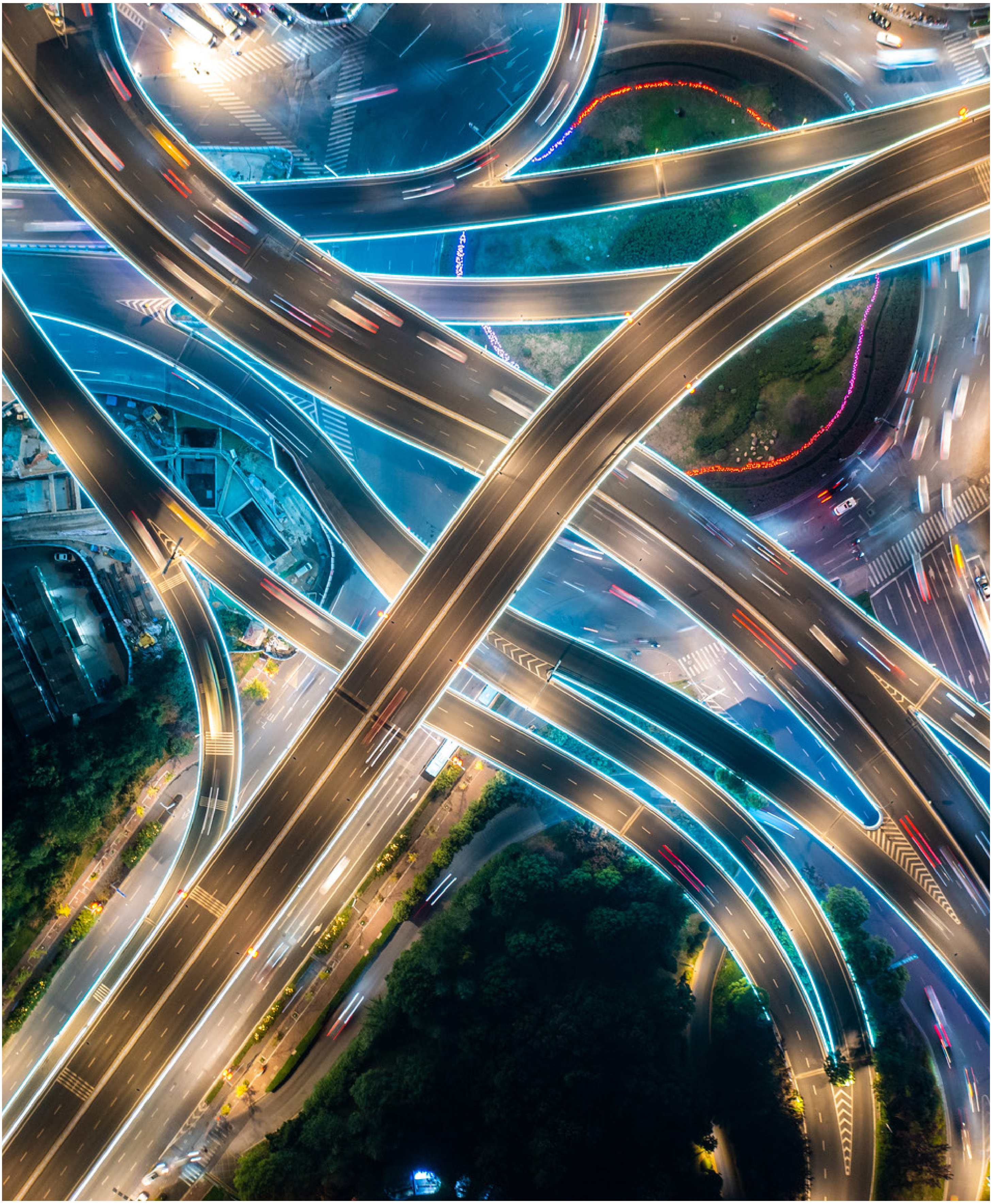
# FX Pulse: 2025 Q1

## Looking for peak dollar

January 2025



## Summary & conclusions

USD has strengthened on revised market views about Fed easing (partly linked to the election outcome) but we expect a reversal in 2025. We think BOJ tightening will make JPY the strongest major currency.

