

December 20, 2024

## Holidays

*“Seeing is believing, but sometimes the most real things in the world are the things we can’t see.” – Polar Express*

- **Fed is priced for 34bp of easing in 2025** – this is the first time the Fed projections are ahead of the market easing since September. The implication is that bonds and stocks will shift their correlations.
- **EUR 1.0344 is the low of the week**, perhaps the year, but the role of PMI and other data through the holidays may open a larger run to 1.00 depending on US and EU consumers.
- **Equities down for the week, up on the month?** The question for the rest of the year is whether the FOMC’s hawkish cut delays the Santa Clause rally until January.

### Summary:

The last two weeks of 2024 matter even though most trading desks are lightly staffed, most portfolio managers are at home, and everyone’s focus is on risk management – no surprises – rather than any hopes for Santa Claus rallies or wishes to make the year in the last few business days left. The setup for markets into 2025 is good for a continuation of trends. The US election and the pivot to a stronger USD received support from the FOMC reducing expectations for rate cuts in 2025. The on-hold actions of most central banks this week highlight the uncertainty ahead with all the plans and forecasts for 2025 expected to change on January 20 when President-elect Trump starts his term with a raft of executive orders. Markets are priced for deregulation, tariffs and some immigration restraints. As for taxes and DOGE cost-cutting, the current debate over government funding and the debt ceiling shows a market full of doubt, with the yield curve-steepening trade returning with a vengeance. Year-end and the squeeze for money will be watched closely but few see the US as anything but exceptional as we drift into the holidays.

### Themes:

- **Positioning into 2025** – what is overbought and oversold? Investors were given a warning on Wednesday after the FOMC raised its forecasts for growth, inflation and rates. The risks for bonds going to 4.75% before 4.25% is now skewed to the upside while equities at S&P 500 6,000 look topy and as the USD stabilizes at November 2022 highs near 108 on the index. USD bubble

fears against EUR, JPY, AUD and BRL stand out in FX, while in equities a rotation from the Magnificent Seven to something else continues to be a fear more than a reality.

- **Risk of uncertainty** – throw out all the 2025 forecasts? The models for the US economy all point to 2.5% growth for 2025 if policy remains unchanged. The uncertainty of tariffs, taxes and immigration all leave many waiting for the Trump presidency before acting. Cash on the sidelines is seen as substantial but of the \$6trn in money markets now, how much will stay there in 2024 as a portfolio allocation? The risk of the current uncertainty extending throughout 2025 could spell trouble for global money flows.
- **Market liquidity vs. fragility** – what are the short-term vs. long-term risks ahead? SOFR trading above the FOMC cut today worries some about year-end liquidity but that isn't a sign of fragility. The fear of a larger equity market correction in the US and a global economy primed to growth leave many watching liquidity in the US markets both in bonds and stocks. With \$6trn in money markets there is some cushion. However, the use of leverage has shifted significantly over the past 10 years and the chances of deregulation leading to more leveraged trend chasing makes some worry about market fragility into 2025 as well. The focus for equities will remain on growth vs. value vs. leverage.

