ECOWEEK

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"IF THE US ECONOMY ENDS UP UNDERPERFORMING, A DEPRECIATION OF THE DOLLAR COULD BECOME A REALITY. CONSIDERING AN AGREEMENT ALONG THESE LINES, SIMILAR TO THE PLAZA ONE, SEEMS UNREALISTIC GIVEN THE COMPLEXITY OF ALIGNING INTERESTS."

ECONOMIC RESEARCH

BNP PARIBAS

The bank for a changing world

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COULD TRUMP DRIVE DOWN THE DOLLAR?

On 20 January 2025, Donald Trump once again became President of the United States. With a 'clear mandate', the Republican intends to harness his victory by addressing his favourite issues. His return to the Oval Office comes at a time when the dollar is witnessing one of the biggest rallies in history. The real effective exchange rate of the greenback is now at a comparable level to the one which led to the Plaza Accord of 1985, and its appreciation has a high likelihood of continuing. This trend is likely to frustrate the new President, who is keen to denounce weak currencies as penalising US industry. At the same time, the dollar's status as reserve currency is essential to the strength of the US economy, which suggests (a contradiction between protecting this position and seeking a depreciation. If the US economy ends up underperforming, such a depreciation could become a reality. Considering an agreement along these lines, similar to the Plaza, seems unrealistic given the complexity of aligning interests.

THE RETURN

20 January 2025 marks Donald Trump's return to the White House. Elected by a comfortable margin on 5 November, the former President begins his final four-year term. To say that this event will usher in a new era in international economic relations is an understatement. Conflicting relationships, uncertainty and unpredictability are the central characteristics of this new world. On the domestic front, the first economic implication of Trump's victory, under the (admittedly tight) control of Congress, is the heightened risk of inflation, in stark contrast to his first election's macroeconomic environment. For US counterparties, the two sensitive issues are the potential tightening of global financial conditions, caused by potentially resurging inflation and rising long-term interest rates, and possible prohibitive tariffs. In addition, the valuation of the US dollar relative to other currencies is one area of focus, or, more likely, of tension. Although this issue is not being discussed much outside the United States now, it is one of Trump and his team's favourite economic topics.

STRONG DOLLAR, WEAK DOLLAR: TWO IRRECONCILABLE SIDES OF THE SAME COIN

Donald Trump's position on the greenback is somewhat ambivalent and contradictory, straddled between maintaining its dominance and wanting to see it depreciate to boost the competitiveness of US exports. The upward impact on the dollar of the tariff increases that he plans to implement is a good example of the internal contradictions of his economic agenda.

The 'exorbitant privilege' of the US dollar is a key factor underpinning the country's power. It has been maintained despite the decline in the greenback's share of total world foreign exchange reserves (from over 70% at the start of the 21st century to less than 60% today). At his hearing before the Senate, Scott Bessent, the Treasury Secretary chosen by the President-elect, reiterated the new administration's attachment to the US dollar's status as a reserve currency. Trump is also not particularly keen on this background thrum of 'de-dollarisation'. This appeared in December 2024 in explicit threats to the BRICS, which he wants to block from accessing the US domestic market (notably with 100% customs tariffs) if they try to turn away from the greenback.

However, Trump also believes that the United States has a 'currency problem' undermining the price competitiveness of its industry (his Vice-President, J.D. Vance, also believes that the strength of the dollar is unwarranted and that this has contributed to the country's de-industrialisation). This is why a weaker dollar is seemingly desirable to him.