**Figure 1: Our favoured currencies and favoured hedging activity over the next 3 and 12 months**

| | Favoured currency | Hedge from | Hedge to |
|---|---|---|---|
| 3M view | JPY, AUD | USD, HKD | JPY, AUD, CAD |
| 12M view | JPY, AUD | USD, HKD | AUD, JPY, CAD |

Note: See appendix for currency and central bank abbreviations.
Source: Invesco Global Market Strategy Office

## Recent developments

The central bank easing cycle continues, with around 40 central banks cutting interest rates during 2024 Q4 (according to CentralBankRates). Eight of them were among our selection of the 10 most traded currencies (the BOJ and Australia's RBA were the exceptions).

However, there is now less optimism about the extent of Fed rate cuts, with Federal Funds futures suggesting the upper end of the Fed's policy range will be around 4.00% by the end of 2025 (versus the current 4.50%). That is a full percentage point higher than what markets were suggesting three months ago. This has had a knock-on effect on expectations for some other central banks. Though policy easing has caused 3-month rates to fall in most countries since September (China, Hong Kong and Japan are exceptions), 10-year yields are up almost everywhere (except China and Switzerland) but nowhere as much as in the US (except Hong Kong).

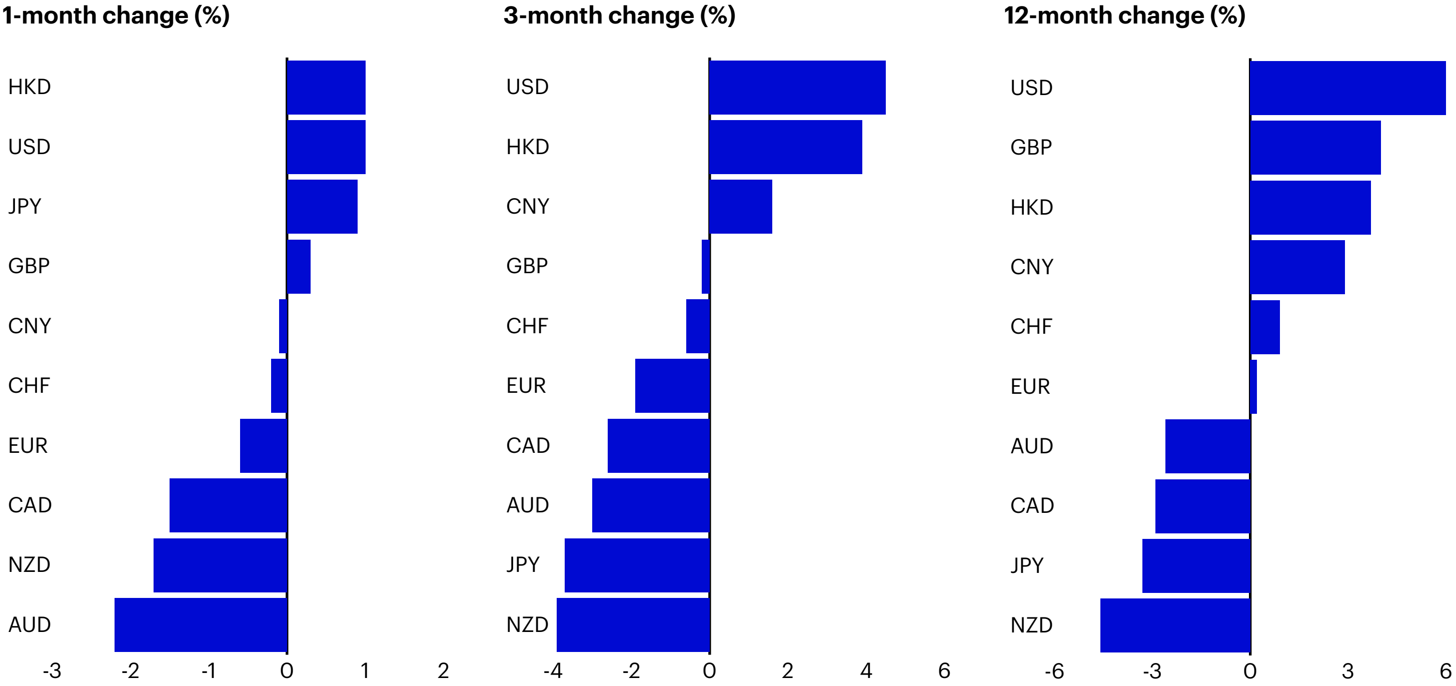
It should then come as little surprise that USD is among the strongest currencies over the timeframes shown in Figure 2. Despite the shockingly weak July payrolls data (which provoked market volatility in early August), the US economy appears to be robust.