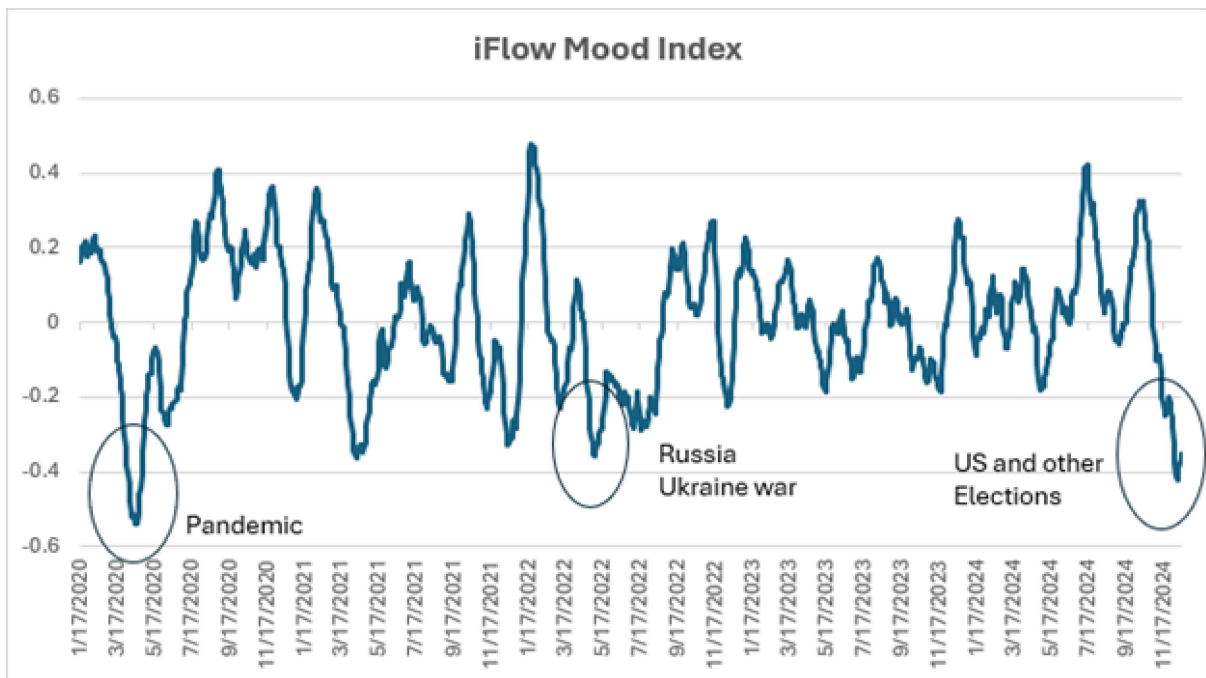
### What does iFlow show?

- **FX:** The USD rally in December has been notable – with trade-weighted short position at just -0.21 – back to March 2023 lows. The iFlow data have matched the market direction (up 0.72 on the month scored flow and 0.56 on the week). From 105.50 on December 6 to 108.49 on December 18, the rally has been mostly steady, gaining 3.5%. Month-to-date, the USD gained the most against JPY (-5%), NZD (-4.6%), AUD (-4%) and KRW (-3.45%), while only COP (+1.25%) and PEN (+1%) made progress against the USD. In contrast, the iFlow data show CAD -0.78 on the month, BRL -0.679 and EUR -0.579, while PLN gained 0.39, JPY 0.35 and COP 0.312. Notable also for FX is that carry moved into extremely positive territory as a factor – up for three days to 0.25 in the 88th percentile. The trend is neutral at 0.02 for three days. The USD correlation to global equity flows is -0.885%, while the correlation to sovereign bonds is -0.86%, both near historic extremes, highlighting how the USD turning could lift global shares and bonds at the expense of US assets.
- **FI:** The break of 4.50% in 10-year US yields has been the story of the week and month, and it follows the shift in the FOMC from 1% easing in 2025 to 0.5% on Wednesday. The 1M move in 10Y yields up 18bps is modest compared to the drops in yields in Korea -25bps to 2.79% or China -37bps to 1.73%. Also notable is that Sweden has seen rates rise 15bps to 2.27% even with a rate cut. UK Gilts also climbed 13.5bps to 4.58%, with higher wages and CPI keeping BoE on hold. In contrast, China saw significant outflows on the week -0.65 as did New Zealand and Israel. On the week and month, the biggest inflows are in India with the new RBI Governor expected to be dovish, while in contrast to the price action US bonds were also notable, up 0.373 on the week and 0.67 on the month. While the US curve steepened to +25bps 2/10Y this week, iFlow was flat and duration buying has continued to

dominate on the week up 0.7 and 1M up 0.83. Cash holdings have also risen notably on the week and now are positive on the month. Cross-border US bond buying dipped back to flat while domestic demand continued. Corporate bond flows were positive in Australia and Canada on the week, but still negative on the month and the quarter.

- **EQ:** December has been difficult for US equities, with the DJIA off 5% and the S&P 500 down 2%, and only the NASDAQ up 1.4%. In contrast, China is up 0.75%, the Nikkei is up 1.5% and the Euro Stoxx 50 is up 1.5%. The BBG world index is off 2.2%. The iFlow data show the US is the worst for the week, down -1.52, followed by the EUR -1.20, with both also down on the month. In contrast, Poland is up 0.68 on the week and 0.50 on the month. South Africa also rose, up 0.54 on the week and 0.28 on the month. US equities show that cyclical factors are rising against defensive, while growth is losing to value and as leverage loses steam. The equity sectors show US gains in consumer staples but faster outflows in consumer discretionary and health care. Globally, we saw that materials and real estate had the largest outflows. Emerging EMEA markets posted the biggest inflows, with gains in IT, materials and consumer discretionary standing out. In contrast, EM APAC was sold across all sectors. Overall, the mood index did show signs of bottoming out despite the US equity moves this week. Mood is still extremely negative at -0.355 in the 2nd percentile, but we have been in this state for 26 days, an extended time given the average over the last 20 years has been 20 days.

