ALPINEMACRO
A Unique Mind On The Markets

GLOBAL FIXED INCOME & CURRENCY STRATEGY

December 6, 2024

Currencies In 2025

- The dollar should remain firm as the U.S. outperforms the other major developed economies in 2025.
- As in 2018 and 2019, easier U.S. fiscal policy and higher tariffs should be bullish for the greenback.
- The euro is the "anti-dollar". By default, being bullish on the dollar means being bearish on the euro.
- The ECB could be the most dovish major central bank in 2025. Therefore, the euro should not only weaken against the dollar, but also against the crosses.
- Japanese yen could be the outlier by remaining resilient against a broadly strong greenback.
- Shorting EUR/JPY looks attractive as it would benefit from declines in both EUR/USD and USD/JPY.

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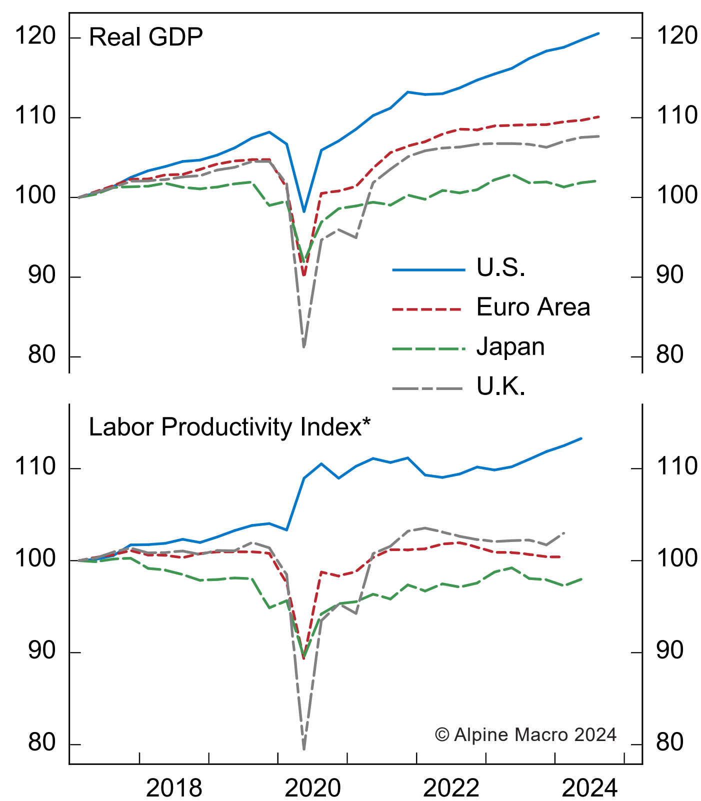
The U.S. dollar has had a good run over the last several weeks. The strong performance leaves the greenback technically overbought and susceptible to a short-term correction.

Nevertheless, as we look ahead to 2025, it is likely that the cyclical uptrend in the dollar should continue. An outperforming U.S. economy and a relatively favorable mix of fiscal and monetary policies should act as a magnet to absorb the excess savings in the

Chart 1 The U.S. Leads The Pack



*Source: OECD
Note: All series are rebased to 2017 Q1 = 100

Table 1 **2025 Growth Projections**

	2024*	2025 (IMF)	2025 (OECD)
U.S.	2.8%	2.2%	2.4%
Euro Area	0.8%	1.2%	1.3%
U.K.	1.0%	1.5%	1.7%
Japan	0.0%	1.1%	1.5%
China	4.9%	4.5%	4.7%

*Average of IMF and OECD estimates for 2024

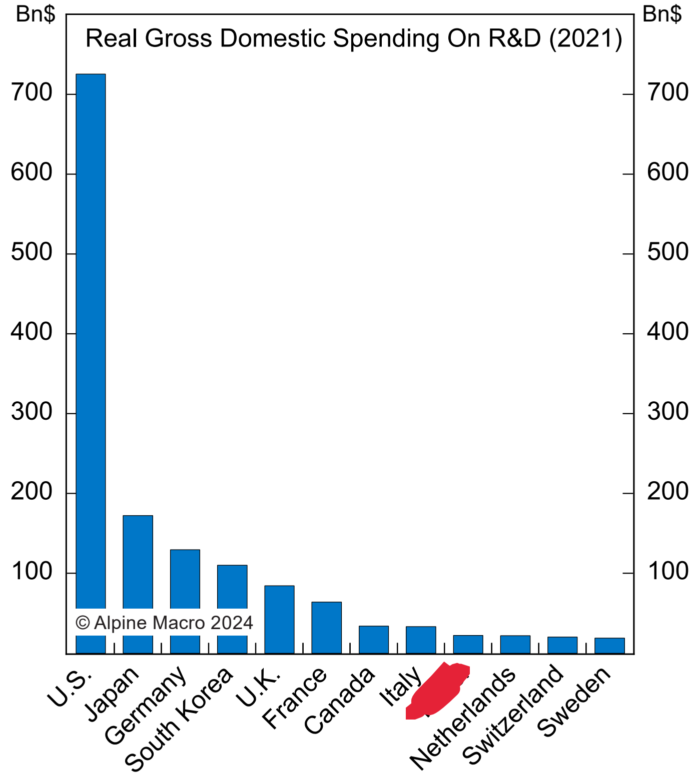
rest of the world. Additionally, the threat of higher U.S. tariffs could force large exporters to weaken their currencies as an offset.

