Monthly Report

May 2025

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Introduction – Trump's trade shock flips FX on its head

A once-in-a-century trade shock sends shockwaves through markets

There was one day that really mattered last month: the now infamous 'liberation day'. Almost everything after Trump's once-in-a-century trade shock was just the fallout. Aside from the highly simplistic calculation method, the inclusion of uninhabited islands, and the fact that they were chosen at the last minute, the 'reciprocal tariff' figures were far more severe than expected, and that set in motion a big wave of dollar selling.

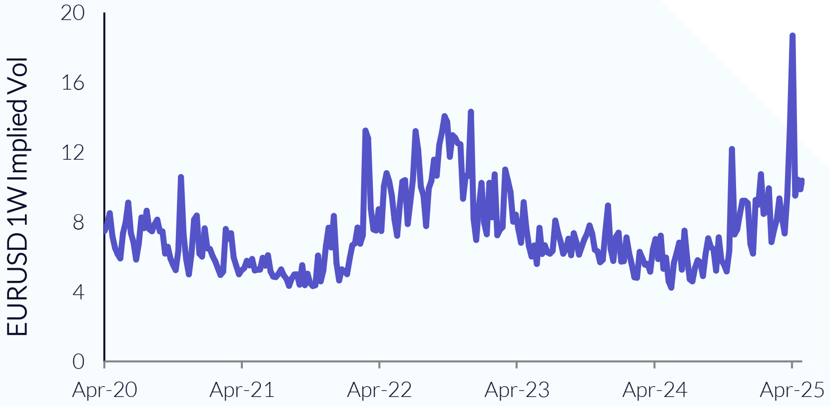
It led to volatile ruptures and historic moves in the bond, equity, and FX markets. Looking at the biggest one-day moves, the Swiss franc had its best day since 2015, the Australian dollar had both its best and worst days since the 2008, and, at 4.4%, EUR/USD saw its biggest weekly gain since 2009. The CVIX FX volatility gauge surged to a two-year high, at one point the S&P 500 gained 8.5% in half an hour on a false headline, and we saw the biggest weekly loss in Treasuries for 20 years, as leveraged hedge fund trades unwound and investors dumped US assets.

A concern in recent months has been that the hoped guardrails around Trump policy (the markets, the CEOs, his advisors, the judicial branch etc) had been severely weakened, but they did eventually prove to still be in place at some level. He had accepted the fall in stocks as a necessary and temporary evil, but the risk of breaking the bond market and triggering a financial crisis proved motive enough to announce a 90-day reprieve on the higher rate tariffs only a week later, leaving all countries at the baseline 10%.

The shockwaves flipped traditional FX correlations in a sustained way. There are normally two main ways to strengthen the dollar in the short term: a) increase US yields compared to elsewhere, or b) spook the markets into seeking safe havens. The dollar-yields correlation inverted as investors sold both Treasuries and the dollar (something Liz Truss is familiar with), and monetary policy – the dominant driver for FX for a long time– fell to the wayside as instinct and risk took over.

The dollar no longer traded as a safe haven – in fact, it became the opposite. Tariffs and market chaos become a dollar negative even as the likes of CHF, JPY, and even EUR benefitted from safe haven flows. With the White House itself implementing the economically damaging policy, whilst it was also floating firing Fed Chair Powell and introducing charges on foreign Treasury holdings, the instinct of investors was to find alternatives to the dollar. Many articles and commentary have described it as the beginning of a structural rebalancing away from now overvalued US assets.