**Exhibit #1: iFlow Mood Index Bottoming Out?**



Source: iFlow, BNY

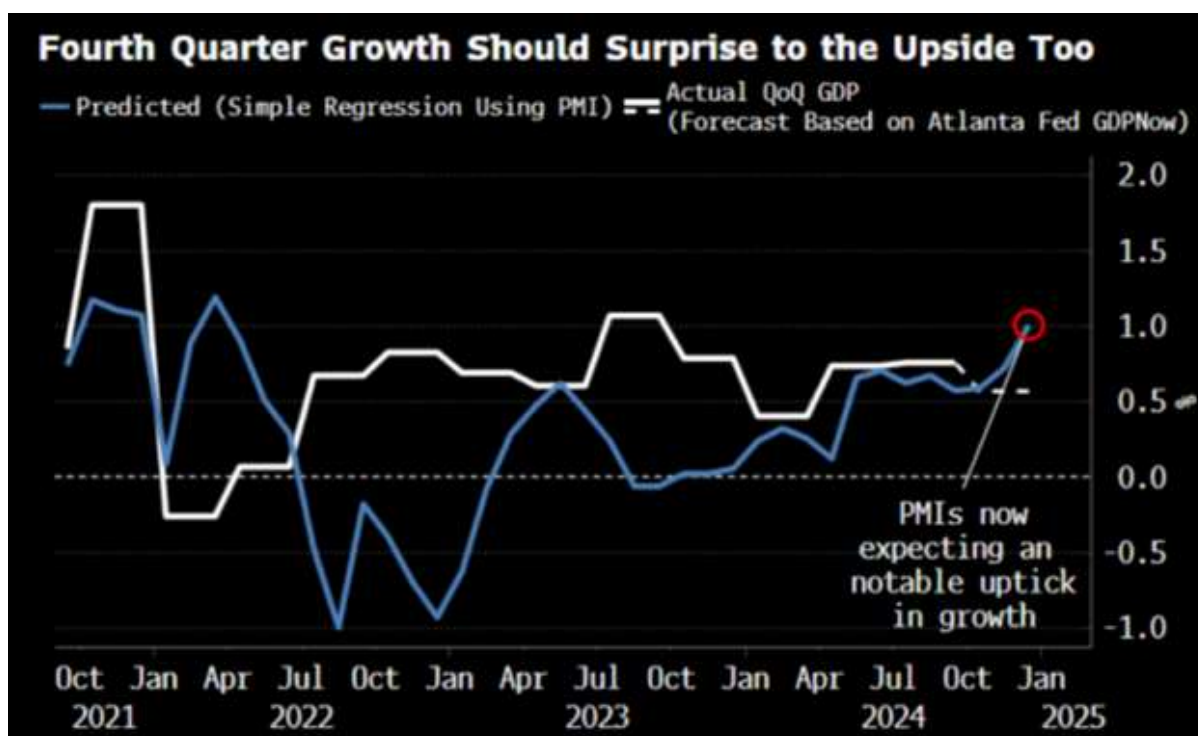
**News agenda – US durable goods, ISM, home prices; Turkey TCMB, Japan CPI, Eurozone PMI, holiday spending**

While the next two weeks have both the Christmas and New Year holidays, markets still get some important news, with the highlights in the US coming from next week’s durable goods and home prices, along with how the US supply in coupons gets absorbed. The focus in Asia will be on the RBA minutes, the BoJ summary of opinions, the Tokyo CPI and National CPI along with China and the roll-over of the 1-

year MLF. China NBS and Caixin manufacturing will also be watched for further bottoming out of the economy. In Europe, PMI reports on manufacturing will set the tone for how Q4 ends and add to pressure on the ECB to do more. Turkey and the TCMB is the final central bank on rates, and their decision matters though consensus is on hold at 50% given CPI stickiness even as the economy slows.

**1. Q4 growth and USD exceptionalism.** The risk for markets in the next two weeks revolves around the economic data. US durable goods, manufacturing ISM and jobless claims all matter, as does the final tabulation for holiday spending. The risk of Q4 upside growth surprises dominates. The markets are likely to focus on what this means for US rates. We are back looking for a “goldilocks story” where growth isn’t too hot or too cold, but just right for keeping inflation slowly dropping to the 2% target by 2027. The Fed’s focus on inflation stickiness over labor market stability remains finely balanced and any data challenging such will be a driver of volatility.

