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US election guide for the FX market

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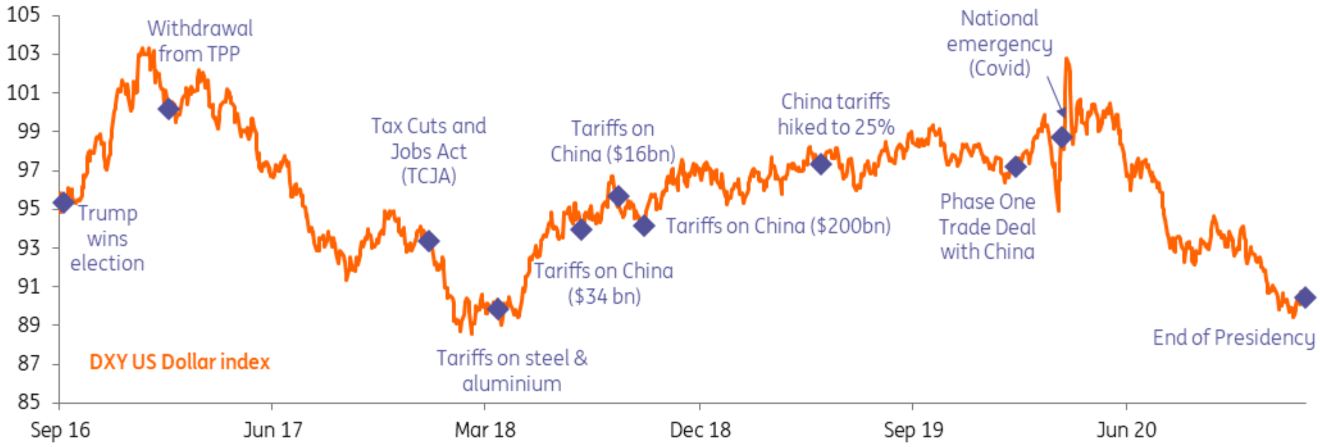
This election guide is a companion to our article '[US presidential election: Three scenarios for markets](#)' which we published in August. In this piece, we drill down into what new policies may mean for each of the major currency blocs. In addition, we offer three brief 'Focus' articles looking at the threats of: US debt sustainability, the adoption of weak dollar policy and the long-standing topic of de-dollarisation.

DXY Dollar index performance during Trump's first presidency



Source: Refinitiv, ING

Executive Summary

- **G10**: The interplay of the domestic, foreign and trade policy channels of the next US administration will be key. Loose fiscal, tight monetary and protectionist policies are all dollar positive and more likely under Trump. European FX would come under broad pressure in the event of universal tariffs and worsening geopolitics, while the low yielding JPY and CHF are more susceptible to higher US rates.
- **CEEMEA**: Higher defence spending and closer trade ties with the US could provide the CEE currencies with some protection against any new US trade threats. South Africa's rand remains a China growth story, while Turkey's lira remains a bystander.
- **ASIA**: Any renewed trade protectionism could broaden out beyond China to countries like Vietnam. Tariffs could be used as a threat to deliver stronger Asian FX. Chinese authorities, playing the long game, will continue to fight a weaker CNY.
- **LATAM**: Brazil and Chile's currencies performed poorly through the last Trump administration – Chinese demand playing a key role here. Universal tariffs or any threats to renegotiate the USMCA in 2026 could drag Mexico's peso a lot lower.
- **US Debt Sustainability**: Default has not happened before, but the next administration will have to work very hard to keep investors onside. A debt crisis and the threat to the US financial system could counter-intuitively send the dollar higher.
- **Weak $ Policy**: Judge any new administration by its deeds, not words. The fiscal and monetary policy mix will drive the dollar whatever the next Treasury Secretary says.
- **De-dollarisation**: A gradual decline in the dollar's role in trade seems likely. But as the financial flow's currency of choice, the dollar will remain in demand.