EURUSD volatility shot to a post-Covid high



De-escalation does little for the dollar

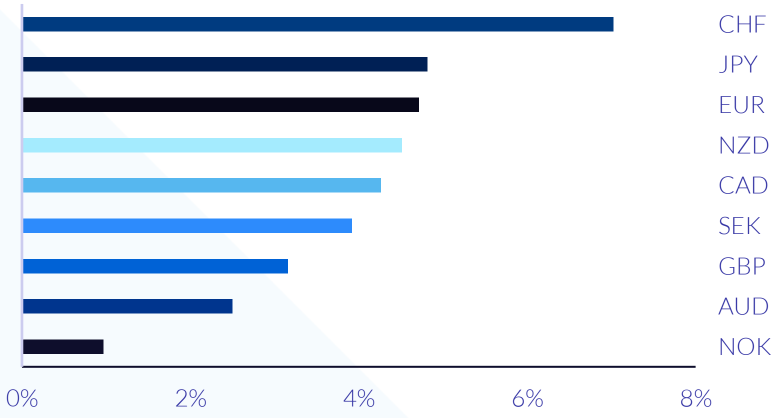
In the weeks after, the consolidation in FX stood out in contrast to the recoveries in the equity market. The S&P 500 has fully recovered its post-'liberation day' drop, while the dollar continues to lag behind. The dollar is quick to drop when there is tariff chaos, but there needs to be a consistent stream of good news to convince the market to bid the greenback back up. It suggests that there is a structural downshift that cannot be put back in the bottle easily – the damage has been done, and building back trust cannot happen as quickly.

Where from here?

Trade is central to the FX narrative, and China is at the epicentre. A series of retaliatory measures took tariffs above 100%, creating a de facto trade embargo between the world's two biggest economies. CEOs warned about empty shelves, and shipping volumes have fallen off a cliff. We now have a 90-day truce that have pulled tariff rates down significantly, but it is certainly not the end of the story, and the hard work has only just begun in terms of agreeing to a deal with China. Analysis by Apollo suggests that it takes the US on average 18 months to flesh out a deal, and then 45 months to implement.

Monetary policy, meanwhile, is still a much weaker driver than before. Most central banks are in wait-and-see mode as , like the market, they wait to see how things play out, and currencies have moved more according to instinct and risk conditions in recent months. This is clear in the graph on the right – CHF, JPY, and EUR all performed best last month, despite their outlooks become markedly more dovish, while it was the riskier currencies that fell behind. NOK was the worst performer behind the dollar despite the first Norges Bank rate cuts being pushed back. This type of scenario rarely lasts for long, however, and the pace of rate cuts in 2H 2025 is wide open, particularly for the Fed.

G10 April Performance vs USD



FX Reviews

USD

Liberated… from strength
Trump might have done some irreversible damage to the dollar on April 2nd. His shockingly high tariffs (>100% for China and delayed rates of 41% for the eurozone and 90% for Vietnam, for example), his slightly frightening words on Federal Reserve independence, the constant uncertainty, the flotation of charges on foreign Treasury holdings, and the consensus for significant incoming economic weakness, among other things, wrecked the dollar's safe haven status and triggered heavy capital outflows. It fell to the lowest in three years.

It was nothing short of a regime change for FX. At times, the dollar's behaviour resembled that of an emerging market currency, with yields rising and the greenback falling. That has only occurred on a handful of occasions. Everything that used to make the dollar stronger now seems to have the opposite effect, and things improved slowly even when there were delays and trade talks. Trump was ultimately tamed by the market, but the trust has been broken and will be difficult to rebuild.

The soft measures remain bleak. Consumers' confidence is at a five-year low, a record amount are worrying about business conditions, the biggest proportion of S&P 500 firms are lowering their EPS estimates since the pandemic, and measures of term (i.e. risk) premium on US Treasuries are at the highest in a decade.

