FX Strategy EUR/USD – THE CONJURING

Going into 2025, we stick to our strategic LONG USD positioning. Several forces are conjuring against the single currency, making us stick with our SHORT positioning.

From a macro standpoint, the gap between the US and the EA is set to consolidate in the coming quarters. The Eurozone's challenges, including weakening growth prospects, contrast with the relatively more resilient economic outlook in the US. As a result, the EUR is likely to face headwinds, while the USD benefits from these contrasting economic trends.

Furthermore, political forces will weigh on the EUR. In the US, the re-election of Trump and his penchant for protectionism, if implemented at face value, could stir fresh economic and geopolitical pressures for the region. In the EA, the latest political stalemates in France and Germany will also put downward pressure on the single currency.

Against this backdrop, we expect the EUR/USD to stabilize in the 1.03-1.06 range over the next 6/9 months. Beyond this period, the potential for significant gains in the euro appears quite limited. Conversely, the US dollar remains poised for further upside due to the increasingly unfavorable growth and inflation dynamics in the Eurozone compared to those in the United States.

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THE CONJURING

We stick to our strategic LONG USD view, as we SHORT the EUR. We increasingly think downside risks for the EUR are mounting, owing to an entrenching adverse growth/inflation mix for the Eurozone vis à vis the US. Furthermore, we believe several other factors, such as the re-election of Trump and political stalemates in France and Germany, will conjure against the single currency at least throughout H1-25.

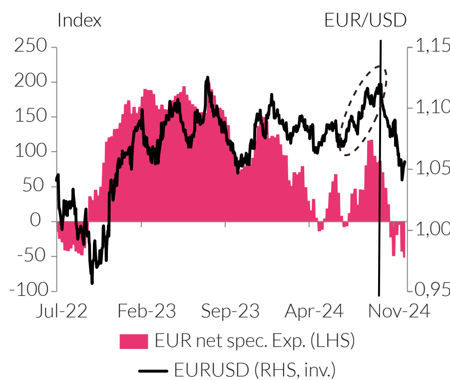
1 – Fed. Risks are tilted toward less cuts in 2025 owing to a "die-hard" economy.

Fed expects the economy to weaken next year. The US dollar experienced a notable decline over the summer, as EUR/USD reached a year-to-date high (**Figure 1**), following the Federal Reserve's anticipated policy reversal during the FOMC meeting on September 18. The Fed surprised markets by implementing a sharper-than-expected rate cut of 50 basis points, followed by another 25bp cut in November, with projections pointing to further easing ahead.

This proactive approach reflected the Fed's response to a sharper-than-expected weakening in the labor market (**Figure 2**, **3**), consistent with expectations for a slowing US economy. The GDP growth is projected to stabilize from an estimated 2.9% in 2023 to 2.8% in 2024, and then decelerate to 2.3% in 2025 (**Figures 4**).

FIGURE 1.

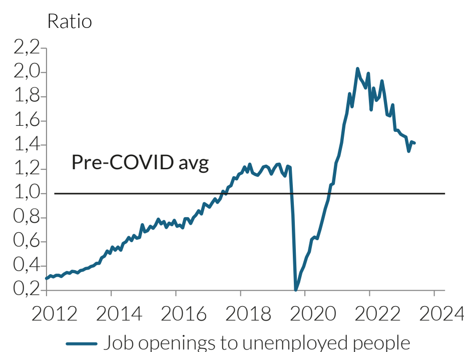
The USD weakened going into the September FOMC meeting



Source: Haver Analytics, ANIMA Research

FIGURE 2.

Labour market continues to cool…



Source: Haver Analytics, ANIMA Research

The dots project 150 bp of further cuts over 2025-26. Against this backdrop, the Fed maintained its growth projections across its forecast horizon, while it adjusted other key metrics: unemployment estimates were revised upwards, and inflation forecasts were lowered to 2.3%-2.1%-2.0% for 2024, 2025, and 2026, respectively (down from 2.6%-2.3%-2.0% projected in June). Thus, the Fed projected a total reduction of 100bps by the end of 2024, another 100bps in 2025, and 50bps in 2026, culminating in 250bps of cuts over three years.

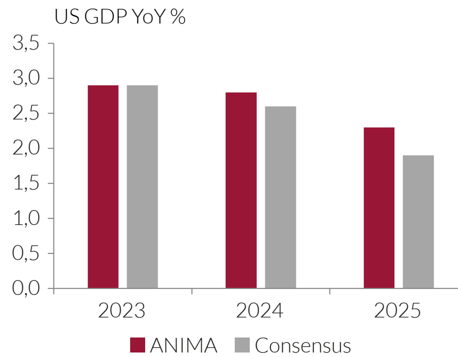
FIGURE 3.