The 2024 US Presidential Election

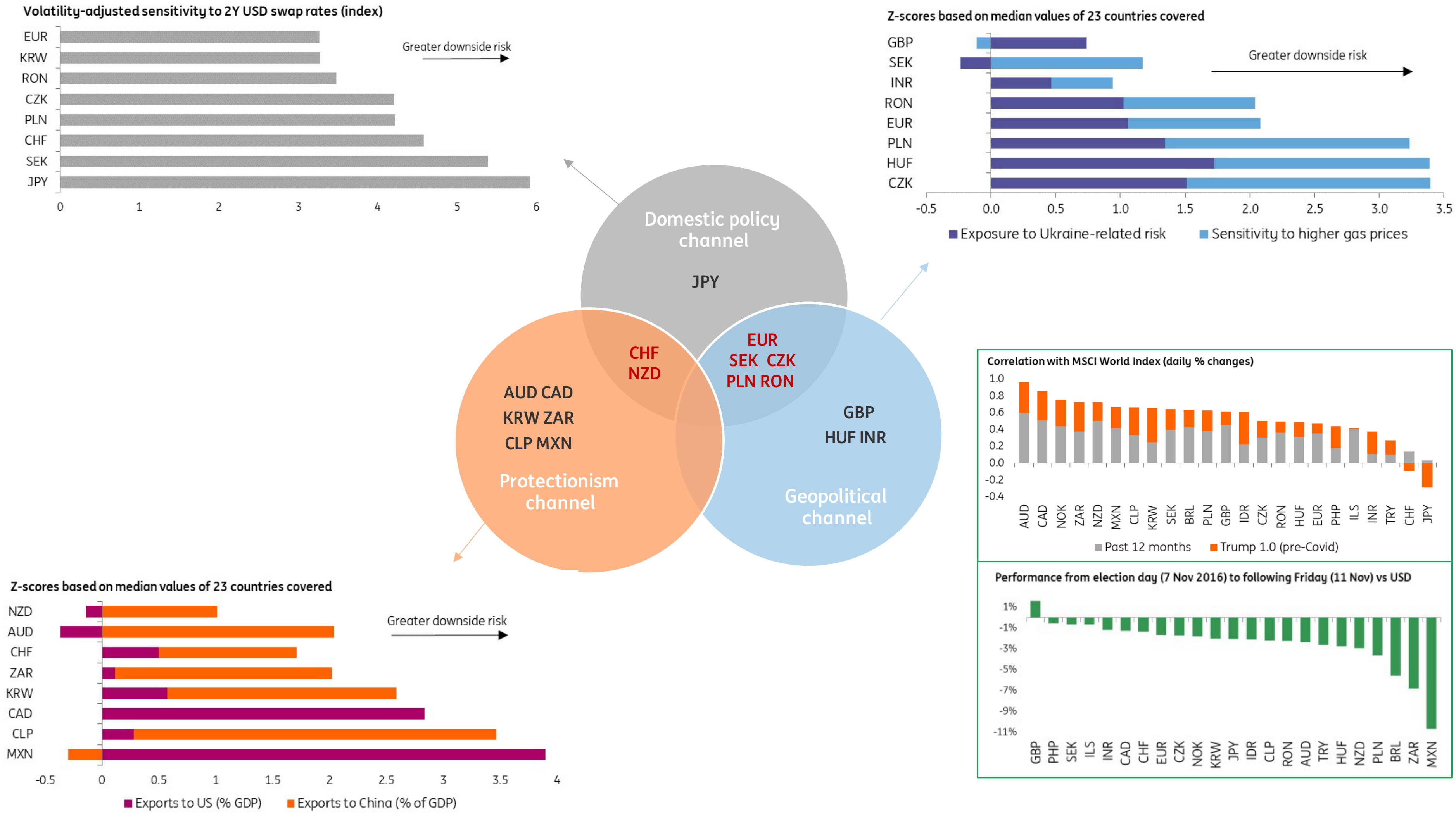
Three scenarios for the currency market

Policy drivers and USD impact

Relevance for markets	Domestic policy	Foreign policy	Trade policy	Fed policy impact	EUR/USD	USD/JPY	EUR/PLN	USD/CNY
1 **Trump clean sweep** Trump Presidency Republican House Republican Senate	USD Tax cuts are a dollar positive as they inflate both US growth prospects and market expectations for the Fed's terminal rate	USD Trump is more focused on domestic policy, but less support for Ukraine is still negative for European FX, favouring rotation to safe-havens	USD High tariffs in China will hit EM FX and help the safe-haven USD. Timing of tariffs is key: delayed protectionism -> longer-lasting USD benefits	USD Protectionism and tax cuts mean slower and smaller Fed rate cuts. The USD is expensive to sell: bad for both high-beta and low-yield FX	4Q24 1.02 2Q25 1.00 4Q25 0.95	4Q24 152 2Q25 155 4Q25 155	4Q24 4.35 2Q25 4.37 4Q25 4.42	4Q24 7.20 2Q25 7.25 4Q25 7.35
2 **Trump constrained** Trump Presidency Republican House Democrat Senate	USD Tighter migration rules & rollover of 2017 tax cuts can help USD, but a split Congress should block new tax cuts. Milder US exceptionalism	USD Transactional approach to NATO and forced peace deal in Ukraine can raise perceived risk in Europe, leading to risk-off flight into USD	USD Aggressive trade policy from the start. Asia FX and exporting countries' currencies take the biggest hit, sharp USD rally by mid-2025	USD Fed more careful with cutting rates. But tariffs and migration curbs are bad for growth. High-beta FX losses partly mitigated	4Q24 1.06 2Q25 0.98 4Q25 1.03	4Q24 150 2Q25 145 4Q25 148	4Q24 4.30 2Q25 4.37 4Q25 4.33	4Q24 7.20 2Q25 7.30 4Q25 7.30
3 **President Harris** Harris Presidency Republican House Democrat Senate	USD Tax hikes hit US growth, risk sentiment shaky. Liquid currencies (e.g. EUR, JPY) and those with slower domestic easing gain the most	USD Potential relief rally after vote, but picture in Ukraine unimproved (less US funding). ME tensions may escalate. Risks balanced for USD	USD Tariff risks priced out (USD -ve), focus on domestic stories in FX. China's growth keeps Asia FX capped, but rest of EM FX supported	USD Fed may cut to less than 3.5% to help growth. Easing largely priced in, but will still favour a cheaper and broadly weaker dollar	4Q24 1.12 2Q25 1.15 4Q25 1.18	4Q24 140 2Q25 135 4Q25 130	4Q24 4.25 2Q25 4.23 4Q25 4.20	4Q24 7.10 2Q25 7.05 4Q25 6.90

Source: ING

Which currencies are most vulnerable to a change in US policies?



Source: Refinitiv, Macrobond, IMF, World Bank, ING calculations

G10: The return of the king dollar?

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Consensus expects that any return of a Trump administration would be dollar positive. We agree. Yet the relative thrust of policy channels would determine the performance of currencies within the G10 bloc. If the story is higher US rates, then the low-yielders look more vulnerable. If it's geopolitics, arguably Europe looks more threatened. And if it's trade, targeted or universal tariffs make a big difference.

The dollar: Binary outcomes

In our election scenario analysis, we outlined three key channels through which the next US administration would impact FX markets. Those being: Domestic Policy, Trade Policy and Foreign Policy. Despite occasional speculation over the desire for a weaker dollar, most assume any Trump administration would be dollar positive. And we see the status quo of any Harris administration as a mild dollar negative.

Tax cuts should lead to longer lasting USD strength

The most lasting dollar gains during a Trump White House would be on the back of looser fiscal/tighter monetary policy settings which would revive the investment thesis of 'US exceptionalism'. The question here is, 'how long would a Trump administration take to get extended tax cuts through Congress?'. Back in 2017 it took a year to get the tax cut through and, in the meantime, the dollar had fallen 5%.

More immediate, but less lasting dollar strength would be seen if any Trump administration led with protectionism. Pursued through executive orders, these could come early in any Trump presidency and, as the 2018/19 trade war showed, the dollar enjoyed broad strength – especially against high beta currencies. Back then the focus of US trade policy was China. Whether that protectionism would remain China-focused or become more global (universal tariffs) would determine whether the currencies of Canada and Mexico would be dragged into the sell-off.

Trump's foreign policy approach can boost the dollar

When it comes to the foreign policy channel, the risk of a more isolationist Republican administration again poses an upside risk to the dollar. The only Republican foreign policy scenario we see as dollar negative would be one in which Trump engineers a Middle East peace deal. Lower fossil fuel prices would be a boon to Europe and Asia.

Should Kamala Harris prevail in November, Democrat fiscal consolidation should only add to expectations of an orderly Fed easing cycle and a weaker dollar.

Euro and low-yielders (EUR, JPY, CHF): More of a rates story

The yen and the Swiss franc are well known for their low betas to risk assets and the degree to which the new US administration could maintain an orderly rise in equities will have a big say in how these currencies trade. What is less well known is that the low-yielders have some of the highest betas to US rates and will thus be dragged around by whether the US economy is fiscally pumped or broadly slows. Both currencies will do better if global rates converge lower.