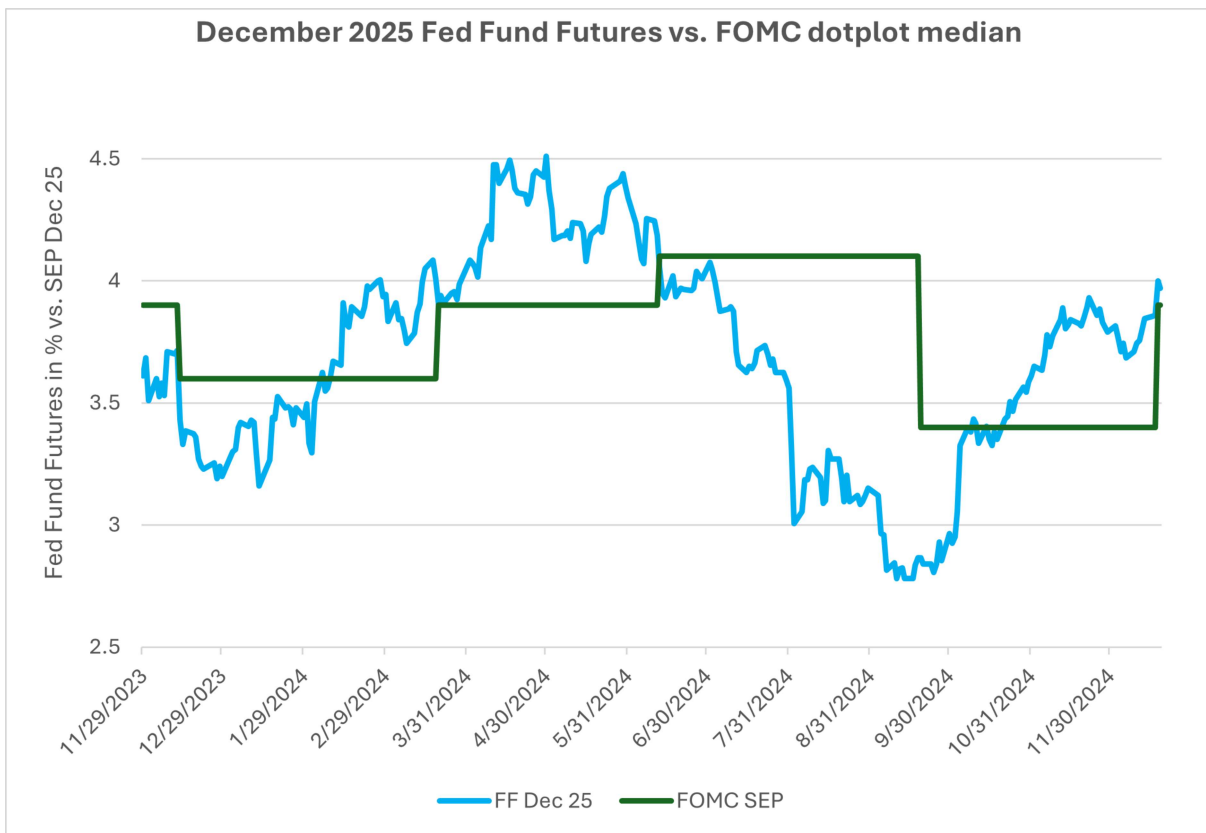
Exhibit #2: US Q4 Growth Also 3%?



Source: Reuters, BNY

**2. FOMC rate cut expectations vs. market.** This year, the spread between market expectations for 2025 rates and the FOMC forecasts for policy mattered to how risk markets traded. The correlation of the S&P 500 to the spread of fed fund futures for December 2025 to the median Fed summary of economic projections was significant. The sell-off in US equities after the Fed December rate cut surprised many but given the drift up in rates from the SEP, it’s still a forward guidance story for risk in 2025. What might be underappreciated in the weeks ahead is how uncertainty over fiscal and other policy from the new Trump administration plays out against Fed guidance and market expectations on growth and inflation.