We think this partially explains market reassessment of the potential for Fed rate cuts. The other factor, in our opinion, is the victory of Donald Trump in November's elections and the Republican clean sweep. There could be both good and bad reasons for this: on the good side may be the belief that the US economy will receive a boost from a second Trump presidency, while more negative would be any expectation of higher inflation due to tariffs. Either way, the election outcome could persuade the Fed to be less aggressive in cutting rates than it would otherwise have been.

We think the strong showing of HKD and CNY in Figure 2 is explained by the weighting of the US dollar within their currency targeting regimes (100% and around 19%, respectively). GBP on the other hand seems to have benefitted from the relatively high rate of wage and price inflation in the UK, which may cause the BOE to delay rate cuts. However, a weak economy may eventually encourage the BOE to ease more rapidly.

More confusing is that RBA reluctance to ease has not prevented AUD weakness, perhaps due to economic softness. CAD and NZD have also been weak but those central banks have been easing aggressively (and the New Zealand economy is in recession).

**Figure 2: Currency momentum (based on nominal broad trade weighted indices)**




Notes: **Past performance is no guarantee of future results.** As of 31 December 2024. Based on JP Morgan Nominal Broad Trade Weighted Indices.
Source: JP Morgan, LSEG Datastream and Invesco Global Market Strategy Office

## Fundamentals

We believe interest rate spreads have been supporting USD, with Figure 3 showing that other interest rates are lower than normal versus US counterparts. Indeed, with internal (budget balance) and external (current account) indicators suggesting the US economy is imbalanced, we think that generous rate spreads (and reserve currency status) were an important factor in USD strength over recent years.

We have already noted that 10-year spreads have moved in favour of USD over the last three months. Figure 4 hints that rising term premia may explain a lot of the recent rise in US 10-year yields. If that is the result of concern about future fiscal policy and the independence of the Fed, we fear those rising US yields may eventually be accompanied a weakening of USD. Indeed, we note that, after dollar strength at the end of 2016 (upon the first election victory of Donald Trump), USD fell by around 6% during 2017 (based on JP Morgan's trade weighted index) and by around 5% from the start of 2017 to the end of 2020. We suspect that a period of consolidation in USD (and perhaps outright reversal) could occur as markets digest the early stages of the new administration.

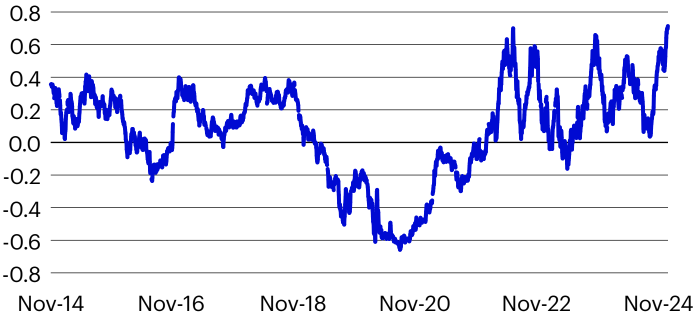
Similar internal and external imbalances are seen in New Zealand and the UK, both of which also have large negative net international investment positions (the cumulation of past current account balances), though not as big as the US.

China, Japan and Hong Kong also have budget issues but their external positions are stronger, with current account surpluses and healthy NIIP positions (they are net creditors to the rest of the world, while the US is a large net debtor). We think CHF has the best underlying fundamentals (budget surplus, large current account surplus and large positive NIIP), which may explain why it remains resilient despite Swiss policy rates falling to 0.50%.

We believe that positive fundamentals could result in upward pressure on CHF and HKD over the coming year, a trend that we suspect will be resisted by the respective central banks.

Unfortunately, USD is more expensive than normal (compared to a broad basket of currencies, when adjusted for inflation differentials). CHF is the next most expensive, while JPY is at the other end of the spectrum (cheaper than usual).