Euro has substantial exposure to global trade

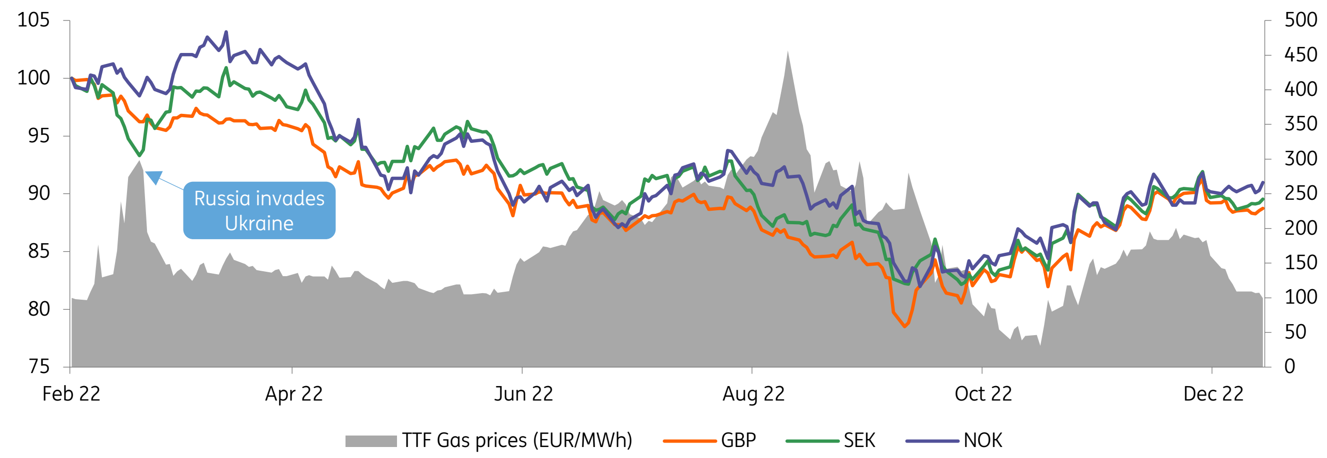
Trade wars will have a greater say in the path forward for the euro. Not receiving much attention recently has been the Eurozone quietly building a very positive Balance of Payments position. A deterioration in world trade, particularly should the US adopt universal tariffs, would weigh heavily on the euro. Additionally, were geopolitics to send fossil fuel prices higher or if a sense were to emerge that Vladimir Putin had been appeased and threatened more of Europe, the euro would also suffer greatly.

Pro-cyclical Europe (GBP, SEK, NOK): Geopolitical questions to answer

High sensitivity to geopolitics

SEK and NOK face very large downside risks from changes in the US relationship with Europe and Ukraine. GBP is less volatile, but structurally more vulnerable to new potential spikes in gas/oil prices due to the UK's lower energy independence. As shown in the chart below, sterling depreciated in line with NOK and SEK during the 2022 energy crisis, and even emerged as underperformer in a few instances (the September GBP drop should be ignored, as it was caused by the Liz Truss mini budget).

Performance vs USD during 2022 Ukraine invasion and energy crisis (17 February 2022 =100)



Source: ING, Refinitiv

Our basic assumption is that Harris will keep supporting Ukraine militarily (albeit with some opposition from a split Congress), while Trump will scale back support and seek a compromise peace deal with Russia. We don't see markets welcoming the latter scenario, and risks of Russia adding pressure on other parts of Europe (Baltics, Moldova) may be priced in, potentially weighing heavily on Nordics FX.

Trade and US fiscal policy should be secondary

Turning to the other two channels – trade and domestic policy – SEK and NOK are also more at risk than GBP in a Trump scenario. While none of the three countries are heavy exporters to China, SEK and NOK will be sensitive to global trade dynamics. SEK is more at risk from US universal tariffs, as Swedish exports to the US are worth a non-negligible 3.1% of GDP (vs 1.3% in Norway, 1.9% in UK), and the non-commodity export composition means more susceptibility to a slowdown in global trade/growth.

When it comes to domestic US policy, our measure of volatility-adjusted sensitivity to higher USD short-term rates ranks SEK as the most vulnerable in a basket of 23 currencies. Ultimately though, if the Fed has already delivered substantial easing by the time tax cuts are delivered, the net impact on equity markets, and by extension on high-beta FX, may be positive as growth prospects improve. In other words, the timing of potential tax cuts under Trump is what will determine the impact on GBP, SEK and NOK.

NOK and SEK face larger downside risks

We expect a Trump win to generate an immediate negative reaction in pro-cyclical European FX as markets price in fresh geopolitical turmoil, with the relatively illiquid NOK being among the worst performers in G10. However, Sweden's fundamentals can be hit harder than Norway's due to the composition of exports ahead of a protectionism-led slowdown in global trade. GBP has a lower beta to risk sentiment and the UK does not hugely rely on exports, meaning lower downside risks than Nordics barring another major energy crisis.

Dollar-bloc (CAD, AUD, NZD): Protectionist mix will be crucial

Trade policy more important than geopolitics

G10 commodity currencies aren't probably going to be driven by large swings in commodity prices under the new US President. Our commodities team's forecasts for the next two years are within a tight US$77-87/bbl range for Brent across all US election scenarios. What will determine the direction for CAD, AUD and NZD – as well as potential divergence among them – will be primarily the magnitude and geographical focus of US protectionism. This is a group of currencies that is less exposed to the geopolitical channel (ie, Ukraine and NATO developments) compared to European pro-cyclicals.

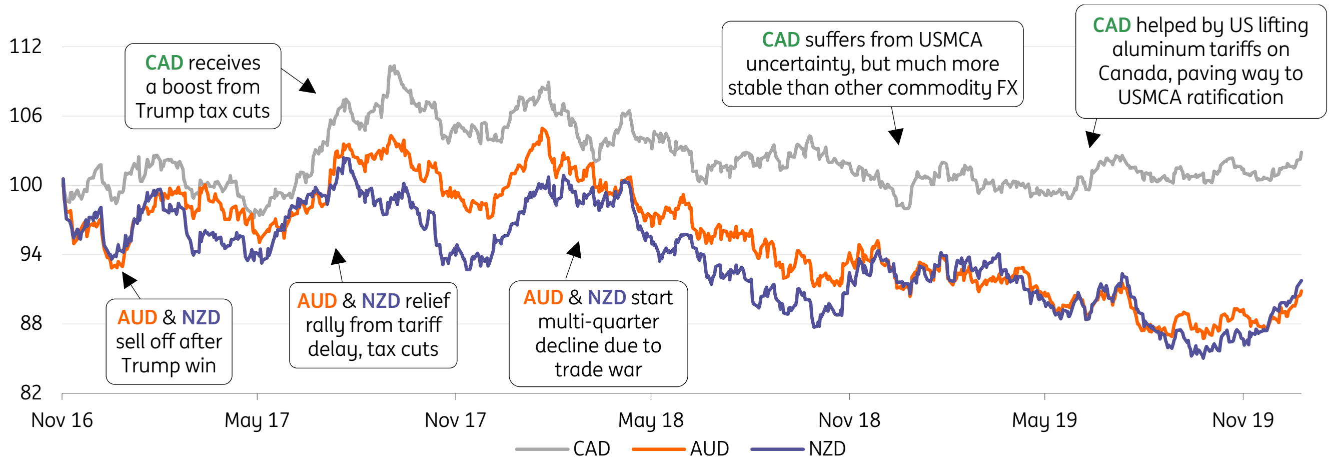
AUD & NZD should outperform CAD under Harris...

As discussed above, a Harris presidency should not be associated with tougher protectionism, so we expect any Trump defeat to trigger a relief rally in $-bloc currencies in November-December as the USD drops. With Harris as president, AUD and NZD have more upside than CAD over the medium term: they can benefit from a more predictable global trade picture, while CAD can suffer from a negative re-rating of US growth.