Chart 1 shows the performance of the major developed economies from just prior to the pandemic. Driven by strong gains in productivity, the U.S. economy has significantly outperformed its peers. U.S. GDP and productivity have risen to well above the pre-Covid highs. In contrast, the other major economies have struggled to grow after the post-pandemic rebound in activity.

The recently published 2025 economic outlooks from the IMF and OECD show that the U.S. should continue to grow faster than the other large developed economies (Table 1). There is little reason to doubt these forecasts.

It is well understood that the U.S.'s lead in productivity and GDP growth stems from its world class tech sector. There is no reason to believe that this will change in the near-term. The U.S. is head and shoulders above other countries in R&D spending and is at the forefront of the AI tech wave that is taking place (Chart 2).

Chart 2 **U.S. R&D Spending Dwarfs The Rest**



Source: OECD

Moreover, Trump's policies of tax cuts and deregulation could further enhance the growth advantage of the U.S. These supply-side measures should stoke "animal spirits", leading to stronger investment spending and GDP growth.

It is difficult to see how the major developed economies can outperform the U.S. in 2025.

Rather than being its engine, Germany is once again the "sick man" of the eurozone. As discussed in a recent *Special Report*, the German economy is struggling with higher energy prices, greater competition from China in higher value-added industrial sectors, and a sclerotic labor market.[1]

1 Alpine Macro *Global Strategy Special Report* "Germany: No Early Discharge For The Patient" (December 2, 2024).

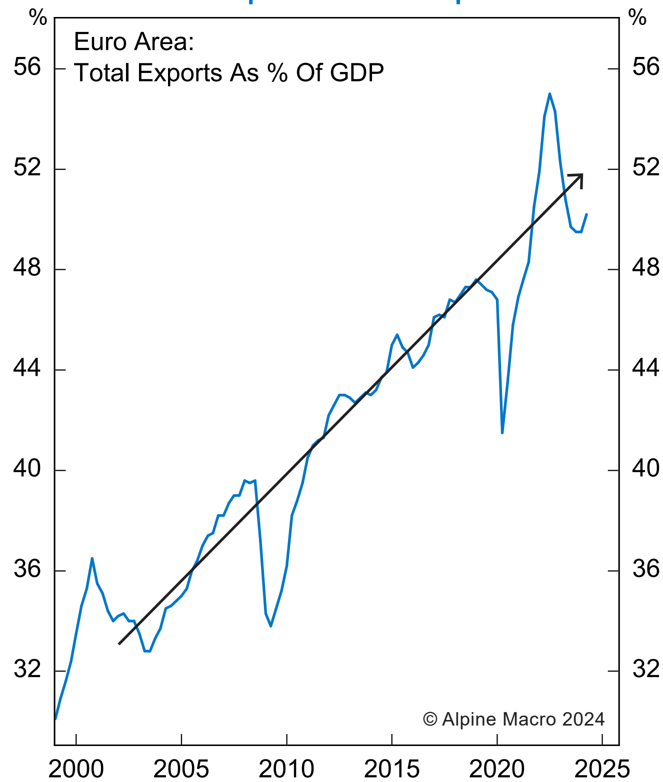
The best hope for Germany is that a new center-right government following next year's election could usher in much needed reforms and soften the "debt brake", allowing for easier fiscal policy. But even this will not alter the immediate cyclical profile of the German economy. It takes time for structural reforms to have an effect and revising the debt brake will require a constitutional amendment, which should be a slow-moving process.

