2025 FX Navigator

EUR/USD

Explore the key themes influencing FX markets, reflecting on last year's drivers and anticipating how these themes might develop in 2025.

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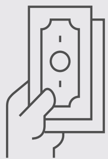
ARGENTEX

Trump, tariffs and turbulence; embracing volatility in 2025



"History doesn't repeat itself, but it often rhymes"

Mark Twain

Mark Twain's quip that "history doesn't repeat itself, but it often rhymes" seems very fitting, as 2024 followed a strikingly similar path to the year before.

A familiar pattern emerged as the dollar softened in the first half of 2024 only to once again perform a dramatic U-turn in the autumn. Central bankers faced a precarious balancing act with interest rate policy, but ultimately cut rates by less than markets had expected given the 2% inflation target remained elusive. Meanwhile, political shifts—from a 'fiscally responsible' Labour government in the UK to the return of Trump's volatile policy playbook in the US—spiced up market dynamics.

As we step into 2025, the echoes of these trends promise another year of intrigue and volatility. Will the forces shaping monetary policy, growth, and geopolitics harmonise—or clash?

2025

As we enter the start of the new year, the timing and extent of rate cuts between the major central banks remain a key focus. Recently, expectations for further cuts in the UK and US have reduced significantly, as stagflation concerns have risen alongside bond market volatility.

President Trump is at the epicentre of potential future FX volatility driven by various areas including trade wars, tariffs, inflationary policies, geopolitics and the US debt ceiling. Will we see ongoing resilience of the US economy when contrasted to eurozone growth woes, a low productivity UK, and Chinese efforts to stimulate their economy? Simmering in the background remain geopolitical issues from Russia/Ukraine and the Middle East which can escalate or abate. While a lack of political cohesion in France and Germany remains a headwind, there is scope for some positive resolution, with a potential path of looser fiscal policy. For many G10 central banks, striking the delicate balance between stimulating growth and controlling inflation remains a challenging task in 2025.

A look back at 2024

Euro woe

The euro kept its head above water in the first half of the year as the ECB preferred not to pre-commit to rate cuts but to remain led by data. Economic slowdown in Germany was evident for much of the year, but the euro refused to weaken, in part due to strong overseas investment in European bonds which had accelerated since mid-2022 and had underpinned some euro resilience.

It took abysmal services/manufacturing PMI in September, the chaotic developments in French and German politics and a far more dovish ECB to sink the euro in Q4 when it finally succumbed to weak fundamentals.

Although the outlook for the euro appears bleak, several potential tailwinds linger in the background - ranging from a possible settlement of the Ukraine conflict, to increased fiscal spending under a new German government and China's stimulus efforts gaining momentum, which could boost demand for European goods. Probably the best chance of a euro recovery would stem from the ECB not following through with as many rate cuts as markets currently expect.

Two speed dollar

After a strong start, the dollar slumped for much of the summer, as cracks began to appear in US economic data, and the Fed's rhetoric became decidedly more dovish. Markets began to see the Fed as a likely candidate to be the 'hard and fast' rate cut leader; a view validated by a larger-than-expected 0.5% rate cut at the September meeting.

In Q4, however, the dollar found an extra gear, performing a 'volte face' as US data improved. The Fed became, and remain, far less dovish, but most importantly, Trump won the election and sparked a flurry of dollar strength as markets moved to price in the inflationary impact of his policies.

The dollar may have already partially 'priced in' many of these supportive themes, but they continue to underpin the current dollar strength, and with the US economy showing resilience it looks difficult to fight the dollar short term. Should Trump's bark be worse than his bite on many of his policy threats, the dollar will pare some of its 2024 gains.

Key themes shaping our journey into 2025

Inflation edging higher

As headline inflation edged toward the 2% target, and in some cases below, many G10 central banks began a rate cut cycle in 2024. However, inflation has been broadly edging higher again in the US, Europe and UK of late. As such, markets are becoming more sceptical of deeper rate cuts from central banks like the Fed in 2025.

