

FX: Why we remain bullish on the dollar

The dollar has come under some pressure on the back of the rerating of the US growth outlook and expectations that the Russia-Ukraine conflict is nearing an end. However, we expect US tariffs to regain centrality and drive the dollar sustainably higher



Large post-US election dollar long positions were trimmed in February as markets reassessed some of the key drivers of the USD bullish trend. In this note, we discuss those drivers and why we remain bullish on the dollar.

Firstly, US tariffs. Markets have adapted to President Trump's unpredictable communication style and are treating tariff threats with a greater dose of scepticism. However, our baseline view remains that the US will go ahead with tariffs on the European Union and Asia. That could be part of a Treasury-led, longer-lasting policy measure – as opposed to the erratic, border-focus approach seen in the US-Mexico-Canada trade incident. We expect a peak protectionism risk premium in FX in the second quarter, which implies a stronger dollar and a weakening of developed European and emerging Asia currencies.

The second factor that contributed to recent dollar weakness has been souring sentiment on US activity. The consumer story has softened, but we doubt there will be enough deterioration in hard

data to bring the Federal Reserve closer to a rate cut, which we currently expect only in September. As long as markets are comfortable with no more than two cuts (our call) in 2025, the pass-through to a weaker dollar will be limited, and a gradual worsening of US activity and employment should not really hinder a tariff-led dollar rally.

Finally, geopolitics. The FX market is broadly pricing in a Russia-Ukraine peace deal in the near term, and the residual downside risk for the dollar from that should not be big. Ultimately, a clear shift towards a more confrontational US-EU relationship could be the longer-term takeaway, and EU defence spending shouldn't be enough to revive the bloc's stagnant economy.

We continue to expect downside potential extending to parity for EUR/USD. Our year-end target is 1.02, but we acknowledge there are some upside risks should the tariff story or US exceptionalism deflate sooner. The European Central Bank will likely continue to cut rates to at least 2.0%, and remain a net negative for the euro.

In the rest of G10, sterling is facing substantial downside risks from fiscal turbulence and potentially larger Bank of England cuts, and we see GBP/USD heading towards the low 1.20s. Commodity currencies should suffer from revamped tariff risk, while the yen can resist a dollar reappreciation better than others.

Author

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.