FX Forecasts

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INTRODUCTION

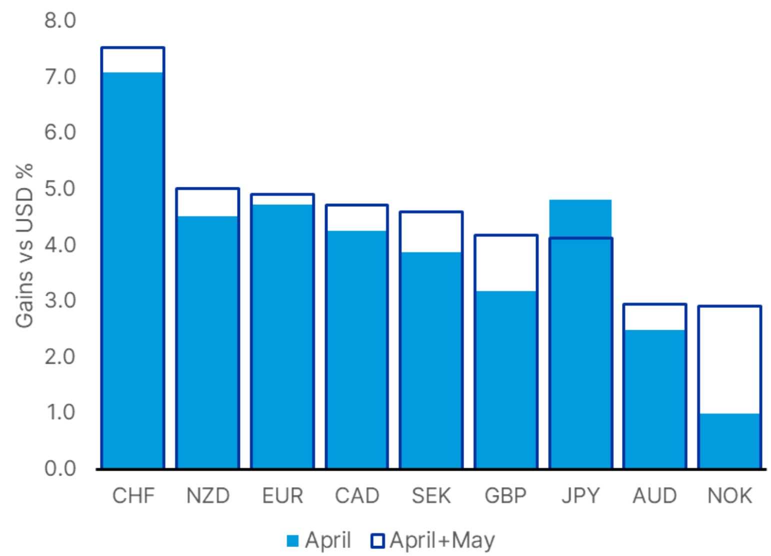
After looking set for a turnaround through the first half of the month, the dollar finished May little changed. Underpinning this performance – President Trump, again. A focus on geopolitics from administration officials coincided notably with an initial uptick for the buck – albeit subsequently undermined by the growing prominence of fiscal risks, and a return to trade and tariffs as a key theme for markets. June looks unlikely to be much different. A suspension of most Trump tariffs on May 28th is an inconvenience, but not a fatal blow to the President's policy approach. It will also ensure that trade policy remains centre stage for markets, alongside fiscal worries. This is likely to stymy any dollar upside that could otherwise be prompted by a Fed meeting that we see leaning hawkish. Indeed, US political upheaval will likely overshadow rate decisions set to emanate from most major central banks over coming weeks. All told then, we think this backdrop leaves the greenback in limbo for the time being, and are updating our forecasts accordingly, with Trump-induced uncertainty more than offsetting favourable fundamentals, leading us to pull down our short-run dollar forecasts this month.

A re-set for the dollar

As noted in our May forecasts, we were inclined to see the readjustment lower for greenback valuations in April as just that – a one-time shift by markets to price in a Trump-related discount. With that in mind, last month's forecasts saw a roughly 5% reduction in our DXY projections, reflecting our initial estimate for the magnitude of discount that would prove sticky, and an expectation that the distribution of gains against the dollar would become more broad-based as markets continued to assess the implications of US policy.

Taking these two assumptions in reverse order, May did indeed see a broadening in FX returns across dollar pairs, as anticipated. While the franc remained the favoured haven expression of choice, CHF gains were middle of the pack amongst all G10 currencies.

May saw a broadening in G10 gains against the dollar, leaving post-Liberation Day returns more evenly distributed



Meanwhile, the euro, which received much attention as an alternative haven to the dollar was amongst the worst performing currencies through May, ending the month near-as-makes no difference unchanged, with only the yen delivering weaker returns and actually losing ground against the buck. By contrast, sterling and the Scandis played catch up, leaving G10 returns through both April and May looking much more evenly distributed than those recorded for April alone.

That all being said, our initial assumption of a 5% DXY discount has proven a little wide of the mark. This was, roughly speaking, the broad discount implied rate differentials at the end of April, although as we noted last month, some pairs were trading wider, with EURUSD specifically embedding a 6-8% premium. Crucially, we assumed that currencies that had overshot would retrace, in light of toned-down rhetoric from the White House, US data resilience, and ongoing Fed hawkishness. In fact, the opposite happened. This has seen the dollar discount to rate differentials widen again through last May, with the spread now implying a 6-8% markdown for the DXY index as a whole.

