Global Currency Dynamics

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Date: May 20, 2025
Session: #37042

Global Currency Dynamics

- USD vs EUR, CHF, GBP, JPY & CNH
- What are the drivers and what is the outlook?
- One of the main drivers of inflation is the price of energy
- Are cheaper oil prices always good news?

Global Currency Dynamics

- Winners & losers
  - Countries
    - Argentina
    - Turkey
    - Taiwan
    - India
  - Industries
    - Exporters vs Importers

Global Currency Dynamics

- Status of the US Dollar as the global reserve currency
- The cost of hedging – even if you don't hedge

The new dynamics

- In recent months we have seen currencies going up not because they are the "better" currency perse but more because of doubts by the markets on the stability of the USD.
- Now a lower currency is not perse a bad thing as it can help export but it does carry the risk of inflation and if it is the result of investors losing trust we have a potential systemic risk.
- while the dollar has only recovered a portion of its losses, parts of the equity market have fully recovered the losses endured in the first week of April. While still down 4% this year, the S&P 500 rose back to pre-April levels last week, and Germany's DAX was back to hitting record highs. This buoyant mood has been reflected in the recent pullback in gold prices.
- A caveat, you may have noticed that stock prices nowadays do not follow the historic correlation between expected profit vs share price but will react on any news whether it is correlated or not and whether it is positive or not (see pharma)

What we have seen in the past months

USD – EUR

The markets have reacted, sometimes quite dramatically, to any news which could affect the US economy. With swings up to 10% in a very short period, we have seen a bit of recovery after some temporary measures. However, the USD remains volatile ..

USD

- A more sustained recovery for the dollar will require some genuine progress on trade. With dozens more deals promised to come over the next few weeks, the market will need to decide whether they are good enough to buy US assets again. The 10% base rate tariff looks set to stay, however, and the lost confidence will take time to rebuild. The Fed has opted to stay on the sidelines as it waits for the impact of tariffs to filter through into the hard data. If we start to see an indication that tariffs are increasing prices already, markets might begin to wind down their expectations for three cuts this year.

EUR

- The euro is likely to be driven by the tariff story. The European Commission laid out an expanded list of retaliatory tariffs in the case that negotiations with the US sour, including levies on aircraft, cars, chemicals, and electrical equipment. In general, a positive mood on US trade will take EUR/USD lower. But there will also be concerns that, if talks break down, retaliation might drive eurozone inflation higher and give the ECB a tough job in managing both rising prices and a weakening economy.

USD/CHF

The Swiss frank is viewed as a safe haven currency and "profited" the most from the turmoil on the international markets. Due to the neutrality and political stability of Switzerland investors flocked to the CHF. This does not mean however the CHF is a candidate to replace the USD as major reserve currency. It will continue to be one of the reserve currencies though..

USD/GBP

The GBP did not profit as much as the other currencies did. The exchange rate did improve (when viewed from the British side). However, not as dramatic as the EUR and CHF. This has to do with Brexit still and the fact that the UK did not have any trade deficit with the US, so any negotiation would likely result in limited "success" for the UK

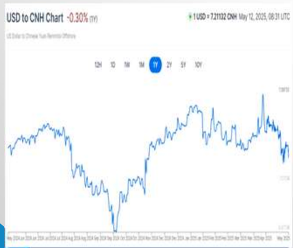
USD/GBP

- The last hurdle in normalising rates for the BoE has for some time been stickiness in services inflation, and services is a labour-intensive industry in which price growth is driven predominantly by wages. The ex-bonus figure is expected to cool slightly from 5.9% annualised salary growth to 5.6% - a step towards further rate cuts. We also get the GDP figure for Q1 on Thursday morning, where the consensus is for a much-improved 0.6% growth after the UK economy posted only a 0.1% gain in Q4. This is positive for UK sentiment - the BoE was forecasting only 0.75% growth for the entirety of 2025 earlier this year – but there are obvious headwinds coming up, as the US trade war likely softens global demand.GBP forms about 5 % of the reserve currencies.

USD/JPY

Within the JPY it is perhaps more clear to see that any change in the exchange rate has less to do with the Japanese economy. However, it does follow a broadly similar pattern to the other major western currencies.

USD/CNH



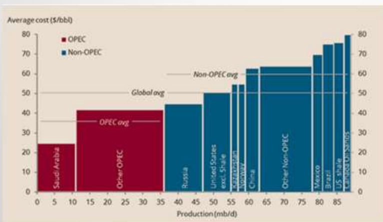
You can clearly see that the Chinese renminbi is a more controlled currency, whereby the Chinese government devalues or appreciates the currency depending on the economy's needs. The swings are much less dramatic, but they are still there.

Canadian dollar, Argentine Peso

Oil

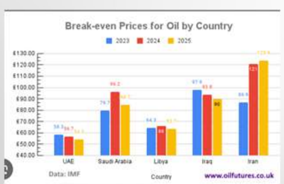
Lower energy prices do have a potential downward influence on inflation. But in the world of currencies it has another negative effect for the oil producing countries if it hits a certain threshold.

You might recall from earlier presentations that countries have a minimum price acceptable for them to produce.



This is a basic cost price for a producer to drill oil

Fiscal breakeven prices



From this chart you can see that although some countries have a very low cost of producing oil, they cannot sustain long periods of oil being below 100 USD. This is because oil being their major export product is used to sustain the local economy as we as service the countries debt.