...but may be the worst G10 performers under Trump

Should Trump win in November, we anticipate sharp underperformance of AUD and NZD. Unless protectionist pledges are surprisingly scaled back, tariffs on China should cause high pressure on the currencies of China-dependent exporting economies. Around 37% of Australia's and 29% of New Zealand's exports land in China. In the medium term, AUD may look worse than NZD, as exports to China are worth 8.9% of GDP in Australia, versus 5.4% in New Zealand. Canada's reliance on Chinese demand is small and, as mentioned, we don't expect oil price volatility. CAD was an outperformer during Trump's first presidency, while AUD and NZD lost more than any other G10 currency between November 2016 and December 2019 (before Covid hit).

Performance vs USD during Trump's first term (7 November 2016 =100)



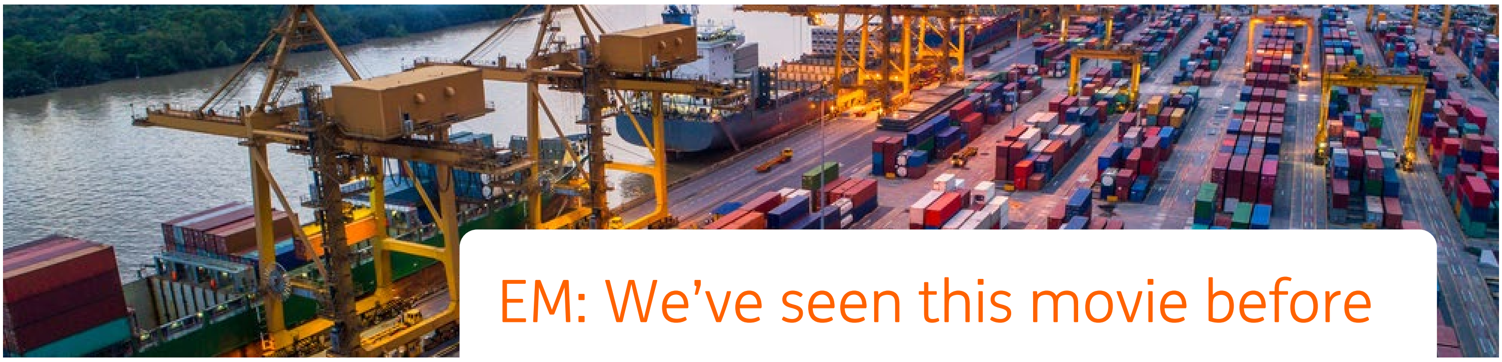
Source: Refinitiv, ING

Universal tariffs and USMCA renewal are big risks for CAD

However, CAD's role as a safe-haven among commodity currencies will only be guaranteed if Canada is not hit by tariffs itself. Canada exports to the US were worth US$421bn in 2023: 71% of total exports and a huge 19% of GDP. A 10% US tariff on all of Canada's exports (as part of universal tariffs) would likely cause severe CAD depreciation.

Also, the USMCA agreement will need to be renewed in July 2026. A combination of Trump winning in the US and centre-left Trudeau/Singh winning in Canada (October 2025 election) could lead to greater uncertainty around US-Canadian trade relationships. Instead, a coalition led by conservative leader Poilievre (seen closer to Trump) could mean lower risk of trade tensions with the US.

If CAD can dodge the direct tariff risk, then expansionary fiscal policy under Trump should favour the loonie against high-beta peers, as demand from the US will be seen as more robust and the Bank of Canada may also need to slow the pace of easing.



EM: We’ve seen this movie before

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Healthy world trade and a dynamic China are normally pre-requisites for a strong performance of EM currencies. The America First approach of any Trump administration would clearly hurt. Expect Chinese authorities to continue to resist FX depreciation, while other large surplus Asian countries could be dragged into trade wars. Elsewhere, higher defence spending might offer some protection to CEE currencies. The geographic mix of any tariffs will determine Latam performance.

CEEMEA: This time it's different with the focus on Ukraine

CEE currencies are directly affected in our scenarios through the EUR/USD channel, but geopolitics will play a bigger role than in the case of previous US elections, in our view.

The situation has changed dramatically in recent years both positively and negatively and the details of each scenario will be crucial. Although in the first term of Trump's presidency it initially appeared that low military spending within NATO would be the biggest disadvantage for CEE countries, ultimately, the US trade wars with China proved most impactful.

CEE FX now more protected from US-China trade tensions

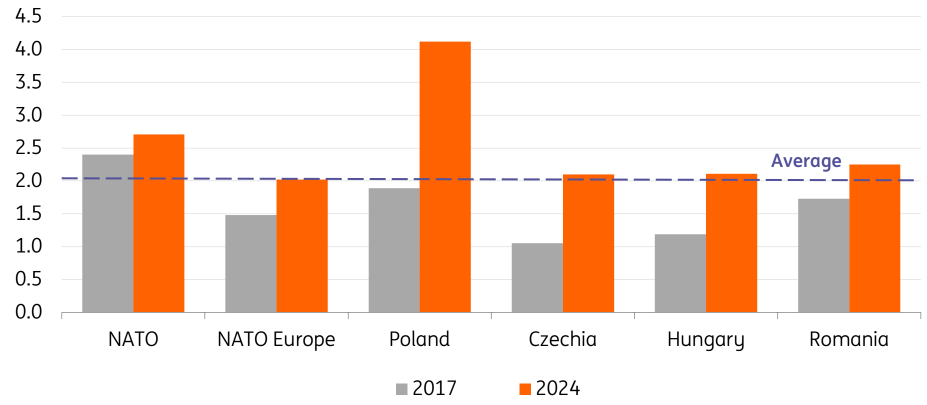
Although the CEE region's direct foreign trade linkage with China has historically been low, through Germany the exposure is actually quite high. This can rapidly result in a weaker CNH leading CEE currencies lower – as was especially the case in 2019.

However, in the run up to this election we believe the situation is different and the CEE region will avoid the worst of any impact from a possible escalation of US-China relations. The main issues in the US election for the CEE region are, of course, the presidential candidates' approach to NATO and the Ukraine-Russia conflict, which by its proximity and political involvement affects the CEE region the most. US policy towards China and the Middle East is more of a secondary channel, in our view.

CEE-US ties are stronger than ever

Since 2017, the CEE countries' relationship with the US has changed significantly, and the economic and political ties are stronger than ever. Although the main reason over the past two years has been the Ukraine-Russia conflict, we can also see an intensification of foreign trade in the years before. In terms of foreign trade, the US has moved up significantly in the ranking of largest trading partners for CEE countries. But most importantly, while in 2017 the military spending of some CEE countries was among the lowest in NATO, estimates for 2024, by contrast, move CEE countries to at least above the NATO Europe average and mainly above the 2% of GDP threshold.