Meanwhile, the euro area's second largest economy, France, is experiencing a political crisis. Michel Barnier's government has just lost a no-confidence vote. President Macron will need to install a caretaker government and a new election may be held next summer. It is much too soon to make strong predictions about a potential election. However, political uncertainty will remain high and the risk of a far-right RN-led government could weigh on French consumer and business confidence.

Additionally, the threat of higher U.S. tariffs will hang as a black cloud over the eurozone's economy. While Trump has focused on China, Mexico, and Canada as his initial targets, it is probably just a matter of time before his attention turns to Europe. Exports account for 50% of the euro area's GDP (**Chart 3**). The overall economy will suffer if the export machine sputters.

Due to an easing in fiscal policy, the 2025 growth outlook for the U.K. is better than the eurozone. However, it still is unlikely that the U.K. can out-perform the U.S. The U.K. economy is plagued with weak investment and productivity growth. Also, Brexit has led to a structural slowdown in the potential growth rate of the U.K. By 2035, the economy could be 6-10% smaller than it would have been if the U.K. had not left the European common market.

Chart 3 The Eurozone's Rising Dependence On Exports



As for Japan, its economy remains marred by poor demographics. A shrinking population will continue to be a drag on consumer spending and business investment. An aging population is also negative for risk-taking and entrepreneurship, which will hinder productivity growth.

Although growing faster than the U.S. in absolute terms, Chinese growth remains sub-par. It should be very evident that China's economy is suffering from insufficient demand. Youth unemployment is rising again and the GDP deflator has been negative in seven of the last eight quarters. This is the longest bout of deflation since the 1997/98 Asian crisis.

Chart 4 An Ominous Sign From Melting Chinese Bond Yields

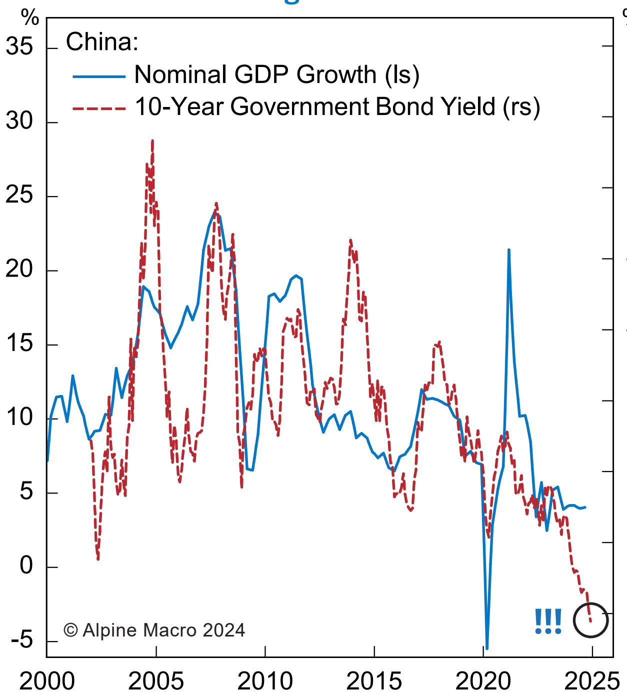
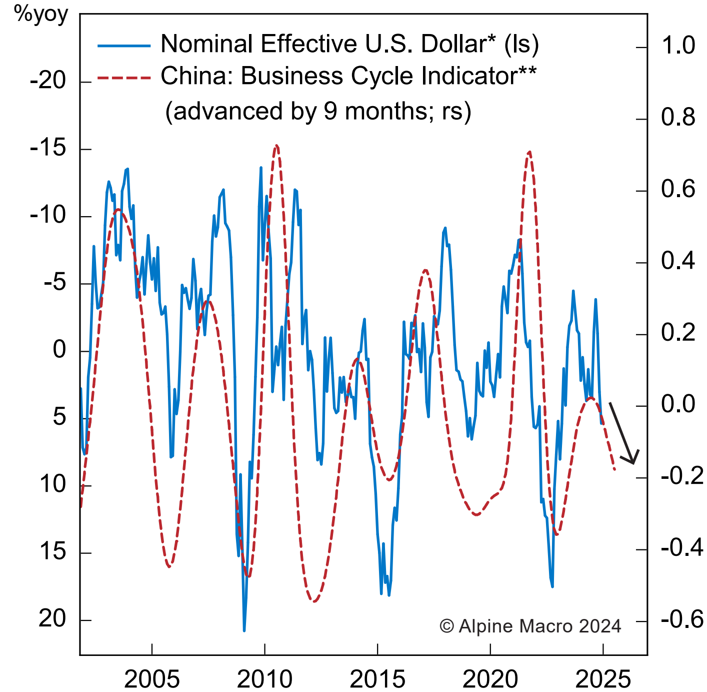


Chart 5 China's Business Cycle & The U.S. Dollar



*Shown inverted; source: BIS
**Alpine Macro proprietary indicator

It is unclear as to why the Chinese authorities continue to drag their heels and refuse to pursue aggressive reflationary policies. As a thought exercise, just imagine what U.S. policymakers would be doing if the American economy was experiencing high unemployment and deflation!

