Forex markets in an era of tariff siege

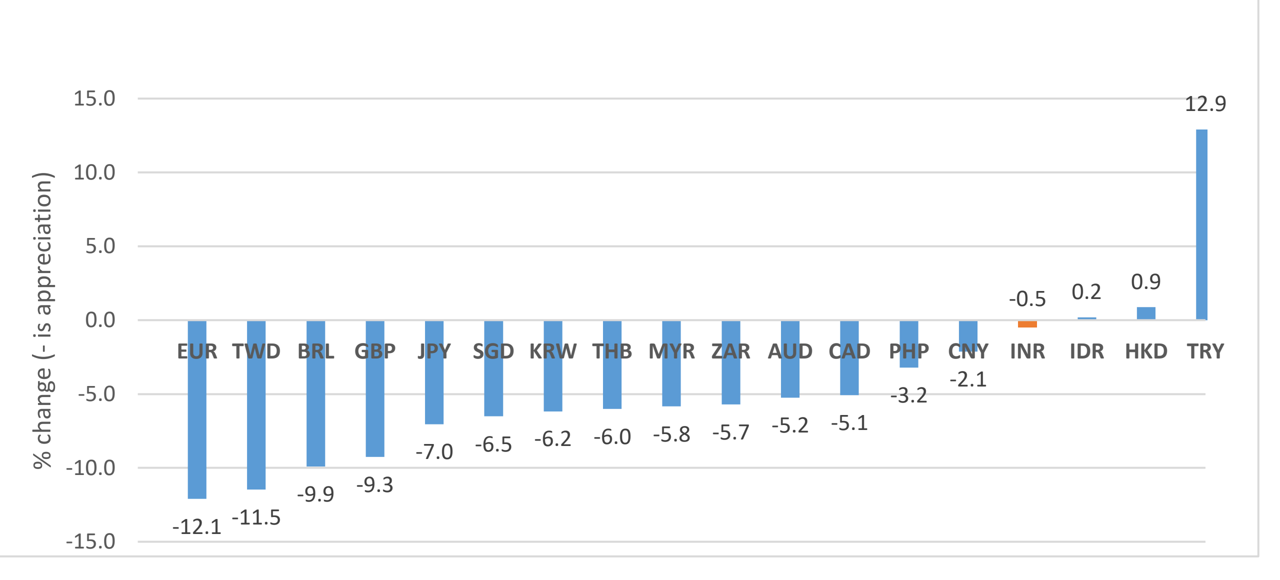
Overview

2025 has begun with a bang with Mr Trump taking over as US President. While there have been several disturbances on the political side, the biggest disruption, which is now into 6th month, is the tariff issue. There have been several announcements made which have had an impact on the currency market. Any change in tariff structure for any country would mean change in the fundamentals affecting the currency which can change the current account deficit with exports being impacted. The major impact has however been on the dollar with the Fed thinking harder every time it meets to take a call on the interest rates. Against this background the performance of various currencies can be analyzed.

Main takeaways

In this exercise the first 20 days before Mr Trump coming to power has been taken as a pre-policy period while the terminal point is the first fortnight of July which was when the Liberation Day deal announced was to be implemented but has been deferred till August 1. Nonetheless there have been some specific announcements for countries as well as for products.

Chart 1: Movements in currencies July (first fortnight) over January pre 20th



The graph above tracks how currencies have moved over the last 6 months or so with January (pre-20th) being compared with first fortnight of July. As can be seen, almost all the currencies considered here have appreciated with the exceptions being Indonesian rupiah, Hong Kong dollar and Turkish lira. The euro has strengthened the most by 12.1% followed by Taiwanese dollar and real of Brazil. The rupee has probably been the most evenly balanced with appreciation of just 0.5% which is similar to Indonesia where there was a marginal depreciation of 0.2% during this period.

Interestingly during this period, the DXY had fallen by 10.6%. Hence while fundamentals did affect currency movement the dollar strength or weakness had a sharp impact on other currencies. In case of India, the following can be looked at in terms of fundamentals:

1. As of January 17th, forex reserves were $ 624 bn including $ 533 bn of foreign currency assets. As of July 4th reserves increased to $ 699. 7 bn with currency assets of $ 591.2 bn.
2. FPI inflows were negative at $1.8 bn with equity being $ -5.8 bn and debt +$ 4.3 bn.
3. Cumulative trade deficit for Feb-June was $ 103 bn compared with $ 91 bn last year.

Quite clearly, the fundamentals have also supported a firm rupee as denoted by the increase in forex reserves during this period.

There has however been variations during this interim period depending on how the tariff roadmap has played out as different numbers were announced for various countries and those which faced higher rates would have tended to be affected more.

While the comparison over Feb is useful as it does denote the relative strength of currencies in these turbulent times, the volatility during this period also deserves attention. This is so as every announcement made tends to have an impact on markets as the currency does react immediately. However, this may be for just a couple of sessions before reverting to the trend. The same may not be evident when comparisons are made across two periods of time. Also there would be several interventions in the forex market by central banks either in the spot of forwards/futures market that would have restored movements to the trend rates.

