Americas FX Morning Bullets

18 March 2025

Currencies
Global

- USD on the defensive again, but positioning has shifted
- EUR gains on fiscal hopes and a possible peace dividend
- GBP-USD hits 1.30, but questions around GBP remain

The USD is back on the defensive amid hopes for clarity on US tariffs, a European fiscal boost, and a peace dividend for the EUR. We look at the European aspects of this below, but it is clear the USD is battling adverse sentiment and a big shift in positioning. IMM data already show a decisive reduction in USD longs in recent weeks. Bloomberg this morning cites a survey showing the biggest ever drop in investor exposure to US equities, the flipside being that 39% of investors are now overweight European equities, the highest share since mid-2021. The battle now is between momentum, to see if the recent consolidation in the DXY gives way to fresh selling, and a market which has already made big adjustments in FX and equity markets. In some respects, the easy part is the correction as the market responded to tariff confusion and Germany's fiscal U-turn. Now the going may get tougher for EUR bulls and USD bears.

Today's USD weakness is partly related to hopes for a pragmatic US trade policy approach even as President Trump awaits "Liberation Day." The market has taken solace from a Bloomberg report that US Trade Representative Jamieson Greer is seeking to introduce a more orderly approach to tariffs. According to the report, this will include soliciting feedback from businesses and other stakeholders when setting up the tariff programme. There are clearly many moving parts still undecided with just two weeks to run to the deadline. The market's hope for a dovish trade policy outcome remains rather at odds with the tone being offered by President Trump. On his Truth Social platform last night, he again suggested that "April 2nd is Liberation Day for America" and said the US "will start taking back some of the vast wealth that has been taken from us". Perhaps the technocrats and USTR Greer will end up setting the tone, but the USD is likely to capitalise if the outcome is hawkish.

The EUR is enjoying a double-whammy of hopes for German fiscal support and a peace dividend. Today, Germany's parliament is likely to vote in favour of debt brake reform that will open the door to a big increase in defence and infrastructure spending. It is possible that a lot of the good news on this front is already in the price. Last week's news that Germany's Green party was on board with the plan failed to provoke much EUR strength, for example. Leaders of the main parties supporting today's bill sound confident it will pass, and the parliamentary maths suggests they are likely to be correct. Separately, US President Trump and Russian President Putin will hold talks today, with markets hoping it moves the Ukraine peach process ahead. Despite the EUR enthusiasm around these two factors, it remains questionable whether they will be enough to quickly lift the entire Eurozone economy out of its stagnant state. For example, as we noted yesterday, consensus GDP forecasts for Germany remain little changed despite the fiscal U-turn.

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It is a landmark morning for GBP-USD as it moves back above 1.30 for the first time since November 2024. It is another example of where USD enthusiasm in the wake of the Republican Party clean sweep in the US election has now fully reversed. The rise in GBP-USD off the January lows has been helped in recent weeks by the upward move in UK-US 2Y yield differentials, but the pace of the move upwards in FX looks rather exaggerated relative to the move in yields. Most of that shift in the differential has been driven by more dovish US rate expectations, rather than a shift higher in UK rate expectations. In fact, UK 2Y Gilt yields are 38bp lower than they were when GBP-USD bottomed in January, but remember that GBP benefitted from lower yields in January as it was associated with lower UK fiscal risks. Now we are back in the more conventional positive correlation between rates and FX. But this raises two problems for GBP. The first is whether the Fed is really likely to cut rates more than the BoE (which is what the market says). The second is whether UK fiscal constraints may return as a headache for GBP. The UK government is set to announce GBP5bn in spending cuts today as part of its welfare system reform. The fiscal cuts come days after GDP data showed the UK economy unexpectedly contracted in January.

LatAm currencies extended their recent gains yesterday as risk sentiment remains intact. For a third session USD-BRL moved lower, seeing the pair close below the 200-day moving average (5.70877) for the first time this year. The CLP and COP also gained on the session, while the MXN was quieter amid a local holiday. In the absence of any negative global risk developments, we would expect LatAm currencies to remain in good cheer, though the threat of potential unsettling tariff news remains ever present. Today we see minor data prints for Chile (Q4 GDP and current account) and Brazil (March IGP-10 inflation), neither of which are likely to move their respective FX markets. Meanwhile, in Brazil the government has said it expects that the planned expansion of income tax exemptions will only see reduced tax revenues of BRL27bn, rather than the previous estimate of BRL32bn (Bloomberg). On paper, this seems positive, but the adjustment to the projections is small, and market participants are unlikely to be particularly assuaged of their lingering fiscal concerns by this.

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