The spread between interest rates and DXY valuations widened marginally through May, albeit driven primarily by currencies that underperformed in April playing catch up

TACO bulls

We think there are a few points worthy of note when it comes to this shift in market behaviour that has resulted in a sustained dollar discount. First, to state the obvious, it has been almost entirely caused by the Trump administration. Markets have concluded that tariffs are bad for the US economy and the dollar, as is the broader uncertainty stemming from the administration's approach to governing, encompassing efforts such as DOGE, threats to fire Fed Chair Powell, and the so-called "Big Beautiful Bill" which put fiscal stability back in the spotlight for market last month. In effect, there is little, if anything, the administration does that markets are inclined to positively at this juncture.

Second, Trump appears to have a relatively low tolerance for market punishment. A bond market selloff in April prompted a suspension of Trump's reciprocal tariffs. A similar albeit less spectacular wobble saw the President walk back his threats regarding Chair Powell. The tendency has acquired a moniker amongst traders over the past month too: TACO. Trump Always Chickens Out. And, unless and until proven wrong, this looks set to be the market bias when assessing US policy moving forward.

The new normal

Putting these two factors together suggests that while the current dollar discount is likely to persist, there is also a floor under the greenback in the short run. As we see it, erratic policymaking might be a bug, but it is also a feature of this administration that we view as unlikely to change. But, given there is a limit to the extent Trump is willing to test markets, the dollar is only able to soften so far, absent a deterioration in the macro backdrop.

"So, in the short-run at least, we now expect the dollar to stabilise at a new, albeit lower, level after a volatile couple of months."

One final consequence, if our view is correct, is that these dynamics also hold implications for broader FX markets as well. Assuming that markets can act as a brake on the President, implies a limit left-tail risks, which should in turn see a reduction in haven demand. From an FX perspective that favours a rotation away from haven currencies and back towards broader G10 appreciation vs USD. Indeed, we think this goes some way to explaining the broadening of FX returns in the past month, and is a trend that we expect will continue to drive marginal outperformance in our updated June projections.

The dollar is not smiling (quite as much)

In the long term, however, macro factors will likely play more of a role, opening up a channel for renewed dollar depreciation. The sentiment knock that has seen the dollar re-set lower over recent months should also start to weigh on the upcoming macro data. This in turn is likely to act as a drag on the dollar over the medium run - under our base case, we expect this dynamic to become apparent in Q3, and increasingly pronounced from Q4 onward.

Yet despite our forecast for a US growth slowdown, we think the left-hand side of the dollar smile is set to remain firmly closed. The negative consequences of US policy dysfunction will be most acutely felt in the US. Meanwhile, the fading effects of an initial Trump shock, combined with stimulus efforts, most notably in Europe, suggest a pick-up in growth outside the US toward the back end of the year.

"A backdrop of relative US underperformance does not favour dollar haven demand. Rather, it is likely to ensure that alternatives, such as the euro, remain favoured as safe havens for investors."

This absence of a greenback haven trait has one final implication for our forecasts – it implies that the dollar will trade with a more positive beta to risk, particularly under risk-off conditions. If it does, then the greenback will no longer act as an effective hedge for non-US investors buying US assets. That would, in turn, favour capital allocators increasingly hedging dollar exposure. Admittedly, any investors for which this was an acute concern have likely already taken action, suggesting that the probability of a sharp drop lower for the buck on increased hedging demand is low.

"But we still suspect that this will be a consideration for the marginal new investment, adding a further headwind for the dollar."