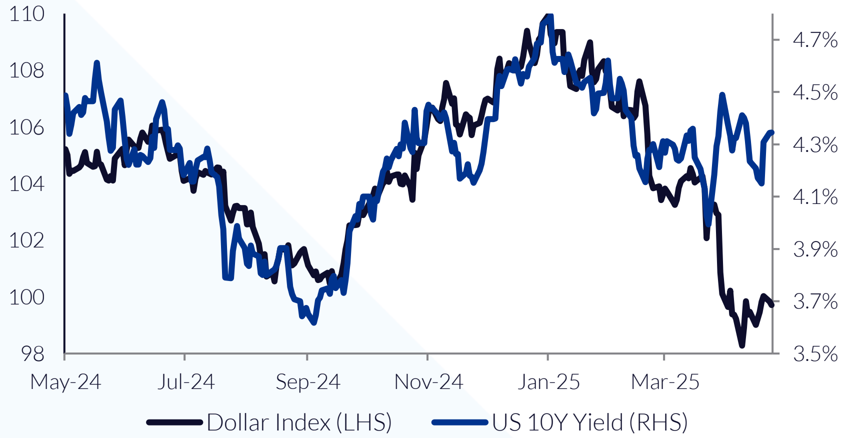
However, we are yet to see any clear passthrough to the hard data. Non-farm payrolls grew 177K, although there were 58K in negative revisions to previous months, unemployment is holding steady, retail sales were solid, jobless claims are flat, and the housing market is not falling away. The exception was the -0.3% Q1 GDP print - the first economic contraction for three years – but most brushed that off and saw relatively strong underlying details.

The frontloading of imports ahead of tariff implementation heavily distorted the overall figure, providing a -4.8% drag. Final sales to domestic purchasers was solid at 2.3%.

That said, few are expecting this to last. While deals and de-escalation might improve the outlook, it is already too late to prevent an initial hit to growth, and most are expecting higher unemployment and a chance of a recession as the tariff-driven supply shock hits the US economy. The risks to the dollar seem skewed to the downside, too – there will be more weakness to come if the economy goes sideways, but it is difficult to envision a scenario where it fully recovers in the near term. Whether or not Trump's trade policy has catastrophic effects on the economy, the trust has been broken and investors have been resistant to send the dollar higher in response to good news. That contrasts with full recoveries in the equity markets.

The uncertainty has kept the Fed on the sidelines. In short, they have no idea how trade policy will evolve, what impact that will have on the economy, or what will be appropriate monetary policy in the medium to long term. The rate path is wide open, and it will depend greatly on the tension between the two sides of its dual mandate. Policymakers are expecting both higher inflation (requiring more restrictive rates) and higher unemployment (requiring further easing) – and they cannot lean against both. It will come down to which becomes the greater concern, and perhaps to the Fed's subjective judgment on which they should be fighting against. So far, Powell has tilted to the hawkish side, explaining that price stability is a necessary condition for strong and stable employment. But the market still sees another three or four rate cuts by year-end.

Trump severed the US dollar's tight relationship with yields



"There isn't a modern experience for how to think about this."

-Fed Chair Powell

GBP

First to make a deal

A weaker dollar, a split Bank of England, and a dealmaking spree have all led GBP/USD higher, with it hitting a three-year high in mid-April. But the riskier pound struggled to capitalise on the dollar's losses as much as the euro.

The general assumption was that Trump's tariffs would open the door to sterling outperformance, thanks to the UK's services-dominated and largely balanced trade with the US. But with the April 2nd tariffs far worse than expected and investors worrying about the state of the US and global economies, the euro became the more liquid and safer alternative. Sterling clawed back losses against its continental neighbour, however, as risk appetite began to turn and the UK became the first to pen a trade deal with the US.

The deal itself it still worse than the pre-Trump situation – the 10% base tariff remains – but the steel and auto tariffs have now been largely avoided. The legality is also not clear, as it looks more like a rushed framework rather than a comprehensive, signed agreement. And the deal was low hanging fruit – deals with other countries won't come so easily, and the UK economy might yet suffer from softer international demand.

The data picture is very mixed. The PMIs fell to the lowest since November 2022, with businesses blaming a slump in confidence among clients and a 'wait-and-see' approach to major spending decisions. Like other anecdotal data, the reports also cited an avalanche of job cutting since the employers' NI hike.

