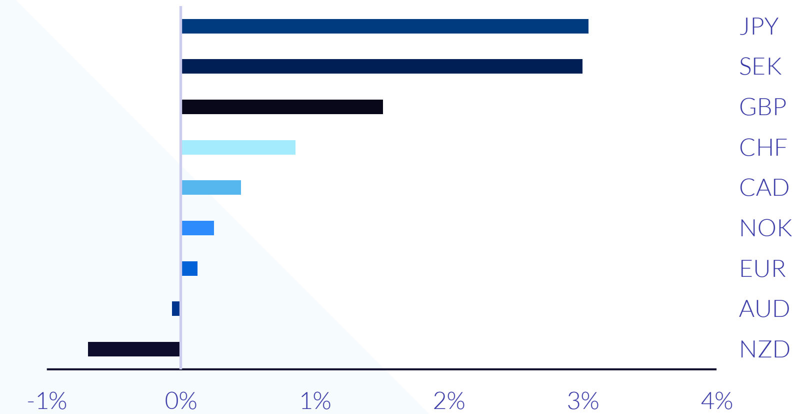
This has two major implications for FX. The first is that fiscal borrowing is now likely to rise in a context where countries like France and Italy are already running large deficits and racking up significant amounts of debt – that will likely mean higher yields and potentially a fiscal risk premium for the euro. The second is that peace in Ukraine might not be as cleanly positive for European FX as many would have hoped. The main benefits of peace - lower energy prices and more secure supply chains - might not make up for a deal that includes significant concessions from Ukraine and an emboldened Putin.

Nowhere is the fiscal budget as important as in the UK this month. The previous event in October has already hurt growth and increased volatility for the pound, and the March announcement is likely to involve some difficult choices that risk derailing sterling's recovery.

Safe havens cut through the noise

Amidst all the noise, the safe haven currencies are a refuge for those miss just watching monetary policy. With risk dynamics largely cut out of the equation, USD/JPY and USD/CHF are trading in a bubble where only rates seem to matter. For the yen, this has translated into large gains as yields rise and the BoJ continues on its hiking path, while the franc is still following the ebb and flow of the US economic narrative.

G10 February Performance vs USD



FX Reviews

USD

Trump honeymoon is over
The momentum has moved firmly against the dollar over the last month or so. Trump's re-election had initially triggered a surge in growth optimism around tax cuts and deregulation, but the lightspeed pace of policy change and the potential harm it could do to the US have dented confidence and softened demand. The result is a tripling in Federal Reserve rate cut bets for 2025 and a smaller yield advantage that have outweighed the positive impact of tariffs.

The hard data early in the month was mostly solid – the unemployment rate dropped, wage growth accelerated, payrolls were a healthy 143K, core CPI reaccelerated to 3.3%, and the economy grew at an annualised 2.3% pace in Q4. The inflation data was a more difficult signal to dissect, as CPI was strong but 'residual seasonality' distorted the figures and core PCE was softer.

But the softer data began telling a different story entirely. The PMIs were exceptionally weak, with services falling into contraction for the first time since December 2022 and manufacturing propped up mainly by firms front-running tariffs. Consumer confidence slumped to an 8-month low, and the regional surveys all pointed to a sharp weakening in demand. The Treasury Secretary himself reckoned that the private sector has been shrinking, and the Atlanta Fed's GDPNow forecast for Q1 crashed to -2.8%, primarily because of weak trade data.

It is easy to imagine why Americans might be cautious. DOGE is chipping away at the federal government at lightning speed, the headlines are flooded with geopolitical news, and uncertainty on tariffs is paralysing businesses. What is not clear is whether this is simply a Trump-related blip, or if there is a genuine, underlying trend that is being aggravated by the uncertainty.

The first option means that potentially the economy can reaccelerate when there is more clarity on policy. The second would drive a much more persistent bear trend in the dollar. Already rate cut expectations have risen dramatically since earlier in the year. On occasion, the market has wondered whether the Federal Reserve would feel comfortable easing policy at all this year, but now there are three fully priced in by the December meeting. Expectations are cooling at the long end, too , with the 10-year Treasury yield dropping by 70bps since mid-January. These mounting negatives for the dollar have offset the gains it has made through tariff threats on other countries.