FX VIEWS

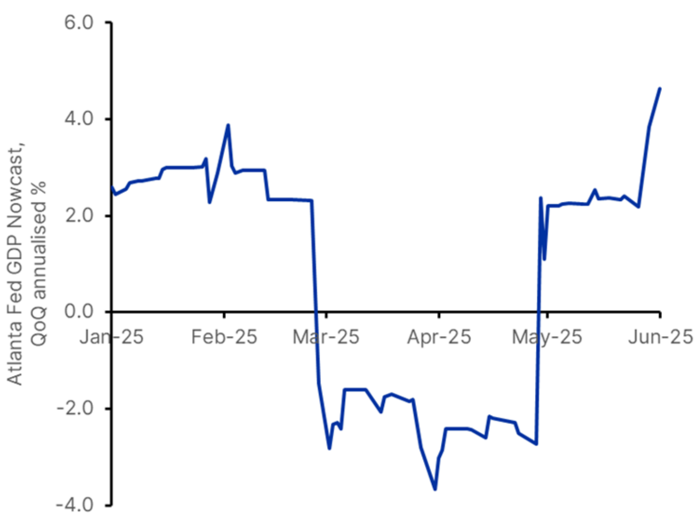
USD

A breather on the way down

After posting dire performances through March and April, the dollar ended May having eked out marginal gains. And, given our high-level view on the President's reaction function when it comes to markets, we think the dollar could temporarily stabilise around current levels. Moreover, we expect that macro fundamentals will help stymy any dollar selloff in the short term, offsetting structural headwinds. To reiterate a point made last month, we think Q1 GDP figures look suspect, failing to pick up fully a surge in inventories that we suspect took place, and we are sceptical that a third attempt will prove any more successful. If we are right, then Q1 GDP growth will once again appear weak when final numbers are published later this month, but this should also provide an uplift to Q2 GDP figures.

Similarly, we continue to predict that the Fed will be more hawkish than markets expect when it comes to cutting rates, with swaps pricing almost 50bps of easing through to end-2025. Recent Fed speak has all but ruled out trimming rates in July and August, leaving September as the earliest possibility to resume easing. We think that is still too early, with any tariff-related peak in price growth likely clear in the data by mid-Q4. To us, that suggests December or January 2026 as the most likely dates for the FOMC to deliver another rate cut. A readjustment higher for swaps reflective of this view should also help offset downside dollar pressures in the short term.

We expect to see a sharp rebound in Q2 growth figures, which should help support the dollar temporarily, before a slowdown takes hold later in the year



Putting all this together, we now expect the DXY to trade at 99.1 and 98.6 over the next one and three months respectively. Further out, however, our base case sees the index dropping to 97.1 in 6 months, and 93.4 over a 12-month time horizon. Underpinning this longer-term view, we expect that growth conditions will progressively cool as erratic policymaking translates into real economic damage. This should in turn ensure that when the Fed does resume easing policy, rate cuts will come rapidly. Our base case sees a succession of 25bp rate cuts for next year, which if delivered, is also likely to catch markets by surprise.

"Add this to the structural headwinds facing the dollar from stronger growth ex-US and a shift in hedging behaviour, and we now see significant downside risks to the dollar through to mid-2026 and beyond."

EUR

Eyeing new highs

A corollary to our updated greenback forecasts is a much flatter path for EURUSD in the coming months. We now expect the pair to record a slow but steady and likely choppy appreciation to 1.16 by mid-Q4, projecting 1.20 for the pair over a 12-month time horizon. That said, despite these revisions, our underlying perspective on the eurozone is actually little changed on this occasion. We still expect growth to undershoot expectations in the short run due to delayed fiscal stimulus and trade headwinds, with this in turn helping to see ECB rates bottom out slightly below current market expectations at 1.50%. This view prevents us from pricing in notable upside for the single currency over a six-month time horizon, despite the euro's new-found haven status. But, from mid-Q4 onward, a domestic growth rebound and the termination of the ECB's easing cycle should combine to see more notable euro appreciation.

"We are pencilling in 1.20 over 12 months, but with risks skewed to the upside if the EU can, in contrast to prior efforts, fully deliver the fiscal stimulus that has been promised."

