



What's next for the USD?

Global Markets Research

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Global Markets Research

Author



Lee Hardman

Senior Currency Analyst
London

Lee.Hardman@uk.mufg.jp
(+44) 20 7577 1968



Derek Halpenny

Head of Research, Global Markets
EMEA & International Securities,
Global Markets Division for EMEA

Derek.Halpenny@uk.mufg.jp
(+44) 20 7577 1887



Abdul-Ahad Lockhart

Currency Analyst
London

Abdul-Ahad.Lockhart@uk.mufg.jp
(+44) 20 7577 1183

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Middle East Geopolitical Risks

USD | Geopolitical importance of Strait of Hormuz

It accounts for around 25% of total daily global oil transport

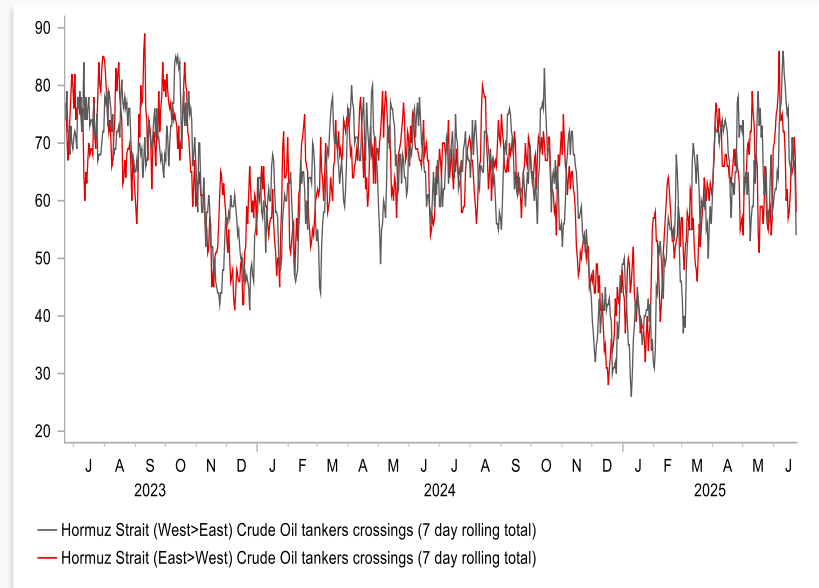
Tanker traffic has slowed over the past couple of weeks in response to geopolitical tensions

Petroleum flows from key global choke-points

Location (MMBbl/d)	2023
Strait of Homuz	20.9
Strait Malacca	23.7
Suez Canal & SUMED Pipeline	8.8
Bab el-Mandeb	8.6
Danish Straits	4.9
Turkish Straits	3.4
Panama Canal	2.1
Cape of Good Hope	6

World maritime oil trade	77.5
World total oil supply	101.9

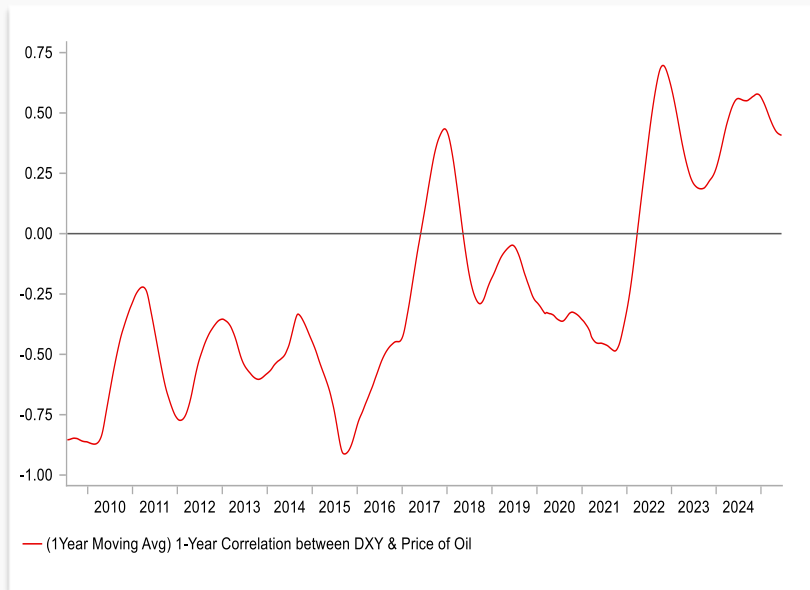
Crude oil tanker crossings



USD | Middle East tensions offering some support for USD

USD has become more positively correlated to price of oil over past decade

Correlation between USD & crude oil



Surplus of oil ($S > D$) is helping to dampen upside risks for price of oil

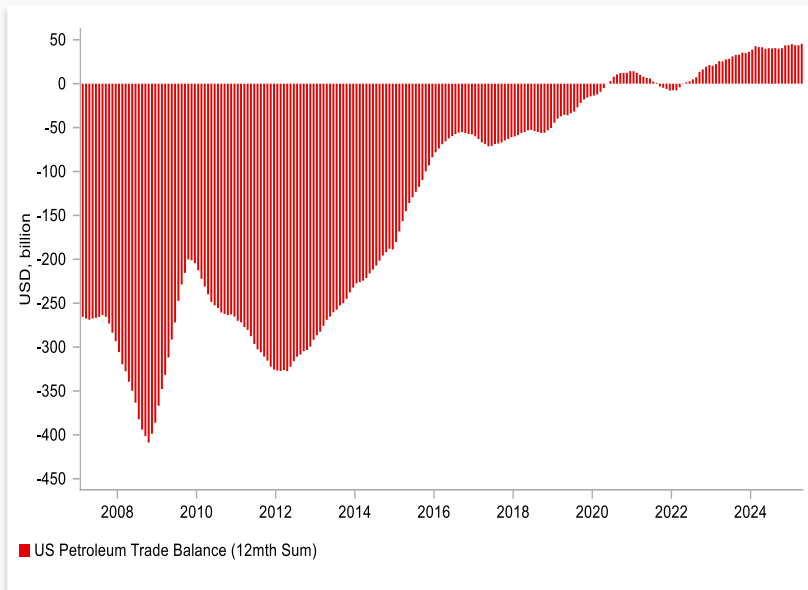
Average annual oil supply & demand growth



USD | US has become more self reliant for energy supply

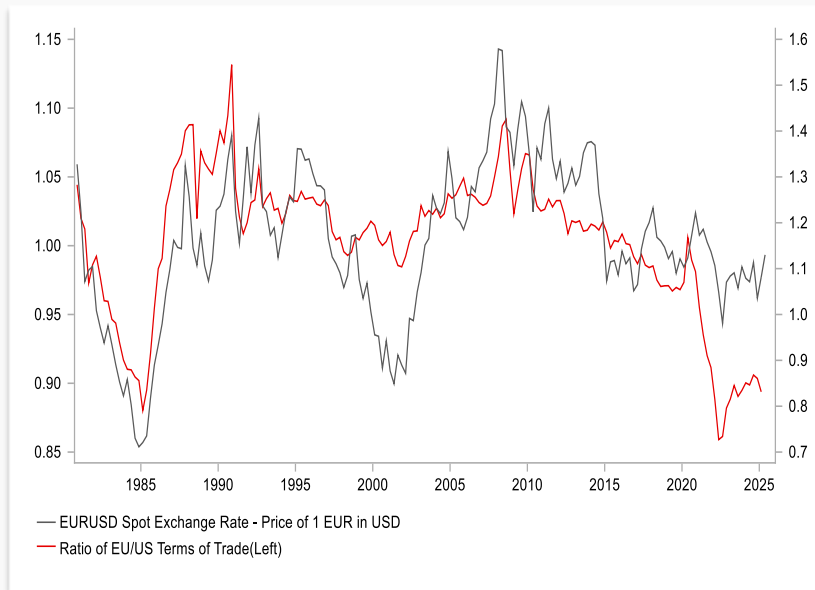
USD has become more positively correlated to price of oil over past decade

US petroleum trade balance



Negative energy price shock for US economy from Ukraine conflict was less than for RoW

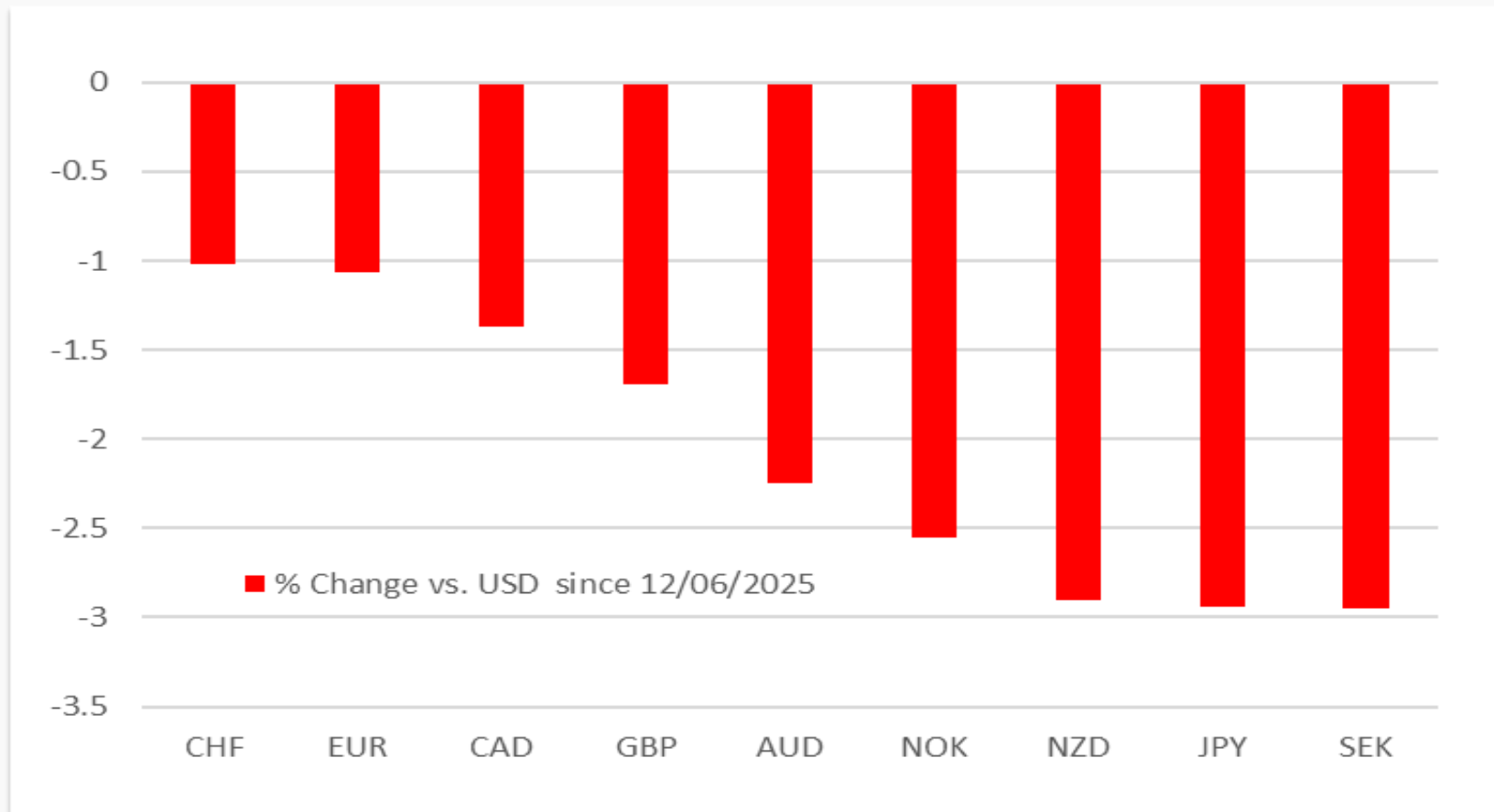
EUR/USD vs. ratio of EU/US terms of trade



USD | It has performed better than other safe havens of CHF & JPY so far

Middle East tensions have triggered broad-based USD rebound

G10 FX performance since Israel attacked Iran launching "Operation Rising Lion"