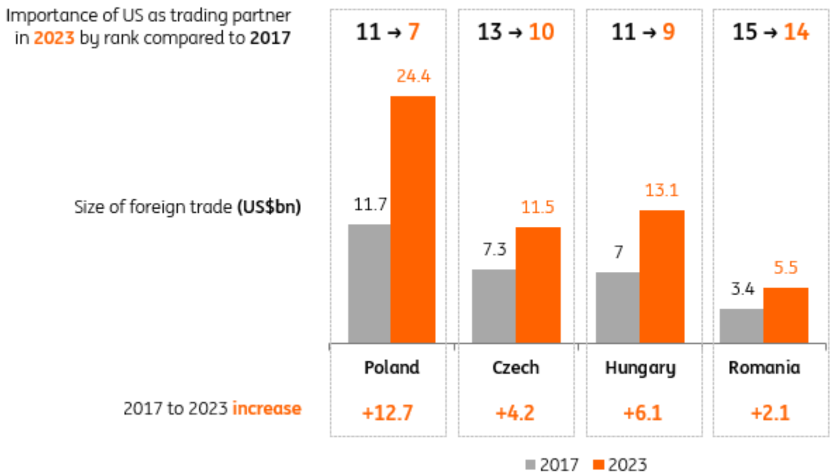
CEE region moved to leading position in military spending in Europe (% of GDP)



Source: NATO, ING

We believe Poland may benefit most from this position, having more than doubled its foreign trade with the US over this period but also being the biggest defence spender in relative terms across NATO with 4.1% of GDP. Moreover, much of the military spending in the CEE region goes directly to the US military industry and in some cases is funded through the US Foreign Military Financing mechanism (notably Poland, Romania). Overall, the interconnection between the US and CEE is thus arguably at its strongest in history, which should deflect any political backlash in any scenario.

Connections between the CEE region and US have grown significantly in recent years



Source: Macrobond, ING

Details of any Ukraine-Russia peace deal to have magnified impact on CEE FX

The second key channel for us is the Ukraine-Russia conflict and the approach to its conclusion by the US presidential candidates. The CEE region is the most exposed to this conflict, of course because of its geographical position but also because of its political involvement. Although the markets appear to have put this issue on the back burner, the greater the market reaction may be in the event of any escalation or de-escalation.

In the event of any peace agreement changing the status quo, the details of the agreement would matter considerably. On the one hand, a loss of US support and an end to the conflict could be read by the market as a promise of further escalation later in the direction of the Baltic countries, Moldova, etc.

In such a scenario, Poland comes to the attention of the markets due to its closest proximity to the conflict and greatest political involvement in supporting Ukraine. Moreover, we have some indication from the past two years that PLN is the most exposed currency in the CEE region. At the same time, in our experience, we have seen particularly among US clients an aversion to PLN assets over the past two years due to this risk, which may partly explain the significantly lower foreign holdings in POLGBs relative to CEE peers.

However, if an end to the conflict were linked to a permanent resolution of the situation, we see the Ukraine Reconstruction Project as a wild card for the region, in which Poland and the Czech Republic are the most engaged within the region, promising a large volume of investment and orders for local industry and construction. This could give a significant boost to the so far weak economic recovery in the CEE region, but also push inflation higher and keep policy rates higher, supporting stronger FX.

TRY looks more shielded, ZAR still sensitive to global trade

In our view, Turkey remains the lowest dollar beta currency in this region within our scenarios and should remain isolated from these events, focusing on a strong local story with the start of the central bank's cutting cycle and double-digit inflation. Although the US-Turkey relationship was strained at the start of Trump's first term, there was a later calming. At the same time, in recent years we have seen efforts to improve relations from both sides, which we expect to continue regardless of the outcome of the US presidential election, however, without meaningful impact on markets.

Given South Africa's heavy trade ties with China, we would again expect the rand to be hit were a new US administration to take Chinese protectionism to a new level. Equally, universal tariffs and what they would mean for global trade and emerging market growth would be bad news for the high beta rand.

Asia EM: China to resist depreciation pressure

Market focus will undoubtedly be on the risks to its biggest exposure in the region – China. Yet it is worth considering what other risks the rest of Asia faces, and if there will be any insulation following the China plus one supply chain adjustments that have already been made.

A stable yuan should remain Beijing's priority

We address the broad channels through which Asian FX will be affected below, but the primary focus here has to be what happens to USD/CNY? A case can be made that some combination of an aggressive tariff regime and stronger US growth/higher rates under any Trump administration would be a clear catalyst for a repeat of the step CNY depreciations seen in 2019.

However, we hold to the view that Beijing is playing the long game when it comes to FX and it will not allow CNY depreciation to damage the objective of renminbi internationalisation. Here Beijing will be welcoming recent data which shows that the use of the renminbi in China's inbound and outbound transactions has risen a third to just over 50% over the past three years.

We struggle to see USD/CNY above 7.30/7.35 under any of our three scenarios and would expect Chinese authorities to again use the counter-cyclical factor on their onshore USD/CNY fixing and CNH liquidity drains as tools to fight intense CNY depreciation pressure.

Could Harris turn more lenient on China?

And, alternatively, most in the market have assumed that a President Harris would continue the Democratic status quo. Perhaps we should not price out the possibility of a Harris administration deviating from the tariff stance, given Harris and Walz have both previously expressed disapproval of tariff policy. It is not a mainstream scenario, but if that is actually how they both feel, perhaps we should not rule out a different China approach if they win. Needless to say, such a switch could trigger a sizable CNY recovery.

One important point to make is that it may not just be China that comes into the firing line in the event that we see a re-run of the trade wars that epitomised the Trump administration. Since investments have switched from China to other countries, so too have bilateral surpluses with the US. The largest of these could well see their trading status with the US challenged and may also come under additional scrutiny from currency manipulation, which was a tool employed previously.

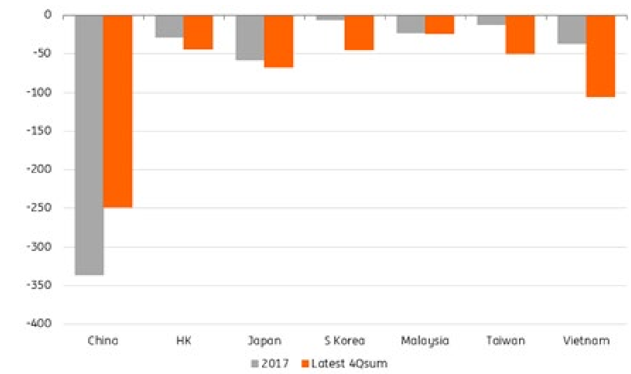
Since 2017, the first full year of the last Trump presidency, we have seen the impact of his and the subsequent administration's trade war and sanctions on the US bilateral deficit with China, which has shrunk by about US$87bn on an annual basis. Bilateral deficits with other Asian countries have, however, risen by more than double that amount, with Vietnam seeing one of the biggest swings in absolute and percentage terms, and South Korea and Taiwan also seeing their surplus positions with the US expand substantially.

US retaliation may include currency manipulation charges

Large surpluses of this nature could act as a target for retaliatory measures or charges of currency manipulation. In the case of Korea and Taiwan, much of the surplus will come from semiconductors, and one has to wonder if these inputs get specifically targeted in some way, which could also affect all of the large electronics-driven economies and currencies of the region – which is most of them, with the exception of the INR and IDR.