**Figure 4: US 10-year treasury term premium (%)**



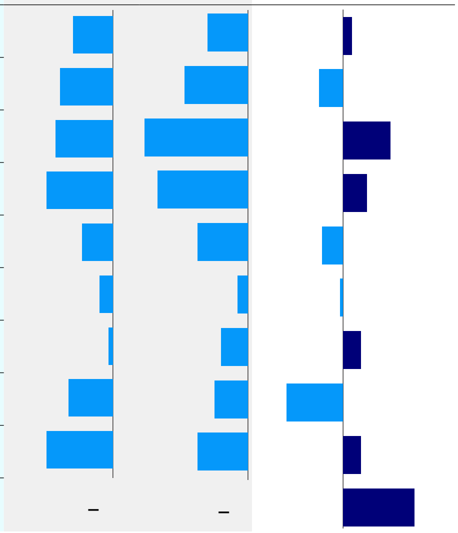

Note: **Past performance is no guarantee of future results.** Based on daily data from 10 November 2014 to 27 December 2024. Based on calculations provided by the Federal Reserve Bank of St. Louis. The term premium is the excess return demanded by investors to hold a long-term bond rather than rolling a series of shorter-term bonds. Source: Federal Reserve Bank of St Louis and Invesco Global Market Strategy Office

Importantly, we think that some commodity related currencies in our universe (AUD and CAD) may receive support as the global economy accelerates during 2025. We believe that such acceleration is possible due to rising real wages and the easing of financial conditions as central banks cut rates.

Though the start of 2025 has brought a lot of commentary about USDCNY, those movements are limited and we think that USDJPY will remain the focus for currency markets. Of course, US trade policies could have a negative effect on both CNY and JPY (along with EUR) but it is our belief that trade brings benefits to everybody and that attempts to restrict it will have a damaging effect on all economies. That includes the US, especially if other countries retaliate.

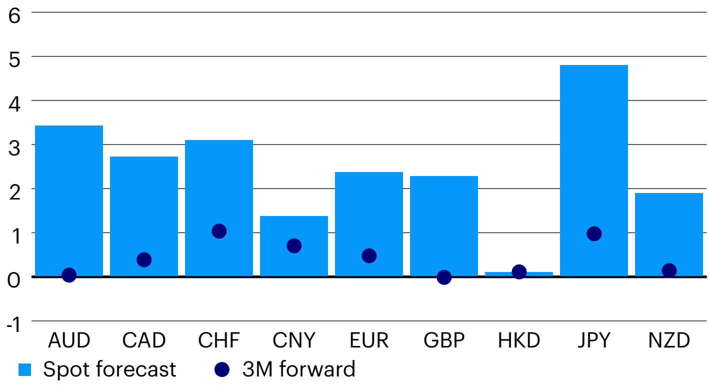
**Figure 3: Currency fundamentals (as of 31 December 2024)**

| | GDP Growth 2025 (%) | CPI Inflation 2025 (%) | Current Account % of GDP | Budget Balance % of GDP | Net Intl Inv Pos % of GDP | Interest Rates 3M % | Interest Rates 10Y % | Spreads vs US 3M bps | Spreads vs US 10Y bps | Spreads vs US Std vs norm 3M | Spreads vs US Std vs norm 10Y | Real Effective Exchange Rate Std vs norm |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **AUD** | 2.1 | 3.6 | -1.1 | -2.0 | -32.2 | 4.3 | 4.5 | -16.0 | -9.6 | | | |
| **CAD** | 2.4 | 1.9 | -1.3 | -1.0 | 50.1 | 3.2 | 3.2 | -128.5 | -133.8 | | | |
| **CHF** | 1.3 | 1.0 | 7.6 | 0.3 | 99.0 | 0.4 | 0.3 | -402.5 | -429.8 | | | |
| **CNY** | 4.5 | 2.0 | 1.6 | -7.6 | 16.4 | 1.9 | 1.7 | -249.2 | -289.3 | | | |
| **EUR** | 1.2 | 2.0 | 2.4 | -3.1 | 2.8 | 2.7 | 2.4 | -172.1 | -220.9 | | | |
| **GBP** | 1.5 | 2.0 | -2.8 | -3.7 | -24.8 | 4.9 | 4.6 | 47.0 | 0.0 | | | |
| **HKD** | 3.0 | 2.4 | 9.2 | -2.5 | 468.6 | 4.3 | 3.8 | -15.0 | -76.7 | | | |
| **JPY** | 1.1 | 1.8 | 3.6 | -3.0 | 78.7 | 0.1 | 1.1 | -438.0 | -349.2 | | | |
| **NZD** | 1.9 | 2.2 | -5.0 | -3.5 | -53.6 | 4.0 | 4.5 | -42.0 | -2.5 | | | |
| **USD** | 2.2 | 1.9 | -3.1 | -7.3 | -71.6 | 4.4 | 4.6 | - | - | – | – | |