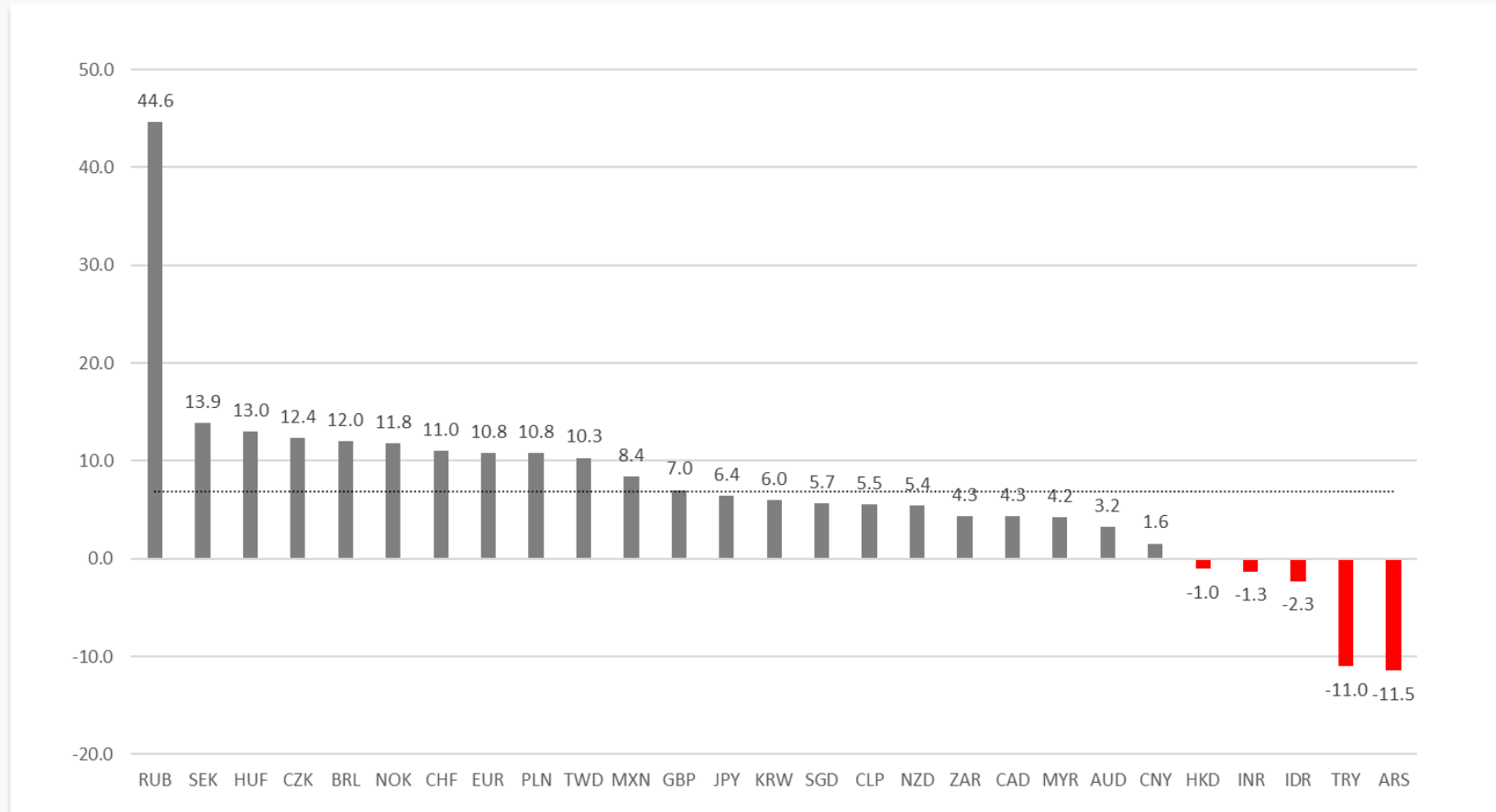
**USD Sell-off Year to
Date**



USD | Defying expectations to strengthen further at start of Trump's 2nd term

A broad-based and sharp USD sell-off

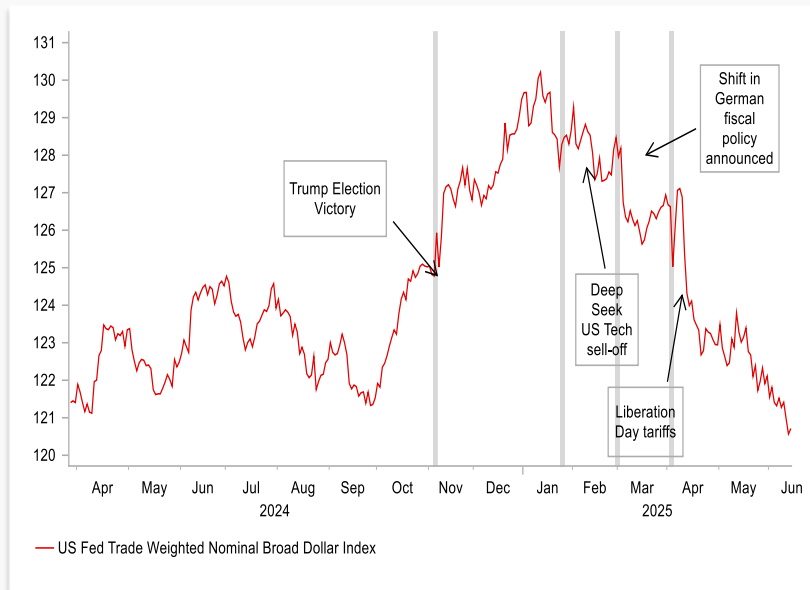
% Change vs. USD YTD



USD | Gains in run up & following US election have been fully reversed

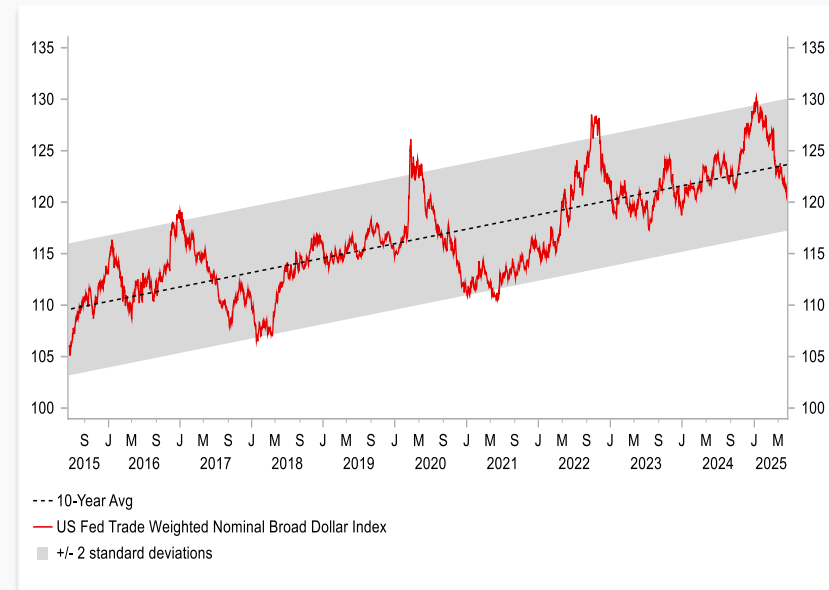
Full reversal of pre & post US election gains

Performance of Fed's TWI USD



A correction within the upward trend or start of new weaker trend?

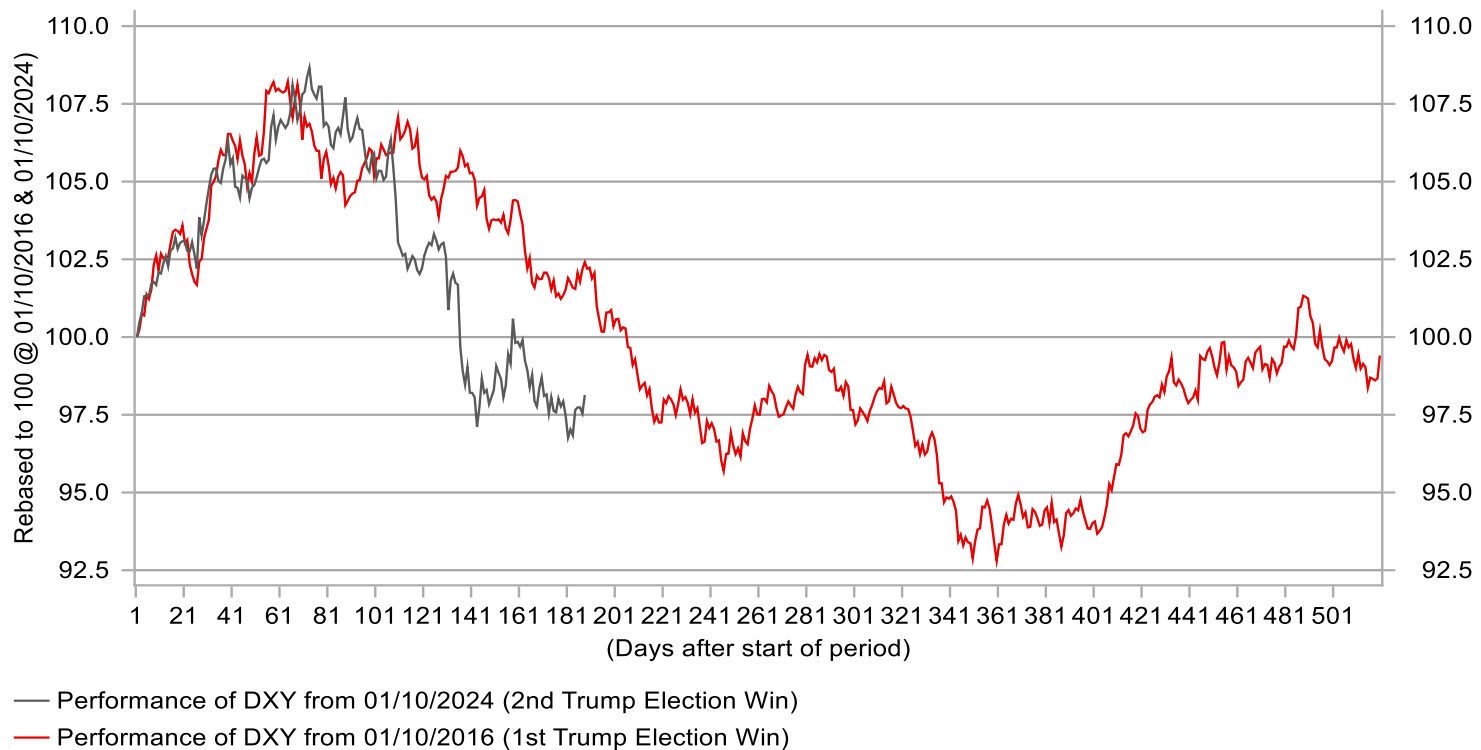
Fed's TWI vs. 10YR trend



USD | Weaker USD following similar path to during Trump's 1st term

USD weakened in first year of Trump's 1st term as well before rebounding in following years as trade war intensified

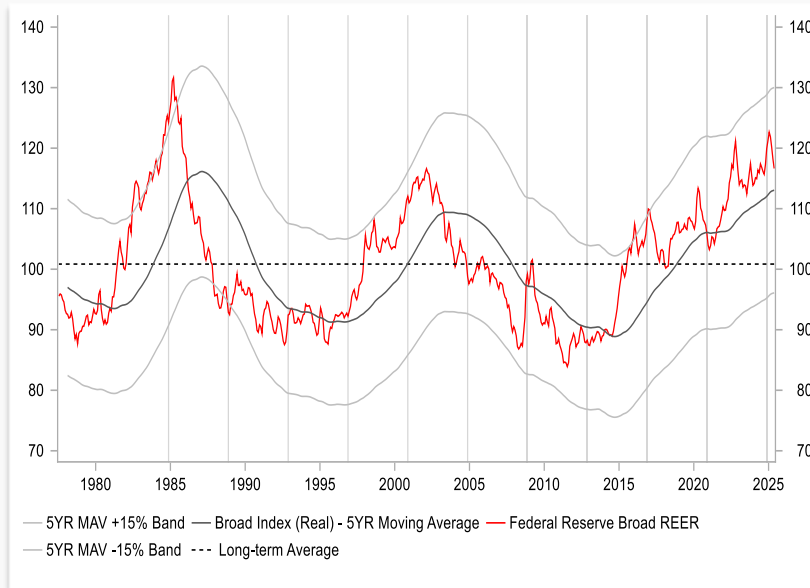
USD performance around Trump's 2 election victories



USD | Does Trump's 2nd term mark a long-term peak for USD?