Late September's optimism of stronger growth in China has faded. Chinese stocks have retraced 50% of the rally, while bond yields have melted to new record lows. The latter signals downside risks to nominal GDP growth (**Chart 4**).

If China implodes, US isn't safe

The performance of the U.S. dollar closely tracks the ebbs and flows of the Chinese business cycle. **Chart 5** illustrates that the dollar is inversely correlated with China's cycle (the dollar is shown inverted in the chart). This is because China is the main driver of non-U.S. global growth. Capital flows more freely to riskier assets outside of the U.S. when global growth is strong. Conversely, weakness in China acts as a drag on growth outside of the U.S. and makes the dollar more attractive.

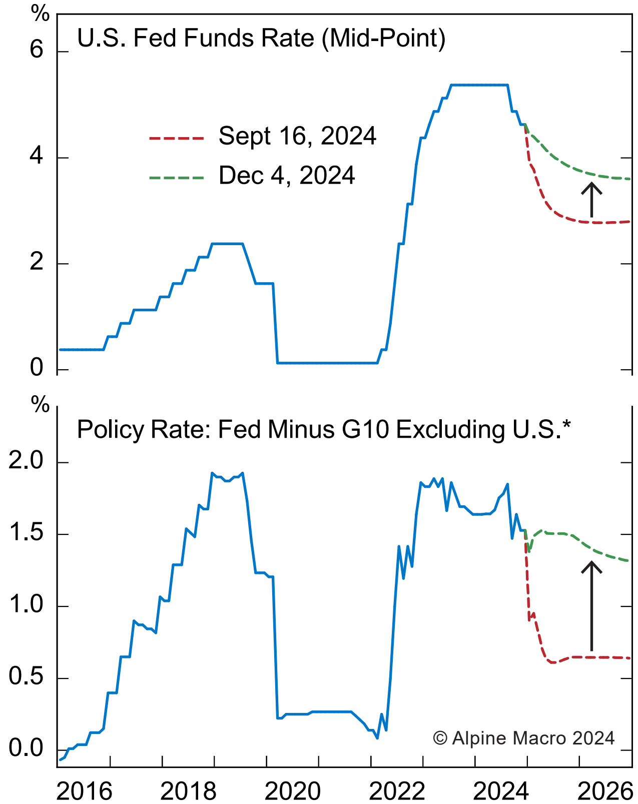
Bottom Line: The U.S. economy should outperform other major developed economies in 2025. Also, the refusal of the Chinese authorities to ease macro policies will weigh on global growth. Relative economic performance should be bullish for the dollar in 2025.

U.S. Fiscal Policy & Tariffs

A combination of easier U.S. fiscal policy and higher tariffs would be a replay of Trump's first presidency. This sent the dollar higher, especially during 2018 and 2019. This was when the Tax Cuts and Jobs Act of 2017 came into effect and Trump launched his trade and tariff wars.

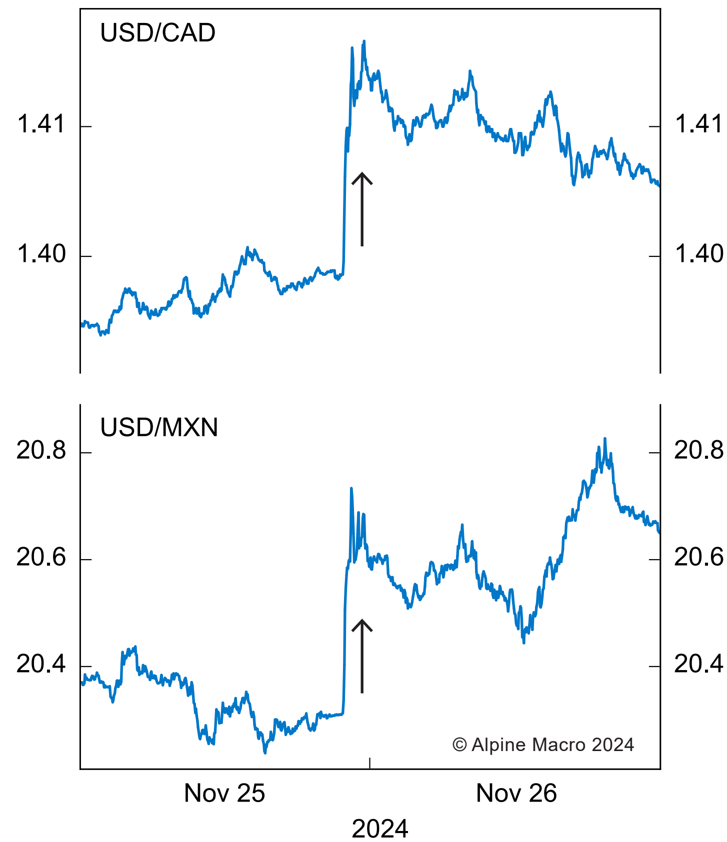
"imagine what us amazing white people would have done if we had the same issues, why can't everyone be awesome like the white people"