UNITED STATES: LONG-TERM PERSPECTIVE OF THE USD REAL EFFECTIVE EXCHANGE RATE (BROAD INDEX) AND THE EURUSD

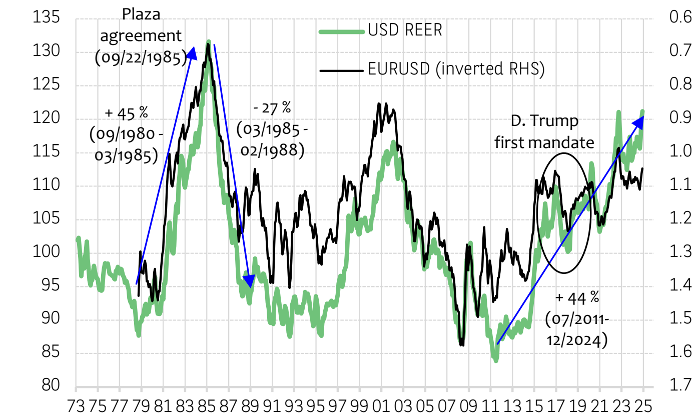


CHART SOURCE: FED, MACROBOND, BNP PARIBAS

However, this would not come without negative repercussions on its attractiveness. In this realm, the targets of the 45th and now 47th President of the United States include his trade competitors, as well as those within the country. For example, Trump has warned China and Japan against further appreciation of the USDCNY and USDJPY. However, seeing these developments as the result of manipulation does not seem relevant given the structure, with the exception of the Chinese case, of the floating exchange rates of US partners. Trump has also pointed the finger of blame for the strong dollar at his domestic institutional partners. In 2019, against the backdrop of a trade war with China, he referred to Jerome Powell as an 'enemy' of the United States, a position that he could repeat in 2025 in view of our scenario of extended monetary *status quo*.

THE DOLLAR IS SMILING

Recent developments in the dollar are not moving in the direction of the competitive weakening sought by Trump. The pre-election period already saw a sharp rise in the Bloomberg Dollar Spot Index, closely correlated with the increased likelihood of a Trump victory. The US currency is also being supported by factors that go beyond expectations about future economic policy. The dynamism of US growth, both cyclical and structural, relative to a less positive situation in the Eurozone, Japan and even China, is helping to support the dollar in real effective exchange rate (REER) terms.

The interest rate and monetary policy differentials are also in its favour. The greenback is benefiting as well from its status as a safe haven currency and from the increased demand resulting from current geopolitical tensions and the major economic uncertainties surrounding the implementation of Trump's economic programme. The dollar's appreciation is not a recent phenomenon either, as it is part of a longer-term trend that has been underway since the post-GFC recovery, and which has taken the dollar's REER to levels not seen since the mid-1980s and the signing of the Plaza Accord (*see chart*).

STRENGTHENING EXPECTED, BUT REVERSAL STILL POSSIBLE

The dollar's general uptrend is set to continue, mainly as a result of the Federal Reserve's monetary *status quo* that we anticipate, and the resulting widening of US interest rate spread vis-à-vis the rest of the world. According to our forecasts, the dollar's appreciation will come mainly from the interest rate channel rather than the terms-of-trade channel, even though the latter is also favourable to the greenback. We have seen how sensitive the dollar can be to announcements about Trump's tariff policy (the possibility of targeted hikes, limited and/or postponed, for example, causes it to fall back instantly).

While it seems highly likely that the dollar will continue to appreciate, at least in the short term, a reversal cannot be ruled out. With its high level already pricing many favourable expectations, its further upside potential may not be as great as all that, and any disappointment could trigger a correction. Furthermore, as mentioned above, the dynamism of the US economy is one of the factors behind the dollar's current strength. However, Trump's tariff policy as well as his environmental policy will negatively affect US growth and attractiveness, which should in turn weigh on the currency. And while Trump's economic policy seems clear given the announcements made during the campaign, we still know nothing about what will actually be implemented, or when or how. This uncertainty is detrimental to the rest of the world and, by extension, to US growth. So perhaps it's not so much a question of whether the dollar will weaken, but when.

PLAZA 2.0?

The parallel was suggested above: in terms of REER, the dollar has returned to a similar level to the one which led to the Plaza Accord signed on 22nd September 1985. The seeds of the dollar's depreciation were already there, but this agreement certainly also played a role. Faced with a widening US trade deficit, the aim was to counter the dollar's strength against the yen and deutschmark through combined and concerted action by the G5 countries (France, Germany, the United States, the United Kingdom and Japan) on interest rates and foreign exchange markets. In 1987, the United States did not want to see the dollar weaken any further and a second agreement was reached, the Louvre Accord (symmetrical to the Plaza Accord) to halt the fall in the dollar and stabilise exchange rates.

Given the current strength of the dollar and the size of the US trade deficit, the idea of a new Plaza-type agreement seems understandable at first glance. An orchestrated depreciation of the dollar might also make sense from the perspective of global financial stability. It would ease financing conditions for numerous emerging countries. Europeans, Chinese and Americans might also have an interest to reach a 'deal', as Trump enjoys them (for example, no tariff hikes in exchange for a concerted fall in the dollar), and thus avoid the greater damage caused by tariff hikes and the risk of a trade war. For the United States, such an agreement would also have the advantage of avoiding the negative combination of 'higher inflation/higher interest rates/less growth' resulting from tariff hikes.