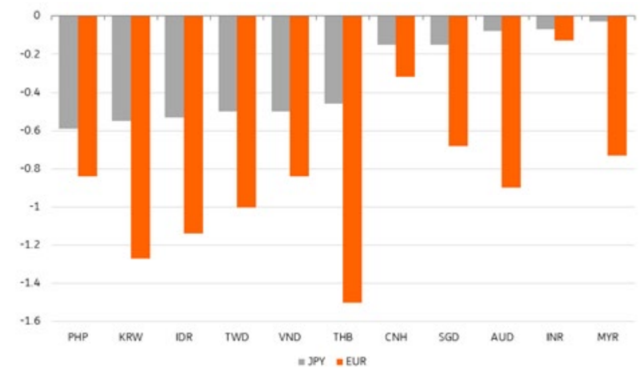
The US Treasury is carefully monitoring these developments and pronounces currency manipulation through its semi-annual FX report. In its last report in June, the Treasury identified Vietnam, Taiwan and Japan falling foul on two of its three criteria to assess currency manipulation. South Korea on just one. Most of these players (China and Vietnam excepted) are staunch US allies and retaliation seems unlikely to be a factor except under a Trump administration where traditional allegiances have taken second order with respect to more mercantilist considerations.

Asia's bilateral surpluses with the US ($bn)



Source: Macrobond, ING

APAC's year-to-date correlations with EUR/$ and $/JPY



Source: Macrobond, ING

China-Philippines friction could be under-appreciated

While it gets less airplay than some of the other APAC regional geopolitical issues, the growing friction between the Philippines and China is a source of potential currency instability that is worth considering. China continues to flex its muscles in the South China Sea in areas internationally recognised as being in the Philippines' sphere of influence, and the degree to which this is occurring appears to be growing.

Further escalation of this friction could see the PHP coming under downward pressure compared to its reginal peers. It is not clear that either one of the election scenarios considered will be more or less likely to result in further escalation, though it may not be unreasonable to consider the US role of international policeman in the South China sea as a less likely deterrent under a Trump administration with the America First approach reducing the incentive to provide a safety umbrella further afield. It could also see FX weakness in other currencies with similar territorial disputes at play – namely the IDR, and VND.

Cyclical considerations

Much of the movement we expect from Asian FX in the months ahead will have more to do with international factors than anything local and, in particular, how policy in the US and elsewhere develops, and what it does to FX benchmarks like EUR/USD.

That said, it's not all about the USD these days, and key local currencies, the JPY and CNY can have substantial impacts locally, which also need to be taken into account.

Broad movements in the USD as proxied by EUR/USD are often heavily reflected in local Asian FX swings. The THB has a particularly high volatility to USD swings, but the KRW and IDR are not too far behind. In addition, the MYR tends to track the CNY very closely, so unilateral CNY strength/weakness will be rapidly and fully reflected in the MYR. The PHP has also had the highest daily beta with respect to the JPY in 2024 and, if that continues, any large volatility swing resulting from BoJ normalisation could cause the PHP as well as some of the North Asian currencies to fly.

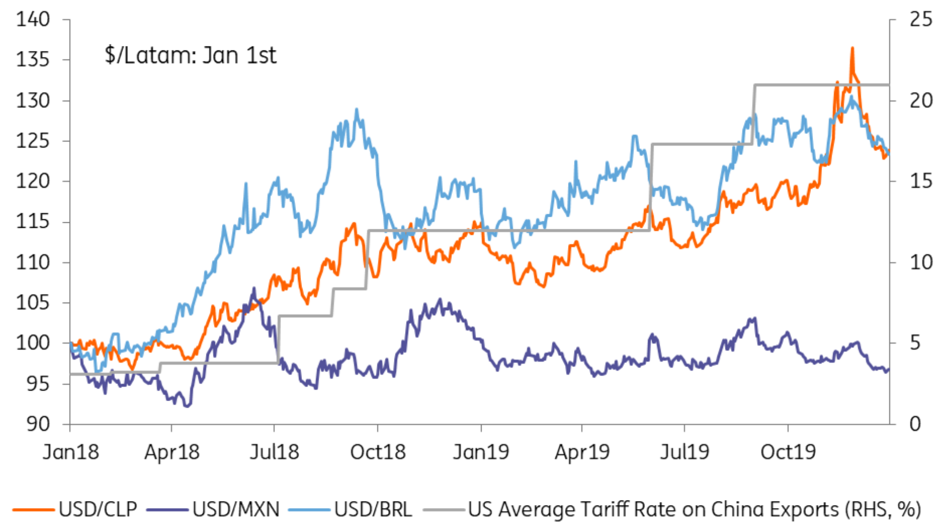
Latam: Trade, rates and local politics all in play

Trade channel looks the more dangerous under Trump

Notwithstanding the current woes being suffered by the currencies of Mexico and Brazil, US elections in November could have far-reaching implications for Latam. The trade channel looks the most dangerous one under a Trump administration, while a Democrat presidency probably presents the most benign external environment for the region.

On the trade side, the performance of our three tracked currencies – Mexico's peso (MXN), Brazil's real (BRL) and Chile's peso (CLP) – proved instructive during peak Trump trade war (2018-19). Notably the BRL was hit the hardest, closely followed by Chile. MXN losses were reasonably contained.

USD/Latam performance during Trump's trade war with China



Source: Refinitiv, ING

This performance can be rationalised by Chile and Brazil having, respectively, thirteen and six times as much as Mexico in terms of trade share with China. One can argue that if any Trump administration's battle in 2025 is primarily with China – then the CLP and the BRL would again underperform.

Universal tariffs can hit MXN hard

But if any Trump administration's trade battle is with the world in general, the MXN could be very vulnerable indeed. Implementation of 10% universal tariffs would leave Mexico exposed given its exports to the US represent a huge 26% of GDP. Equally, any Trump administration would likely employ maximum leverage on Mexico in the run-up to the first review of the USMCA trade agreement in July 2026. Trump's trade team inserted such a review into the agreement for that very reason.

BRL most vulnerable to potentially higher US rates

When it comes to the US domestic policy channel – again any Trump administration would pose the most risk for Latam. The stronger dollar and higher US interest rates would stress test debt trajectories across Latam. Even though it has proportionally the least FX debt of the three, Brazil would be the most vulnerable. Not only is Brazil's sovereign rating three notches below Mexico (BB versus BBB), but it has the lowest share of long-term fixed rate debt of the three and a worrying 44% of government debt on floating rates. Higher US rates would inevitably feed into higher local interest rates in Brazil and only add to Brazil's fiscal woes.

Equally, any Trump administration's efforts to re-orient the auto industry towards combustion engines and away from electric vehicles would hit Chile's main export, copper. The metal is heavily used in electric motors, batteries and wiring.

Domestic politics will remain very relevant in Latam

When it comes to politics, Latam domestic developments will probably play as much, if not more, of a role than developments in Washington. After a landslide win in June, the Mexican Morena party are trying to push through some very non-market-friendly constitutional reforms. This is driving unwelcome volatility in Mexican asset markets and undermining the peso's appeal in the carry trade.

In Brazil, President Lula faces elections in October 2026. Fiscal restraint in 2025 could therefore prove challenging and would super-charge debt concerns were US rates to be on the rise, as we discuss above. In Chile, President Boric faces elections in December 2025. Market fears over his left-wing administration have so far failed to materialise, but we are concerned that Chile's FX reserves have struggled to recover from the beating they took in 2022.