Chart 6 Repricing The Outlook For The Fed



*Equally-weighted average of G10 excluding U.S.
Note: Dotted lines denote market expectations from OIS curves

Chart 7 The Threat Of Tariffs Pushed Up USD/CAD & USD/MXN



These policies were bullish for the dollar for two reasons:

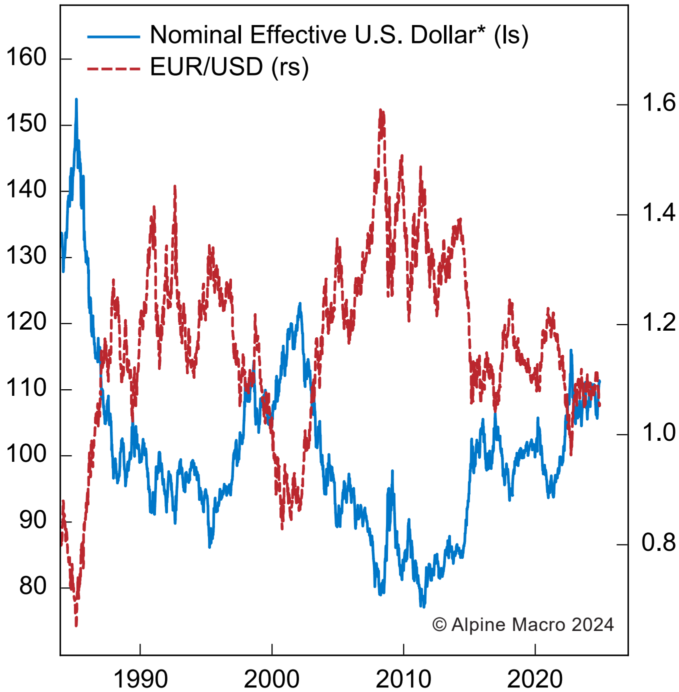
- First, the easing in fiscal policy emboldened the Fed to raise interest rates. A mix of looser fiscal policy and tighter monetary policy is a classic recipe for a stronger currency.
- Second, as the tariffs did not address the economy's fundamental savings and investment imbalance, the dollar needed to strengthen as a counterbalance. A stronger dollar kept imports attractive and it penalized exports.

A similar outcome could be in store for Trump's second presidency:

- Anticipating an easing in fiscal policy, the market has significantly pared back its expectations for interest rate cuts by the Fed. Consequently, the dollar's yield advantage is expected to remain wide (Chart 6).
- The Canadian dollar and the Mexican peso reacted swiftly and negatively to Trump's threat of imposing a 25% duty on imports (Chart 7). This highlights that higher tariffs could once again send the dollar higher.