But that was not the story in the hard data. The official payroll data, while admittedly still plagued by low response rates, points to a soft jobs market but not a wave of layoffs. Growth also significantly beat expectations, posting a 0.5% gain in the month of February, which should make the UK one of the best performers in the first quarter. There might be a seasonal effect at play here that the statistics haven't ironed out, though, as this is a similar pattern to what we saw last year, when growth spiked in the first half and then fell away towards the end.

Wage growth remains the bane of the Monetary Policy Committee, continuing to print around the 6.0% mark and defying indications of a slowing jobs market. The BoE projects slower inflation that previously expected this year, however, although that is driven largely by lower energy prices.

The Bank opted to continues its quarterly pace of rate cuts at the beginning of May, but, like most central banks right now, there is nothing resembling consensus on the way forward. The vote was split three ways, with two voting for a 50bp rate cut, five voting for 25bps, and two voting to hold steady. At one end of the spectrum, you have Taylor and Dhingra fretting about a serious weakening in demand this year, while Pill and Mann worry about a persistently hot jobs market on the other. The path for rates is wide open, though the market's guess is that we get two further cuts by the December meeting

EUR

A dollar alternative

While the euro has been a star performer since 'liberation day', it was the dollar and broad risk dynamics that did the work. There was a domestically driven uplift from 1.04 to 1.08 in March thanks to big spending plans from Germany, but the recent peak above 1.15 came without any reason to get excited about eurozone growth or rates,

It did not just gain against the weakening dollar, though. With the dollar's safe haven status coming into question, investors started looking for liquid alternatives – a role taken on, it seemed, by the euro. Typically, in times where risk appetite is shrinking, the euro tends to outperform the riskier G10 (GBP, CAD, NOK, SEK, AUD, NZD) but lag USD, JPY and CHF. Since 'liberation day', however, EUR has acted more like a safe haven and USD has shifted to the risk-sensitive bucket. Bad tariff news meant a surge in demand for the euro.

Monetary policy absolutely dominated as the driver for EUR/USD in 2024, but as policymakers' guidance has fallen in significance, its impact has diminished significantly. Trade headlines and US policy announcements are taking precedence instead.

That is not a trend that is likely to persist, however, and as more clarity comes on longer-term trade policy and the relative interest rate paths, the usual relationship between short-term rates and EUR/USD will probably resume. And right now, there is far more appetite to cut rates at the ECB than the Fed.

Not long ago, the market was betting on a pause in April. Enter 'liberation day', and suddenly those looking for a pause were swept up in the more dovish camp.

Here's the key phrasing from the decision:

> *The outlook for growth has deteriorated owing to rising trade tensions. Increased uncertainty is likely to reduce confidence among households and firms, and the adverse and volatile market response to the trade tensions is likely to have a tightening impact on financing conditions.*

There were a couple of references to 'exceptional uncertainty' too. Disinflation is well advanced now – headline inflation is at 2.2% - business confidence in the services sector is at a five-year low, and a trade shock of an unknown scope is on the way. Markets are now pricing in a terminal rate of 1.50%, which is right at the bottom of the 'neutral' range, or perhaps in stimulative territory, depending on who you ask. Of course, as Lagarde has argued, the 'neutral' concept becomes pretty much useless when contending with multiple shocks.

Things can go a couple of different ways here for the euro. At one extreme, by some miracle US trade policy could begin to look more normal, the dollar is deemed safe again, and rate spreads take EUR/USD back to the lower end of the 1.05-1.10 range. Or at the other end, US-China talks could collapse, the global economy might slow down, and the Fed could start cutting at a rapid pace to stem a spike in unemployment. 1.20 then becomes a real possibility.

