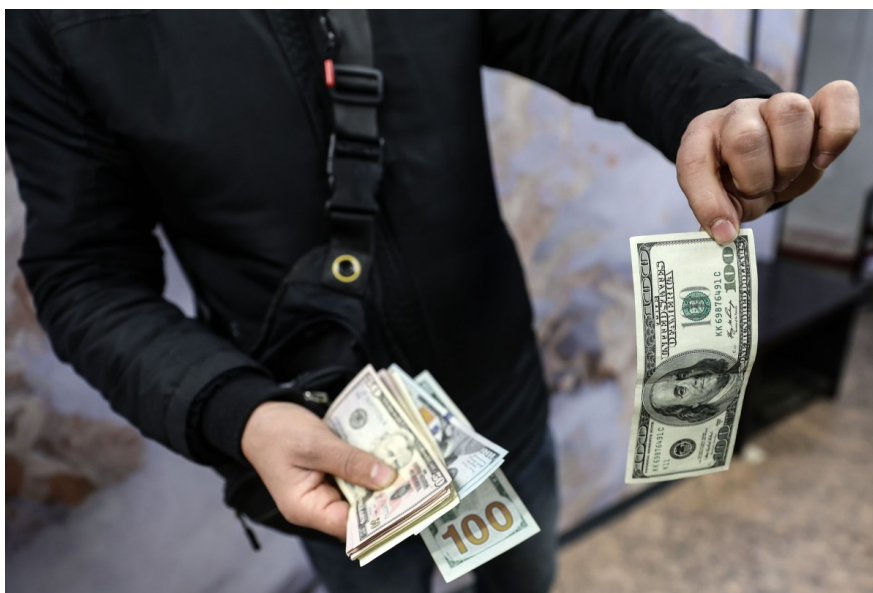


Three calls for FX: All hail the mighty dollar

2025 looks like it's going to be a year of dollar strength. That is ING's house call. The main risk to that probably stems from the US economy being softer than expected and a Republican administration pursuing a weaker currency



We're looking at a stronger dollar in 2025, but there are risks

How we got here

The Federal Reserve's broadest measure of the trade-weighted dollar has rallied 5% over the last two months as markets positioned for and then witnessed a Republican clean sweep. European currencies have borne the brunt of dollar strength as the mixture of soft eurozone survey data and Europe's fiscal straitjacket has pressured US:Eurozone interest rate spreads to the widest levels since 2022.

Geopolitical developments have hit European currencies, too, as the war in Ukraine has escalated. Investors and corporates remember only too well the spike in energy prices in 2022 and the damage those energy prices did to the eurozone's trade surplus and the euro.

From the US side of the equation, the FX market is leaning towards the view that President-elect Donald Trump will hit the ground running. This has meant very little reprieve for any global

currencies, although the more commodity-linked currencies are faring slightly better on the back of some fiscal stimulus out of China.

1 Call 1: A trade war will see the dollar outperform

Trump's mix of policies is dollar-positive. US growth at the expense of the rest of the world should see a repeat of the broad dollar rally witnessed in 2018-2019 under peak Trump 1.0. Rate differentials and an elevated risk premium will drive the dollar's strength as the new administration keeps trade partners guessing on the next round of tariffs.

In harm's way will be the currencies of the more trade-dependent nations in Europe and Asia – both in the firing line for their large trade surpluses with the US. Relatively low interest rates and generally dovish (excluding Japan) central banks will make it easier for corporates and investors alike to remain underweight in these FX pairs. The euro looks most vulnerable given the eurozone's stagnation and the delayed prospect of any fiscal support. Here, we think EUR/USD will remain under pressure all year and could be closing 2025 very close to parity.

2 Call 2: Weak dollar policy could emerge if growth disappoints

If we're underestimating the power of restrictive Fed monetary policy, the dollar will not prove the outperformer we expect. Weaker growth could see the new administration putting more pressure on the Fed to ease and also show greater interest in a softer dollar.

The topic of dollar policy typically rears its head more frequently under Republican administrations. However, this debate should not have a meaningful impact on FX trends unless the US economy shows surprising weakness.

Any ceasefire in Ukraine could also trigger the riskier call for a higher EUR/USD. While many view this as mere appeasement, the prospect of a peace dividend in Europe could prompt a re-assessment of European currencies – especially if a ceasefire becomes a more sustainable chapter for Ukraine's major reconstruction.

3 Our bold call: Dollar crashes if Trump outspends his welcome

Our wild call is for a dollar crash – probably led by the US Treasury market. It is very rare to see US Treasury yields rising and the dollar falling at the same time – but it has happened before. Here, investors baulking at the insufficient compensation for taking on US asset exposure could see all US asset markets under pressure as a 'sell America' mentality takes hold.

At the same time, there could be concrete evidence of central banks in the BRICS sphere of influence further reducing – or accelerating their reduction in FX reserves and, most likely, increasing their allocation to gold.

The sequence of events here could trigger a Treasury sell-off (poor auction, downgrade, etc.), higher bond yields taking their toll on a growth-stock-concentrated US stock market, and the Fed ultimately being forced into a deep easing cycle. USD/JPY would lead the dollar lower under this scenario.

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