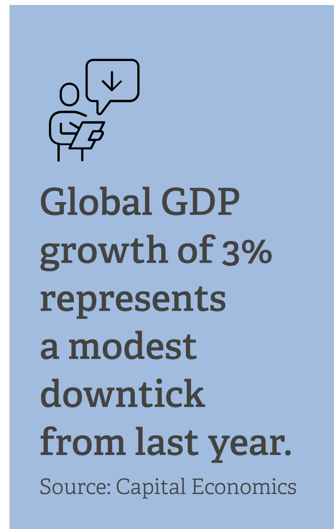
Quickly shifting rate policy expectations

In late 2024, markets had expected up to 1.5% of rate cuts in the US during 2025 which has now reduced to just 0.25%. We may see more rate policy divergence this year than last. For example, the underlying weakness in the eurozone means the ECB could continue to cut rates far more aggressively than the Federal Reserve in the US or the BoE in the UK. Such potential divergence remains one of the biggest drivers of FX market moves.

Trump is at the epicentre of escalating FX volatility

Trump, his character, and his policies will be a key driver of FX volatility. Detail on the scope and extent of tariffs is eagerly anticipated. Any 'climb down' from the President's combative pre-election stance could challenge the recent dollar strength.

The year ahead



The global economic outlook for 2025 hinges on a confluence of inflation, growth, tariffs and geopolitics. From shifting central bank policies to the economic ripple effects of Trump's return, cautious optimism is tempered by persistent uncertainties in Europe, China, and beyond.

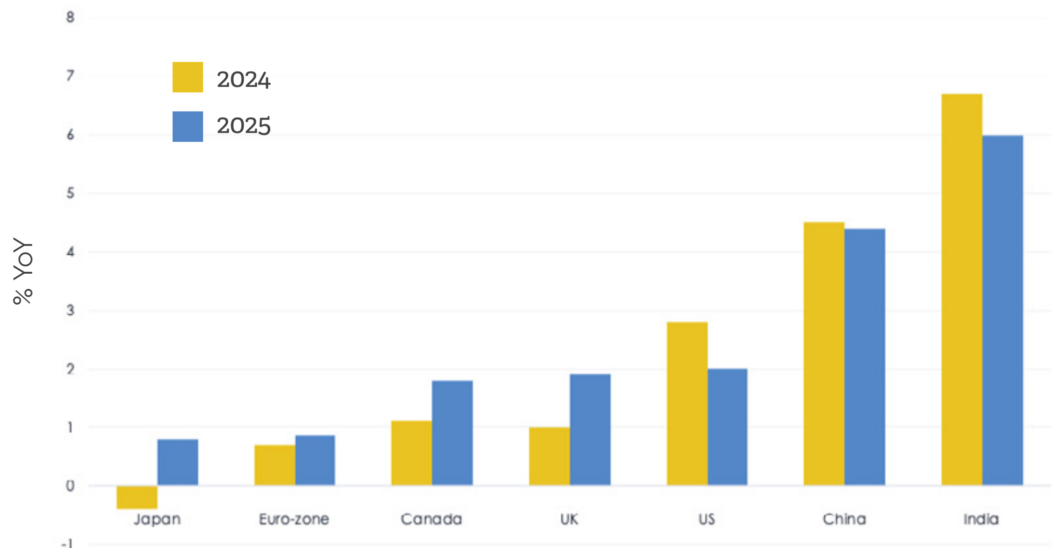
Global Growth

Despite idiosyncratic impacts from inbound Trump tariffs, major economies are likely to see steady, but unspectacular growth in 2025. Despite clear uncertainties around the UK's growth plan, many economists still expect GDP growth approaching 2% partially owing to Reeves' 10-year infrastructure spending plan focused on transport, energy, infrastructure, housing, etc. Details are due in the spring.