This volatility is captured in the table for this set of currencies. The annualized average daily volatility is presented for all the months to provide an idea of the challenges for central banks given that it has been considerably high during certain months for various economies.

Table1: **Annualized average daily volatility over the months %**

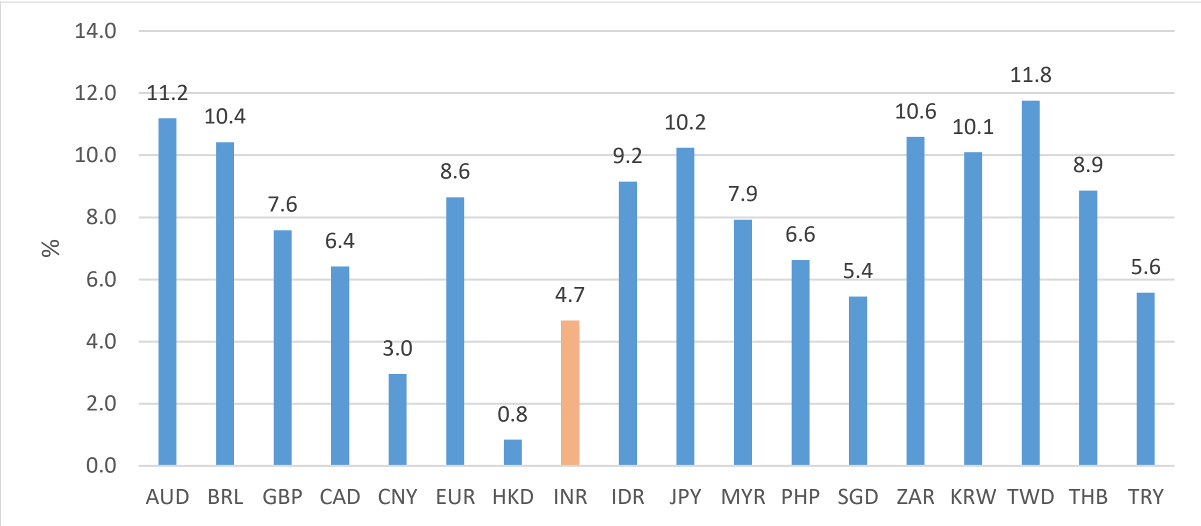
	AUD	BRL	GBP	CAD	CNY	EUR	HKD	INR	IDR	JPY	MYR	PHP	SGD	ZAR	KRW	TWD	THB	TRY
Jan	7.2	8.5	8.6	5.2	3.0	7.6	0.6	3.6	7.6	7.4	9.5	6.1	5.5	12.4	8.6	4.4	7.8	2.5
Feb	9.3	7.9	6.2	8.7	3.4	7.9	0.8	5.1	8.9	9.8	7.0	6.4	6.1	8.9	7.5	3.1	9.5	2.9
Mar	8.5	9.6	5.6	5.6	2.7	8.9	0.5	3.0	8.0	7.9	6.7	6.1	3.9	7.6	6.0	2.0	5.7	12.0
Apr	21.1	17.2	11.5	8.7	3.7	12.3	0.8	4.9	11.3	12.7	7.7	6.4	6.9	16.1	10.8	6.7	11.1	3.4
May	9.5	9.8	6.6	5.9	3.6	8.8	1.3	6.1	11.3	13.6	10.9	7.4	6.7	9.0	15.9	27.4	12.2	3.3
Jun	8.5	6.1	6.6	4.9	1.8	7.1	0.5	5.4	10.0	9.3	7.0	8.3	4.5	8.8	11.1	7.1	7.4	4.1
Jul	6.1	9.3	4.3	3.2	1.3	3.8	0.4	3.1	3.2	8.0	3.4	4.5	2.0	9.1	3.9	5.8	5.6	4.0

The table highlights that April was the time when volatility in currency movements was highest in several countries with Australia having 21%. Prior to April, high volatility was more sporadic and witnessed in a couple of currencies which got enlarged when the formal announcement on differing tariffs was announced on April. This does pose challenges for central banks which have to take a concerted decision on whether or not to support the currency or let the market find an equilibrium.

10 of the 18 countries had high volatility in currency movements of above 8% in April. For the DXY the average annualized daily volatility was 8.3% for the entire period January to July 15th. A similar picture was also noticed in May when 10 currencies witnessed high volatility. It moderated in June with 5 currencies having high volatility while in July 2 currencies, rand and real had high volatility.

For the entire period the annualized average daily volatility has been presented in the chart below. As can be seen 6 of the 18 currencies had very high volatility of over 10%. Taiwan had the highest rate of 11.8% though was distorted by single month phenomenon when it was high in May with two days witnessing extreme change in currency. Here it can be seen that volatility was continued in India which had a number at the lower end at 4.7%. China and Hong Kong were the only two countries which had volatility less than India.

Chart 2: Annualized average daily volatility January-July 15 (%)



Concluding remarks

The uncertainty on tariffs has definitely added a strong dose of volatility to all currencies keeping central banks on the alert. With there still being apprehension of how the final story will unfurl on tariffs, it may be expected that similar tendencies would persist albeit to a lesser extent, as the major shock in April is less likely to be replicated over time as the shock of higher tariffs gets absorbed by economies.

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