However, it is also in the interest of the Eurozone and China for their currencies to be relatively weak, as this is a factor supporting growth. Japan's difficulties following the Plaza Accord are a reminder of how important exports are as a growth engine. For the Eurozone, the rise in imported inflation could embarrass the European Central Bank (ECB) somewhat. However, it is more likely that disinflationary pressures will prevail, enabling the ECB to continue its gradual easing of monetary policy. For China, imported inflation is rather a good thing, given the existing deflationary pressures. However, we know too that China is monitoring closely the situation, keeping a close eye on any capital outflows that might be triggered by an overly weak yuan, which would further weaken the economy. It is also controlling the depreciation of the yuan against the dollar in order to retain some leeway in order to allow its currency to depreciate further in response to the tariff hikes targeting it. China also has a trump card, as it could push up its currency against the dollar by reducing its purchases of Treasuries, or even by actively selling them. This would be a potential retaliatory weapon, which the United States probably has no desire to test, given the scale of its financing requirements.

In addition, the size of the foreign exchange and capital markets and their dominant role in determining the exchange rate make them difficult if not impossible to manipulate, even jointly, conversely to 1985 and 1987. Nevertheless, in view of today's context of heightened geopolitical and geo-economic tensions, it seems illusory and unrealistic for current stakeholders, who are far greater in number today than in 1985, with such different interests to reach a consensus.

Hélène Baudchon and Anis Bensaidani

ECONEWS

Find our scenario and forecasts

FRANCE

The Prime Minister has announced that the **2025 budget** will target a deficit of 5.4% of GDP (compared to 5% for his predecessor's plan), in particular due to a reduction in measures weighing on households. These parameters, together with the start of negotiations between social partners to improve pension reform without damaging its financial balance, should reduce the political and economic uncertainty that has weighed on growth for several months. **Corporate bankruptcies** reached an all-time high of nearly 66,000 in 2024[1], partly reflecting a catch-up from the post-COVID dip. The economic weight of corporate bankruptcies, calculated and published by the Banque de France, remained stable in December 2024 for the third consecutive month, at a historically high level of 0.61 after three consecutive years of increase.

GERMANY

The country recorded **negative growth** for the 2nd consecutive year (-0.1% in 2023 and -0.2% in 2024 as an annual average).

EUROZONE

A very limited drop in the **savings rate** in Q3 2024, from 15.6% in Q2 to 15.3%. This level remains well above the pre-COVID average (12.6% between 2009 and 2019). At the same time, **household debt** fell in Q3 2024 (-0.7 percentage points) to 82.7% of gross disposable income, its lowest level in 21 years. **Industrial production** continued its downward trend in November: although the index rose by 0.2% m/m, production continued to fall on a three-month moving average basis, reaching a new post-COVID low.

UNITED KINGDOM

Slowing activity and inflation growth in Q4 looks subdued: real GDP rose by only 0.1% m/m in November after two consecutive months of contraction (-0.1% each), while retail sales fell by 0.4% m/m in December and by 0.7% in Q4 compared to Q3. The decline is particularly affecting food, where spending reached its lowest level since April 2013. On the **inflation** side, there was also a downside surprise: in December, headline inflation fell from 2.6% to 2.5% y/y, while core inflation (excluding energy, food products, tobacco and alcoholic beverages) slowed from 3.5% to 3.2%. Inflation in services fell from 5.0% to 4.4%, half of the decline was due to the drop in air fares, a highly volatile component. These developments enabled a strong easing of UK long-term interest rates.

UNITED STATES

A positive surprise on inflation reassured the markets. Inflation, measured by the CPI, rose to +2.9% y/y (+0.2pp), a high since July, but which was expected and can be explained by the rebound in energy commodity prices. The nice surprise came from core inflation, which fell slightly unexpectedly (+3.2% y/y compared to the +3.3% projected). This number enabled the bond and stock markets to wipe out the sudden movements in the previous week after stronger nonfarm payrolls than expected. **Small business sentiment** ended 2024 on a very high note. The December NFIB survey gained 3.4 points to reach 105.1 (long-term average = 100), confirming the post-election boost; sentiment was therefore at its highest level since October 2018.