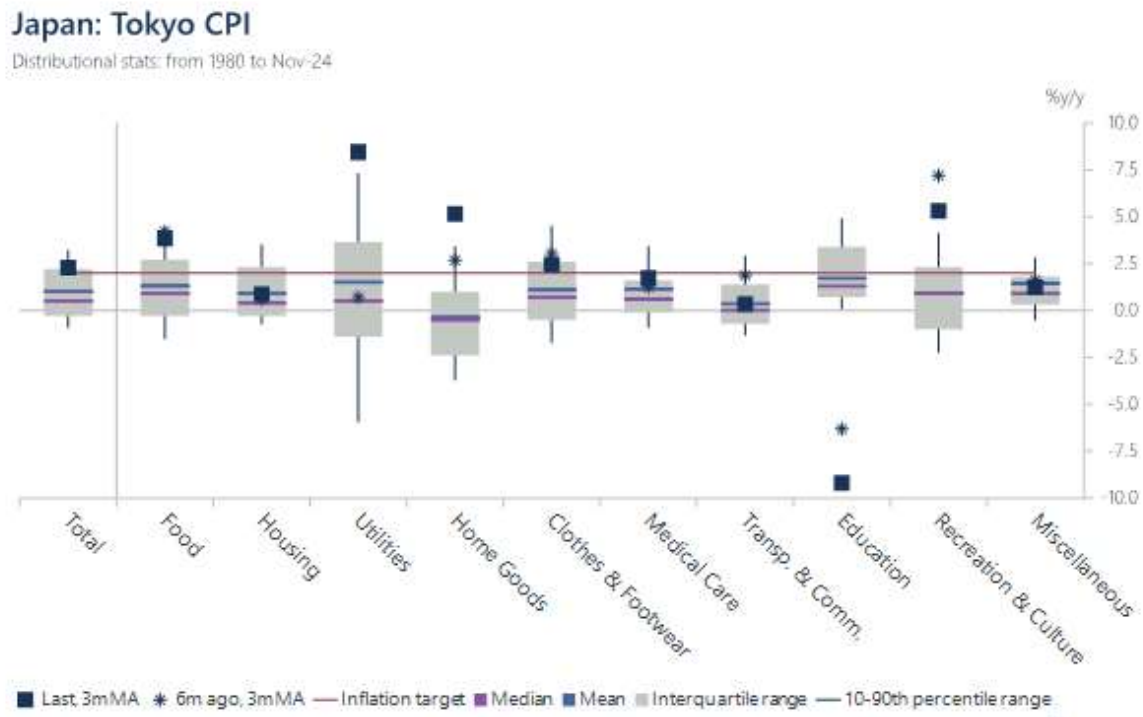
Exhibit #3: Will the Market Stay above the Fed on Rates in 2025?



Source: iFlow, Bloomberg, BNY

**3. Japan inflation, real household spending and JPY.** The BoJ passed on the December rate hike opportunity, but Governor Ueda was clear that a January hike is probable. However, the level of uncertainty surrounding geopolitical factors could keep them back from faster normalization. Ueda explained that the BoJ would need a stronger magnitude of confidence about the sustainability of wage rises and the gradual recovery of overseas economies. On the other side, household spending lags with inflation higher than the target and aggravated by a weaker JPY driving up import costs – particularly for fuel. The Japan Tokyo CPI next week will be key to January hike odds and the JPY correlation to BoJ pressure to act. The recent JPY weakness will matter.

