Americas FX Morning Bullets

19 March 2025

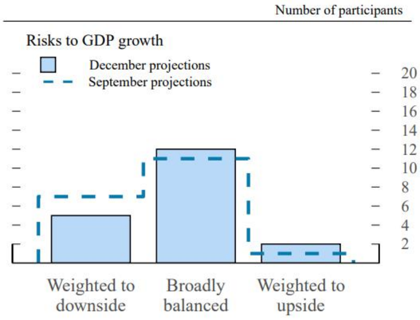
Currencies
Global

- USD gains ahead of March FOMC meeting
- Focus will be on 'dots', risks and economic projections
- EUR-USD and GBP-USD show signs of fatigue

Despite the likely lack of a rate cut at today's FOMC, there will still be a lot of moving parts for the market to digest. These include a new set of 'dots' projections from FOMC members. Our economists expect these to be unchanged from those published in December, which would imply a median Fed expectation of 50bp of easing over the remainder of the year, a little less dovish than a market priced for 58bp. Another focus will be on the accompanying statement to see if the Fed wants to signal greater unease with the economic outlook, although here too there may be little change. The Fed could retain the language that the risks remain balanced, and just caveat it by repeating the observation that uncertainty remains high. Our economists also expect the changes to the central tendency forecasts to be little changed, with only a nudge lower to the 2025 GDP forecast, and perhaps a nudge higher to the forecast unemployment rate. An upward revision to the core PCE forecast would offer mixed policy signals to a market pondering stagflation risks.

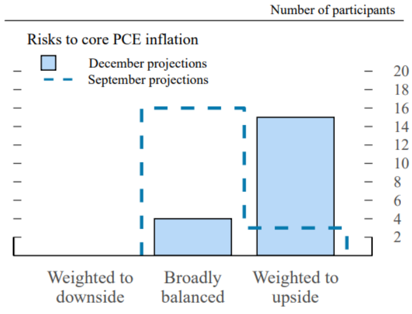
One detail, likely to be missed by the FX market but worthy of attention, is how the Fed views the risks around its forecasts. Our economists flagged that buried in the Summary of Economic Projections report, there are charts that reveal whether FOMC members see upside or downside risks to the forecast components. So for example, while we might see only a modest downward revision to the GDP forecast, it is possible that a greater number of participants might see downside risks to this new forecast. At the same time, it will be interesting to see how many see upside risks to the inflation forecast. Taken together (downside risks to growth/upside risks to inflation) could allow the Fed to argue that the risks are again roughly in balance. But those balanced risks would speak more of stagflation thoughts than Goldilocks.

1. Fed viewed growth risks as 'broadly balanced' in December…



Source: US Federal Reserve, FOMC meeting December 2024

2. …but saw upside risks to core inflation



Source: US Federal Reserve, , FOMC meeting December 2024

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After gapping higher in early March on the back of fiscal stimulus hopes, EUR-USD may be showing some signs of topping out (and GBP-USD too). This morning's move lower is admittedly very small when compared to the surge higher so far this month, but it could still be significant. The drop could be blamed on the lack of material progress in yesterday's call between Presidents Trump and Putin, denting an EUR premium related to a peace dividend. It is also possible that the market is still mindful of yesterday's comments from ECB centrist, Ollie Rehn, who emphasised that the hit to activity from a trade war would be greater than the inflationary impact. While fiscal policy may energise ECB hawks, any inflation boost from fiscal spending likely remains rather distant. The activity threat of a 2 April deadline on possible tariffs from the US is more immediate. But perhaps the simplest explanation is that the enthusiasm for EUR-USD topside is waning given the already sizeable clearing out of USD longs, the shift in equity market positioning, and a reality check that the eurozone economy faces a challenging time ahead despite the prospect of some help on the fiscal front.

USD-JPY briefly hit 150 overnight, but is now mostly unchanged following the BoJ's similarly unchanged policy rate decision. The statement was also mostly a copy of January's outlook report. In his press conference, Governor Ueda noted wage negotiation results were at the stronger end of expectations, external uncertainties are high and rising, and the risk of the BoJ falling behind the curve is not so high. USD-JPY has been rising since 11 March, with VIX off its highs, JPY long positioning already stretched, and domestic news unhelpful (e.g. GPIF will not change its asset allocation targets, Nikkei 11 March). The JPY may also have less safe-haven allure given Japan may also be affected by US tariffs. It may also be vulnerable to any future US administration accusations of excessive weakness. Still, it may outperform those countries more exposed to US tariffs, or that are highly risk-sensitive. All in, we see USD-JPY moving sideways or even falling slightly in the near term before rising later in 2H when the US economy overcomes growth concerns and the BoJ is closer to its neutral rate range (1-2.5%). (See *FX Snap - JPY: Waiting for tariffs*, 19 March.)

