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Market Services FX Spotlight

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Where we stand

The US dollar lagged against peers resulting in the dollar index falling to levels last seen in December of 2023 despite higher US yields and optimism surrounding potential trade deals.

On Thursday May 8, the US and the UK agreed on the first post-Liberation Day trade deal, decreasing tariff rates on auto and steel while offering clues into the format for future deals. But the big news came the following weekend from Switzerland, where **the US and China agreed to lower tariffs rates on one another for 90 days.** The US decreased tariffs on Chinese goods to 30% from 145%, and China lowered their tariffs to 10% from 125% (with the extra 20% applied by the US stemming from the fentanyl penalty that remains in place). Since the relief measures came into place, several White House officials along with President Donald Trump have accused China of slow walking a trade deal and suggesting a Trump–Xi call is necessary to reach a deal.

As widely expected, **the Bank of Japan held their target rate steady at 0.5% during their May meeting** and followed up with dovish comments by projecting a longer timeline to reach the 2% inflation goal.

The FOMC unanimously agreed to leave the benchmark rate unchanged at 4.25–4.5% at the May 7 meeting citing risks of both higher inflation and higher unemployment. Powell signalled the Fed's inclination to remain patient on lowering rates given the currently unknown economic consequences of tariffs while also highlighting the ongoing resiliency and strength of the US economy as evidenced by the recent hard economic data. During the Q&A, the dual mandate was thrown into question in the case of stagflation and the balance of risks to lowering inflation versus keeping unemployment in check. Powell indicated the Fed would look at where each of these metrics stand with respect to their distance from their goalpost in making the decision to balance the dual mandates.

The BoE cut the bank rate by 25 bps, but the MPC vote was split as five members voted for a 25-bps cut, two voted for a 50-bps cut and two opted to hold. The dissenters were split in their reasoning with the doves worried about downward risks to global growth stemming from trade policy while the hawks—including BoE Chief Economist Huw Pill, who argued that lower borrowing costs were already easing financial conditions while inflation persistence was also a concern.

Once again, **inflation figures for the US continued to ease with headline year-over-year figures coming in at 2.3% versus expectations of 2.4%,** the softest print on the metric since February 2021. Despite the softer figures, economists have cautioned that the costs imposed by universal tariffs may not feed into the inflation data until June and July. Moody's downgraded US debt to Aa1, a notch below Aaa, aligning the rating with S&P Global and Fitch's downgrades in past years and marking an end to the Aaa credit status held for over a century.







On the horizon

After trade talks between the US and EU stalled, Trump had recommended 50% tariff rates to apply to EU goods starting June 1, but this deadline has since been extended to July 9 following a productive call with EU Commission President Ursula Von der Leyen. The current 90-day pause on tariffs for most countries is set to expire on July 9 with the major deals in focus being Canada, the EU, India, Japan, Mexico and China. Further tariff relief came late in May when a US Court of International Trade declared the 1977 law used to impose the tariffs as wrongly invoked. The Trump Administration appealed the decision, which is now paused to hear arguments, and the White House has vowed to appeal this to the Supreme Court if necessary.

HEADLINES

- UK and US agree on trade deal
- US and China roll back tariffs
- BoJ leaves rates unchanged
- Fed leaves rates unchanged
- BoE cuts rates by 25 bps
- EU trade talks under pressure
- US CPI cool but CAD CPI hot

KEY UPCOMING EVENTS

DATE	EVENT
JUN 4	 BoC rate decision
JUN 5	 ECB rate decision
JUN 6	 US unemployment
JUN 17	 BoJ rate decision
JUN 18	 Fed rate decision
JUN 19	 BoE rate decision

Following the hotter than expected Canadian CPI report on May 20, economists have begun revising their outlook for the June BoC meeting. The headline CPI print of 1.7% benefitted from the removal of the carbon tax, but under the surface, month-over-month core figures rose by 0.37%, translating to a 3m annualized print of 3.4%. The OIS curve shifted from 17 bps of easing to only around 5 bps of easing for the upcoming June 4 rate decision.

Emerging markets

As telegraphed, the BCB hiked the Selic rate by 50 bps to 14.75% but left messaging surrounding future hikes more ambiguous, which analysts interpreted as signalling either a pause or a 25-bps hike at the next meeting. Calls for a pause grew as year-over-year inflation later in the month printed at 5.4% versus expectations of 5.49%, helping support the BRL and dampen yields across the swap curve. Also, to manage fiscal deficits, Brazil's Finance Ministry reportedly mulled a 3.5% IOF tax on transfers but backtracked the move following investor concerns that the move was aimed at controlling capital flows.

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