**Exhibit #4: Is Japan CPI at Risk with JPY?**



Source: BOJ, Macrobond, BNY

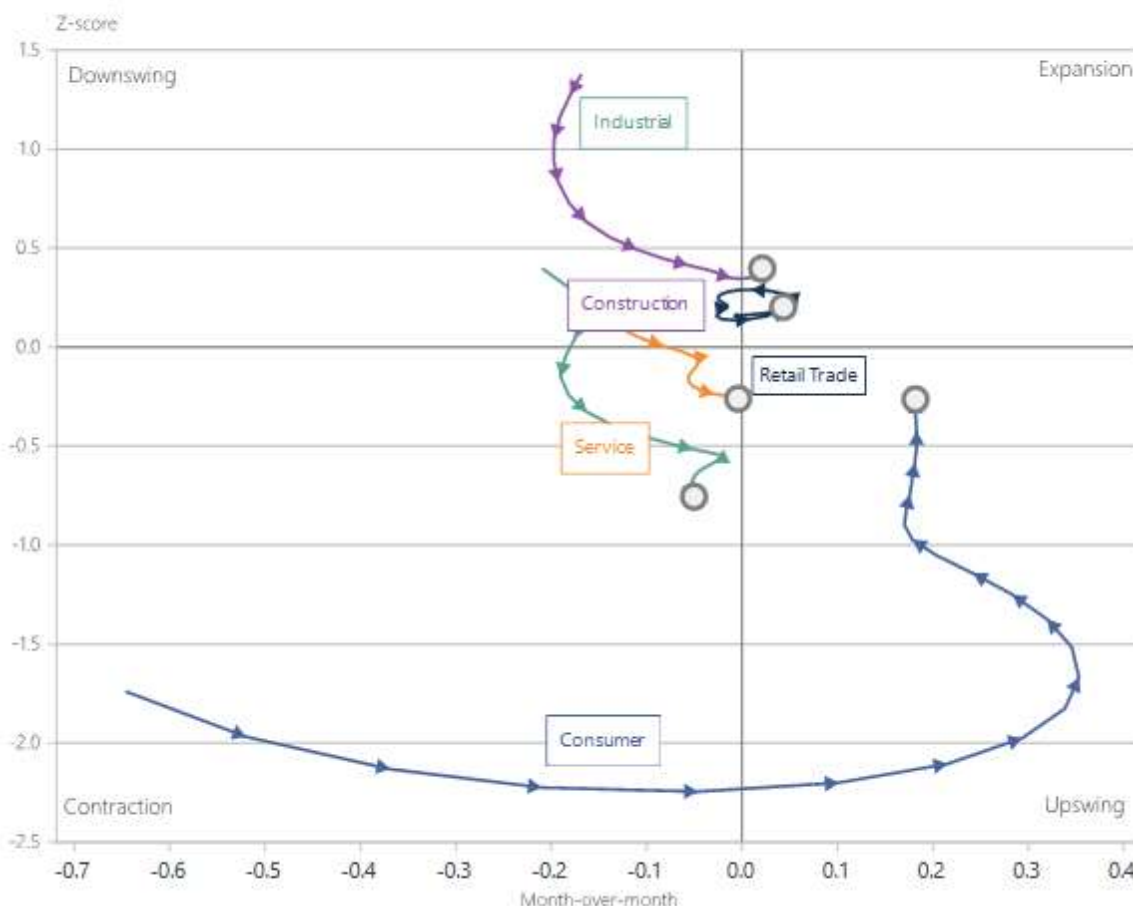
**4. Does the EUR reflect the economy or something else?** The role of European PMI and industrial production in the equation of the EUR/USD will be tested in the next two weeks. The fear of US trade policy shifts, an extended winter with higher

energy costs and troubles from ongoing political risks – with the German election and French budget – all hang over FX markets. The questions for markets are about what leads the EU recovery in 2025 and the current trends by sector are going to be best set up for surprises. The consumer and retail trade are clearly part of the hope, with real income driving – as long as the drop in manufacturing stabilizes.

### Exhibit #5: What Sector Leads in EU in 2025?

#### EU: Sectoral climate clock over last 2 years

Source: European Commission (DG ECFIN)



Source: Eurostat, Macrobond, BNY

### Calendar of economic releases from December 23 to January 3

#### Central bank decisions

- **Turkey TCMB (Thursday, December 26)** – No change is expected in TCMB rates and given the current pressures on the exchange rate – although it is manageable compared to some other high yielders – the need to maintain high real and nominal rates will stay high. Assuming December inflation lingers around 2.5%-3%, whole-year inflation for Turkey will stay at just around 47%, which doesn't leave any room for rate cuts in the near future as the market's benchmark for EM real rates remains relatively high. However, sentiment is robust, and the financial account looks set to end the year on a strong note.