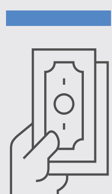
US growth could moderate back toward 2% from 2.5% in 2024, whilst in the eurozone, the recalcitrant German economy contributes to anaemic growth just below 1%. It seems unlikely that each region will deviate from these forecasts this year, despite impactful Trump tariffs, geopolitical flashpoints and high debt levels preventing large fiscal stimulus. China's growth should moderate back toward 4% as structural issues remain in its domestic economy.

In summary, global GDP growth of 3% represents a modest downtick from last year.

GDP growth by major economy % YoY



Sources: LSEG, Capital Economics. CE Activity Proxy measure



'A crucial factor will be the neutral rate for major central banks. This is the rate at which policy is neither stimulating nor restraining the economy.'

Inflation/Monetary policy

We feel that a crucial factor will be the neutral rate for major central banks. This is the rate at which rate policy is neither stimulating nor restraining the economy. For the UK and US, many see the neutral rate at circa 3%, a point which is unlikely to be reached in 2025.

However, markets expect the ECB to cut rates below the neutral rate, and back into accommodative policy to as low as 1.5%.

The ECB is increasingly cognizant of the downside risks to growth in the eurozone, and as such, markets confidently assume the ECB will remain on a steady rate cut path with a series of 0.25% increments, but probably avoiding larger 0.5% moves.

The ultra-low-rate environment seen from 2008 to 2015 will not, and should not, be seen again in coming years.

Geopolitics

Global geopolitical 'flashpoints' remain, including: the existing Middle East crisis, the Russia/Ukraine conflict or the threat of a new risk factor such as China/Taiwan.

Despite minor reactions in global equities and crude oil markets in 2024, we should remain cognizant of the fact that geopolitical developments can occur suddenly, causing strong impacts on FX markets.

Such geopolitical issues will only likely have a meaningful impact on FX markets if they either drive the price of oil higher (inflationary), disrupt global supply chains, or expedite a 'risk off' move in equity indices (with most outcomes driving the US dollar higher).

A perennial geopolitical escalation risk is the notion of China invading Taiwan. China's long-term strategic goals of regional dominance and reunification remain. It may not have the military capability to enact this threat until as far ahead as 2027, so any development in 2025 would remain seemingly unlikely.

Politics

Politically, Europe has stood out as the problem child, with shaky coalitions unable to push forward cohesive legislative agendas in France and Germany, causing markets to demand a higher yield on French debt, and weighing on the euro.

While the fragility of politics within key European countries as Trump takes office makes the eurozone look weak, one could argue that the worst has been seen, and a new German administration could provide a fiscal boost.
Trump remains at the core of any politically driven FX volatility in the US. Early, decisive moves on tariffs have been made, forcing some concessions from countries like Mexico and Canada. The eurozone is firmly in Trump's sights as the next region to face punitive tariffs.

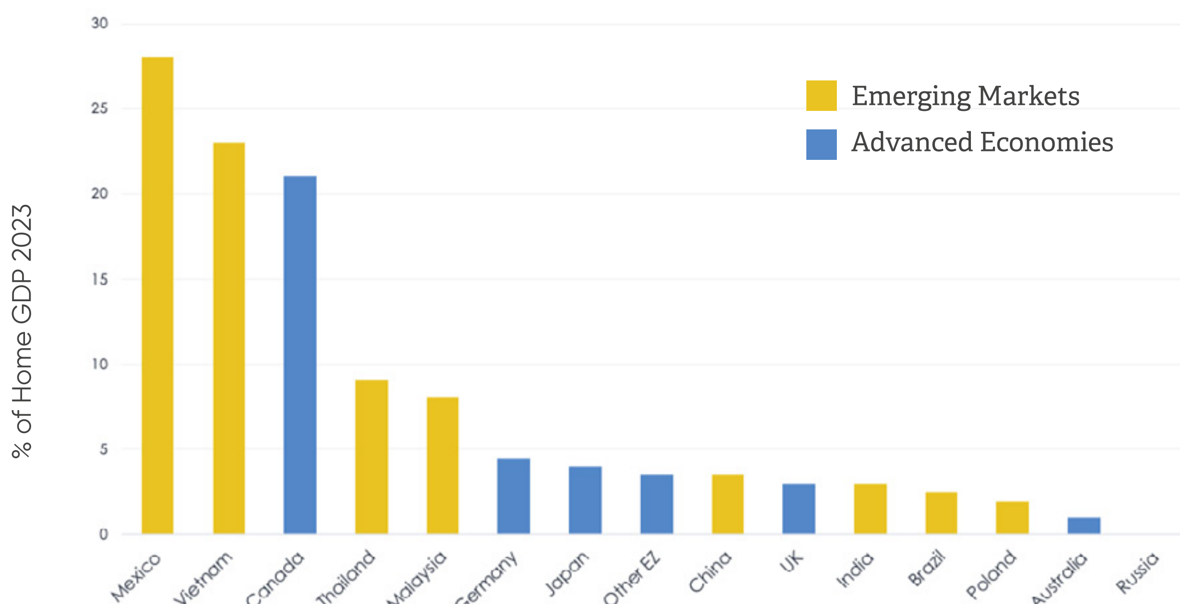
Trump is frustrated by the extent of the US trade deficit with the eurozone ($170Bn). Unless this is addressed, he is threatening decisive action.