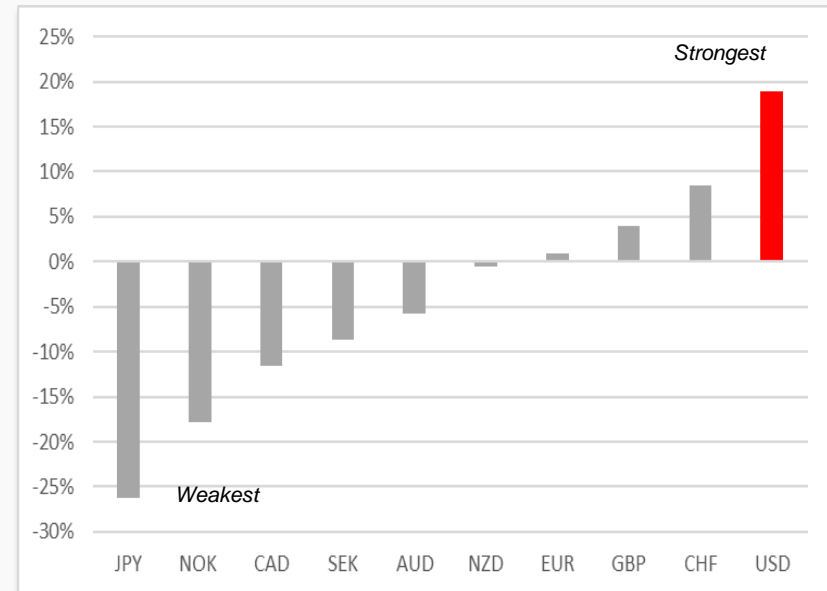
Strongest USD since mid-1980's at start of Trump's 2nd term

Real TWI USD vs. Rolling 5-Year Average



USD remains strong even after recent sell-off

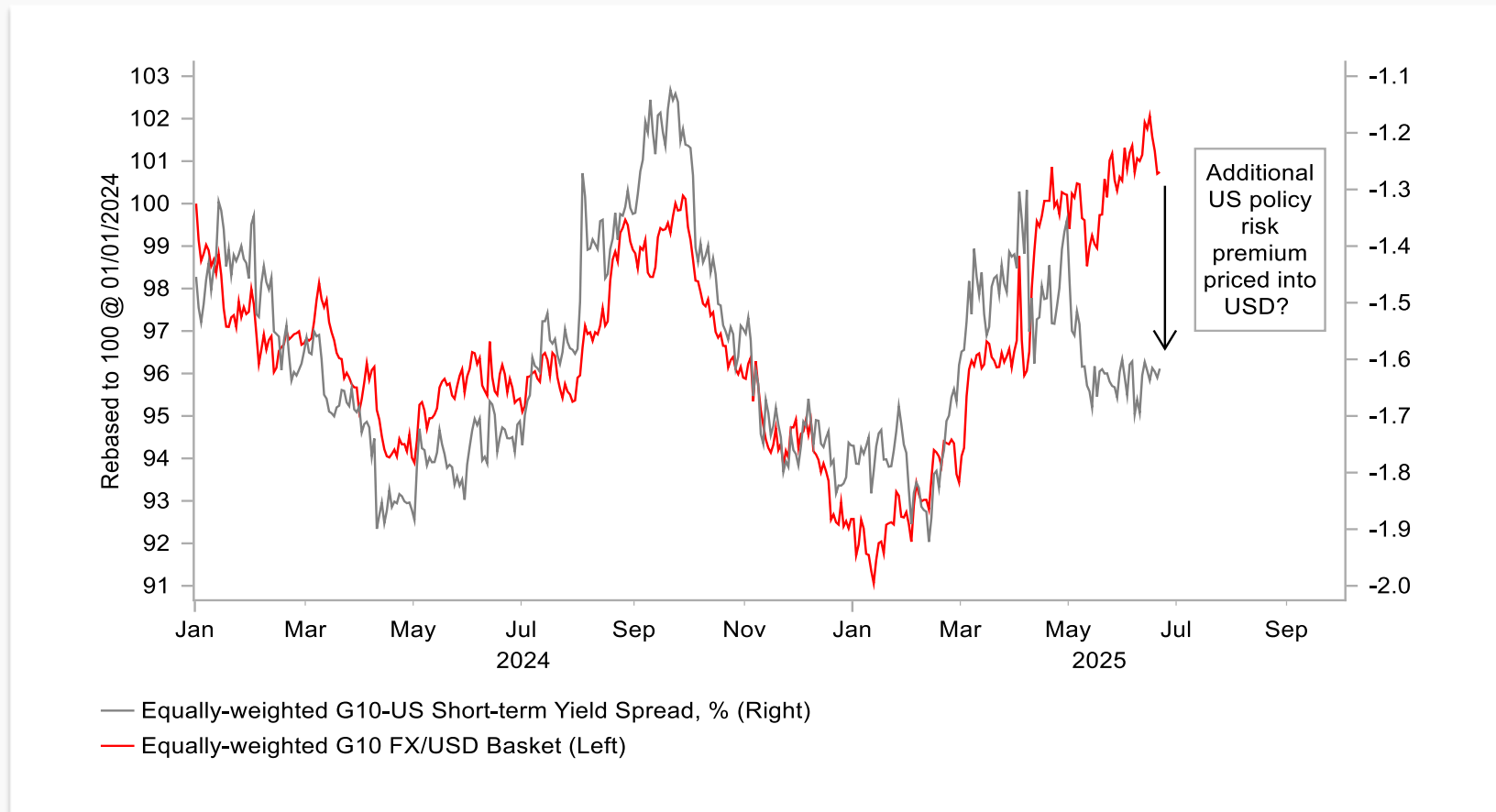
BIS Real Effective Broad Indices vs. 20YR Average (% deviations)



USD | Higher US policy risk premium priced into the USD?

USD has weakened more than implied by yield spreads since Liberation Day tariffs

G10 FX/USD performance vs short-term yield spreads



Tariff & Fed Policy Uncertainty

USD | Trump's tariffs have increased "stagflation" risks for US economy

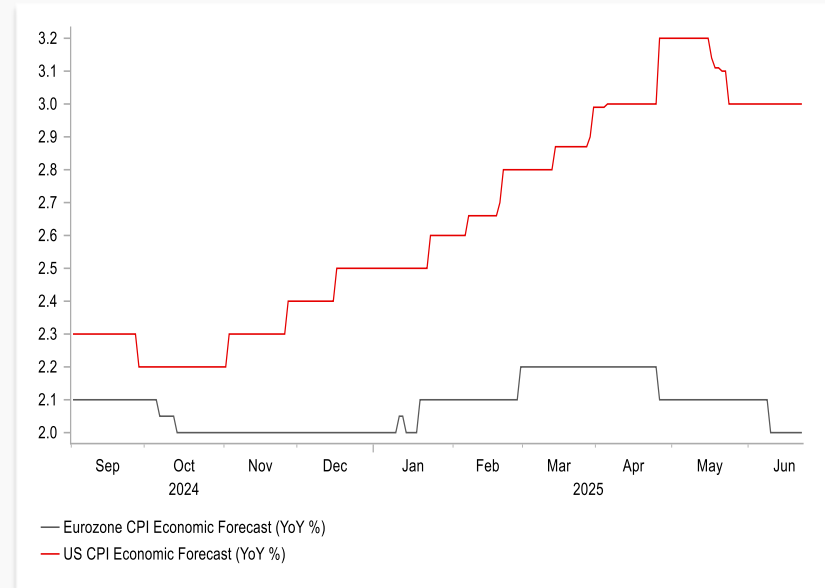
Biggest downward revisions for growth in US, Korea, Mexico, Canada & Japan

Evolution of OECD GDP Growth Forecasts for 2025

	OECD Forecasts for GDP Growth in 2025			Forecast Revisions	
	Set in Dec '24	Set in Mar '25	Set in Jun '25	Dec->Jun	Mar->Jun
India	6.9%	6.4%	6.3%	-0.6%	-0.1%
Indonesia	5.2%	4.9%	4.7%	-0.5%	-0.2%
China	4.7%	4.8%	4.7%	0.0%	-0.1%
Russia	1.1%	1.3%	1.0%	-0.1%	-0.3%
Brazil	2.3%	2.1%	2.1%	-0.2%	0.0%
Turkey	2.6%	3.1%	2.9%	0.3%	-0.2%
Spain	2.3%	2.6%	2.4%	0.1%	-0.2%
US	2.4%	2.2%	1.6%	-0.8%	-0.6%
Korea	2.1%	1.5%	1.0%	-1.1%	-0.5%
Mexico	1.2%	-1.3%	0.4%	-0.8%	1.7%
Canada	2.0%	0.7%	1.0%	-1.0%	0.3%
France	0.9%	0.8%	0.6%	-0.3%	-0.2%
Australia	1.9%	1.9%	1.8%	-0.1%	-0.1%
UK	1.7%	1.4%	1.3%	-0.4%	-0.1%
Italy	0.9%	0.7%	0.6%	-0.3%	-0.1%
Euro area	1.3%	1.0%	1.0%	-0.3%	0.0%
Japan	1.5%	1.1%	0.7%	-0.8%	-0.4%
Germany	0.7%	0.4%	0.4%	-0.3%	0.0%
Argentina	3.6%	5.7%	5.2%	1.6%	-0.5%

Tariffs are expected to lift inflation more in US

Bloomberg consensus forecasts for EZ & US CPI in 2025



USD | Mix of weaker growth & higher inflation complicates Fed policy



Fed signals in no rush to resume rate cuts at June FOMC meeting

Chair Powell emphasized that the Fed was “well positioned to wait to learn more before adjusting” policy. He expects to “learn more about tariffs over the summer”.

He also downplayed the widening divergence in opinion amongst FOMC participants. The updated DOT plot revealed that 7 participants favour leaving rates unchanged this year, 2 favour one 25bps rate cut, 8 favour 50bps of cuts and 2 favour 75bps of cuts.

It follows the downward revisions to GDP forecasts (1.4% for 2025 & 1.6% for 2026) and upward revisions to inflation forecasts (core PCE inflation at 3.1% for 2025 & 2.4% for 2026)

The Fed's reluctance to cut rates has drawn criticism from President Trump

“ADP NUMBER OUT!!! ‘Too Late’ Powell must now LOWER THE RATE”

- Truth Social post from 4th June 2025

“Go for a full point, Rocket Fuel!”

- Truth Social post from 6th June after NFP report released.

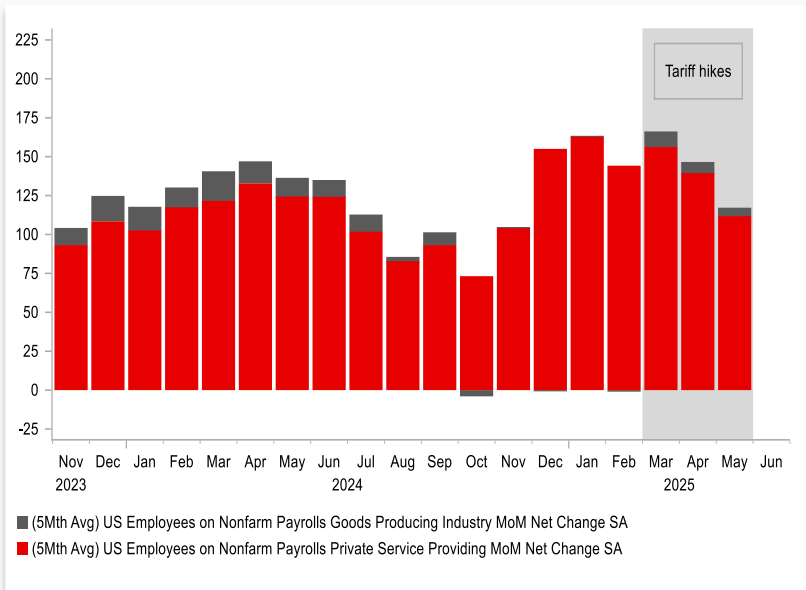
On 13th June 2025 he claimed that a 2ppt rate cut would save the US government USD600 billion annually “but we can’t get this guy to do it”.