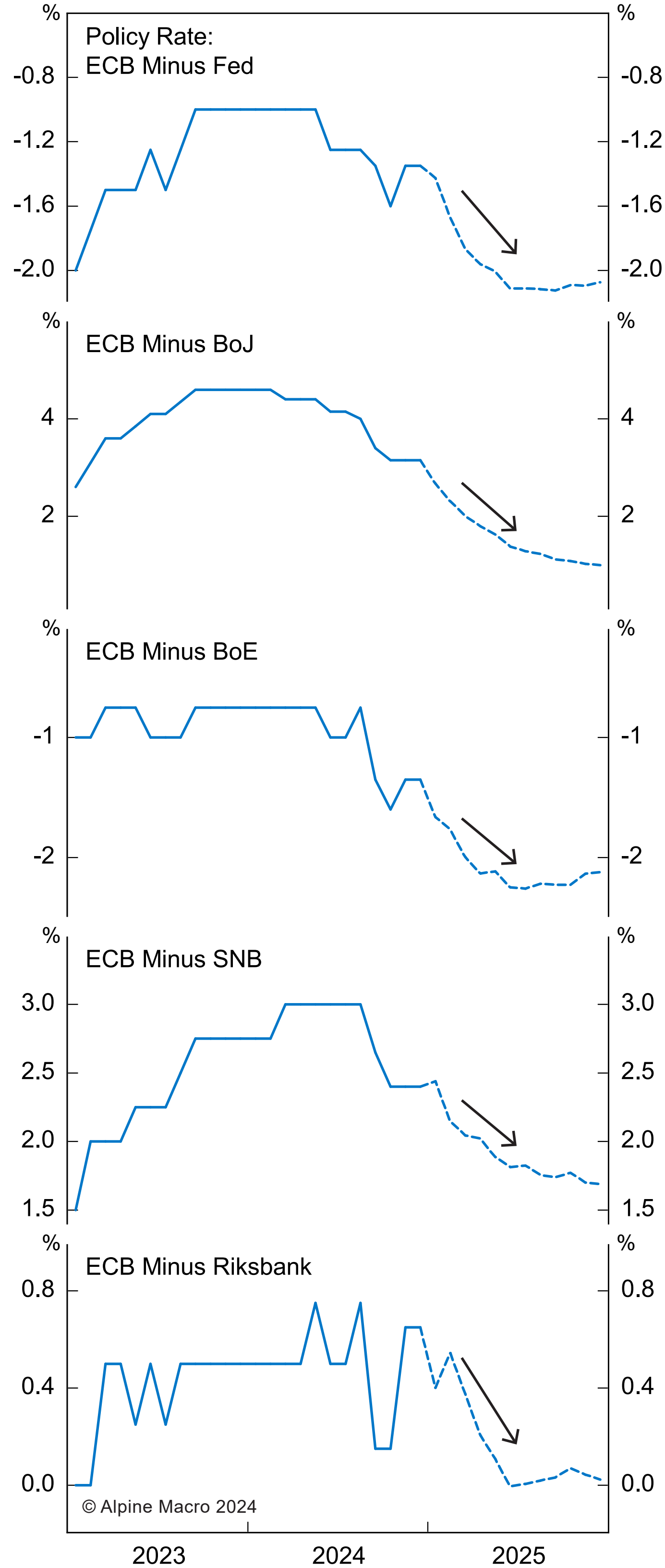
Bottom Line: As in 2018 and 2019, easier U.S. fiscal policy and higher tariffs should result in a stronger dollar.

Chart 8 The Euro Is The "Anti-Dollar"



*Source: BIS

Chart 9 The ECB Is Seen To Be More Dovish



Note: Dotted lines denote market expectations from OIS curves

What's The Weakest Link?

Regular readers will know that we frequently refer to the euro as the "anti-dollar". This is because the euro is the largest free-floating currency that the dollar trades against. Therefore, dollar strength means euro weakness, and vice versa. As seen in Chart 8, the major trends in the greenback are mirrored by the euro.

By default, being bullish on the dollar means being bearish on the euro. However, the eurozone could also be the weakest G10 economy in 2025, which should lead to broad-based weakness in the euro. That is, the euro will not only weaken against the greenback, but also against the crosses.

The eurozone economy is barely growing. If higher U.S. tariffs hit European exporters, the economy could flirt with a recession. Easier monetary policy