...as finding a job is getting harder

Source: Haver Analytics, ANIMA Research

FIGURE 4.

We are more sanguine than consensus over US growth



Source: Haver Analytics, ANIMA Research

Chances, though, are the Fed could do less in 2025. As recent speeches from Fed's members and FOMC minutes conveyed the message that the Fed is not in a hurry to cut rates, we think the Fed could finetune its rate cuts projections in December, as chances are the CB could decide to trim total rate cuts in 2025 by 25bp.

The "Trump's effect" translates into a pro-dollar bias. Following the electoral outcome in November and Trumps' clear victory, we think it could be even more unlikely to derail the dollar's consolidating trend. Trump's protectionism and expansionary fiscal measures should boost the trade balance and growth, supporting the USD. Furthermore, rising long-term yields triggered by overly aggressive fiscal policies could add to the USD's strength.

The dollar is set to remain strong in H1-25. We expect the US dollar to remain relatively robust during the first half of 2025, even amid projected declines in interest rates and bond yields. While these economic adjustments typically exert downward pressure on the currency, we believe that the downside risks from current levels are likely to be contained by the influence of President Trump's political agenda, which historically favors protectionism and expansionary fiscal measures. We expect the USD to stabilize within the 1.06-1.07 range in H1-25 and maintain a more lateral trajectory throughout this period.

Overall, the dollar's strength in early 2025 will likely result from a balance between Fed rate cuts and political factors, keeping the currency relatively stable.

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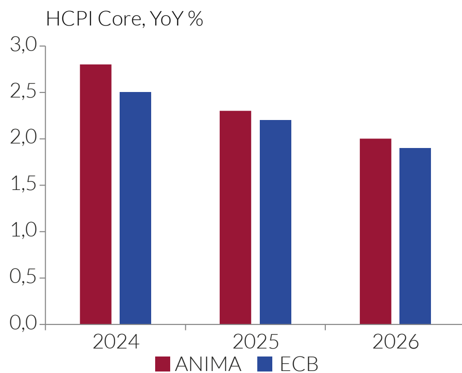
FIGURE 5.

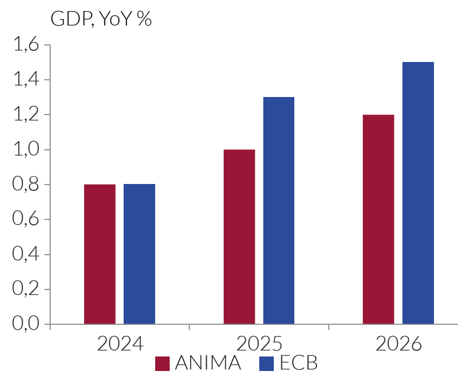
Eurozone inflation set to continue declining over 2025-26



Source: Haver Analytics, ANIMA Research

FIGURE 6.

We are less sanguine than the ECB over Eurozone growth perspective



Source: Haver Analytics, ANIMA Research

2 – The ECB. Risks are tilted toward more cuts in 2025

The EUR uptrend has ended earlier than expected owing to a deterioration in the growth/inflation profile. During the summer, the EUR climbed from its spring low of EUR/USD 1.059 to a high of EUR/USD 1.12 in August. This upward trend largely mirrored a weakening U.S. dollar, driven by expectations of a Federal Reserve policy reversal, as the ECB had already begun easing monetary policy in June, followed by another 25bp cut in September. The euro regained strength as anticipation of the Fed's pivot grew.

The latest ECB economic projections, though, left inflation forecasts unchanged at 2.5%, 2.2%, and 1.9% for 2024, 2025, and 2026, respectively. On the other hand, the CB finetuned its growth projections by -0.1 percentage points to 0.8%, 1.3%, and 1.5% over the same period (**Figure 4**, **5**). Considering we are less sanguine over the region's growth perspectives, the projection of inflation smoothly falling below the 2.0% target within two years, raises the possibility of further-than-expected ECB rate cuts.

Risks are the ECB could end up cutting more than expected. The baseline remains the ECB would cut rates by 125bp over 2025-26. Against this backdrop, we continue to anticipate a 25bps cut in December, followed by an additional 100bps next year.

