

FX: We're paring back our dollar pessimism

We have been mildly bearish on the dollar for some time. Our forecast dollar decline was premised on a US soft landing and a more dovish Fed outlook than the consensus. However, our new house view of a later/shallower Fed easing cycle means we have to pare back our dollar pessimism. The case for EUR/USD being materially over 1.10 by year-end has faded



Our dollar house-view has changed

The case for a higher EUR/USD fades

Given the more substantial changes being made to our Fed profile this month, we feel that now is the right time to cut back our end 2024 EUR/USD forecast to 1.10, which is consensus. This has been a difficult call for us in that, in theory, an environment of lower US rates and marginally improving global growth prospects should be a promising one for EUR/USD. Yet the reality is that real interest rate spreads have been steadily widening in favour of the dollar over recent months, and it has only been the low volatility rally in global equity markets (a mild dollar negative) which has prevented EUR/USD from trading closer to the 1.05/1.06 area.

In our [2024 FX Outlook published last November](#), we made the case for EUR/USD to stay pretty range-bound through the first quarter of this year and then embark on a modest rally from the second quarter onwards as the Fed prepared to pull the trigger on a June rate hike. Over recent months, we have been salami-slicing our year-end EUR/USD forecast lower as US hard data has failed to slow.

We are also flat-lining our 2025 EUR/USD forecast at 1.10 for the time being, acknowledging that, at current levels, EUR/USD is not far from its medium-term fair value and that the US monetary/fiscal/trade mix for 2025 remains very uncertain.

For USD/JPY, we are particularly revising up our 2025 profile given the view of our US rate strategy team that a term premium will probably have returned to US Treasury markets by this time. Despite a slightly more hawkish Bank of Japan, we therefore suspect USD/JPY will not spend too much time sub 140 over the next eighteen months.

Some early thoughts on the US election and FX

Though the Presidential candidates have yet to put much flesh on the bones of their policy platforms, most FX participants are thinking that former President Donald Trump's agenda is going to be more positive for the dollar, largely through the trade side. Presumably opinion polls coming in after the summer break will start to weigh on FX markets.

However, the makeup of Congress and what the next Administration plans to do on the fiscal side will be key. A looser fiscal/tighter monetary policy mix under Donald Trump would likely be seen as more dollar-positive, although investors will be wary of debt sustainability. Additionally, US protectionism during a US slowdown has not always ended well for the dollar; just think back to the early 1990s!

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