CHINA

Economic recovery confirmed in Q4 2024. The official figure for economic growth in 2024 reached 5%, exactly in line with the authorities' target. Activity strengthened in December and in Q4 2024 as a whole (real GDP: +1.6% q/q and 5.4% y/y), driven by strong export growth and the recovery in household demand. The acceleration benefited the industrial sector (+5.6% y/y in Q4 compared to 5% in Q3) and the services sector (+6.3% in Q4 compared to 4.8% in Q3). Encouraged by policy stimulus measures, retail sales growth strengthened in December (but remained modest) and housing sales rose very slightly y/y over the last two months of 2024, interrupting more than three years of contraction. These dynamics are expected to continue in Q1 2025.

SAUDI ARABIA

Current account balance in the red in Q3 2024. Saudi Arabia posted a current account deficit of almost USD 9 billion in Q3. This situation illustrates the pressure exerted by the Vision 2030 diversification programme, at a time when Saudi Arabia must also bear a significant share of the oil production restrictions decided by OPEC+. The economy now needs a Brent price of around USD80/barrel to balance its current account, compared to less than USD55 in 2022. Saudi Arabia is therefore expected to record fiscal and current account deficits in 2025, a situation unprecedented since the pandemic.

COMMODITIES

There will be a continued supply surplus according to the first 2026 forecasts of the EIA (US Energy Information Administration), which do not take into account the new raft of sanctions on Russian oil. Oil production (crude and other liquids) is expected to increase by 1.8 mb/d and 1.5 mb/d in 2025 and 2026 respectively, with OPEC+ members contributing significantly to this increase in 2026. On the demand side (crude and other liquids), growth is expected to be 1.3 mb/d and 1.1 mb/d in 2025 and 2026, mainly fuelled by India. Against this backdrop, the price of Brent is expected to fall by 8% in 2025 (USD 74/b on average) and by 11% in 2026 (USD 66/b on average).

1 This ratio compares the amount of outstanding bank lending to newly defaulting companies to the total amount of outstanding lending to companies (in difficulty or not).

MARKETS OVERVIEW

Bond Markets

Bond Markets	in %	in bps			
	17-janv.-25	1-Week	1-Month	Year to date	1-Year
Bund 2Y	2.25	-4.7	+18.5	+18.8	-70.9
Bund 5Y	2.28	-5.7	+23.9	+16.7	+4.5
Bund 10Y	2.51	-6.3	+27.2	+14.1	+23.0
OAT 10Y	3.22	-11.6	+26.9	+9.7	+49.2
BTP 10Y	3.54	-12.0	+26.3	+11.6	-21.6
BONO 10Y	3.13	-9.2	+24.5	+11.1	-6.9
Treasuries 2Y	4.28	-10.1	+2.1	+3.2	-13.5
Treasuries 5Y	4.42	-16.4	+15.2	+3.9	+40.5
Treasuries 10Y	4.61	-15.7	+22.0	+3.7	+51.2
Gilt 2Y	4.16	-13.5	-5.7	+1.6	-21.0
Treasuries 5Y	4.39	-16.9	+1.8	+4.1	+60.4
Gilt 10Y	4.66	-18.2	13.7	+8.5	+59.0

Currencies & Commodities

Currencies & Commodities	Level	Change, %			
	17-janv.-25	1-Week	1-Month	Year to date	1-Year
EUR/USD	1.03	+0.5	-1.9	-0.5	-5.1
GBP/USD	1.22	-0.2	-4.0	-2.6	-3.6
USD/JPY	156.12	-0.9	+1.7	-0.7	+5.2
DXY	111.99	+7.9	+11.5	+10.5	+6.1
EUR/GBP	0.84	+0.7	+2.2	+2.1	-1.5
EUR/CHF	0.94	+0.2	+0.2	+0.3	-0.1
EUR/JPY	160.82	-0.4	-0.2	-1.2	-0.1
Oil, Brent ($/bbl)	81.02	+2.8	+11.4	+8.4	+4.4
Gold ($/ounce)	2717	+0.9	+3.0	+3.5	+35.1

Equity Indices

Equity Indicies					
World					
MSCI World ($)	3778	+2.7	-0.9	+1.9	+21.1
North America					
S&P500	5997	+2.9	-0.9	+2.0	+26.5
Dow Jones	43488	+3.7	+0.1	+2.2	+16.7
Nasdaq composite	19630	+2.4	-2.4	+1.7	+32.1
Europe					
CAC 40	7710	+3.8	+4.7	+4.5	+5.3
DAX 30	20903	+3.4	+3.2	+5.0	+27.2
EuroStoxx50	5148	+3.4	+4.2	+5.2	+16.9
FTSE100	8505	+3.1	+3.8	+4.1	+14.2
Asia					
MSCI, loc.	1399	-0.8	-1.4	-2.4	+9.3
Nikkei	38451	-1.9	-2.3	-3.6	+8.4
Emerging					
MSCI Emerging ($)	1070	+1.2	-2.1	-0.6	+11.7
China	62	+3.3	-2.5	-3.3	+24.7
India	986	-1.4	-7.7	-4.1	+6.4
Brazil	1233	+4.4	-0.9	+4.8	-27.7