USD | Fed waiting for evidence of looser labour market to resume cuts

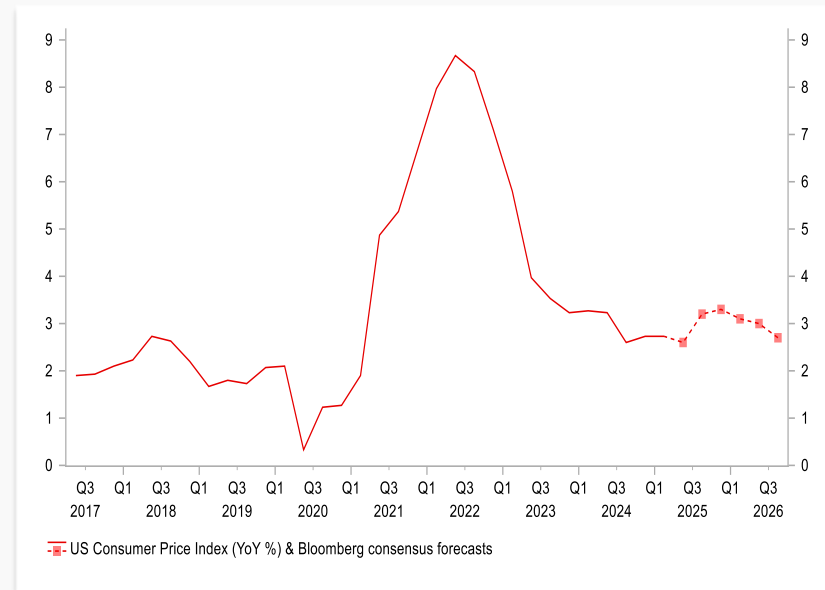
Slowing employment growth in response to trade disruption & policy uncertainty

Private Nonfarm Employment –Services vs. Goods



US inflation to move further above Fed's target this year

Bloomberg consensus forecasts for US CPI



USD | Threat to Fed's monetary policy independence

President Trump has dampened investor fears that he could try to fire Fed Chair Powell

"I have no intention of firing him. It's the perfect time to lower interest rates. If he doesn't, is it the end? No" Press briefing at Oval Office from 23rd April 2025

Can President Trump fire Fed Chair Powell if he wants to?

The Federal Reserve is an independent agency, and its leadership is protected by statutes that allow removal only "for cause" – typically defined as inefficiency, neglect of duty or malfeasance in office. The protection is rooted in legal precedents like: *Humphrey's Executor v. United States* (1935) which upheld limits on presidential removal power for independent agencies.

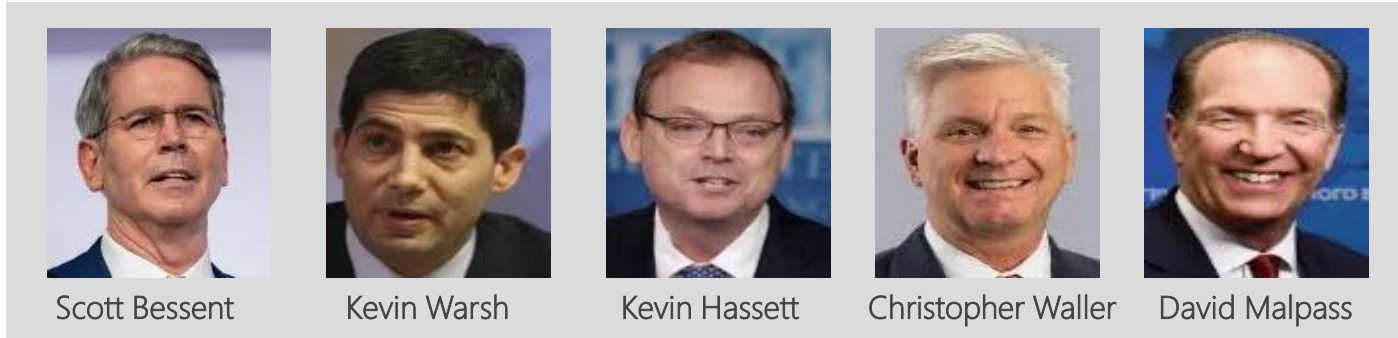
In recent ruling the US Supreme Court signalled that the Federal Reserve is uniquely structured and should be treated differently from other agencies suggesting that the president does not have the authority to remove the Fed Chair at will.

President Trump will be able to nominate the next Fed Chair when Jerome Powell's term ends on 15th May 2026

He told reporters on 6th June that he has considered successors for Powell, and an announcement is "coming out very soon" without naming any potential candidates. Putting in place a so-called shadow Fed Chair could further undermine confidence in the USD.

Downside risks would increase for the USD if Trump chooses a candidate who is judged as more of a "yes" man and more open to cutting rates than Fed Chair Powell.

USD | Potential candidates to be the next Fed Chair

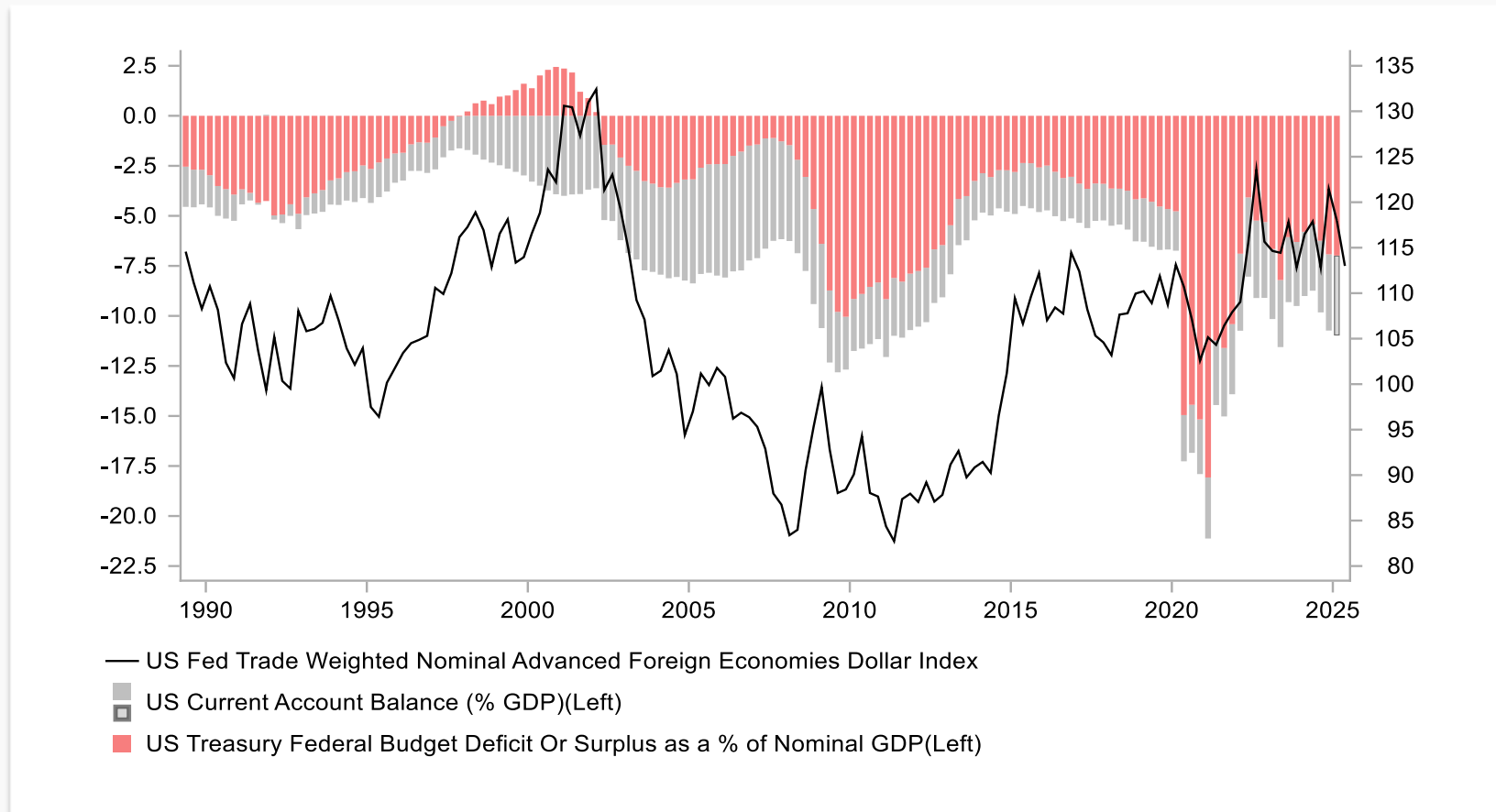


- US Treasury Secretary **Scott Bessent** and Director of the National Economic Council **Kevin Hassett** currently **hold important roles in the Trump administration**. Both are regarded as **credible figures within the Trump administration's economic team**.
- Former Fed Governor **Kevin Warsh** has been a **vocal critic of the Fed's balance sheet expansion** creating market distortions. He stated on 9th May 2025 that "**if the print press could be quiet, we could have lower policy rates**".
- Fed Governor **Christopher Waller** has just expressed support for cutting rates as soon as next month, He stated that "**we could do this as early as July**". "I think we've got room to bring it down, and then we can see what happens with inflation".
- Former President of the World Bank **David Malpass** **has publicly supported President Trump's calls for the Fed to cut rates**. He believes that the Fed is overly focused on backward-looking inflation data and **lower rates would help stimulate investment and job creation** in the face of global uncertainty.

USD | Trump administration is testing the “kindness of strangers”

Elevated US twin deficits have attracted more market attention

Trade-weighted USD vs US budget & current account deficits as a % of GDP

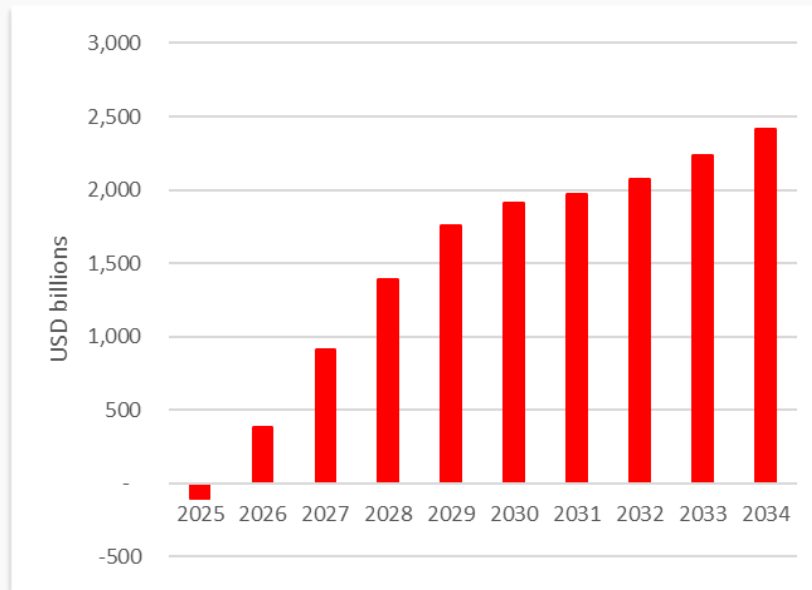


US Fiscal Policy Concerns

USD | “One Big Beautiful Bill” is reinforcing concerns over US twin deficits

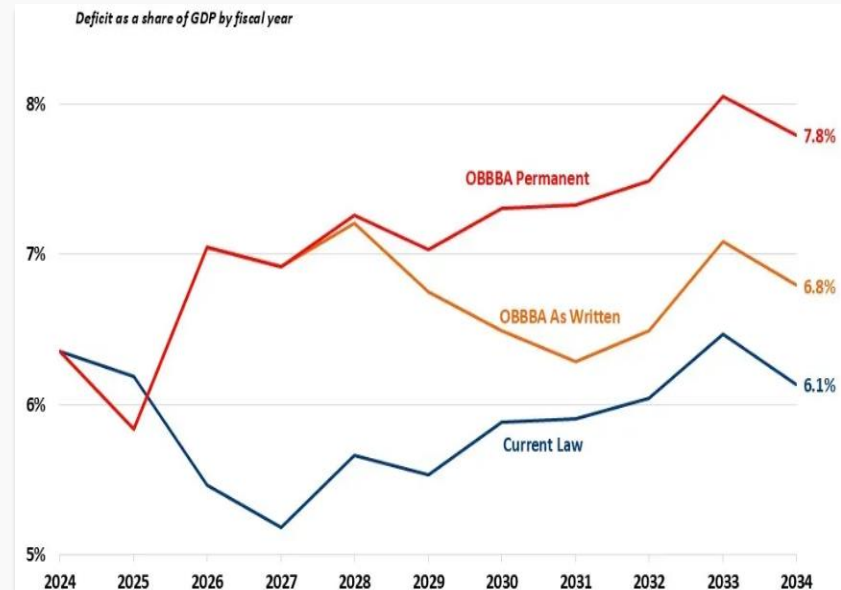
CBO estimates One Big Beautiful Bill in current form will add USD2.4 trillion to budget deficit