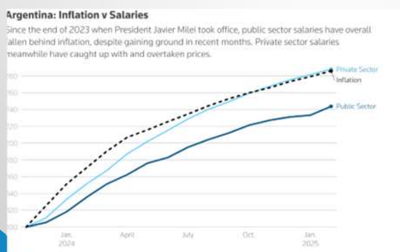
Oil

- Countries with a cost price above 60 USD will see a negative effect on the influx of USD and some countries will simply stop producing and/or will stop investing into the development of new oil fields, which will have a much longer effect. Even for the US a low oil price will lead to less production. And this can again lead to higher prices in the future, with investors not being able or willing to invest in local production.

Winners and losers , starting with Argentina

- + Argentina – Milei has brought down the inflation from 211% to a (still high) annual inflation of 56%
- -/+ He has cut down a lot of regulations and subsidies, this affected a large part of his electorate negatively and there is doubt whether he is able to get a larger part of the parliament behind him in the next elections
- -/+ He borrowed 20 billion from the IMF
- -/+ He has lifted some of the restrictions on the Peso, which now can float more freely

Winners and Losers



The austerity measures have helped Argentina's economy, but at a steep cost for the people. This can affect his chances for re-election.

Winners and Losers
Industries & Producers

Turkey

- Inflation 38 % (slightly down
- Interest up to 46 %
- They profited from shifting trade flows due to the Ukraine war however that effect has diminished quite a bit

Winners and Losers
Industries & Producers

Taiwan

- Inflation 2,03%
- Interest up to 2 %
- Taiwan's economy has been steady over the last decade. The country can profit somewhat if the more high-end production will shift from China to Taiwan. However, that carries a political risk. The semi conductor industry is one of the most sophisticated in the world and the underlying contracts are long term and less prone to sudden economic shifts. With a growing AI, Taiwan is one of the winners in this economy despite the uncertainty we see across the globe.

Winners and Losers
Industries & Producers

India

- Inflation 3,3%
- Interest up to 6,25 %
- India's economy has been on a positive trajectory path for some time now and is expected to surpass Japan in 2030 as the 3rd largest Economy.
- India has been able to manuver between a number of sanctioned countries without much of a negative effect on their relationship with the major economies. The country will profit from a production shift from China to, amongst others, India.

Winners and Losers
Industries & Producers

The Defense industry is clearly a winner. However, the tariffs on steel and aluminum will have an effect on profitability. For Europe it is a but different. To use a small example - Rheinmetall in Germany

Reserve Currency

- Last year we had a view on the status of the USD as the major reserve currency and the global consensus was that, despite some countries moving away from the USD, for non- USD trade the status of USD being the main reserve currency was unthreatened.
- This was due to the stability of the USD and the lack of any viable alternative. Now I'm afraid this stability has come under threat. Although it will take quite a while to replace the dollar, its status will most likely go down in favor of the EUR and the other currencies.

Reserve Currency

Currency composition of official foreign exchange reserves (1965–2023, fourth quarters)

V·T·E	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014	20
US dollar	57.80%	58.41%	58.52%	58.80%	58.92%	60.75%	61.76%	62.73%	65.36%	65.73%	65.14%	61.2
Euro (until 1999—ECU)	19.83%	19.98%	20.40%	20.59%	21.29%	20.59%	20.67%	20.17%	19.14%	19.14%	21.20%	24.2
Japanese yen	5.82%	5.70%	5.51%	5.52%	6.03%	5.87%	5.19%	4.90%	3.95%	3.75%	3.54%	3.8
Pound sterling	4.73%	4.84%	4.92%	4.81%	4.73%	4.64%	4.43%	4.54%	4.35%	4.71%	3.70%	3.9
Canadian dollar	2.77%	2.58%	2.38%	2.38%	2.08%	1.86%	1.84%	2.03%	1.94%	1.77%	1.75%	1.8
Chinese renminbi	2.18%	2.29%	2.61%	2.80%	2.29%	1.94%	1.89%	1.23%	1.08%			
Australian dollar	2.06%	2.11%	1.97%	1.84%	1.83%	1.70%	1.63%	1.80%	1.69%	1.77%	1.59%	1.8
Swiss franc	0.17%	0.23%	0.23%	0.17%	0.17%	0.15%	0.14%	0.18%	0.16%	0.27%	0.24%	0.2
Deutsche Mark												
French franc												
Dutch guilder												
Other currencies	4.64%	3.87%	3.48%	3.09%	2.65%	2.51%	2.45%	2.43%	2.33%	2.86%	2.83%	2.8

Source: World Currency Composition of Official Foreign Exchange Reserves. International Monetary Fund.

Hedging

- **To start of with an example**
  - Trading SGD to USD 3,500,000
  - Exhange rate of 0.77 was quoted by our broker. Our bank quoted an exchange rate of 0.756 - a difference of only 0.014 (!)
  - This is a difference of USD 67,848.55! That same trade at the bottom of the market (3 jan 2025) would have cost me USD 185k.
- So hedging and shopping around for a good quote is worth the effort.
- Now, you might think "well, I only do USD business internationally, so that does not effect me". Actually it does. Because now your counterpart needs to hedge.So you are still paying for it, but perhaps at a less favorable rate than you would achieved by yourself.
- To put things into perspective, last week's pause in the China tariffs caused the dollar to jump in a single day with the same difference used in this example and drop again the day thereafter with almost the same amount.