**Key data/releases**

Date	GMT	EST	Country	Event	Period	Cons.	Prior
23/12/2024	07:00	02:00	UK	GDP QoQ	3Q F	--	0.10%
23/12/2024	07:00	02:00	UK	GDP YoY	3Q F	--	1.00%
23/12/2024	15:00	10:00	US	Conf. Board Consumer Confidence	Dec	113	111.7
24/12/2024	13:30	08:30	US	Durable Goods Orders	Nov P	-0.30%	0.30%
24/12/2024	15:00	10:00	US	New Home Sales	Nov	663k	610k
<b>26/12/2024</b>	<b>11:00</b>	<b>06:00</b>	<b>TU</b>	<b>One-Week Repo Rate</b>	<b>Dec-26</b>	<b>--</b>	<b>50.00%</b>
26/12/2024	13:30	08:30	US	Initial Jobless Claims	Dec-21	--	--
26/12/2024	23:30	18:30	JN	Jobless Rate	Nov	2.50%	2.50%
26/12/2024	23:30	18:30	JN	Job-To-Applicant Ratio	Nov	1.25	1.25
26/12/2024	23:30	18:30	JN	Tokyo CPI Ex-Fresh Food YoY	Dec	2.50%	2.20%
26/12/2024	23:50	18:50	JN	Industrial Production MoM	Nov P	-3.50%	2.80%
27/12/2024	12:00	07:00	BZ	IBGE Inflation IPCA-15 MoM	Dec	0.46%	0.62%
30/12/2024	00:30	19:30	JN	Jibun Bank Japan PMI Mfg	Dec F	--	49.5
30/12/2024			UK	Nationwide House PX MoM	Dec	--	1.20%
31/12/2024	01:30	20:30	CH	Manufacturing PMI	Dec	50.3	50.3
31/12/2024	07:00	02:00	TU	Trade Balance	Nov	--	-5.91b
31/12/2024	12:00	07:00	SA	Trade Balance Rand	Nov	--	14.6b
02/01/2024	01:45	20:45	CH	Caixin China PMI Mfg	Dec	51.7	51.5
02/01/2024	07:00	02:00	TU	S&P Global/ICI Turkey Manufacturing PMI	Dec	--	48.3
02/01/2024	07:30	02:30	SW	Swedbank/Silf PMI Manufacturing	Dec	--	53.8
02/01/2024	08:00	03:00	PD	S&P Global Poland Manufacturing PMI	Dec	--	48.9
02/01/2024	08:30	03:30	CZ	S&P Global Czech Republic Mfg PMI	Dec	--	46
02/01/2024	08:55	03:55	GE	HCOB Germany Manufacturing PMI	Dec F	--	42.5
02/01/2024	09:00	04:00	NO	DNB/NIMA PMI Manufacturing	Dec	--	50.7
02/01/2024	09:00	04:00	EC	HCOB Eurozone Manufacturing PMI	Dec F	--	45.2
02/01/2024	09:30	04:30	UK	S&P Global UK Manufacturing PMI	Dec F	--	47.3
02/01/2024	12:00	07:00	US	MBA Mortgage Applications	Dec-20	--	-0.70%
02/01/2024	12:00	07:00	US	MBA Mortgage Applications	Dec-27	--	--
02/01/2024	13:00	08:00	BZ	S&P Global Brazil Manufacturing PMI	Dec	--	52.3
02/01/2024	13:30	08:30	US	Initial Jobless Claims	Dec-28	--	--
02/01/2024	14:30	09:30	CA	S&P Global Canada Manufacturing PMI	Dec	--	52
02/01/2024	14:45	09:45	US	S&P Global US Manufacturing PMI	Dec F	--	48.3
03/01/2024	07:00	02:00	TU	CPI YoY	Dec	--	47.09%
03/01/2024	09:00	04:00	PD	CPI YoY	Dec P	--	4.70%
03/01/2024	15:00	10:00	US	ISM Manufacturing	Dec	48.5	48.4
03/01/2024			PH	CPI YoY 2018=100	Dec	--	2.50%

**Key speeches/events**

Date	GMT	EST	Country	Event
12/23/2024	23:50	18:50	JN	BOJ Minutes of Oct. Meeting
12/24/2024	00:30	19:30	AU	RBA Minutes of Dec. Policy Meeting
12/25/2024			JN	BOJ Governor Ueda Speech at the Keidanren Council
12/26/2024	22:00	17:00	CO	Colombia Monetary Policy Minutes
12/26/2024	23:50	18:50	JN	BOJ Summary of Opinions (Dec. MPM)
12/30/2024	03:20	22:20	AU	RBA's Jones-Fireside Chat
01/02/2024	08:30	03:30	SW	Riksbank minutes from December meeting published
01/03/2024	16:00	11:00	US	Fed's Barkin Gives Keynote Address

Source: Bloomberg, BNY

**Conclusions: How are markets set up for 2025?**

Recapping the last week might be the best way to understand what happens next:

**FOMC eased 25bp to 4.25%, also cut the RRP 30bp to 4.25%** – but it kept QT and pushed for more SFR use with much focus on year-end liquidity. The SEP sees just 50bp of easing in 2025 and a higher CPI and GDP. USD is up to 108 on the index while 10Y US rates are up 70bp on the year at 4.57%. The S&P 500 is up 23%, with a focus on 6,000 as key pivot still.