Estimated cumulative federal deficit caused by Bill



Budget deficit is expected to widen further over next 3-4 years

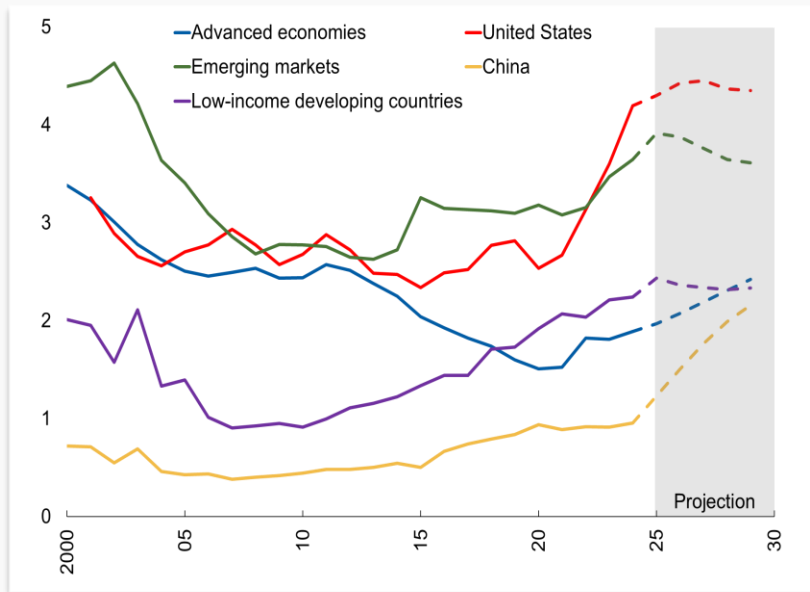
CRFB estimate for budget deficit as a % of GDP



USD | Higher yields & more debt lifting US debt servicing costs

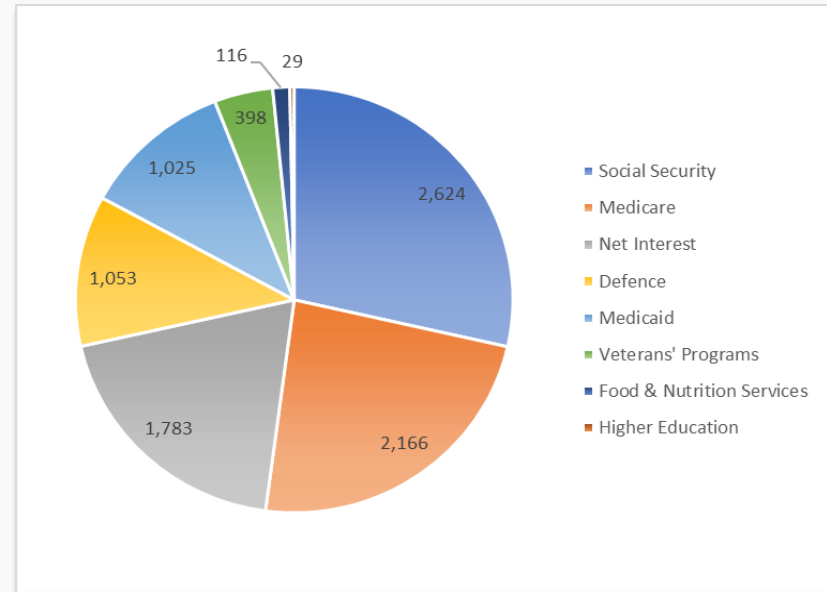
US debt costs are expected to remain elevated

General Government interest expenses, % of GDP



Cost of US debt servicing taking up bigger share of government expenditure

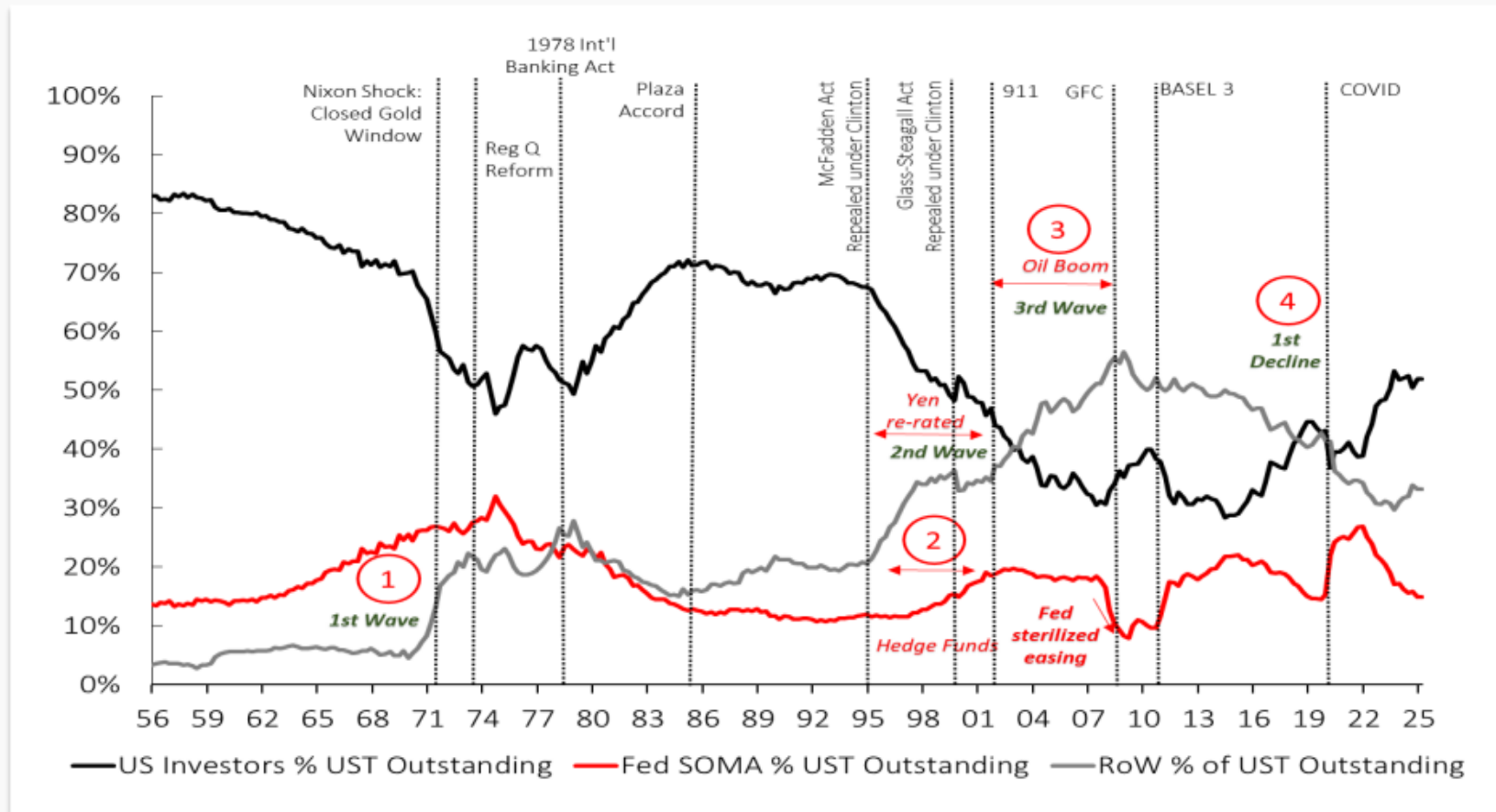
Estimated cost of key programs by 2035, USD bn



USD | Who will be buying all of the Us Treasuries issued to fund deficits?

Reliance on foreign investor demand has declined on a relative basis

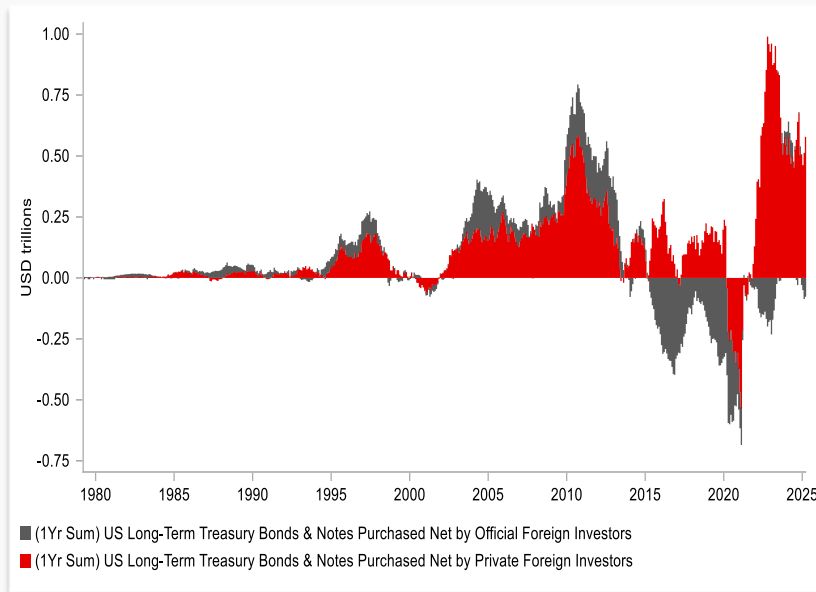
% Outstanding of UST held by US investors, Fed SOMA & ROW



USD | Private foreign investors have stepped up as official demand has dried up

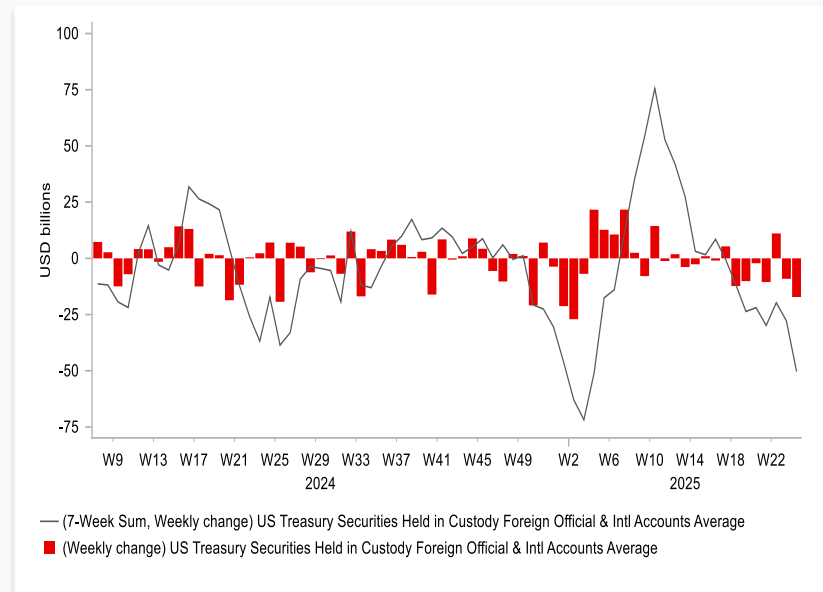
Private foreign investors have been buying while foreign official accounts have sold

US Treasury Bonds Purchased by Foreign Investors



Custody holdings of USTs have declined for 6 out of last 7 weeks

US Treasury securities held at the Fed for foreign official & international accounts



USD | Section 899 raises risk of capital war which could weaken USD (I)

What is Section 899?