The dollar index is following its path from 2016/2017 extremely closely, where it initially strengthened and then slowly fell away as it took time to implement his tax cuts and to start throwing tariffs at China. This time, Trump has hit the ground running, particularly on tariffs, but so far the effect on the dollar has been similar. The test for March will be whether the weakened economic momentum in the soft data is backed up by hard evidence in the labour market, inflation, and growth statistics. A weak payrolls print, a drop off in consumer spending, or a sharp cooling in inflation could see the greenback sink much lower. A further deterioration would be in keeping with the loop in the economic surprise index in the graph to the right. If instead the data remains resilient, there is a wide scope for a rebound, particularly given that huge tariffs are in place.

The US economic data is undershooting estimates

GBP

March budget event looms

Sterling's fortunes have changed markedly since the brief fright in the gilt market that sent GBP/USD down to 1.21 in mid-January. The market's fiscal anxieties remain and will be thrust into focus once again in March, but the pound has rebounded almost 5% since then, thanks to a weakening dollar, a cooling in long-end rates, and a series of upside data surprises.

For some, it might be hard to understand how the pound can recover so strongly in the current economic context. Perplexingly, the main headline from the Bank of England rate decision was that Catherine Mann – typically at the extremely hawkish end of the spectrum, having never voted for a cut until now– performed an incredible U-turn and instead voted for a 50bp move. In her reasoning, she fretted about a 'non-linear' downward adjustment in employment and explained that job losses and a softened consumer had eroded companies' pricing power.

Downside risks to growth and employment, and their linkages to the tense fiscal situation, remain a heavy weight on sterling. The projections accompanying the BoE cut were damning: 2025 growth was slashed *in half*, to 0.75%. While the signals are somewhat mixed, the surveys suggest that the employers' NI tax increase is having a devastating impact on hiring. The official labour market report sees only stagnation in payrolls. But a KPMG/REC survey saw the most widespread weakening in demand for staff since 2020 – something the PMIs concur with - and the CIPD say 1 in 4 businesses are cutting jobs before the tax increases. The ONS also reckons that half(!) of British adults are concerned about losing their jobs – it is no wonder why they are lacking the confidence to spend.

High interest rates and low growth make the March fiscal event an awkward dilemma for Rachel Reeves. Initial OBR forecasts suggest that her 'headroom' – the fiscal cushioning between the budget and her fiscal rules – has been wiped out. If these rules are as iron-clad as the Treasury has suggested, that means that further difficult decisions will need to be made. With a tax rise ruled out, the most likely move is some spending cuts. The risk is that it hurts growth further, putting the UK economy in a downward loop trying to meet its self-imposed fiscal rules.

A combination of factors drove the pound higher. The first is a broad-based dollar weakness, The second was a series of upside surprises on GDP, wage growth, inflation, and retail sales that ultimately constrained how much easing the market could price in. The inventories-driven 0.1% growth in the fourth quarter is nothing to get excited about – obviously – but economists were expecting worse, And while the jumps in wage growth (6.0%) and core inflation (3.7%) were largely down to one-offs, the BoE would struggle to justify anything but caution as it continues to fight to bring inflation back down to 2%. The peak in inflation this year was pencilled in at 3.7% in their latest set of projections. Only two further cuts are priced in for 2025 as a result, and UK yields largely outperformed those of the US and Germany in February.

The final factor working in sterling's favour is its immunity to the direct impacts of Trump's tariffs. It is typically an outperformer when tariff fears intensify, acting as something of a tariff safe haven that can improve even against CHF and JPY.

> *"We could very well end up with a real trade deal where the tariffs wouldn't be necessary."*
>
> *- Trump*

EUR

A reckoning for Europe

Between Trump's trade threats, shifting sands in international security, an election in Germany, and some big questions at the ECB, there is a lot to keep track of for the euro right now. While it gained slightly versus a softer dollar, the common currency weakened against the rest of the G10 complex.

Starting with the ECB, weak growth and softening wages have the market pricing in at least a further three cuts by September, which would put the deposit rate at 2.00% - at the lower end of neutral estimates. But, with the hawkish voices growing louder, and policy restrictiveness becoming less self-evident, the central bank will be turning off autopilot this month. We should see some big debates as to whether it is still appropriate to label rates as 'restrictive' (Schnabel thinks not) and at what point the cuts should end. Holzmann commented that, after March, 'a decision in favour of another cut gets harder and harder'.

