

FX Viewpoint

Currencies
Global

The strong USD story isn't over yet

- ◆ The USD's strength has ebbed lately, with the DXY converging with its rate differential...
- ◆ ...which suggests little US policy uncertainty in the price of the USD, but we are hesitant to downplay these risks...
- ◆ ...and fundamentals still favour the USD

The broad USD has lost steam lately, with the US Dollar Index (DXY) falling below the 107 level. The gap which had emerged between the DXY and that implied by its interest rate differential has also closed (Chart 1). This could be attributed to a reduction of the premium related to the uncertainty regarding the potential measures that could be announced by US President Donald Trump. In other words, **there is little Trump policy uncertainty in the price of the USD.**

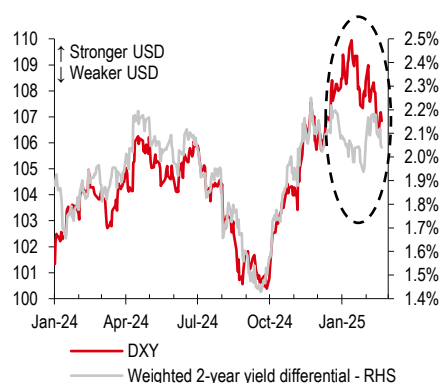
Canada and Mexico reached agreements to postpone US tariffs of 25% each on most of their exports until 4 March. The delay has given the CAD some respite, but it ignores the risk that US tariffs could rise, and the Canadian government retaliates.

We are hesitant to downplay these risks entirely, as we are in the early stages of US President Donald Trump's second term. **The Trump administration's current steps would see tariffs rising at their fastest pace since the 1930s but this could accelerate further** (Chart 2). The more US tariffs on other countries rise, the greater the likelihood of a strong USD, all things being equal.

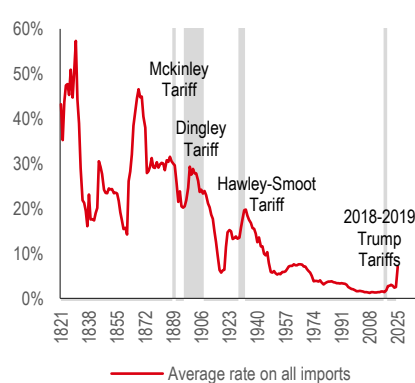
The USD has recently weakened, as the premium associated with US policy uncertainty has waned...

...but this seems peculiar, especially when we are in the early stages

1. The DXY converged with its rate differential



2. The history of US tariffs



The USD now faces asymmetric upside risks related to upcoming tariff deadlines. For example, a further delay in the imposition of tariffs on Canada or Mexico on 4 March might see a slightly weaker USD. But **were the broad 25% tariffs to be imposed, the broad USD would likely surge higher.** It is also worth monitoring whether the broader rhetoric from the US administration could lean more hawkishly on trade over the coming months, especially **if higher US tariffs become an essential component of the fiscal toolkit.**

From the perspective of currency fundamentals, **the USD should remain on a firmer footing, supported by relatively high yields and resilient growth.** Unless there is a dramatic shift in the underlying macro picture – for the US and globally – we find it difficult to envisage a large and sustained decline in the USD.

The USD now faces asymmetric upside risks related to US trade policy

We still expect the USD to strengthen further this year

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