The 2025 US House Budget Bill includes Section 899 which is titled “**Enforcement Remedies Against Unfair Foreign Taxes**” It would **target foreign countries that impose what the US deems to be “unfair foreign taxes”** on American businesses or individuals. Types of “unfair foreign taxes” include: i) **Digital Services Taxes**, ii) **Undertaxed Payment Rule Taxes**, and iii) **Diverted Profits Taxes**. Section 899 does not require presidential proclamation and would apply automatically to countries designated as imposing unfair taxes designated by the US Treasury.

Which Foreign Taxpayers could be affected?

Section 899 casts a wide net **targeting “applicable persons” of a discriminatory foreign country as well as foreign and domestic corporations that are controlled by residents of such countries**. The definition of application person includes: i) governments & government entities, ii) individual & corporate tax residents, iii) third-country corporations that are controlled by one or more residents of discriminatory foreign countries provided they are not “publicly held”, iv) private foundations, v) trusts for which majority of beneficial interests are held by applicable persons and v) other business entities. It would cover sovereign wealth funds and foreign central banks.

USD | Section 899 raises risk of capital war which could weaken USD (II)

Based on commonly understood definitions of unfair taxes, the following countries and their residents could face higher taxes from next year.

I) **Countries with digital service taxes** include Austria, Canada, France, Guinea, Italy, Nepal, Sierra Leone, Spain, Tunisia, Turkey, Uganda, United Kingdom, and Zimbabwe.

II) **Countries that have implemented UTPR taxes** include Australia, Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Lichtenstein, Luxembourg, Macedonia, Netherlands, New Zealand, Poland, Portugal, Romania, Slovenia, South Korea, Spain, Sweden, Thailand, Turkey, and United Kingdom.

III) Australia and United Kingdom have **diverted profits taxes** in effect.

Which US taxes could increase?

The provision targets US source interest, dividends, rents and royalties ("FDAP Income"), income effectively connected with a US trade or business, the US branch profits tax, and the section 4948 excise tax on foreign private foundations. It also increases US withholding tax rates on FDAP income and FIRPTA gains. However, the **House Budget Committee's report on the OBBBA contains a note that the provision "does not apply to portfolio interest," which includes US Treasuries.**

Section 899 would generally increase the current US tax rates imposed on applicable entities by **5% in the first year** following enactment, and then **increased by an additional 5% for each subsequent year** with the increases **capped at 20% above the statutory rate.**

Adjusting Exposure to US Assets & USD

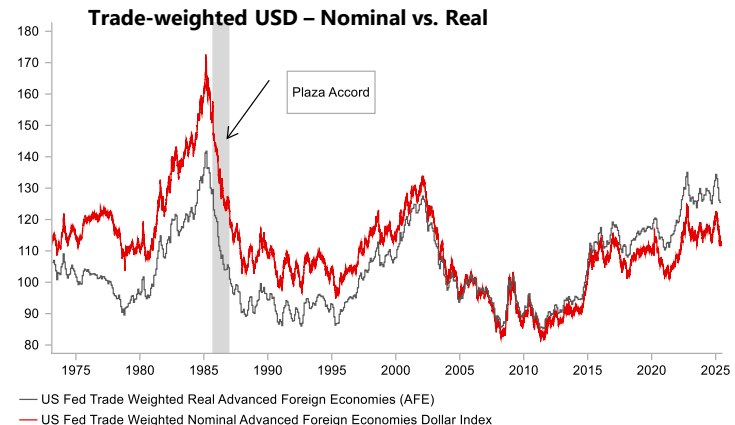
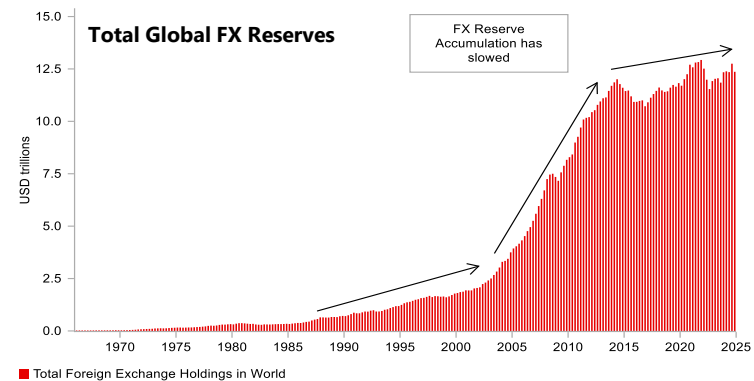
USD | Steps towards a “Mar-a-Lago” Accord?

1. There have been media reports indicating that the Trump administration maybe attempting to force countries to allow their currencies to strengthen against the USD by scaling back intervention in order to secure trade deals.

 **Bloomberg.com**
<https://www.bloomberg.com/news/articles/south-ko...>
South Korea to Keep Discussing Forex With US

2. There has also been speculation that the Trump administration could seek a broader agreement to devalue the USD. A so-called “Mar-a-Lago” Accord.

- The last time there was co-ordinated intervention to weaken the USD was the “Plaza Accord” signed back in September 1985. It involved the US, Japan, West Germany, France and the UK. The aim was to weaken the USD against the JPY and DEM to correct trade imbalances and support US manufacturing. Alongside FX intervention, the US also agreed to reduce its budget deficits and Japan and Germany agreed to stimulate domestic demand.



USD | German fiscal reform set to be a game changer

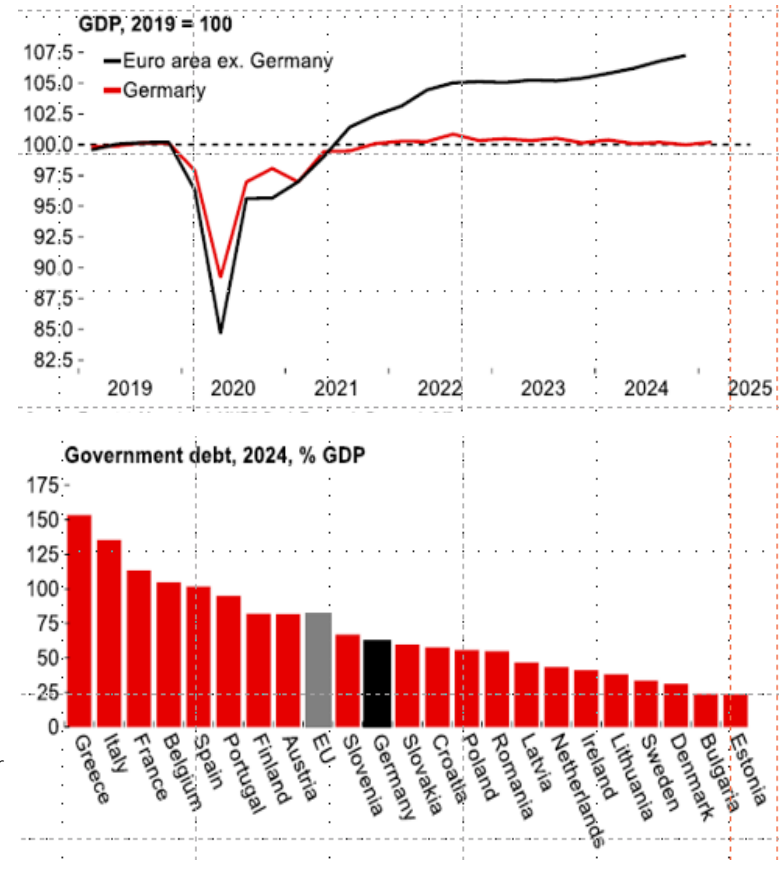
The 3 pillars of Germany's fiscal reform

1. The creation of a **EUR500 billion infrastructure fund** outside of the ordinary budget to be used for additional investment. EUR100 billion of this will be immediately funnelled into the existing Climate Transition Fund (KTF). Of the remainder, EUR300 billion is allocated to the federal government and EUR100 billion for the state governments.

2. Defence spending above 1% of GDP will be exempted from the **constitutional debt brake** which limits the structural deficit to 0.35% of GDP. In other words, it will be possible to fund defence through borrowing and so there will be no legal upper limit to the defence to GDP ratio which currently stands at around 2%.

3. Reform of the **regional debt rule** so federal states will be allowed to run deficits of up to 0.35% of cyclically-adjusted GDP (i.e. matching the federal government's current borrowing limit).

In addition, the German government has announced **plans to cut corporate taxes by EUR46 billion** to encourage investment. From January 2028, the corporate tax rate will be lowered by 1% annually over five years.



USD | China steps up support for domestic demand to offset trade hit

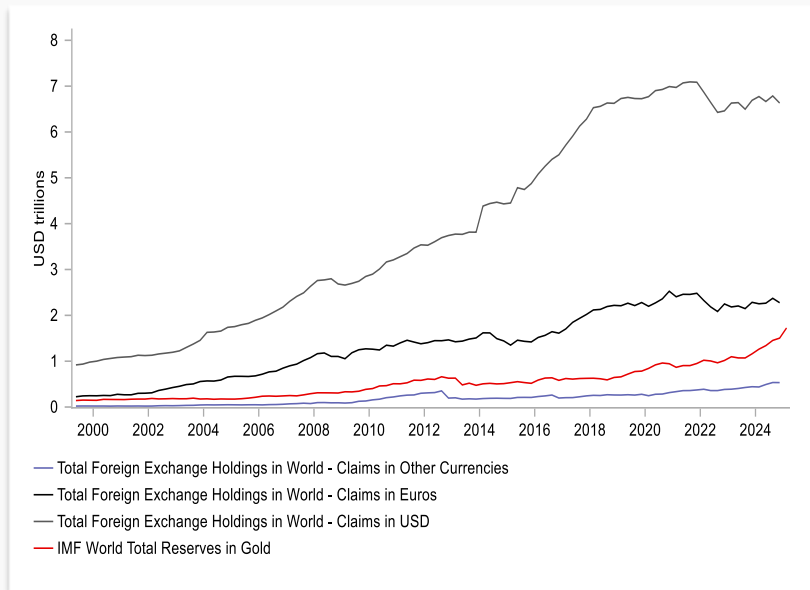
A big focus on boosting economic growth with the 14th National People's Congress on 5th March announcing:

1. An **"around 5%" growth target** and a 2% CPI inflation target
2. Fiscal target: 4% budgeted deficit (% of GDP). Our calculation shows that the **"broad" fiscal support* will be increased to 8% in 2025** up from 2024's 6.6% (right chart). At subsequent Politburo meeting, China's top leaders urged for faster rollout of Rmb2trn NPC-approved stimulus, yet only provided forward guidance on "preparing for the worst case" and developing "contingency plans" – signalling fresh stimulus if data worsens
3. Monetary policy: **Cutting RRR and policy rates at appropriate times**, optimize and innovate structural monetary policy tools. Policy rate cut by 10bps and RRR by 50bps on 7th May.
4. Boosting Consumption: Push more financial resources to "invest in people", expand employment and strengthen consumption incentives. Doubled the size of consumer goods trade-in program to RMB 300bn.
5. Advancing Tech: **Increase funding for industries** of the future and foster industries such as biomanufacturing, quantum technology, embodied AI, and 6G technology. Support the extensive application of large-scale AI models and vigorously develop new-generation intelligent terminals and smart manufacturing equipment (e.g., EV, AI-enabled phones and PC, robots)
6. Housing market: Continued effort to **promote the real estate to stop prices falling and stabilize the market.**