Tariffs impact countries differently, as shown by the percentage of various countries' GDP reliant on exports to the USA below.

In Germany, the fast-approaching election on 23 February is a key development for the beleaguered German economy. Since Chancellor Olaf Scholz lost a vote of no confidence at the end of last year, there is hope that a new alliance could lead to looser fiscal policies, driving some growth and offering euro support. Currently, the CDU/CSU is leading in the polls, but the lead over the SPD is narrowing. The SPD is more closely aligned with looser fiscal policy.

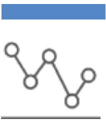
Despite French politics remaining a source of concern and potential volatility, recent developments from PM Bayrou have seen a 2025 budget pushed through parliament. However, markets remain concerned about France's worsening public finances, including up to €30Bn of spending cuts and €20Bn of tax increases.

Goods exports to the US



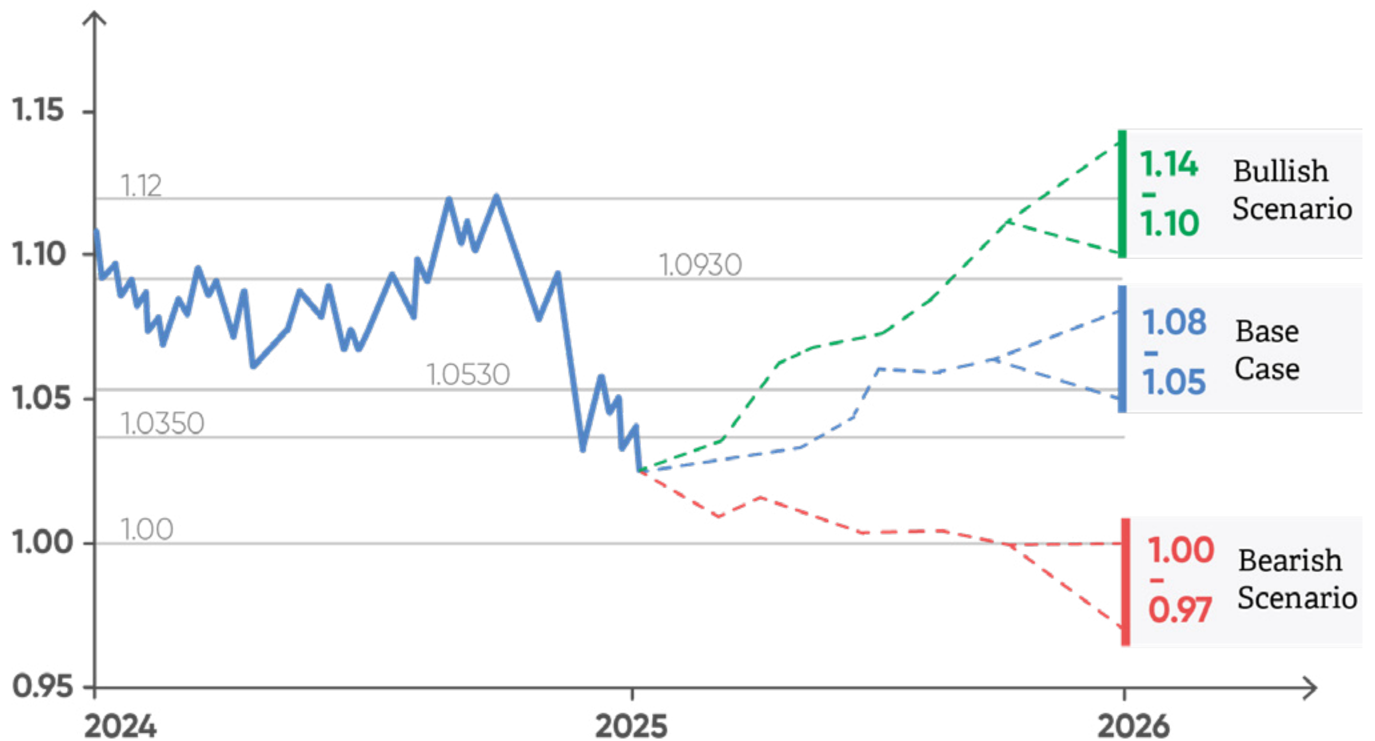
Sources: LSEG, Capital Economics

EUR/USD



Technical snapshot

H1 2024 traded in a sideways consolidation pattern, with robust technical support at 1.0669 and upside resistance at 1.0930. A weaker dollar through the summer allowed two tests of 1.12 before the Q4 slump led price action to consolidate around the major multi-year technical support level of 1.0530, with a brief test of the 2017 lows of 1.0350. In 2025, if price remains sub 1.0350, parity is attainable, below which there is little technical support until the 2022 low of 0.9555. To the upside, regaining 1.0530 and 1.0635 are the first technical objectives, with longer-term levels at 1.0929, 1.1012 and 1.1186. Ultra long-term upside gains would target the 1.15 level.



EUR/USD Scenarios

Bullish

1.14 - 1.10

Eurozone GDP growth modestly outperforms expectations, growing over 1%. The ECB does not follow through with as many rate cuts in 2025 as the market expects (i.e. less than 1%).