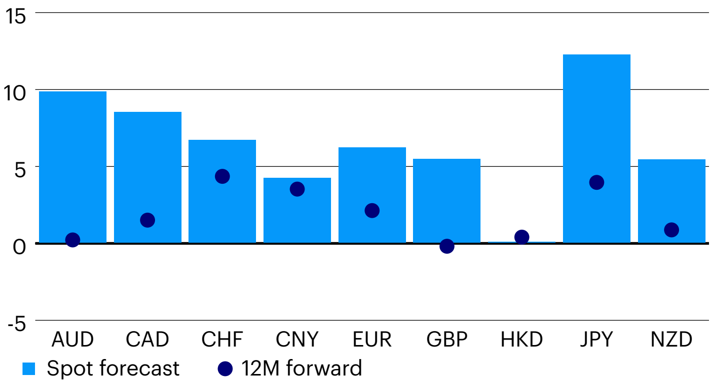
Note: GDP Growth, CPI Inflation, Current Account and Budget Balance are taken from the IMF World Economic Outlook (and are for 2025). Net International Investment Position (for 2023) is sourced from the IMF Balance of Payments Statistics (with GDP taken from the IMF World Economic Outlook). 3M (three-month) and 10Y (10-year) interest rates are sourced form Refinitiv. "Std vs norm" shows the current deviation from the historical average, expressed in standard deviations. Data used for the historical norm is from January 1990 to December 2024, with the following exceptions for start dates: AUD (Jan 1994 for 3M), CHF (Feb 1994 for 10Y), CNY (Jan 2002 for 3M and June 2002 for 10Y) and EUR (June 1990 for 3M and August 1992 for 10Y). Real Effective Exchange Rate is provided by JP Morgan, using consumer prices to make the adjustment for inflation differentials, and the "norm" is measured over the period from January 1990 to December 2024. As of 31 December 2024. Source: IMF, JP Morgan, Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

**Figure 5: Projected 3-month return vs USD (%)**




Note: **These projections may not come to pass.** "Spot forecast" shows projected currency changes versus USD based on our forecasts. "3M forward" shows the difference between the 3-month forward rate versus USD and spot rates. As of 31 December 2024.
Source: Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

**Figure 6: Projected 12-month return vs USD (%)**




Note: **These projections may not come to pass.** ""Spot forecast" shows projected currency changes versus USD based on our forecasts. "12M forward" shows the difference between the 12-month forward rate versus USD and spot rates. As of 31 December 2024.
Source: Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

### Forecasts and hedging strategies

Figures 5 and 6 show our 3-month and 12-month currency forecasts in percentage change terms (versus USD) and compare them to market-based forward currency rates.

The forecasts are based on the information presented in Figures 3 and 7, with the 12-month forecasts placing more emphasis on fundamentals and forecast changes in interest rates. The 3-month forecasts are also influenced by recent momentum, volatility and current interest rate spreads.

The following page gives more detail on individual currencies. The most important conclusion is that we expect all of our currencies to appreciate against USD on both a 3-month and a 12-month basis, thus reversing the trends of recent months and years. This view is based partly on valuations (USD is unusually expensive), partly on anticipation of a global upswing (which may benefit commodity related currencies) and a 2017-style rethink as US policies are revealed.

Among major central banks, we suspect the Fed has more scope than most to ease (given current policy rates), with the exception of the BOE which is also confronted by a weak economy. Among the central banks that we cover, the BOJ is the only one that we expect to tighten (see the rate forecasts in Figure 7).

Our spot exchange rate forecasts are shown in Figure 7 and the most striking is that we expect USDJPY to fall to 140 over 12 months (from the current 157). Figure 6 shows that we expect JPY to outperform other currencies, largely on the belief that the BOJ will continue raising rates, while other central banks cut (and that JPY is much cheaper than usual).