Nonetheless, the ECB faces increasing pressure to adopt additional measures in 2025 to support growth. Several factors are converging to heighten the likelihood of more aggressive policy action:

- **Weakening Eurozone Recovery Prospects.** The outlook for a moderate economic recovery in the Eurozone next year is deteriorating: fiscal consolidation in France, as well as stuttering growth in Germany raise concerns that previously anticipated levels of economic improvement for the region may not materialize.
- **Rising Domestic Political Uncertainties.** Political instability in key Eurozone economies, notably France and Germany, is intensifying. These uncertainties

risk undermining economic confidence and complicating the ECB's efforts to strike a balance between inflation and growth.

- **Adverse External Environment.** Following Donald Trump's victory, external conditions for the Eurozone are set to become less favorable next year (**Figures 7-9**). The expected rise in protectionist policies (see our publications on US Elections[1]) or other geopolitical tensions (a truce/ceasefire in Ukraine) could weigh on Eurozone exports, economic sentiment and overall economic performance.

Together, these challenges significantly raise the probability that the ECB will need to implement deeper rate cuts or expand its monetary support beyond what was previously anticipated (**Figure 10**).

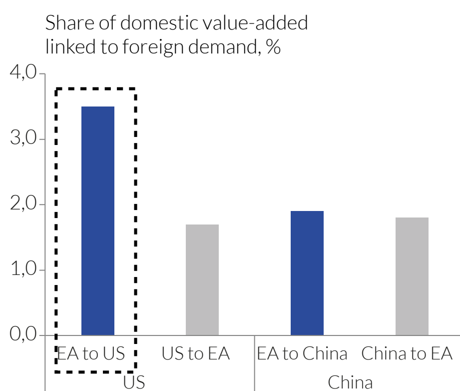
3 – Bottom line: environment for the EUR gets tough as EU-US macro divergence becomes entrenched.

Bottom line: over the next 6/9 months, we expect the EUR/USD to stabilize in the 1.04-1.07 range. Beyond this period, the potential for significant gains in the euro appears quite limited. Conversely, the US dollar remains poised for further upside due to the increasingly unfavorable growth and inflation dynamics in the Eurozone compared to those in the United States.

The Eurozone's challenges, including weakening growth prospects, contrast with the relatively more resilient economic outlook in the US. This divergence underscores the dollar's relative strength, driven by its role as a safe-haven currency and its alignment with more favorable macroeconomic conditions. As a result, the EUR is likely to face headwinds, while the USD benefits from these contrasting economic trends.

FIGURE 7.

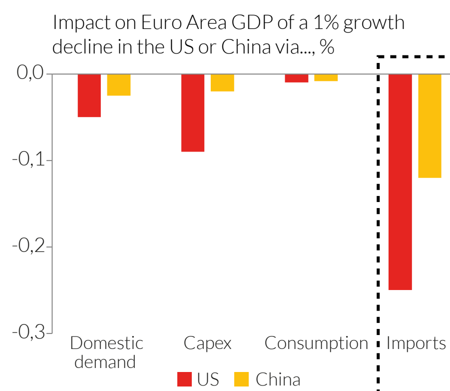
A trade war will affect the EA more than the US...



Source: Haver Analytics, ANIMA Research

FIGURE 8.

...as trade driven effects are the largest

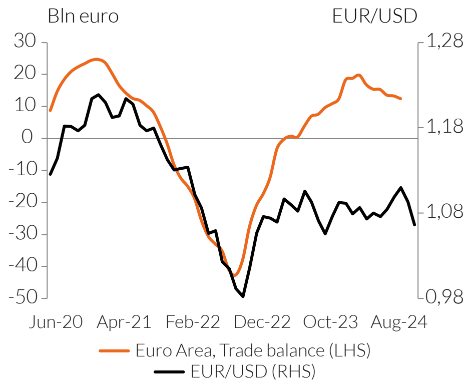


Source: US customs, Haver Analytics, Anima Research

1 - "The Harris case" and "The Trump case"

FIGURE 9.

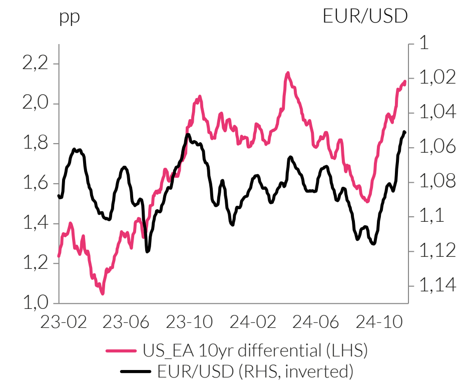
The EUR does not price the trade balance deterioration stemming from Trump's tariffs



Source: Haver Analytics, ANIMA Research

FIGURE 10.

Current levels on yield differential suggest EUR/USD is overpriced



Source: US customs, Haver Analytics, Anima Research

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