Focus piece
US deficit concerns and the dollar

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One of the hottest election topics being raised by both our customers and traders is whether the lack of political will to address fiscal consolidation will lead to a US debt crisis. Here we ask Padhraic Garvey what he thinks.

There are two main types of bond market crises. The most severe is the lead up to a default – an actual or conjectured 'failure to pay' crisis. That's characterised by prices for all bond maturities falling to a level consistent with a likely recovery value. If that were, say, 25% of par value. Here, the yield curve would invert severely from the front end, becoming practically meaningless, as the key factor would be an 75% loss in redemption value, and an imminent default on coupon and/or principal payments. That would be end-of-the-world-type-stuff if the hypothesised market were to be US Treasuries. Thankfully, nothing like that is probable, given what we know.

There is a milder but related risk – a missed payment. The US in fact frequently runs that gauntlet as suspension of the debt ceiling ends, which if not re-negotiated in time, could result in monies not being available to make good on bond payments due. It's never happened, but if it did, it would be a technical default. If it did happen, in all probability the bond holder would ultimately be made whole. But it would still class as a tarnishing default, even if there were to be no lasting contamination to other bond payment obligations. Currently, the debt ceiling is suspended until 1 January 2025; something to watch then through 2025.

If you like, the above two are at opposite ends of the spectrum of default risk. One is severe – a complete default. The other is milder – a technical default on a payment or two that is ultimately made good. There is, however, another bond market risk, one that we run every day – the risk of a crisis of confidence on Treasuries. Here, there is a general belief that the par amount due at redemption is expected to be paid, but there is an uncomfortable element of fear that it might not be, even if that probability is quite low. At the margin that will manifest in the marginal player selling Treasuries, pushing down prices and pushing up yields. Its severity depends on circumstances.

Right now, we have a real and present danger for US Treasuries in the guise of issuance pressure. The US has been running a fiscal deficit of some 6% of GDP since the pandemic. Even in the immediate years leading up to the pandemic, the deficit had risen from around 3% to 5% of GDP. Looking beyond the November elections there is little prospect, given what we know from the candidates, for a magical policy solution to reduce the deficit. That leaves the US Treasury under pressure to continue to hit the market with record levels of issuance, every month, without any let-up. So far, the fiscal pressure has not caused significant issue. But that can change in a heartbeat.

At any point the market could decide it doesn't want to take down new bonds at secondary market levels. Frequently in recent months, bond auctions have tailed, meaning that the price at auction has been below the when-issued market levels. However, these tails, barring a few exceptions, have been relatively mild. And, moreover, have been separated by some very good auctions, where pricing is exceptionally strong. There is a risk that the market decides to input persistent tails, meaning that auction events act to ratchet up yields in a persistent manner. This would be unusual, but far from improbable. It would be seen as a slow creep concession, pushing yields higher.

Then there's the risk that the market decides, enough with the drift higher, and an exodus of demand acts to drive bond yields dramatically higher as a real crisis of confidence takes hold. Here, the scenario could revolve around, say, the 10yr Treasury yield rising by 10bp, then 20bp and then 50bp. And before we know it, it's up by a full 1% before settling. It's rare for such an outcome to occur without other ancillary factors pushing in the same direction. But at the same time, the complacency being shown by the market to date on the size of the deficit is remarkable. If there were to be a reaction in the other direction, hindsight could quickly uncover an inevitability to such a move.

Key events to be aware of here include the quarterly re-funding announcements. These are typically preceded by the budgetary estimates of spending needs and fiscal receipts. Often the Treasury will cater for temporary extra needs through additional bills issuance, as they did for example when the pandemic hit. But for more structural overspends, the bond programme would require adjusting upwards. Note that latest quarterly re-funding is running at around US$1.1tr. That compares with closer to US$0.5tr in 2016, the last time the fiscal deficit was running at around 3% of GDP (before the Trump tax cuts). If that were to push on towards US$1.5tr there would be enough pressure for the Treasury market to bolt in a significant fashion. The baseline view is that re-funding amounts have broadly peaked as a proportion of the economy. Negation of that in an upward fashion would be bad.

Padhraic Garvey

When it comes to FX implications of a US debt crisis, I can only remember one very brief period over the past twenty years when US bond yields spiked higher and USD/JPY sold off. While it is tempting to think of a 'Sell America' view taking hold, I suspect that, in any of the extreme outcomes Padhraic outlines above, the dire implications for the global financial system would dominate.

Here the dollar would initially be pushed to the extreme end of its 'smile curve' and appreciate sharply – in line with a likely spike in demand for dollar funding through the cross-currency swap market. Only after policymakers had addressed these challenges – likely through some combination of US Treasury and the Fed emergency measures – would the dollar fall back to earth.

Chris Turner

Focus piece

Weak dollar policy: Does it matter?

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Donald Trump's July comments that the US 'has a big currency problem' put the issue of Washington's dollar policy back on the agenda. His comments targeted the undervalued Japanese yen and Chinese renminbi. We published a Q&A on those comments back in July, but here we provide some brief context on what a 'weak dollar policy' actually means and argue that whatever policy is chosen, it will likely take a back seat to the US monetary/fiscal mix in determining the dollar's value.

Having experimented with weak dollar policy early in his tenure, President Bill Clinton appointed a new Treasury Secretary, Robert Rubin, early in 1995. Having failed to prise open the Japanese auto-part market in the early 1990s with a weak dollar, Robert Rubin changed his administration's tack and introduced the strong dollar policy. At the same time as G7 central bankers agreed on the need for an 'orderly reversal' of exchange rates which had overshot fundamentals. The strong dollar policy was in effect the US Treasury Secretary saying that a 'strong dollar was in the nation's interests.'

Back in 1995, there was broad agreement among G7 central bankers and finance ministers that communiques were major market drivers. That is no longer the case today and the most recent G7 communique's FX language (May this year) refers to an agreement reached in Italy in May 2017, where all participants agreed on avoiding using exchange rates for competitive purposes. That is now the G7 and G20 default position on FX. Unless the US Treasury hijacks the G7/G20 communique – we believe that happened back in 2003 – it seems unlikely that all G7 parties will agree on the need for a weaker dollar. For example, we cannot see the ECB signing up for a weaker dollar when the trade-weighted euro is already on multi-decade highs.

The dollar is not an issue for the US Democrats, where current Treasury Secretary Janet Yellen has taken a firm line that exchange rates are best set by the markets. And for any Trump administration, instead of powerful joint G7 communiques, any action against the dollar will have to be taken unilaterally.

During his Presidency, Donald Trump pushed back against calls to weaken the dollar in 2019 through intervention. And occasionally other Republican Treasury Secretaries during the George W Bush era had toyed with less than fulsome support for a strong dollar.

Instead, we suspect any Trump administration looking to support the US manufacturing would address any FX concerns through tariffs. That is what happened in August 2019, when the US Treasury brushed aside its rule book and named China a currency manipulator on the day Chinese authorities had allowed USD/CNY to gap above 7.00.