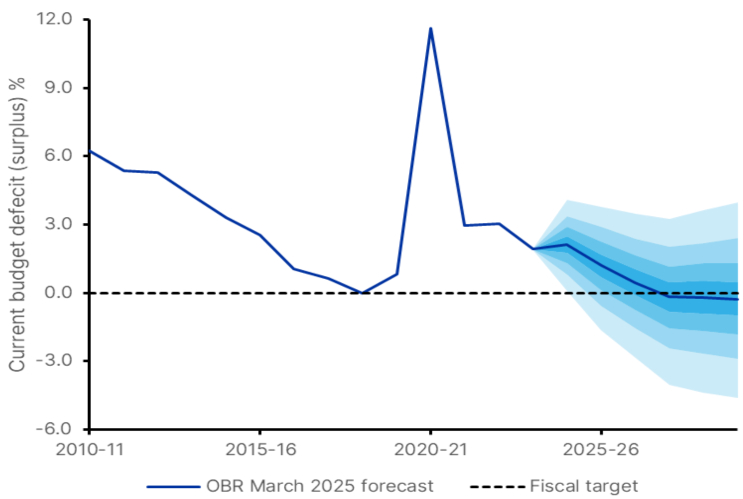
GBP

When to worry about fiscal risks?

One interesting side-effect of the recent Trump-induced uncertainty has been to distract attention away from UK fiscal risks. Indeed, the past month has seen the UK government deliver increasingly strong hints that a U-turn on several cost-saving measures could be forthcoming, prompted by a disastrous set of local election results. And given the Chancellor has just £9.9bn headroom following the Spring Statement, combined with a deterioration in the economic backdrop since, there seems little to no prospect that more tweaks to tax and spending will be needed come the Autumn.

Despite all this, sterling has not come under sustained pressure, in contrast to trading earlier this year. We think this is too good to last. Granted our base case continues to look for the UK economy to outperform relative to the eurozone, with activity supported by solid consumer demand, itself a consequence of sustained real wage growth. But we would also be surprised if markets did not have a wobble in the coming months around the state of the UK public finances. That could come as soon as this month, given that a spending review is due. We think later in the summer is more likely, however, when a slowdown in news flow often sees attention turn to less immediately pressing stories, such as fiscal sustainability. With this in mind, we expect GBPEUR to dip to 1.16 over the next three months, before rebounding to 1.21 – close to the top of post-Brexit ranges for the cross. Against the dollar, that would imply the pound slipping to 1.33 before rebounding to hit 1.45 over the coming 12 months.

The Chancellor left minimal headroom following the Spring Statement, ensuring that fiscal concerns remain a significant risk for sterling traders



CAD

What a drag

While the loonie has kept pace with other G10 FX, we doubt this is set to last. Other commodity-sensitive major currencies have lagged the pack over recent months, and we expect the loonie to join this group eventually, with two specific drivers front of mind. First, the typical CAD beta to oil has proven less of a drag on valuations as of late, despite a decision by OPEC to boost production, weighing on prices. A renewed pick up in this sensitivity should weigh on valuations moving forward. Second, the close link between the US and Canadian economies also poses a downside loonie risk. Our expectation for a growth slowdown south of the border implies a corresponding headwind for CAD.

> "That all being said, this is an argument for loonie underperformance, but not necessarily for USDCAD to rally outright."

We still think that the greenback will prove even more disappointing, given a more acute exposure to Trump policy risks. With this in mind, we see the pair trading at 1.38 in three months, before falling to 1.36 and 1.32 over six and 12 months respectively.

JPY

Hawks not yet in sight

The yen stood out amongst G10 FX in May as the only currency to give back April gains against the dollar. We see little reason that this should not continue in the short term too, especially given a BoJ decision due on June 17th. There appears to be minimal risk of a further rate hike if recent BoJ commentary is to be believed. Rather, we expect the BoJ Governor Ueda to lean dovish following the June 17th rate decision, in keeping with the Bank's typical communication bias. That suggests downside risks for the yen relative to current spot levels in the short run. In the long term, however, we still expect USDJPY downside, supported by at least one further rate hike this year, with the October rate decision looking the most likely candidate.

