19 July 2024

# FX Viewpoint

**Currencies**
Global

## USD: Not struck out

- DXY broke below support, but we look for stability ahead…
- …supported by high US yields, central bank outlooks for monetary policies, and global growth uncertainties
- US elections and future policies will matter for FX

**Politics is increasingly in the spotlight and at times matters a lot for FX**

Politics is increasingly in the spotlight and can sometimes move exchange rates. **The US Dollar Index (DXY) broke below support at around 104** following a Bloomberg interview with **former US President Donald Trump, who reportedly claimed that the USD is too strong versus the JPY and RMB**, which resulted in these currencies strengthening (*Bloomberg*, 17 July 2024).

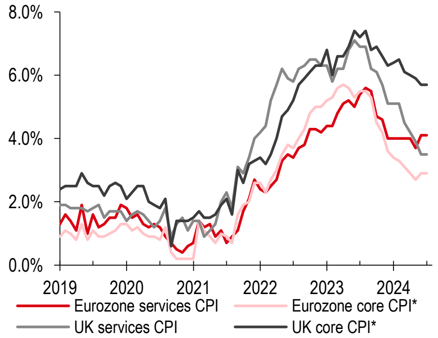
**US elections: Sweep or split?**

While we may be past election season in many economies, the implications for FX are not over just yet, as the policies that are implemented thereafter also matter. This will be especially true of the US elections, given the way that trade and fiscal policies have impacted the USD in the past. For example, historically, **'clean sweeps'** (when the same party has control of the presidency and both houses of Congress) **were USD positive** with the combination of easier fiscal policy alongside tighter monetary policy. However, **the FX implication would be less straightforward** in the case of a **'split outcome'**, with both fiscal and trade policies becoming difficult to navigate.

**The USD weakness is unlikely to be sustained, in our view**

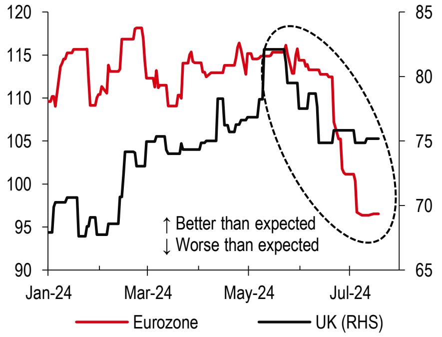
However, while FX can be swept up in politics and our confidence has been dented by recent USD weakness, our FX framework suggests the move lower will not be sustained. **The US economy continues to hold up better than others**. Second, the Federal Reserve's (Fed) easing cycle is likely to be modest, amid no sign of a material US downturn. The recent Fed rhetoric still embodies patience and gradualism. None of this supports the current rates market pricing, which points to about 60bp of Fed easing by end-2024 (*Bloomberg*, 18 July 2024).

**1. Eurozone and UK CPI (y-o-y, %)**




Note: *Core CPI refers to the consumer price index that excludes energy, food, alcohol and tobacco). Source: Bloomberg, HSBC

**2. Economic activity surprise indices**




Source: Bloomberg, HSBC

**Fiscal constraints may be a headwind for both the EUR and the GBP in the months ahead**

While the Fed is set to cut rates during 2H24 (and our economists expect a September cut, **many other central banks are also easing or are about to ease**. We are not convinced that sticky services inflation in the UK and Eurozone (Chart 1) is helpful for their currencies, even if it slows the pace of rate cuts. Recent growth disappointments in the Eurozone point to a troubling growth-inflation mix. Meanwhile, the strong positive momentum in UK economic activity surprises since the start of the year appears to be petering out (Chart 2). **Fiscal frailties also pose downside risks to the EUR and the GBP on both the economic and political fronts**.

In summary, we believe that **the USD is still well placed** amid politics, central bank outlooks for monetary policies, and global growth uncertainties.

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