Positive political developments in France and Germany improve sentiment and provide scope for breaking the impasses of the past with regard to budgets, fiscal policy etc. A new German administration generates looser fiscal policy, relaxing the 'debt brake', thus driving some German growth. A negotiated settlement over Ukraine reduces some negative risk premiums associated with the euro. Chinese stimulus finally gains traction, thus increasing Chinese demand for European goods and services (second biggest export market). The dollar weakens as US 'exceptionalism fades', and the Fed cut by over 0.5% during the year.

Base

1.08 - 1.05

The ECB follows market expectations by cutting interest rates, reducing by around 1% to a terminal rate of between 1.5 to 2%.

Economic data remains mixed - a weak manufacturing sector, particularly in Germany, but with an improving outlook for the service sector. Although Trump's tariffs have a negative impact, they could fall short of being as punitive as first threatened. Generally weak data prompts the ECB to cut rates below the 'neutral rate', possibly entering an accommodative policy once again. It transpires that the late 2024 euro weakness had priced in a large degree of negative euro fundamentals and sentiment, thus leaving limited scope for further aggressive downside below parity.

Bearish

1.00 - 0.97

Economic data remains weak into 2025, encumbered by weak manufacturing output and punitive Trump tariffs of 20% on all sectors.

This prompts the ECB to follow a far more aggressive rate-cut path. This occurs at a time when the Fed remain resistant to further rate cuts, thus prompting some further dollar upside. Political division continues in France and Germany. The reduction of US financial support for Ukraine places increased pressure on European finances should the region need to partially fill the gap. Rate policy divergence between the ECB and Fed widens, and speculators continue to treat the euro as a target for short sellers.