Figure 7 also shows conclusions about whether we think it worth hedging from other currencies into USD (based on a comparison of forecast currency movements and hedging costs, with a cushion for implementation costs). The answer is universally no.  Figure 8 shows the conclusions for all currency crosses (the favoured source currencies for hedging activity are HKD and USD, with JPY, AUD and CAD the favoured target currencies).

**Figure 7: Currency forecasts and hedging strategies versus USD**

| | Momentum (% change) | | | FX rates | | | 3M Projections | | | 12M Projections | | | Implied Volatility | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | | Std vs norm | |
| | 1M | 3M | 12M | Spot vs USD | 3M fwd vs USD | 12M fwd vs USD | 3M rates bpsΔ | Spot FX vs USD | Hedge Into USD? | 3M rates bpsΔ | Spot FX vs USD | Hedge Into USD? | 3M | 12M |
| **AUD** | -2.2 | -3.0 | -2.6 | 0.6188 | 0.6190 | 0.6202 | -25 | 0.6400 | NO | -75 | 0.6800 | NO | | |
| **CAD** | -1.5 | -2.6 | -2.9 | 1.4383 | 1.4327 | 1.4168 | -25 | 1.4000 | NO | -50 | 1.3250 | NO | | |
| **CHF** | -0.2 | -0.6 | 0.9 | 0.9073 | 0.8980 | 0.8694 | 0 | 0.8800 | NO | -15 | 0.8500 | NO | | |
| **CNY** | -0.1 | 1.6 | 2.9 | 7.2994 | 7.2484 | 7.0505 | -10 | 7.2000 | NO | -30 | 7.0000 | NO | | |
| **EUR** | -0.6 | -1.9 | 0.2 | 1.0354 | 1.0403 | 1.0574 | -25 | 1.0600 | NO | -50 | 1.1000 | NO | | |
| **GBP** | 0.3 | -0.2 | 4.0 | 1.2514 | 1.2512 | 1.2490 | -25 | 1.2800 | NO | -115 | 1.3200 | NO | | |
| **HKD** | 1.0 | 3.9 | 3.7 | 7.7681 | 7.7594 | 7.7367 | -25 | 7.7600 | NO | -75 | 7.7600 | NO | | |
| **JPY** | 0.9 | -3.7 | -3.3 | 157.20 | 155.67 | 151.20 | 25 | 150.00 | NO | 50 | 140.00 | NO | | |
| **NZD** | -1.7 | -3.9 | -4.6 | 0.5594 | 0.5602 | 0.5643 | -50 | 0.5700 | NO | -100 | 0.5900 | NO | | |
| **USD** | 1.0 | 4.5 | 6.0 | - | - | - | -25 | - | - | -75 | - | - | _ | _ |

Note: **Past performance is no guarantee of future results. These projections may not come to pass.** Momentum is based on recent changes in JP Morgan Nominal Broad Effective Exchange rates. Spot and forward exchange rates are provided by Refinitiv and are expressed according to market norms. Projections are provided by Invesco Global Market Strategy Office and conclusions about whether to hedge into USD are based on a comparison between current forward rates and projected spot rates (with an annualised 1% hurdle rate of return designed to allow for implementation costs). Implied Volatility is based on 3m and 12m currency options between the US dollar and the respective currencies, as provided by Refinitiv. "Std vs norm" measures the distance from historical averages in standard deviations, based on monthly data starting in March 2003.  As of 31 December 2024.
Source: JP Morgan, Refinitiv, LSEG Datastream and Invesco Global Market Strategy Office.

**Australian dollar (↑↑)**

We think a weak economy will allow RBA easing during 2025 (in line with the Fed) but expect AUD to benefit if commodity prices rise on global acceleration. We expect AUD to be among the stronger currencies and would hedge into it from most currencies (see Figure 8).

**Canadian dollar (↑)**

Because the BOC is ahead of the Fed easing curve, we expect CAD to strengthen versus USD (as the Fed catches up). As with AUD, a rebound in the global economy could help (via commodity prices). We would hedge into CAD from most currencies over 12 months.

**Swiss franc (↑)**

CHF has been robust despite SNB already cutting rates to 0.50%. Fundamentals are strong and other central banks may now cut more rapidly, but the currency appears expensive and we expect SNB to resist CHF strength. Low rates mean that we favour hedging from (rather than into) CHF.