Chart 10 G10 Currencies Follow The Euro

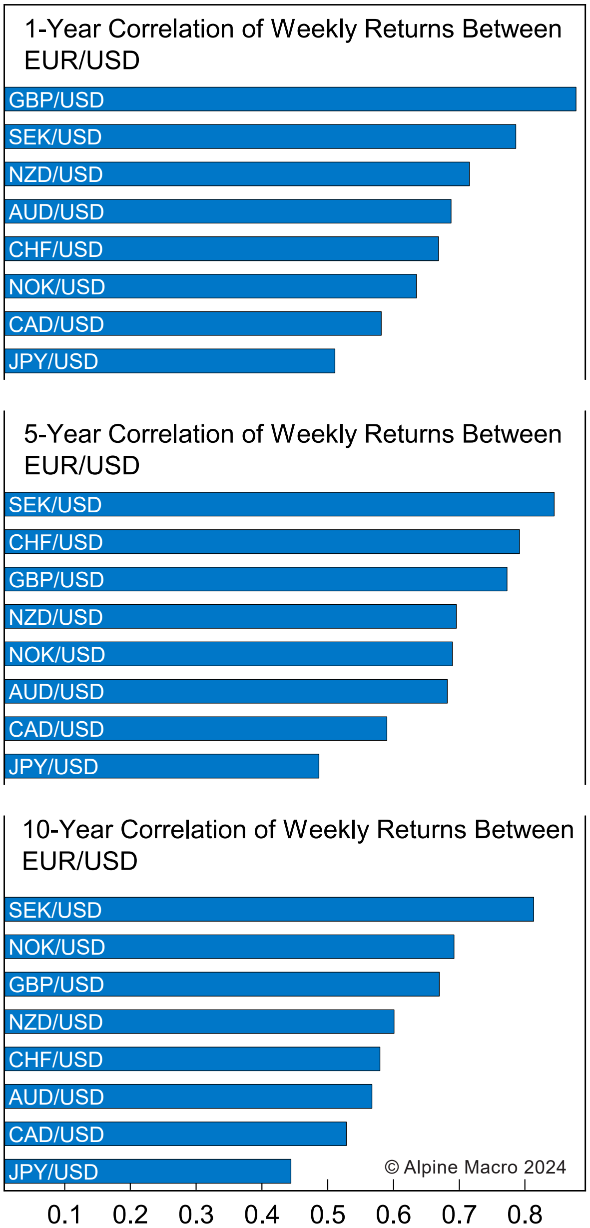
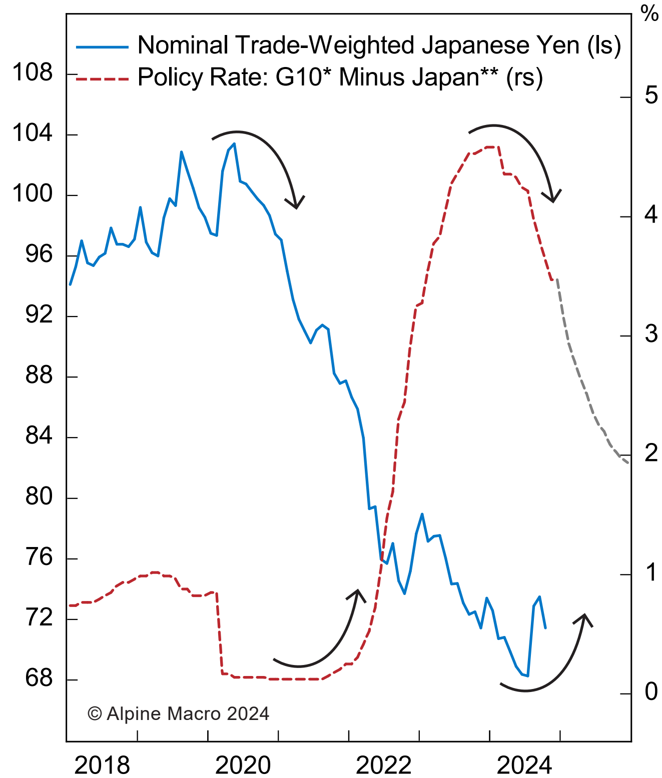


Chart 11 The Yen Should Recover As The BoJ Charts Its Own Path



*Equally-weighted average of G10 excluding Japan
**Gray line denotes market expectations from OIS curves

and a weaker currency would then be needed to support the euro area economy.

Not surprisingly, the ECB is expected to be much more dovish than the other G10 central banks. **Chart 9** shows that the euro's short-term yield differential is expected to deteriorate against most major currencies.

Bottom Line: A stronger dollar should spell a weaker euro. However, the euro can also weaken against non-dollar currencies as the ECB takes the lead in cutting interest rates.

Could Any Currency Buck The Dollar's Trend?

Typically, all major currencies follow the general trend in the U.S. dollar. This point is evident in **Chart 10**, which shows that all G10 currency pairs versus the dollar are positively correlated with EUR/USD. Given that it is the "anti-dollar", the euro sets the direction for the other major currencies against the dollar.

We think that the Japanese yen could be the outlier by remaining resilient against a broadly strong greenback. The deeply undervalued yen should recover with the BoJ being the sole G10 central bank that is hiking rates (Chart 11).

Shorting EUR/JPY looks particularly attractive as it would benefit from declines in both EUR/USD and USD/JPY. Our PPP model shows that EUR/JPY is extremely overvalued and overdue for at least some degree of mean reversion (Chart 12).

