

FX Viewpoint

Currencies
Global

Will USD weakness continue?

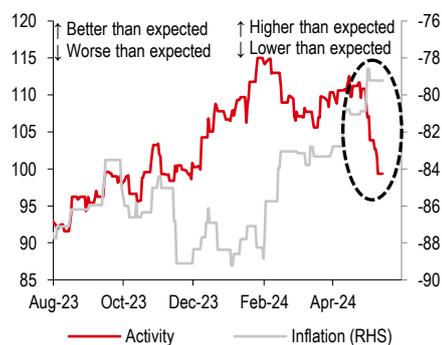
- ◆ Renewed dovish hopes for the Fed and associated gains in risk appetite have hit the USD recently...
- ◆ ...but we think further weakness appears to be limited in the weeks ahead, in part due to high US yields
- ◆ Risk aversion and dovish developments in Europe could see the USD grinding back towards the year-to-date highs

The USD has suffered from a ‘double whammy’ via both rates and risk channels lately. In the US, softer-than-expected activity data, and the lack of further upside surprises in April inflation data (Chart 1) have rejuvenated dovish hopes for the Federal Reserve (Fed) and helped spur risk appetite, weighing on the currency.

However, this two-pronged hit to the USD can also play in the opposite direction. Markets are now almost fully priced for two 25bp rate cuts this year by the Fed (*Bloomberg*, 16 May 2024); while **our economists are less convinced, forecasting only one cut in 2024.** The Federal Open Markets Committee (FOMC) has common ground that patience regarding policy easing is warranted, given the run of upside surprises on inflation for much of 2024. But there are clear divisions on how long that patience should extend. There are only a couple of weeks to run to the pre-FOMC blackout period (which will begin on 1 June). **Fed rhetoric arguing for patience might unsettle markets ahead of the 11-12 June FOMC meeting** where a “dot plot” (i.e., a chart updated quarterly that records each Fed official’s projection for the federal funds rate) lie in wait.

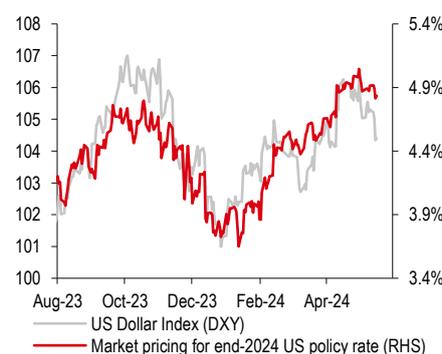
If we are correct in assuming Fed rate expectations and the level of US yields will prove bullish for the USD (Chart 2), the currency will probably enjoy support, or at least stabilisation, via both rates and risk aversion.

1. HSBC US data surprise indices



Source: Bloomberg, HSBC

2. DXY vs end-2024 US policy rate expected by markets



Source: Bloomberg, HSBC

A return to year-to-date highs for the US Dollar Index (DXY) may rely on dovish developments outside of the US. A 25bp rate cut at the European Central Bank’s (ECB) 6 June meeting is now fully priced by markets, but if the door were to be left open to a follow-up cut in July, the EUR would likely weaken. In the UK, our economists expect the Bank of England (BoE) to cut rates at its 20 June meeting, an outcome viewed as finely balanced by markets. **The Fed remains key to the USD, but this remains a relative game, and monetary policy in Europe looks set to out-dove the US.**

US growth disappointments and rising equity markets have seen the USD weaken

Fed rhetoric could be key before the pre-FOMC blackout period

The USD could stabilise in the weeks ahead

The USD may strengthen further on dovish developments outside the US

Disclosure appendix

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