USD | Gold benefitting from broader loss of confidence in fiat currencies

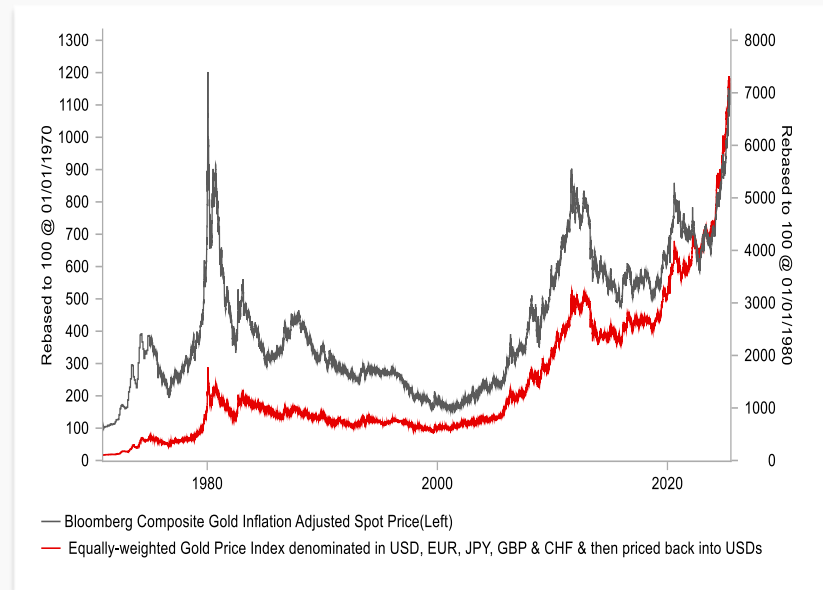
Gold gaining bigger share of World Reserves reflecting loss of confidence in USD & fiat currencies

World reserve holdings by FX & gold



Price of gold has surged to highest level in inflation adjusted terms since 1980

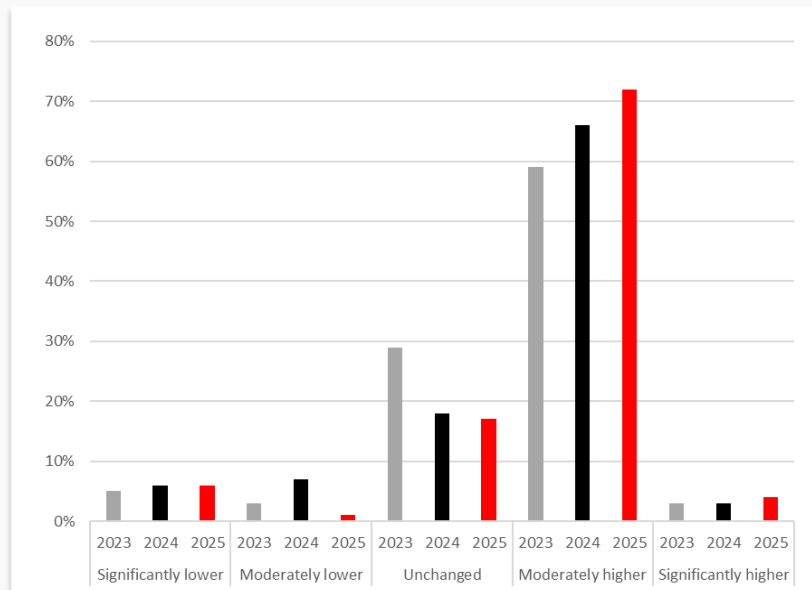
Price of gold priced in 5 major FX vs. inflation



USD | Central banks expect to further increase exposure to gold

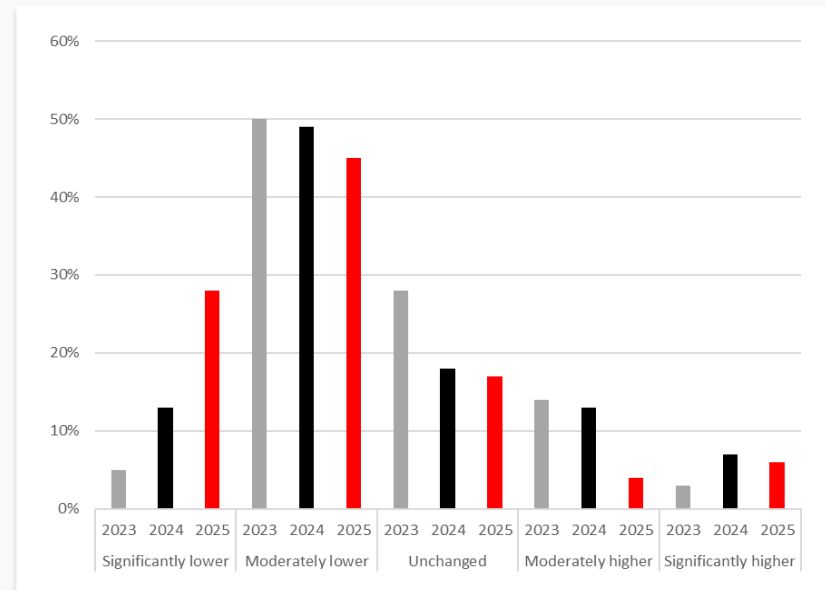
Central banks see gold making up growing share of their reserve portfolios

What proportion of total reserves do you think will be denominated in gold 5 years from now?



Central banks see the USD's share of reserves continuing gradual decline

What proportion of total reserves do you think will be denominated in USDs 5 years from now?



USD | Trump's policies undermining USD's global dominance?

"Trump's policies are steadily undermining the foundations of the dollar's global dominance. His withdrawal from international organizations and agreements, cuts to foreign aid, and transactional approach to US security commitments have unsettled allies and rivals alike. Domestically, his pressure on the Fed, weaponization of the Justice Department, efforts to gut the federal workforce at the cost of key governmental functions, and incursions on the institutional fabric of American society – from universities to judges to the legal profession – have further eroded confidence. Then there's his trade war, unprecedented in its scale, capriciousness, and economic illiteracy.

At the same time, fiscal dysfunction has reached new heights. Congressional Republicans, encouraged by the White House, are preparing to increase the deficit by bypassing the traditional reconciliation process and relying on uncertain tariff revenues. This, too, signals deepening institutional decay – and markets are taking notice".



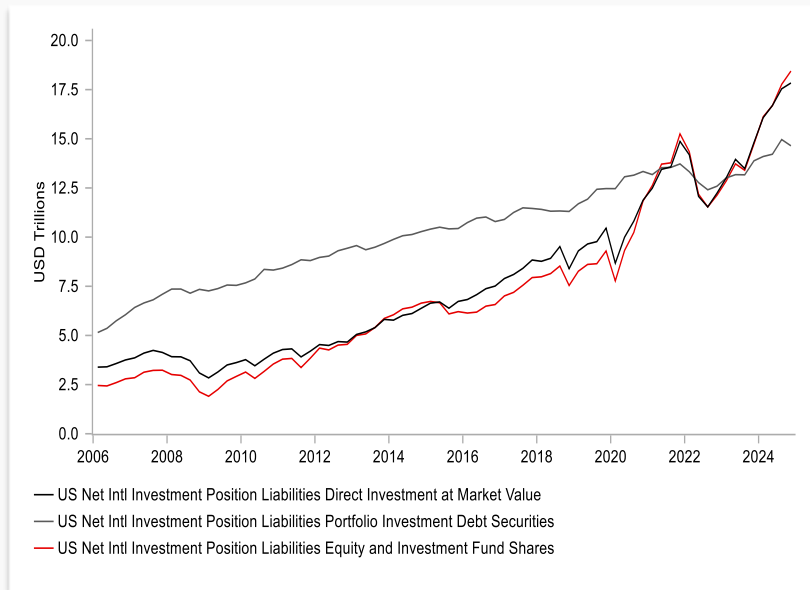
MAURICE OBSTFELD

Maurice Obstfeld, a former chief economist of the International Monetary Fund, is Senior Fellow at the Peterson Institute for International Economics and Professor of Economics Emeritus at the University of California, Berkeley.

USD | Foreign investors paring back and/or hedging more of US exposure?

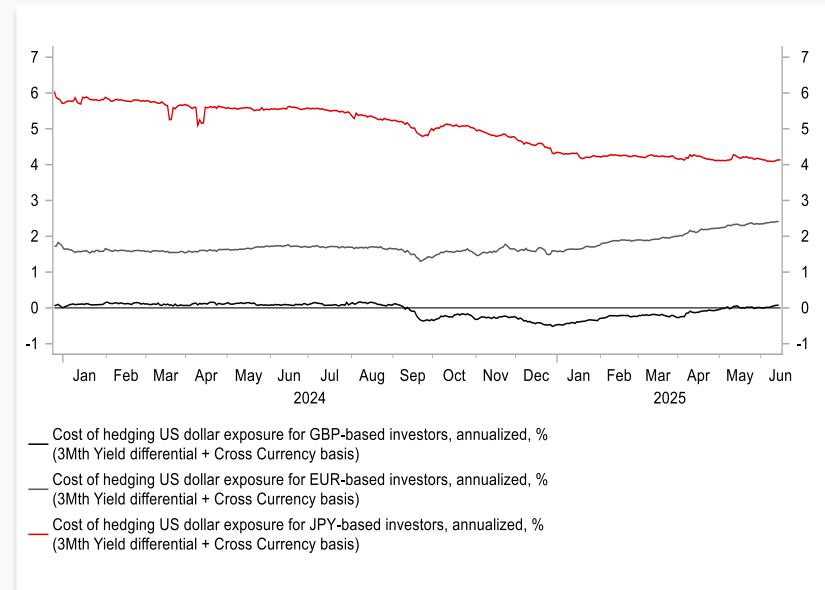
Foreign investors' exposure to US equities had increased sharply in recent years

Foreign holdings of US bonds, equities & FDI



Cost of hedging has become less expansive for JPY-based investors but still high

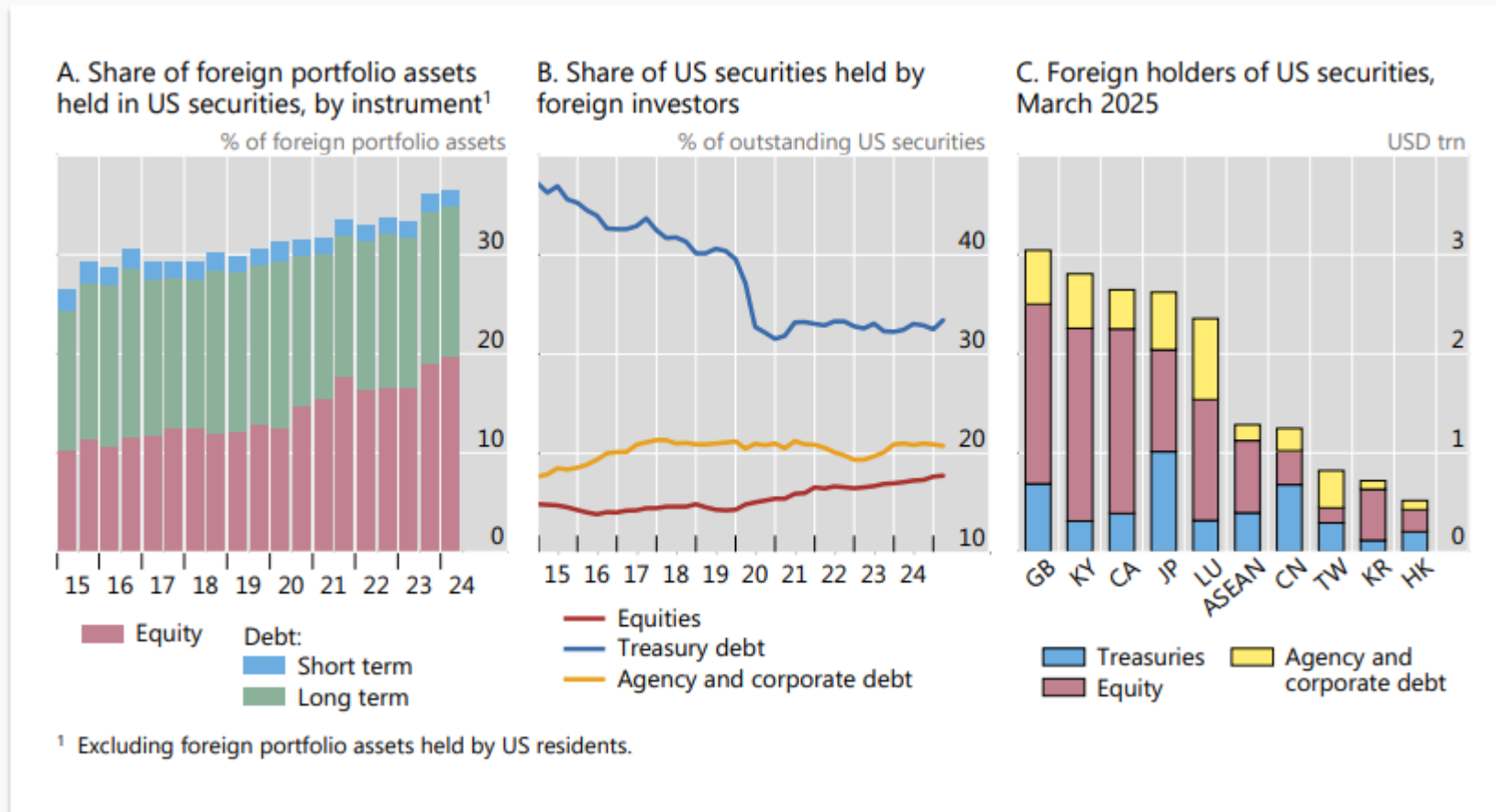
FX hedging cost for GBP, EUR & JPY based investors