Looking back at events this July, the reason Trump's comments resonated with FX markets was because the US cycle looked to be turning. Inflation was becoming more orderly, unemployment was rising and the Fed looked ready to cut.

Our call here is that any Trump administration's dollar policy would take a back seat to the domestic fiscal/monetary mix. Loose fiscal and tighter monetary policy would see the dollar higher under a 'Clean Sweep' scenario, whatever the Treasury was saying about FX. Equally, were any Trump administration to lack the ability to pass tax cuts and the economy to prove fragile, pressure on the Fed to cut rates and calls for a weaker dollar would likely make more of an impression.

Focus piece

What the US election may mean for the global role of the US dollar

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Global role of the US: Declining in trade, growing in debt

We make several observations regarding the global role of US (see table below) to date. Looking at trade flows, the US share has been stable since 2008, largely thanks to persistently high importance for the trade turnover in the Americas (which is 90%+ US dollar-based), while distancing from China was offset by a higher US role in the EU's foreign trade. Financial flows, on the other hand, are suggesting that the US external debt has been outperforming since 2008, aided by public sector borrowing. Also worth mentioning, the elevated importance of the Fed balance sheet in the aftermath of the Global Financial Crisis.

Evolution of US global role, adjusted for FX revaluation effect

	2000	2004	2008	2012	2016	2020	2024*
Global trade turnover	14.4%	12.9%	11.3%	10.6%	10.9%	10.8%	10.8%
Foreign trade of the Americas**	61.2%	56.7%	45.9%	44.2%	44.7%	45.3%	45.1%
Foreign trade of China**	17.0%	16.3%	14.0%	13.0%	14.3%	11.7%	10.2%
Foreign trade of EU**	7.5%	5.9%	5.0%	5.2%	6.1%	6.2%	6.5%
Global gross external debt***	20.3%	18.7%	17.9%	17.7%	19.0%	19.6%	20.9%
Assets of top-25 central banks	16.0%	15.0%	20.0%	18.1%	19.4%	21.4%	20.7%
Memorandum items							
Fed rate (upper bound), e.o.p.	6.50%	2.25%	0.25%	0.25%	0.75%	0.25%	5.50%
EURUSD rate, e.o.p.	0.94	1.36	1.40	1.32	1.05	1.22	1.11

* Latest available data of 2023-24; ** Regional foreign trade not adjusted for FX revaluation; *** including intra-Eurozone external debt
Source: IMF, WB, BIS, SWIFT, UST, US Fed, ECB, Refinitiv, ING

Given the growing role of geopolitics, the recent BRICS expansion to the Middle East (taking the bloc from five countries to ten) is commonly seen as a challenge to US dominance. This may seem true in terms of trade flows. Assuming Azerbaijan's recent bid will be accepted, the BRICS+ account for around 21% of the global trade. This share has been stable since early 2010s, but the geography has shifted from developed markets in favour of trade between the member countries and particularly with other emerging markets (the role of BRICS+ in their foreign trade gained 5ppt to 31%). The BRICS+ role in emerging market fuel trade shot up from 26% to 37%. Meanwhile, the informal bloc's importance in financial flows is growing but is still limited, as core BRICS' external debt is just 6% of the world total. In terms of global macro, BRICS' seems to be competing with the US for the emerging market segment, rather than the world.

A potential Trump administration, depending on the actual policy mix, may to some extent, further reduce the US involvement in global trade, making it more focused on the close neighbours in the Americas. In the meantime, if the fiscal policy proves generous (most likely from the tax side) and the appetite for borrowing persists, the trend for US external debt growth may continue. Provided monetary policy remains orthodox, the US Fed will have to keep policy rates elevated and avoid strong moves in its balance sheet relative to global trends.

Global role of the US dollar: Beyond geopolitics

The topic of 'de-dollarisation' has been highly politicised in recent years, with some observers linking it to deteriorating foreign relations between the US and some of its counterparts, including trade wars and weaponisation of the dollar through sanctions. While not denying the geopolitical dimension, we think the evolution of the US dollar's role since the early-2000s deserves a more nuanced view.

Looking at the various indicators of the US dollar usage in the long run (see table below), we make several observations. First, the trends in various segments are diverse, and a sustained de-dollarisation compared to the early-2000s is evident only in central bank reserves and FX markets – in both cases from an extremely high base and with a noticeable decline first seen after the GFC of 2008 amid falling core rates and elevated exchange rate volatility. The recent de-dollarisation and de-offshorisation of international bank lending represents a return to levels of the early-2000s after a spike in 2012-16, although geopolitics (BRICS expansion, wider US sanctions) may have played a role.

Second, a post-GFC re-dollarisation of international bond market is evident, which correlates well with the outperformance of US external debt volume growth we discussed earlier. Moreover, the recent increase in the USD interest rates after a long near-zero period seems to have restored the global market's appetite for dollar-linked interest rate derivatives and liabilities in general.

The third observation is that usage of the US dollar remains outsized compared to the role of the US in the global economy, suggesting a still large portion of USD dealings not involving US residents. This is largely due to the historical outline of the financial infrastructure, which has seen a great deal of inertia.

Evolution of US dollar's share by segment, adjusted for FX revaluation effect

	2000	2004	2008	2012	2016	2020	2024*
Central banks' FX reserves	70.4%	71.2%	69.6%	67.4%	65.7%	62.5%	58.9%
Cross-border bank claims	46.9%	48.2%	48.5%	49.5%	51.2%	48.9%	46.6%
*Offshore**, % of USD-denominated claims*	*43.0%*	*42.9%*	*37.8%*	*43.6%*	*52.9%*	*48.7%*	*44.1%*
International debt securities	45.3%	40.3%	35.8%	39.9%	46.6%	48.1%	46.9%
Interest rate derivatives (notional)	61.5%	59.2%	51.9%	46.5%	77.5%	62.2%	67.4%
OTC IR derivatives (market value)	31.0%	30.5%	57.0%	35.5%	21.8%	24.4%	27.2%
OTC FX derivatives (market value)***	88.4%	99.0%	92.9%	88.8%	89.1%	88.4%	81.5%
SWIFT transactions					43.0%	41.6%	47.2%
...in trade finance					86.0%	87.4%	84.1%

* Latest available data of 2023-24; ** Offshore means none of the counterparts are US residents; *** FX pairs with USD in one of two sides. 100% means all FX derivatives have USD in one of the sides;
Source: IMF, WB, BIS, SWIFT, Refinitiv, ING

Overall, the period of 2016-20, Trump's first term, doesn't appear to be pivotal for most of the dollarisation indicators, especially when put into a longer-term perspective. As for the prospects, barring a massive geopolitical or credit rating event (not our base case), a Trump 2.0 would be largely supportive of existing trends. The trade-related USD flows are likely to continue gradually giving way to other currencies – higher competition from BRICS+ for emerging market trade turnover should be seen as a watch factor here. Meanwhile, the growing supply of US external debt amid elevated rates should support the global interest to usage of USD as currency of assets and liabilities. The Fed balance sheet is likely to remain a factor to watch, especially for the derivatives market.

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