

FX Viewpoint

USD to grind higher over the near term

- ◆ We look for the USD to extend its rally, though gains from here may be hard to come by over the near term
- ◆ There has already been a substantial re-pricing of Fed cuts, but high US yields can foster a grind higher in the USD
- ◆ Geopolitical tensions and risk aversion could further add to USD strength, although the relationship is less stable

The USD has been leading other G10 currencies so far in 2024, with the US Dollar Index (DXY) rising about 4.5% year-to-date (*Bloomberg*, 25 April 2025). This has been fuelled mostly by the big retreat in markets' pricing of the likely scale and timing of the Federal Reserve (Fed) easing. Having started the year expecting the Fed policy rate to fall by about 150bp to 3.90% by the end of 2024, market expectations now stand at 5%. In other words, **markets now have only one 25bp cut fully priced in this year, with a second one viewed as having only a 33% chance of coming to fruition** (*Bloomberg*, 25 April 2025). There may not be much more for the USD to ride on in terms of further market re-pricing over the near term.

However, we still see grounds for the USD to maintain its lead over the next few weeks. Chief among them is that **US yields are high**, even if they may struggle to move higher (Chart 1). US 2-year yields are at around 5%, while Germany's 2-year yields are around 3% (*Bloomberg*, 25 April 2025).

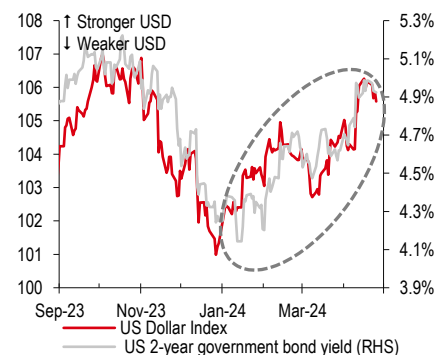
The high US yields may also foster **bouts of risk aversion** in equity markets, supporting the USD. That being said, it is worth noting that there has been a **disconnect in the inverse relationship between the USD and risk appetite so far in 2024** (Chart 2), as the FX market has struggled to decide whether good US data is in turn good for the USD (high yields) or bad (risk appetite). That ambiguity has weakened the USD's inverse relationship with global equities. However, we do not think this will undermine its role as a "safe haven" currency, should geopolitical risks intensify further.

A big shift in the pricing of Fed cuts has supported the USD

High US yields can foster a grind higher in the USD, in our view

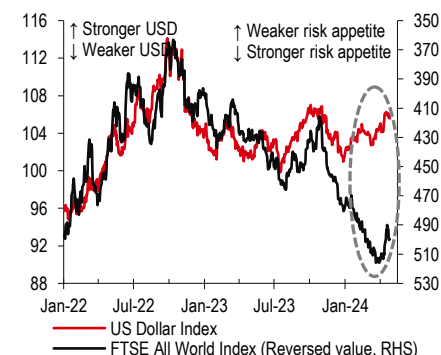
Geopolitical tensions could prompt further support for the USD

1. DXY and US yields



Source: Bloomberg, HSBC

2. DXY and risk appetite



Source: Bloomberg, HSBC

In the weeks ahead, we expect the DXY to grind higher and challenge 107, a level beyond which it struggled in October 2023. Whether it can prove more resilient this time around will **depend on US data, geopolitics, and how other central banks are behaving**.

We still expect the USD to strengthen modestly over the near term

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