USD | Strong USD & high hedging costs had previously discouraged hedging

US dollar assets are a large share of non-US investors' portfolios

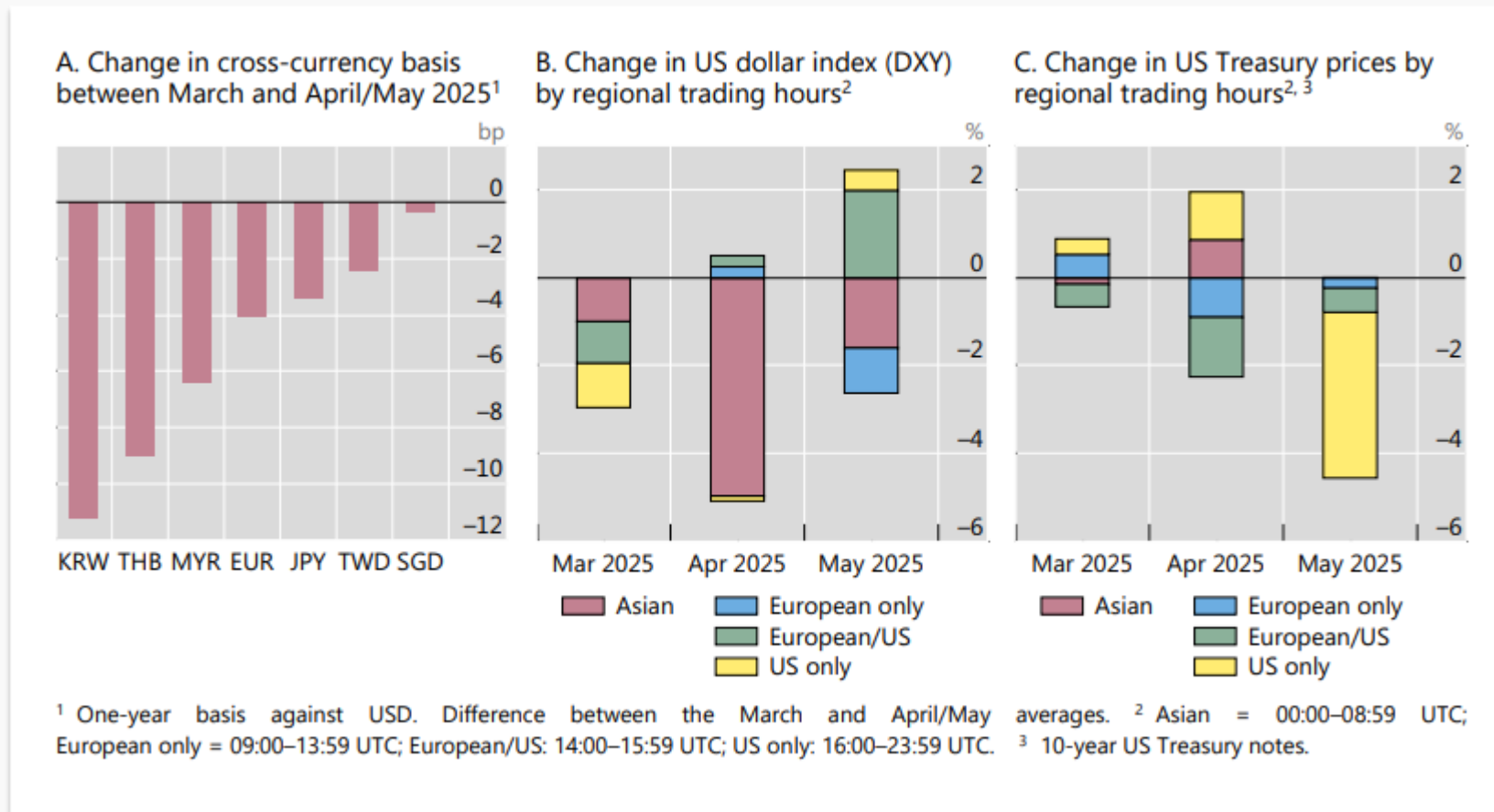
Foreign holdings of US securities broken down by instruments & country



USD | Ex post hedging places downward pressure on USD

Hedging by Asian investors played a role in weakening USD & cross currency basis became more negative indicating increased hedging demand for USDs

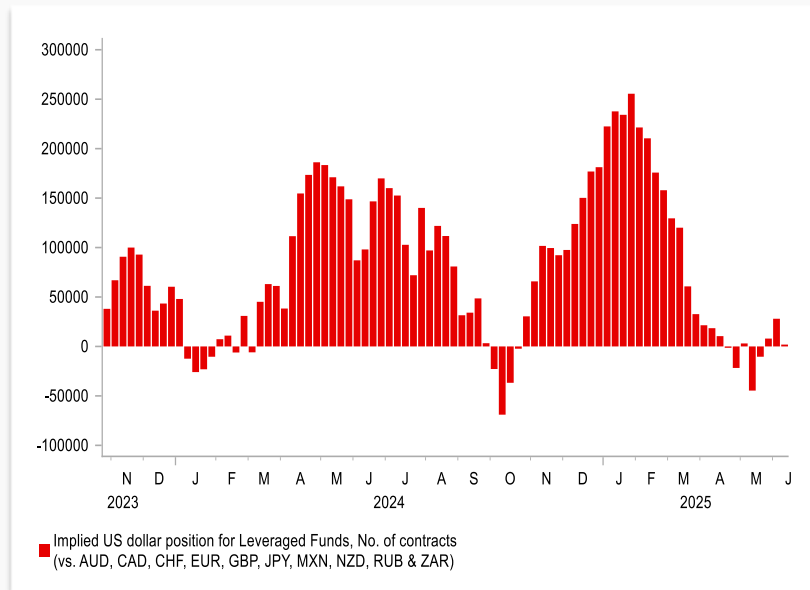
Evidence of increased USD hedging demand during Asian trading hours



USD | Market positioning shifting in favour of further USD weakness

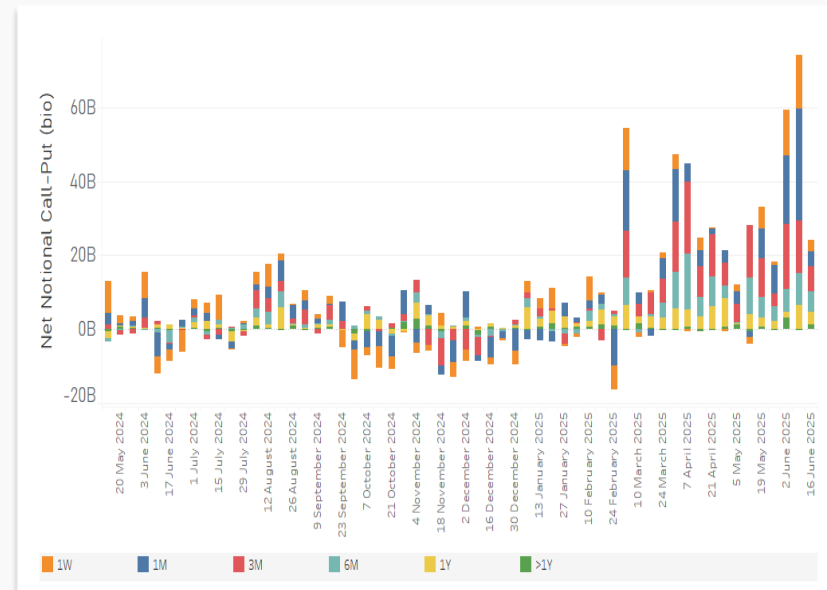
Long USD positions built up after Trump win election have been cleared out

Leveraged Funds positioning for USD



Strong pick-up in demand for EUR/USD calls in anticipation of further USD weakness

Net demand for EUR/USD calls vs. puts



MUFG FX Forecasts



FX Forecasts | USD continues to weaken more quickly than expected

Exchange Rates vs. USD	Spot	Metric	Forecast Q2 2025	Forecast Q3 2025	Forecast Q4 2025	Forecast Q1 2026
JPY	147.53	Forecast	144.00	142.00	140.00	138.00
		Bloomberg Consensus	142.00	140.00	138.00	136.00
		Forwards	144.00	143.00	142.00	140.00
EUR	1.1470	Forecast	1.1200	1.1500	1.1800	1.2000
		Bloomberg Consensus	1.1500	1.1500	1.1700	1.1800
		Forwards	1.1600	1.1700	1.1700	1.1800
GBP	1.3389	Forecast	1.3333	1.3529	1.3642	1.3793
		Bloomberg Consensus	1.3500	1.3600	1.3700	1.3700
		Forwards	1.3500	1.3500	1.3500	1.3500
CNY	7.1861	Forecast	7.2000	7.2500	7.3000	7.3000
		Bloomberg Consensus	7.2000	7.2000	7.2000	7.0400
		Forwards	7.1200	7.0800	7.0400	7.0200
AUD	0.6389	Forecast	0.6300	0.6400	0.6500	0.6600
		Bloomberg Consensus	0.6500	0.6600	0.6700	0.6800
		Forwards	0.6500	0.6500	0.6500	0.6500
NZD	0.5898	Forecast	0.5800	0.5900	0.6000	0.6200
		Bloomberg Consensus	0.6000	0.6100	0.6100	0.6200
		Forwards	0.6000	0.6000	0.6000	0.6000
CAD	1.3788	Forecast	1.3800	1.3700	1.3500	1.3400
		Bloomberg Consensus	1.3800	1.3700	1.3600	1.3400
		Forwards	1.3700	1.3600	1.3600	1.3500
NOK	10.163	Forecast	10.357	10.174	9.8305	9.5833
		Bloomberg Consensus	10.040	9.8500	9.6600	9.4800
		Forwards	10.110	10.110	10.100	10.100
SEK	9.7271	Forecast	9.7321	9.3913	9.0678	8.9167
		Bloomberg Consensus	9.4800	9.3000	9.1500	9.0400
		Forwards	9.6200	9.5700	9.5200	9.4700
CHF	0.8189	Forecast	0.8304	0.8174	0.8051	0.7917
		Bloomberg Consensus	0.8200	0.8200	0.8200	0.8100
		Forwards	0.8100	0.8000	0.7900	0.7800

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