Performance by sector

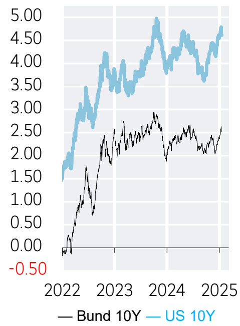
Eurostoxx600
Year 2025 to 17-1, €

+6.9%	Oil & Gas
+5.7%	Banks
+5.6%	Consumption Goods
+5.2%	Technology
+4.8%	Commodities
+3.9%	Industry
+3.5%	Telecoms
+3.2%	Index
+2.8%	Insurance
+2.1%	Automobiles
+1.9%	Media
+1.7%	Chemical
+1.5%	Construction
+0.8%	Health
+0.6%	Utilities
+0.1%	Real Estate
-1.4%	Food industry
-2.2%	Retail
-2.3%	Travel & leisure

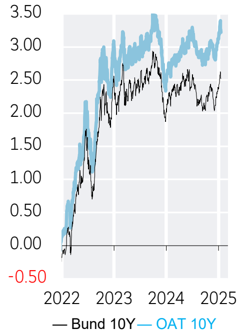
S&P500
Year 2025 to 17-1, $

+9.2%	Energy
+7.7%	Bank
+5.0%	Healthcare
+5.0%	Automobiles
+5.0%	Materials
+4.8%	Capital Goods
+4.1%	Utilities
+3.8%	Real Estate
+3.8%	Semiconductors
+3.3%	Commercial & Pro. Services
+3.1%	Consumer Discretionary
+2.5%	Media
+2.0%	Index
+1.5%	Retail
+1.4%	Insurance
-0.5%	Pharmaceuticals
-0.7%	Consumer Services
-2.1%	Food, Beverage & Tobacco
-2.1%	Telecoms
-5.9%	Tech. Hardware & Equip.

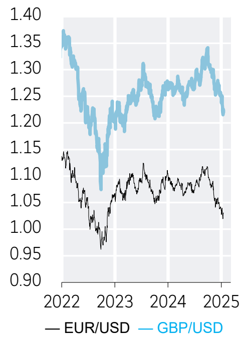
Bund 10Y vs US Treas. 10Y



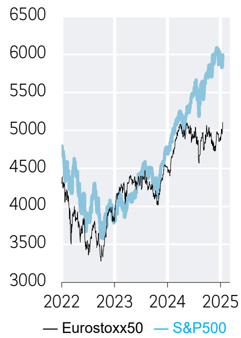
Bund 10Y vs OAT 10Y



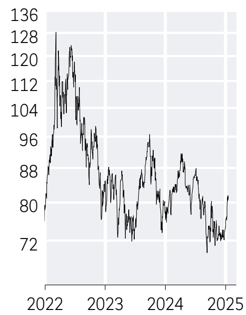
EUR/USD vs GBP/USD



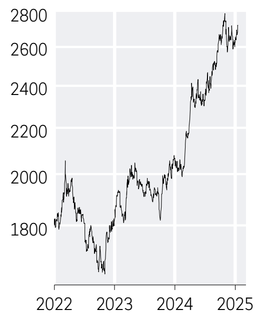
EUROSTOXX 50 vs S&P500



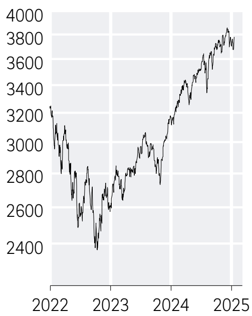
Oil, Brent ($/bbl)



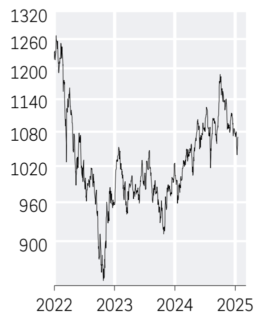
Gold ($/ounce)



MSCI World ($)



MSCI Emerging ($)



SOURCE: LSEG, BLOOMBERG, BNP PARIBAS

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