FX Viewpoint

Currencies
Global

USD: A sustained decline?

- The US Dollar Index is down almost 3% quarter-to-date…
- …in part because of growing risks of a bigger Fed easing
- But even if the absolute level of USD yields falls, relative rates and the risk of softer global growth may still support the USD

The US Dollar Index (DXY) has dropped almost 3% quarter-to-date, hovering at around 103 currently (*Bloomberg*, 15 August 2024). **A popular question is whether the strong USD view is finished.**

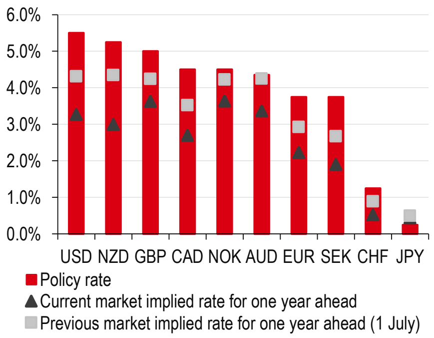
Sizeable Fed rate cuts may challenge the broad USD…

High US yields have been a key source of support for the USD, providing a buffer for the USD against positive risk sentiment. However, there has been a dramatic rethink by markets around the monetary policy outlook for the Federal Reserve (Fed) and other central banks, with markets now looking for sizeable rate cuts in most major economies (Chart 1). **Our economists now expect the Fed to deliver 75bp rate cuts this year**, followed by 75bp rate cuts in 2025. As such, **if current market expectations for Fed rates prove to be correct, this could challenge our thinking over the degree of USD strength.** In other words, it is likely that this year's cyclical high by the DXY was already seen in April.

…but relative rates may still support the USD

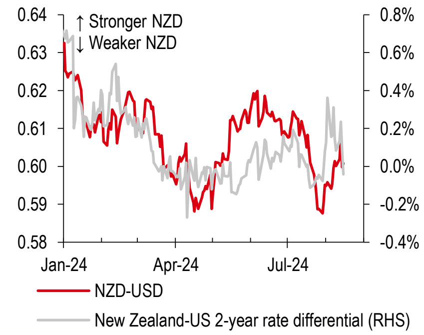
Nevertheless, there are two important factors that may still support the USD. The first is relative rates. **The Fed's easing should not be viewed in isolation as being entirely USD negative when other central banks are also making progress in this regard**. The most recent example comes from the **Reserve Bank of New Zealand (RBNZ) which cut its policy rate by 25bp to 5.25% on 14 August**. Notably, RBNZ Governor, Adrian Orr, said the central bank **had considered cutting by 50bp**, while markets had priced in about a two-thirds chance of a 25bp rate cut before the announcement (*Bloomberg*, 14 August 2024). **NZD-USD dropped more than 1% following its relative rate outlook** (Chart 2). A front-loaded rate cut cycle likely means front-loaded NZD weakness and could bring an earlier-than-expected reprieve to New Zealand's economy, in our view.

1. Markets now expect more easing, compared with early July



Source: Bloomberg, HSBC

2. NZD-USD and its rate differential



Source: Bloomberg, HSBC

…and the USD could hold up in a slowing global economy

The second is the risk of softer global growth. Markets focus more on the implications of a slowing US economy, but less on how slower US growth could weigh heavily on the global economy. **If global growth is shifted into a slower gear, that should anchor the USD in a stronger state**, all things being equal.

Given the circumstances, **we remain unconvinced by the idea of a trend decline unfolding in the USD.**

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