Indeed, there is a tail risk that policymakers 'sleepwalk' to 2.00% or beyond and that inflation resurges. While consumption and the wider economy are undoubtedly weak, the job on inflation is not 100% done and progress is not assured. Services inflation is still hovering close to the 4.0% mark, and if policy easing is pushed too far then it could come back to bite.

Turning to geopolitics, the prospect of peace in Ukraine is a tailwind for the euro, but not as cleanly as it could be. The ideal outcome for the euro would obviously be a deal that respected Ukraine's sovereignty, eased geopolitical tensions, and allowed cheap gas to begin flowing back. That would improve risk appetite and help to boost the economy - particularly in Germany, where the energy price spike has eroded its competitiveness in manufacturing.

But things are not that simple with Trump. Instead of presenting a united front with Europe and Ukraine heading into negotiations, the US has alienated its allies, publicly attacked Ukrainian President Zelenskyy, emboldened Russia with early concessions, and questioned the US' role as a guarantor for Europe's security. This means a couple of things. The first is that, with Trump on the side of the US and nobody else, any deal risks being suboptimal for Ukraine and might contain territorial concessions and demilitarisation. That constrains the possible benefits for the euro.

The second is that Europe is facing a reckoning on the international security order – something that is going to be a big theme moving forwards. With less US support, there is a strong consensus now that the EU needs to up its defence spending. Talks have begun on the nature of the financing, which may come at a national or joint level. There are two sides to this. On the one hand, the extra fiscal spending *might* help to boost growth. But it also means more bond issuance at a time where deficits are already very wide for the likes of France and Italy, and with higher yields there may come a fiscal risk premium.

Defence is a big topic for incoming German Chancellor Merz, who hopes to form a coalition with the SPD by Easter. The election saw vote share sucked out of the centre and flow into the political extremes, with the SPD recording its worst ever result and the AfD doubling its support. Even with the Greens' vote, support would be just shy of 2/3 majority needed for constitutional reforms (including the debt brake), which will make big changes difficult to implement.

CHF

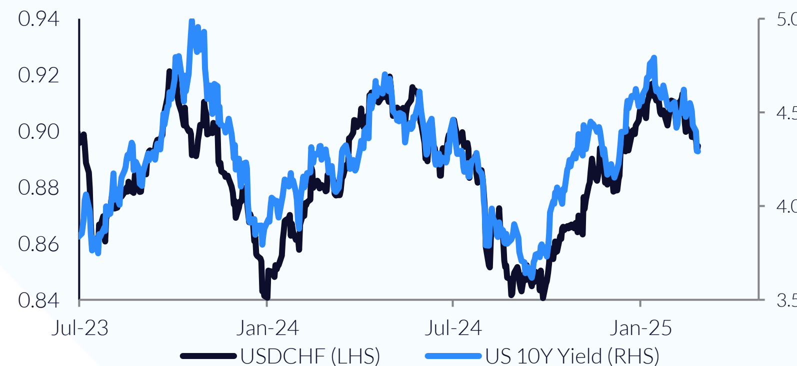
Closing in on 0%

February was choppy, but the franc eked out gains against both the euro and the dollar.

The peak in USD/CHF in January marks a third turn in a cycle that has run since mid-2023, where the pair has peaked at ~0.92 and troughed at ~0.84 (graph below). This has largely been driven by swings in the US growth and interest rate narratives that have seen Treasury yields move in waves. EUR/CHF, meanwhile, has been anchored to the 0.93-0.95 range since last September, because of the offsetting impacts of rate spreads and risk appetite.

The SNB is widely expected to cut rates by another 25bps to 0.25% in March, but the recent uptick in core inflation suggests that maybe that could be where rates settle. There is a high bar for rates to go down to 0% because of its symbolism, and Gov Schlegel has repeatedly highlighted his lack of desire (though not lack of will) to do so.