CNY

Stability remains the watchword

One of our larger revisions this month has been to our CNY forecasts. This is in light of PBoC commentary earlier in May, which we saw as placing significant emphasis on USDCNY stability as part of efforts to internationalise the yuan. Accordingly, we now see USDCNY trading at 7.20 over a three-month time horizon as a base case, close to unchanged from spot levels as of writing. In the long term, however, we think the PBoC will have to allow for appreciation against the dollar. The greenback depreciation we are forecasting will leave the PBoC with a choice: continue to stabilise the yuan against the dollar or allow the yuan to appreciate in line with gains for other currencies.

“We think they will split the difference and as such, project USDCNY falling to 7.00 over a 12-month horizon.”

PLN

Poll-land

A surprise victory for Karol Nawrocki in Poland’s Presidential elections, held June 1st, poses a challenge to the Tusk administration, and uncertainty for the zloty. As of writing, PM Donald Tusk has called for a vote of no-confidence in his government, meaning another return to the polls could be on the cards in the coming months. We think this has offsetting impacts for EURPLN, relative to our prior forecasts, but with no strong conviction yet as to whether these developments weigh more strongly one way or the other.

On the one hand, the prospect of a change in government could inspire a degree of caution at the NBP – indeed, Governor Glapinski highlighted policy uncertainty stemming from a change in administration as a key reason to halt cutting rates in 2023. On the other, political uncertainty will likely weigh on zloty valuations, with risks that PiS could return to power a more pronounced concern, especially following Nawrocki’s victory. Given this, we are leaving our forecasts unchanged for now, albeit with a caveat that uncertainty is much increased.

“Our base case, however, continues to see the zloty softening at the margin, with EURPLN reaching 4.35 over the next 3-6 months.”

Forecasts

Currency Pair	1-month (30th June 2025)	3-month (31st August 2025)	6-month (30th November 2025)	12-month (31st May 2026)
G10				
EUR/USD	1.14	1.15	1.16	1.20
USD/JPY	145	143	138	130
GBP/USD	1.35	1.33	1.37	1.45
USD/CHF	0.82	0.82	0.83	0.83
USD/CAD	1.36	1.38	1.36	1.32
AUD/USD	0.64	0.63	0.63	0.65
NZD/USD	0.60	0.60	0.61	0.63
USD/SEK	9.5	9.4	9.1	8.6
USD/NOK	10.1	9.9	9.6	9.0
DXY	99.1	98.6	97.1	93.4
Emerging Markets				
USD/CNY	7.20	7.20	7.10	7.00
USD/INR	85.5	85.0	84.5	84.0
USD/SGD	1.28	1.28	1.25	1.23
USD/ZAR	18.0	18.2	18.5	18.5
USD/TRY	39.8	41.0	42.0	43.5
USD/PLN	3.77	3.78	3.75	3.58
USD/HUF	355	354	349	333
USD/CZK	22.0	22.2	21.8	20.8
USD/BRL	5.70	5.70	5.60	5.40
USD/MXN	19.5	19.8	20.3	20.3
Euro Crosses				
EUR/GBP	0.84	0.86	0.85	0.83
GBP/EUR	1.18	1.16	1.18	1.21
EUR/CHF	0.94	0.94	0.96	1.00
EUR/CAD	1.55	1.59	1.58	1.58
EUR/SEK	10.8	10.8	10.6	10.3
EUR/NOK	11.5	11.4	11.1	10.8
EUR/TRY	45.4	47.2	48.7	52.2
EUR/PLN	4.30	4.35	4.35	4.30
EUR/HUF	405	407	405	400
EUR/CZK	25.1	25.5	25.3	25.0
EUR/BRL	6.50	6.56	6.50	6.48

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