**Chinese yuan (↓)**

The PBOC may ease again but other central banks are easing more rapidly. The link to USD (via the currency basket) could be a negative and we expect losses against some currencies. Low interest rates favour hedging into most other currencies.

**Euro (-)**

EUR is close to valuation norms and we expect the ECB to be in the middle of the central bank easing pack. We expect EUR to strengthen against USD but weaken against some other currencies. Hedging signals are mixed.

**Sterling (-)**

GBP has been strong (BOE reluctance to ease). Valuations are fair but fundamentals are weak (we think). BOE is likely to be slow to ease, which could help GBP. We think high rates make GBP a better hedging target, than funding source.

**Hong Kong dollar (↓↓)**

The peg to USD means the fate of HKD depends on the Fed. Fundamentals are strong, so HKMA may struggle to prevent appreciation against USD, especially if the Chinese economy strengthens. We think it is worth hedging out of HKD into most currencies.

**Japanese yen (↑↑↑)**

JPY remains cheap and we expect interest rate differentials to narrow as the BOJ tightens. We expect JPY to be the strongest among our group of currencies and would hedge into yen from all nearly all counterparts (despite the hedging costs).

**New Zealand dollar (-)**

NZD is a little expensive (we think), the current account deficit is large, the economy is in recession and we expect RBNZ to ease more rapidly than some other central banks. However, NZD may be helped for a while by still relatively high rates. Hedging signals are mixed.

**US dollar (↓↓)**

In our view USD remains expensive, has poor fundamentals and is entering a phase of public policy uncertainty. Hence, we expect recent strong momentum to reverse and would hedge out of USD into most of this group of currencies.

**Figure 8: 12-Month currency hedging decision matrix**

To

| From | AUD | CAD | CHF | CNY | EUR | GBP | HKD | JPY | NZD | USD |
|---|---|---|---|---|---|---|---|---|---|---|
| AUD | | X | X | X | X | X | X | X | X | X |
| CAD | ✓ | | X | X | X | X | X | — | X | X |
| CHF | ✓ | ✓ | | X | ✓ | ✓ | X | ✓ | ✓ | X |
| CNY | ✓ | ✓ | ✓ | | ✓ | ✓ | X | ✓ | ✓ | X |
| EUR | ✓ | ✓ | X | X | | ✓ | X | ✓ | — | X |
| GBP | ✓ | ✓ | X | X | X | | X | ✓ | X | X |
| HKD | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ | — |
| JPY | ✓ | X | X | X | X | X | X | | X | X |
| NZD | ✓ | ✓ | X | X | X | ✓ | X | ✓ | | X |
| USD | ✓ | ✓ | ✓ | — | ✓ | ✓ | X | ✓ | ✓ | |

Note: The above matrix shows our analysis of whether it is economic to hedge currency exposure, based on a comparison of our 12-month currency forecast and the cost of hedging (using 12-month forward contracts). All currency pairings are tested (from the currencies down the vertical axis to those along the top). A tick signifies that the profit from hedging (currency movement less hedging cost) would be 1% or more (which we deem offers sufficient cushion to cover implementation costs). A dash signifies that the profit would be greater than zero but less than 1%, so may not offer enough of a cushion. A cross signifies that the profit would be negative. This is a theoretical exercise and is for illustrative purposes only. It does not represent an actual portfolio and is not a recommendation of any investment or trading strategy. As of 31 December 2024.
Source: Invesco Global Market Strategy Office.

## Appendix

**Abbreviations for currencies**

| | |
|---|---|
| AUD | Australian dollar |
| CAD | Canadian dollar |
| CHF | Swiss franc |
| CNY | Chinese yuan (onshore) |
| EUR | Euro |
| GBP | British pound (sterling) |
| HKD | Hong Kong Dollar |
| JPY | Japanese yen |
| NZD | New Zealand dollar |
| USD | US dollar |

**Abbreviations for central banks**

| | |
|---|---|
| RBA | Reserve Bank of Australia |
| BOC | Bank of Canada |
| SNB | Swiss National Bank |
| PBOC | People's Bank of China |
| ECB | European Central Bank |
| BOE | Bank of England |
| HKMA | Hong Kong Monetary Authority |
| BOJ | Bank of Japan |
| RBNZ | Reserve Bank of New Zealand |
| FED | US Federal Reserve |

## Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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