USDCHF continues to move in waves



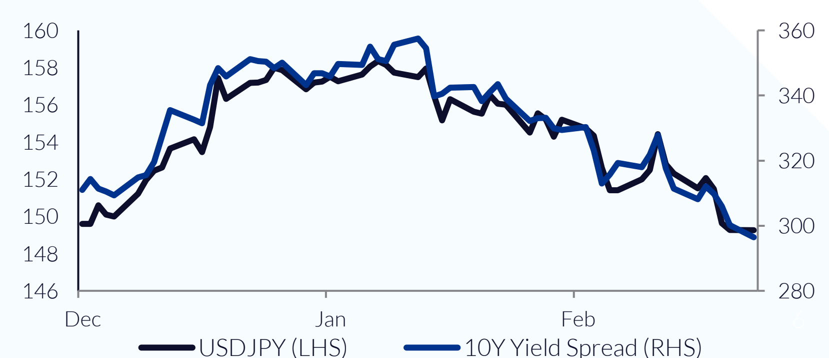
JPY

All about rates

The yen is an outlier in that it is the only major currency to have appreciated against the dollar since Trump's election win. And, as always, it is all about the 10-year yield differential, which has shrunk around 60bps since November and taken USD/JPY back below 150.

Both are safe havens, which tends to neutralise the noise created by the fluctuating risk premia that have dominated for much of the G10 in recent months. Long-end rates in Japan have rallied strongly in recent months, and 10-year yields have doubled in the past year from 0.7% to 1.4%. The data in February supported these moves: GDP strongly outperformed expectations at 2.8% annualised in Q4, core inflation rose to 3.2%, and indications are that there will be another solid round of wage hikes this year. Traders have also been emboldened to take rates higher by Gov Ueda's general indifference to the rise in JGB yields. The next rate hike is pencilled in for around Q3.

Ignore the Trump noise – rates are in charge for USDJPY



SEK

The crown of Europe

The krona has strongly outperformed its European peers so far this year, having gained over 4% against the US dollar. Much of the downside in USD/SEK is the result broad dollar weakness and fading tariff risk premia, which tends to benefit risk-sensitive currencies like the krona the most. But it is the rates story that has helped it to beat the likes of NOK, EUR, and GBP.

EUR/SEK touched a one-year low in February, fuelled by a shock surge in core CPIF inflation which blindsided markets and supported the Riksbank's stance that it may have already delivered the final rate cut. The jump from 2.0% to 2.7% was well beyond even the highest forecast. At the last meeting, the bar was set very high for another rate cut in March, having already reduced rates considerably to 2.25%. Now, the January inflation figures appear to have wiped out any remaining chance. Expectations for another cut in Q1/Q2 have swiftly been pushed back to Q2/Q3, with only a 46% chance priced in for another 25bp rate cut by the June decision.

The Riksbank started cutting early, and now it is finishing early. SEK is now recovering that gap in rates, particularly against the late-to-the-party Norwegian krone. With the Norges set to begin its own cuts this week, NOK/SEK fell 2.5% in February.

CAD

A short-lived break on tariffs

The loonie began the month with a tariff-induced meltdown. USD/CAD hit a 22-year high as Trump confirmed that the 25% blanket tariffs on Canada and Mexico. A couple of phone calls with Trudeau and Sheinbaum later, however, and there was a 30-day delay. At the beginning of March, these have finally been implemented.

The market has struggled to catch its breath. Prior to the first deadline, it had settled on the idea that last-minute negotiations would avert the tariffs, and traders ascribed very little probability to a trade war overall. Then the deadline arrived, and all of a sudden the tariffs were coming. But when the eleventh-hour deals came, CAD recovered sharply, and it continued to strengthen as Trump reinforced the notion that tariffs were primarily a negotiation tool, and that concessions were the remedy.

Now in March, of course, a trade war has begun. But the loonie has not suffered as much this time around. That is not because expectations for Canada have improved – the tariffs will still be devastating if it has some persistence – but because the US economy is now softer, too. That has brought attention to the negatives on both sides, rather than just in Canada. The monetary policy side has been Fed-driven, where extra bets on cuts have shrunk the US yield advantage. With the BoC close to the end of the line in terms of cuts, domestic monetary policy is taking a backseat for now. A pause is expected in March, but two further cuts are priced in by the end of the year.

From here, a long-term recovery back into the 1.30s requires a) a further dovish repricing of the Fed path through weaker US data, and b) a settling of the trade dispute.