USD-CAD remains rather directionless despite yesterday's data showing higher inflation. Both the headline and core CPI measures accelerated higher in February, outstripping consensus expectations. This caused the market to trim expectations for the likelihood of the BoC cutting interest rates in either April or June. The statistics office noted that the February print was skewed due to end of a general sales tax holiday. More data is needed for the BoC to come to a conclusion on the April meeting. The March CPI print would be released just a day prior to the 16 April BoC meeting. Swap markets are currently pricing in less than 30% probability of a rate cut in April. But the inflation prints really only provide the starting point for the policy conundrum that the BoC will face if tariff risks fully materialize on 2 April. Then the central bank would have to balance the potentially near-term inflation impulse against the more lasting downside risks to activity (and inflation thereafter).

The announcement of the Istanbul Mayor Ekrem Imamoglu's detention (Bloomberg) has triggered a sharp TRY depreciation. Beyond the initial price action, such a sizeable move raises two mains risks for the TRY in the medium term: 1) The dollarisation risk: Over the past 15 months or so, the reduction of residents' appetite for FX has been at the core of the policymakers' objectives and has also been pivotal in the TRY's performance. Admittedly, we have seen an increase in FX deposits since the start of the year. But up until now, we have been unconcerned by this modest pickup since it was likely temporary and driven by the phasing out of FX-protected deposits and slightly lower nominal rates. Today's sharp depreciation, however, could encourage residents to increase their demand for foreign currencies. 2) The sustainability of the current FX policy: Since the start of 2024, supporting real FX appreciation has been an implicit intermediate target to fulfil the core objective of lowering inflation. The sudden and abrupt TRY depreciation is a challenge to the current FX policy, which is based on a slow and moderate nominal depreciation. Given the extent of the move, we believe that it has become impossible in the near term to achieve real TRY appreciation. Over the medium term, the TRY will have to face a significantly higher inflation risk as Türkiye has one of the highest FX pass-throughs in the EM space. A re-acceleration of inflation would bring into question the sustainability of the current FX policy given the unintended consequences of such a policy (e.g. on export competitiveness). In such a scenario, the policymakers would also have to rethink the path of the policy rate. Overall, the recent developments have made the TRY's outlook much more uncertain, with the risk of more depreciation in the upcoming period.

The CLP strengthened yesterday as Q4 GDP came in above expectations at 4.0% y-o-y, taking full year 2024 GDP growth to 2.6%. The upward surprise was mostly driven by a sharp increase in exports, as favourable agricultural harvests in addition to supportive global commodity prices drove figures higher in H2 2024. Additionally, domestic demand has been steady, growing by 1.3% y-o-y in Q4, pairing consumption with a stable FDI stream. Notably, services exports contributed to growth as well in the form of transportation and business services. Stronger growth could alleviate the fiscal concerns somewhat, taking some pressure off the Ministry of Finance to deliver spending cuts. It remains uncertain if this momentum can be continued throughout 2025, although we expect exports to remain strong in the first part of the year due to bolstering commodity prices. We believe USD-CLP should trade in a 900-960 range in the near term. We see scope for USD-CLP to fall further if sentiment towards China continues to improve, while later this year we see a chance the CLP could benefit from positive sentiment surrounding local elections.

Colombia's Finance Minister Diego Guevara confirmed his resignation yesterday, after only three months in office. The COP notably underperformed the region yesterday as Guevara met with President Petro to discuss the former's resignation, which initially came a few weeks ago. The market fears that Guevara's resignation could represent a danger of moving away from fiscal responsibility, given the ex-finance minister's efforts to rein in spending. A possible candidate for his replacement would be German Avila, current president of Grupo Bicentenario, the government's financial holding (La Republica, 18 Mar). He would be the fourth finance minister during Petro's term. This development comes during a day yesterday in which President Petro had called on Colombians to demonstrate their support for the various social reforms currently under debate. Among the reforms is the highly contested healthcare reform, being debated again in Congress after numerous setbacks. Markets have been wary of this reform due to the significant fiscal cost. Indeed, the financing of the health reform was one of the points of contention between President Petro and Finance Minister Guevara, who disagreed with the fiscal endorsement of the reform (La Republica, 18 Mar). The labor reform, on the other hand, appears likely to be shelved in Congress (La Republica, 18 March).

Political and fiscal uncertainty in Colombia appear to be impacting investment flows. FDI fell 15.2% y-o-y in 2024, a trend we expect to continue throughout 2025, and is contributing to overall weakness in investment. While the COP has been sensitive to negative headlines, the currency has proven fairly resilient this year, despite the fiscal and policy setbacks, in large part thanks to still-high carry given a cautious central bank, and the market's view that elections next year will result in a change in government. Still, we think that potential upcoming negative ratings development could be a catalyst that allows COP to underperform LatAm FX in the months ahead. A potential rate cut by the central bank later this month would also be a negative catalyst for the currency.

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