CHF

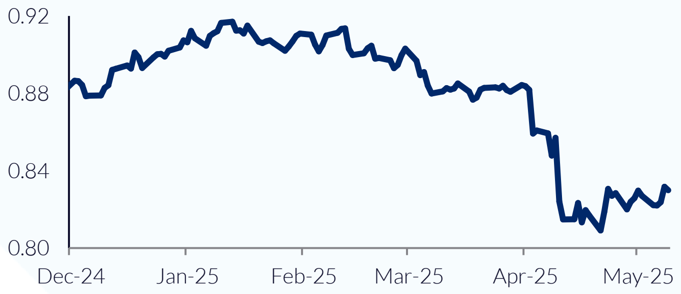
Safe haven surge

The tariff turmoil of the past month has certainly been interesting for the franc, which hit a ten-year high against the dollar thanks to haven-related capital inflows. The current Swiss macro narrative has all but fallen into irrelevance, and instead the franc has traded as a simple proxy for trade anxiety and distaste for the dollar. Bad news is good news for the franc.

That said, it could be reaching an SNB-imposed ceiling. Swiss policymakers are fighting a battle against inflation falling too low – CPI sank to 0.0% in April – and a strong franc only makes things worse by depressing import costs. A cut to 0% interest rates is a certainty as a result, according to market pricing, and there is assumed to be an 80% chance that rates are negative by next March.

Chairman Schlegel has repeatedly commented that they are ready and willing to go below zero rates if need be. But he has also ramped up verbal intervention on the FX markets, warning that if rate cuts cannot do the job, then an artificial weakening of the franc is on the table. Whether or not that is a serious threat, it will make traders nervous about taking the franc too high.

USDCHF fell off a cliff in early April



JPY

Trump complicates hiking path

Similar to the franc, USDJPY detached from rate fundamentals (i.e. the 10-year yield spread) and the yen's status as a safe haven had been the dominant driver in recent months. It managed to briefly dip below 140 at the peak of the dollar selloff, but it is climbing back towards 150 in May.

It is staggering how quickly USDJPY dropped its tight correlation to longer-term yields. The dollar actually gained quite strongly on this front, because while the BoJ is still on a path to normalisation and higher rates, the trade uncertainty is likely to make policymakers much more reluctant to move forward. The market is pricing a 30% chance that there are no further hikes at all this year, meaning we may have to wait until 2026 or even 2027 until the 1% level is reached. 10-year JGB yields have taken a 20bp haircut, although they remain much higher on a year-to-date basis.

With some explosive moves in TWD recently, a lot of attention has been focused on Asian FX and the ability for large, unhedged holdings of USD-denominated assets to trigger an avalanche in currency strength in the event that the dollar falls further and a wave of hedging takes place. Japan is the largest foreign holder of US Treasuries.

SEK

Crown of the G10

The Swedish krona remains the best performing G10 currency this year by a significant margin. It is up 13% YTD thanks to a boost to European sentiment, a weakening dollar, and the Riksbank reaching (or nearing) the end of the cutting cycle.

Like most central bankers since 'liberation day', though, the Riksbank has changed its tune somewhat over the past month. The consensus is that the inflationary spike in Q1 is a temporary story and that the disinflationary narrative will go back to normal as energy prices subside and global uncertainty softens demand. CPIF held at 2.3% in April, after jumping from 1.1% to 2.9% at the beginning of the year. The krona's massive rally will also depress import costs and provide a bit of extra disinflationary pressure.

This led to a dovish tweak to the messaging at the last rate decision, with the potential for one more cut put back into the picture after previously calling an end to the cutting cycle. The wording was intentionally vague to retain optionality, however, with Gov Thedeen arguing that they were 'not at all certain' of another move.

The market thinks that a June cut is a 50/50, though SEK remains well-placed for some strength purely on a rates basis, with the likes of the Fed, the ECB, and the Norges Bank all still assumed to have further room to ease policy over the next year or two. As is often the case for the Nordics, however, the trade story and risk conditions will be a major factor.

CAD

Carney's challenge

It has been an interesting ride for CAD this year. The loonie all but collapsed from October onwards and it briefly went to 1.48 at the peak of Trump's tariff threats its weakest in over 20 years. Now, although its proximity to the US has been a drag on the crosses, USD/CAD is back in the 1.30s.