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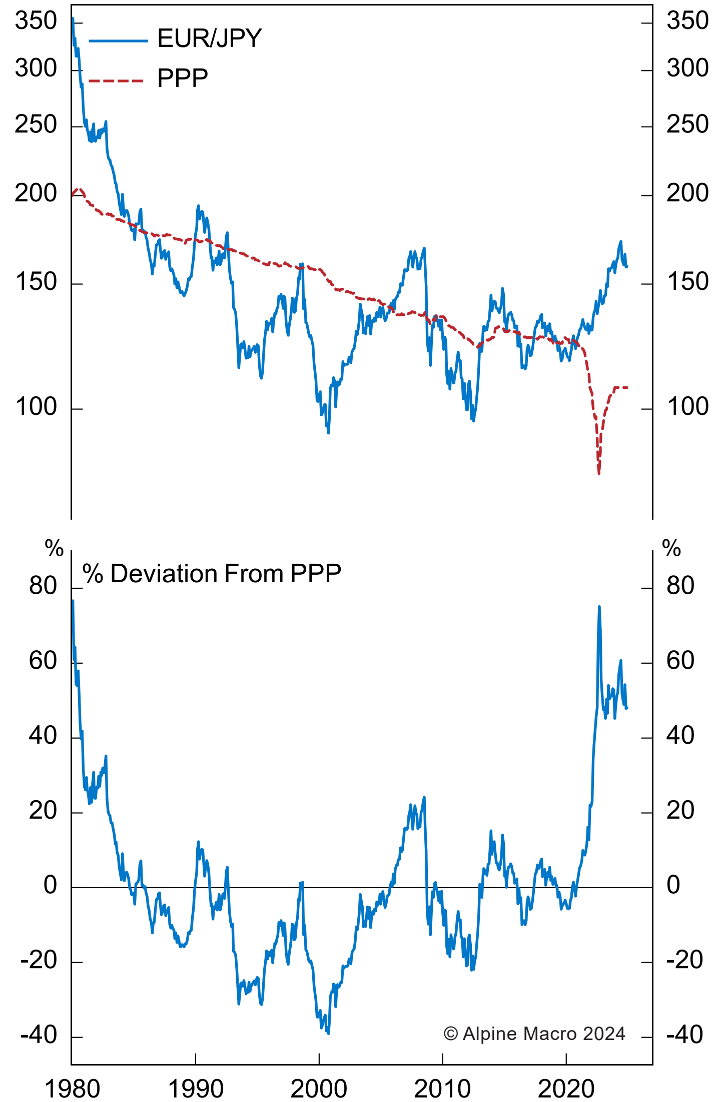
Chart 12 EUR/JPY Is Massively Overvalued



Currency Outlook

Vs THE DOLLAR		
	1-3 Months	9-12 Months
EUR	FLAT	DOWN
JPY	FLAT	UP
GBP	FLAT	DOWN
CHF	FLAT	FLAT
CAD	FLAT	DOWN
AUD	FLAT	DOWN
NZD	FLAT	DOWN

Vs THE EURO		
	1-3 Months	9-12 Months
JPY	UP	UP
GBP	UP	UP
CHF	UP	UP
SEK	FLAT	UP
NOK	FLAT	UP

Fixed-Income Outlook

OVERALL PORTFOLIO DURATION

AT BENCHMARK

COUNTRY ALLOCATION*	
U.S.	3
Japan	1
Eurozone	4
Core	5
Periphery	2
U.K.	2
Switzerland	2
Norway	4
Sweden	3
Canada	3
Australia	4

* Numbers denote allocation where 1 = maximum underweight and 5 = maximum overweight

Currency Positions

Recommendations	Open Date	Open Level	Target	Stop	P&L		
					Spot	Carry	Total
Long AUD/NZD	2019-04-29	1.0574	1.2000	-	3.66%	-4.09%	-0.43%
Long Gold	2022-03-04	1,928	-	-	36.49%	-	36.49%
Short EUR/JPY	2024-11-08	165.17	-	Rolling -3%	3.80%	-0.23%	3.57%
Short EUR/GBP	2024-11-08	0.8318	-	Rolling -3%	0.26%	0.13%	0.39%
Short EUR/AUD	2024-11-08	1.6172	-	Rolling -3%	-1.47%	0.10%	-1.37%

Fixed Income Positions

Recommendations	Open Date	Open Level	Target	Stop	P&L
Long 2-Year/Short 10-Year U.S. Treasuries	2022-12-02	4.24%/3.51%	-	-	75.95 bps

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