Will best laid plans get Trumped?

USD

The dollar sell-off seen over the summer occurred at a time when US data began to show some signs of weakness (poor Non-Farm Payrolls and some weak PMIs) and the market perception that the Fed was on the cusp of aggressive rate cuts.

Despite a 0.5% rate cut in September, the dollar's volte- face in Q4 owed to a trifecta of Trump, a less dovish Fed and solid US economic data. As we move forward, markets eagerly await the extent of Trump tariffs, immigration, tax and Ukraine, alongside the underlying issues of the debt ceiling. Trump inherently drives market volatility, ranging from outbursts on the 'Truth Social' platform to meddling with Fed policy!

If the Fed barely cuts rates in 2025, and US economic data stays resilient, it is difficult to see much dollar weakness in the first half of the year, or perhaps the entirety of 2025. The conservative dollar view hinges on some rate cuts later in the year, more modest US growth/data and/or Trump not following through on some of his policies, allowing the dollar to give back some of the profound gains seen in recent months.

EUR

At the close of 2024, the euro faced mounting pressure from a range of negative factors. These included deeply contractionary services and manufacturing PMIs, political instability in France and Germany, and growing market expectations of an aggressive rate-cutting trajectory by the ECB.

Further, the spectre of onerous tariffs from the US on European goods weighed heavily, alongside diminishing trade with China. Whilst it would be brave to stand in the way of some further euro weakness, it is not inconceivable that, deeper into the year, the euro recovers a little, as the ECB may not cut as much as markets think, perhaps tariffs aren't as large as once feared, and political developments in France and Germany take a step for the better.

GLOBAL VIEW

A look at other global FX themes

Japanese Yen (JPY)

Swiss Franc (CHF)

Australian Dollar (AUD)

Japanese Yen

The Yen suffered significant weakness in recent years, as a lack of inflation caused the Bank of Japan (BoJ) to not raise rates, while most other central banks were aggressively hiking.

This meant the Yen was sold heavily in what is known as the 'carry trade'. However, tectonic plates are shifting. The BoJ are now tentatively raising rates as others look to cut, meaning the Yen has grounds to appreciate this year. Rising wages filtering into consumer demand will help drive this hawkish theme.

Swiss Franc

Whilst the Swiss Franc can, and often does, strengthen from safe-haven inflows during times of wider financial market stress, a mix of inflation and central bank policy has driven the franc's weakness in recent months.

Low inflation shapes market expectations of further rate cuts from the Swiss National Bank (SNB), who only meet four times a year. The SNB cut by a surprise 0.5% at the end of 2024, which weakened the franc, and the central bank has little tolerance for currency appreciation, regularly intervening in FX markets when necessary. Remain vigilant on the franc, as it could strengthen in a broader flight to safety during periods of wider market stress.

Australian Dollar

The Aussie dollar (AUD) is tied to global growth narratives. When there is positive global growth, a buoyant Chinese economy and demand for commodities, AUD fares well.

When global themes splutter, so too does AUD, whilst also being driven by domestic themes and of course the policy path of the central bank, the RBA. For some time, the AUD was supported by the fact that the RBA may be one of the last central banks to cut, but this support has ebbed away, particularly now that many other central banks also look less dovish. Furthermore, inbound Trump tariffs on China have weakened the Renminbi, spilling over into the AUD, given the inextricable ties between the Australian and Chinese economies.

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Joe Tuckey has been Argentex's lead analyst for six years. He regularly publishes market commentary and analysis, both technical and fundamental, for all Argentex stakeholders to help with market timing and hedging, establishing a 'balance of probabilities' in market analysis. Joe regularly appears on CNBC and BBC TV, and has contributed to currency related content across various media platforms including; The Times, Daily Mail, The Telegraph, Reuters and BBC Radio 4 Today programme. Prior to Argentex, Joe was a derivatives trader for over twelve years, across equities, commodities and FX.

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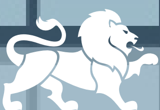

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