Despite originally being one of the main focus countries for tariffs, Canada seems to have gotten off lightly for now. It never featured in 'liberation day', and the initial 25% tariffs appear to be on an indefinite hold. The remaining tariffs are on steel, aluminium, autos, and non-USMCA compliant goods (the latter is a tiny proportion of US-Canada trade). Alongside the persistent uncertainty, that is still damaging to the Canadian economy, but it is clearly preferable to when it was staring down the barrel of 25% blanket tariffs. Canadian exports have actually held steady so far, even as they fell to the US, as firms successfully directed them towards other markets.

The Bank of Canada repeated its mantra that they simply 'don't know what's coming next' but that they are prepared to act 'decisively' as new information clears up the outlook. Its two scenarios saw Q2 GDP at either -1.3% or 0.0%, and 2026 was seen to either involve total stagnation or a slightly weaker growth rate of 1.4%. Another cut is fully priced this year, and a second is marginally favoured, too.

Having completed the impressive turnaround in the Liberals' election prospects and winning with a minority, Carney now faces the tough task of negotiating with Trump and navigating a much more complex global trade landscape. Poilievre was always considered the more market-friendly option, but investors seem calm about Carney's crisis experience.

AUD

China proxy

The Australian dollar has seen some historic volatility since 'liberation day'. It saw both its biggest one-day gain since 2011 and its worst one-day loss since 2009 within three days of each other, as Trump launched his trade shock and then subsequently put it on hold.

It still ended last month at a higher level than it started against the dollar, although it underperformed the likes of EUR, GBP, and CHF because of its high sensitivity to risk and its tendency to trade as a proxy for the Chinese yuan.

Inflation was a bit stickier than expected, at 2.4%, but the market is fully pricing a second rate cut at the May decision, followed by a further two before the end of the year.

Economic Calendar – May 2025

May includes central bank decisions in Japan, the US, the UK, Australia, and New Zealand.

Date	Time (CET)	Currency	Event	Previous
Thu 1st	**5:30am**	**JPY**	**Bank of Japan Policy Decision**	**0.50%**
Fri 2nd	11:00am	EUR	CPI y/y	2.2%
Fri 2nd	2:30pm	USD	Non-Farm Payrolls m/m	228K
Mon 5th	8:30am	CHF	CPI y/y	0.3%
Wed 7th	**8:00pm**	**USD**	**Federal Reserve Policy Decision**	**4.25-4.50%**
Thu 8th	**1:00pm**	**GBP**	**Bank of England Policy Decision**	**4.5%**
Fri 9th	2:30pm	CAD	Employment Change m/m	-32.6K
Tue 13th	8:00am	GBP	Average Earnings Index 3m/y	5.6%
Tue 13th	2:30pm	USD	CPI y/y	2.4%
Thu 15th	8:00am	GBP	GDP m/m	0.5%
Thu 15th	2:30pm	USD	PPI m/m	-0.4%
Thu 15th	2:30pm	USD	Retail Sales m/m	1.4%
Tue 20th	**5:30am**	**AUD**	**Reserve Bank of Australia Policy Decision**	**4.10%**
Tue 20th	2:30pm	CAD	CPI y/y	2.3%
Wed 21st	8:00am	GBP	CPI y/y	2.6%
Thu 22nd	10:00am	EUR	Flash Manufacturing PMI Flash Services PMI	48.0 49.7
Thu 22nd	10:30am	GBP	Flash Manufacturing PMI Flash Services PMI	44.0 48.9
Thu 22nd	3:45pm	USD	Flash Manufacturing PMI Flash Services PMI	50.7 51.4
Wed 28th	**4:00am**	**NZD**	**Reserve Bank of New Zealand Policy Decision**	**3.50%**
Fri 30th	2:30pm	CAD	GDP m/m	-0.2%
Fri 30th	2:30pm	USD	Core PCE Price Index m/m	0.0%

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