**Bank of England in a tight 6-3 vote left rates on hold at 4.75%**. This was seen as a dovish hold and three cuts of 25bp each are now priced for 2025. GBP is weak at 1.2510, well below the 1.35 to 1.40 range near REER. The FTSE is up just 4.8%, while the GBP is off 1.7% against the USD and Gilts 10Y are up 1.05% at 4.58%.

**Bank of Mexico cut rate 25bp to 10% – as expected** – and suggested more cuts ahead. It cited worries about tariffs and MXN weakness ahead but left open possibility of faster easing given deflationary pressures and growth. The Taylor rule suggests 8% would be the target for rates in 2025. MXN is off 16.5% on the year at 20.30. The MXN \$ bonds 10Y are up 1.17% to 6.58% while the Bolsa stock index is off 14%.

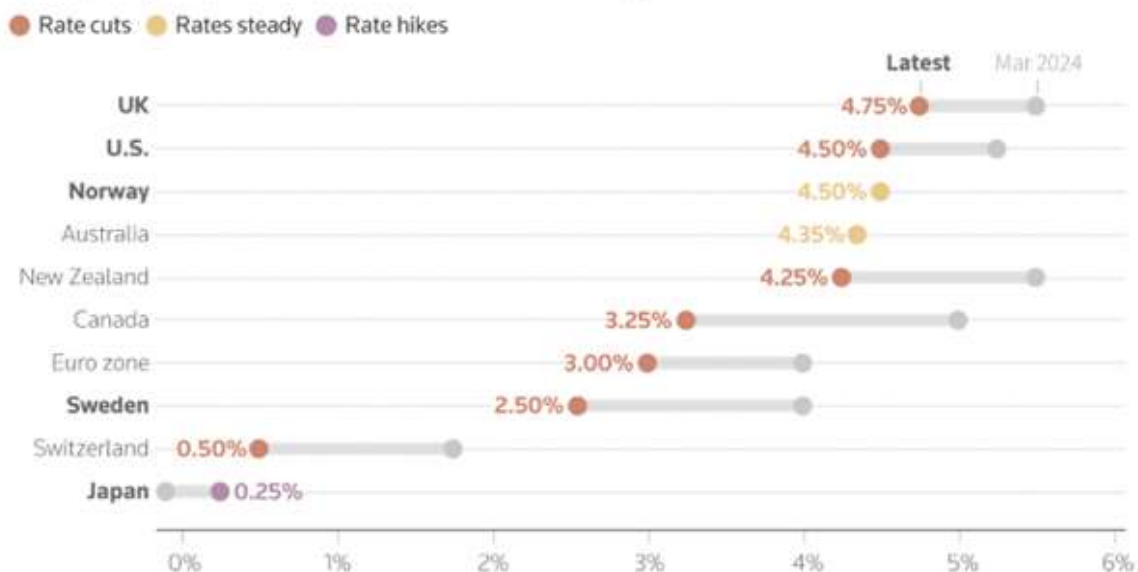
**Bank of Japan left rates unchanged at 0.25% – as expected** – and Governor Ueda strongly suggested that further hikes would come in January unless tariffs or other geopolitical factors didn't derail hopes for further wage support to the inflation expectations ahead. Markets price hikes of 50bp in 2025 – we see even more – but much of this is based on growth and wages beating forecasts. JPY is off 10.5% to 157.45 on the year to date with a focus on 140-160 now at key levels.

**Brazil real fell to 6.30 this week** – new historic lows – with central bank intervention this week over \$14bn to cap the USD rally. This is against \$380b in reserves. The key to Brazil maybe in President Lula and what happens with his health, how the left sees a succession plan and how the government pushes a more serious fiscal plan to counter fiscal dominance. Brazil BCB also promised 2% more hikes to 14% but market prices in even more. BRL is off 20.5% on the year and 10Y \$ rates rose 1.10% to 7.06%. The Bovespa is off 9.7% on the year.

### Exhibit #6: Are GBP and the USD Set to Outperform Still?

#### A rate cutting spree

Change in policy rates by central banks overseeing the 10 most traded currencies



Note: Countries are sorted in descending order of current interest rates.

Source: Reuters, BNY

Please direct questions or comments to: [iFlow@bny.com](mailto:iFlow@bny.com)

### Disclaimer & Disclosures



**Bob Savage**  
HEAD OF MARKETS STRATEGY  
AND INSIGHTS

CONTACT BOB



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