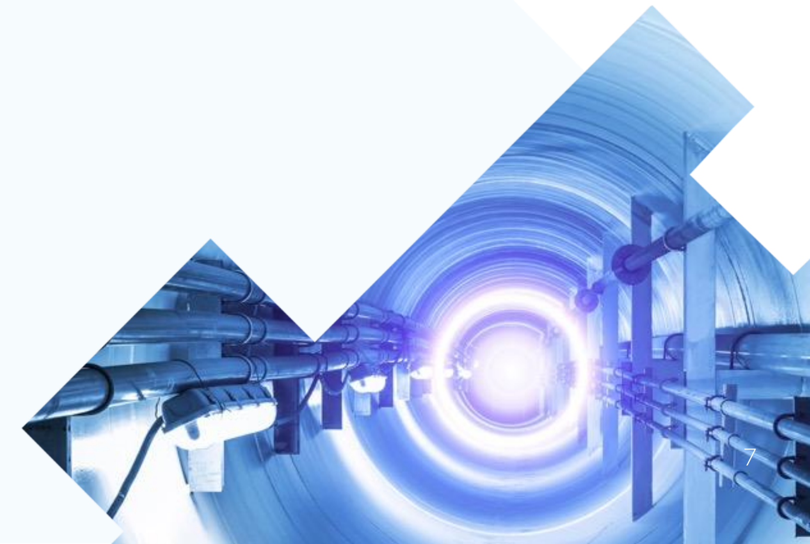
AUD

Finally

The Reserve Bank of Australia cut rates for the first time in the cycle in February. But true to character, it did so in the most hawkish way possible, scolding the market for pricing in so many extra cuts in 2025 – two! That, broad dollar weakness, and the resilience of the yuan helped AUD/USD to post a solid gain.

RBA Governor Bullock said that the board needs more evidence of disinflation. They have received some since, as CPI fell to 2.5% in January – the midpoint of the 2-3% inflation target. Core inflation is soft, too, at 2.8%. Further cuts are coming, and the next is expected in May.

However, monetary policy is far less relevant than market sentiment and China. The Aussie has traded as a close yuan proxy since last August, with a correlation of 0.95.



Economic Calendar – March 2025

Starting with non-farm payrolls, markets will be looking to see if the economic weakness from the soft US data starts to surface in the hard data. Look out for eight central bank decisions, too.

Date	Time (CET)	Currency	Event	Previous
Mon 3rd	11:00am	EUR	CPI y/y	2.5%
Wed 5th	8:30am	CHF	CPI y/y	0.4%
Thu 6th	2:15pm	EUR	ECB Policy Decision	2.75%
Fri 7th	2:30pm	CAD	Employment Change m/m	76K
Fri 7th	2:30pm	USD	Non-Farm Payrolls m/m	143K
Wed 12th	2:30pm	USD	CPI y/y	3.0%
Wed 12th	2:45pm	CAD	Bank of Canada Policy Decision	3.00%
Thu 13th	2:30pm	USD	PPI m/m	0.4%
Fri 14th	8:00am	GBP	GDP m/m	0.4%
Mon 17th	2:30pm	USD	Retail Sales m/m	-0.9%
Tue 18th	2:30pm	CAD	CPI y/y	1.9%
Wed 19th	5:30am	JPY	Bank of Japan Policy Decision	0.50%
Wed 19th	7:00pm	USD	Federal Reserve Policy Decision	4.25-4.50%
Thu 20th	8:00am	GBP	Average Earnings Index 3m/y	6.0%
Thu 20th	8:30am	CHF	SNB Policy Decision	0.50%
Thu 20th	9:30am	SEK	Riksbank Policy Decision	2.25%
Thu 20th	1:00pm	GBP	Bank of England Policy Decision	4.50%
Mon 24th	10:00am	EUR	Flash Manufacturing PMI Flash Services PMI	47.3 50.7
Mon 24th	10:30am	GBP	Flash Manufacturing PMI Flash Services PMI	46.4 51.1
Mon 24th	3:45pm	USD	Flash Manufacturing PMI Flash Services PMI	51.6 49.7
Wed 26th	8:00am	GBP	CPI y/y	3.0%
Thu 27th	10:00am	NOK	Norges Bank Policy Decision	4.50%
Fri 28th	2:30pm	CAD	GDP m/m	0.2%
Fri 28th	2:30pm	USD	Core PCE Price Index m/m	0.3%

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