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FX

FX: risk premium to stay in the dollar

While we're not expecting the dollar to collapse, we do think there are enough negative factors out there to keep it under pressure for the rest of the year



The dollar is likely to remain under pressure for the rest of the year

Divestment alert

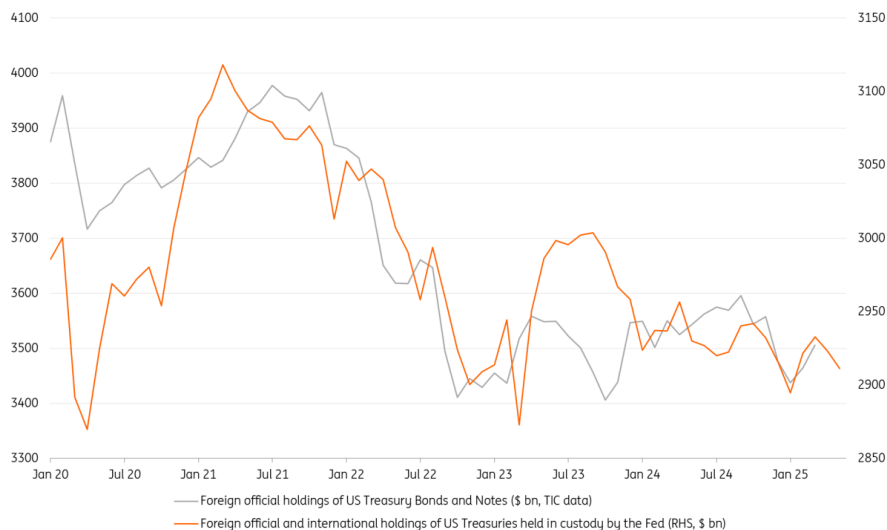
There has been a lot of talk about the 'Sell America' thesis and also 'de-dollarisation'. The two are linked, but the former, in our opinion, best describes the acute sell-off in US asset markets in April. The latter represents the much slower, secular trend away from a unipolar to a multipolar global financial system.

Relevant for both is the view that foreigners will end up holding fewer US assets than they have previously. A key focal point here is the US Treasury market and any evidence that foreigners have indeed been selling. There will therefore be interest in the US TIC data released on 18 June, which covers the month of April. Were central banks one of the key communities selling Treasuries that month?

The chart below shows foreign official holdings of Treasuries, drawing on data from both the US Treasury TIC report and the Fed's custody holdings. The latter is a subset of the former, but they typically profile quite well. The more frequent release from the Fed shows a \$20bn decline in foreign official holdings since April and suggests the April TIC data could well support the

foreign divestment hypothesis – a dollar negative.

Snapshot of foreign central bank holdings of Treasuries



Source: US Treasury, US Federal Reserve

The macro is dollar negative too

We expect tariff and US policy uncertainty to keep a risk premium in the dollar this year. One such policy on the market's radar is Section 899 of the tax bill, which threatens a new withholding tax on foreign investors whose governments are deemed to run discriminatory tax regimes. Should that go into law, expect the dollar to turn quite offered into year-end as global investors optimise portfolios ahead of its introduction in 2026.

But dollar weakness will not be entirely down to a risk premium. The softer US growth trajectory and the restart of the Fed's easing cycle later this year should keep the dollar offered. Fed rate cuts, in particular, can reduce dollar hedging costs and make it easier to increase hedge ratios on holdings of US assets. On this subject, we suspect that current high dollar interest rates are discouraging some of that activity.

Equally, the eurozone story should start to look a little more attractive through 2026 as the benefits of this year's fiscal stimulus decisions bear fruit. Importantly, we're looking for eurozone money market rates to start picking up in late 2026 ahead of what could be an ECB hike in early 2027. We expect EUR/USD to trade towards the upper end of a 1.15-1.20 range at that stage. And that's why this month we are nudging our EUR/USD forecast profile slightly higher.

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