21 June 2024

FX Viewpoint

Currencies
Global

USD: Still in a sweet spot

- We still expect a strong USD in the months ahead…
- …supported by the level of US yields and divergent monetary paths
- The "safe haven" USD is also likely to benefit from growing uncertainties in 2H24

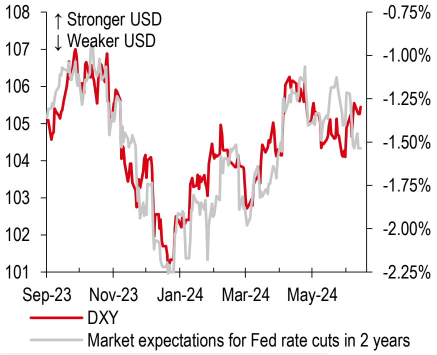
We believe that the USD will remain strong…

We are nearing the halfway point of the year and our broad FX views remain largely unchanged. **Since early September last year, we have believed in the strong USD, and we see this continuing in the months ahead.** The US Dollar Index (DXY) has strengthened since the start of the year and has been tracking changes in the Federal Reserve (Fed) rate cut expectations closely (Chart 1).

…supported by the level of US yields and divergent monetary paths

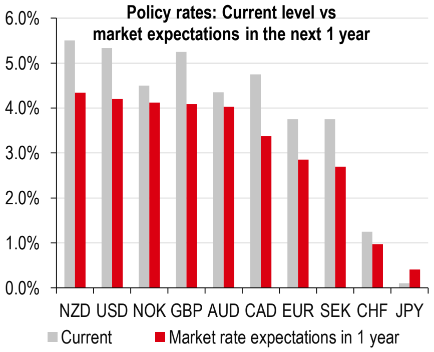
As we enter the second half of the year, **uncertainties appear to be growing, rather than easing.** Some central banks, like the European Central Bank (6 June), the Bank of Canada (5 June), and Sweden's Riksbank (8 May) have begun cutting their policy rates. More recently (20 June), the Swiss National Bank delivered its second 25bp rate cut in the current easing cycle. However, other central banks, like the Bank of England (BoE) and the Reserve Bank of Australia, remain on hold in June. **Questions abound on the pace and depth of the respective cutting cycles**. If the Fed is not rushing to lower its policy rate, the focus could increasingly shift to other central banks and the complexities that they face. **Divergent monetary paths and the level of US yields should support our strong USD view** (Chart 2).

1. The USD has been tracking closely market expectations for Fed rate cuts



Note: Data was updated on 20 June 2024 at 20:30 HKT.
Source: Bloomberg, HSBC

2. The USD is expected to continue to be a higher yielding currency



Note: Data was updated on 20 June 2024 at 20:30 HKT.
Source: Bloomberg, HSBC

The "safe haven" USD is also likely to benefit in uncertain times

It is clear that **elections are mattering a lot more for currencies**, with French parliamentary elections (first round on 30 June and second round on 7 July), UK general elections (4 July), and US presidential and congressional elections (5 November). Against this backdrop, **the USD appears to be in a position to benefit, given that it is a hedge against most currencies in uncertain times.**

Both the EUR and GBP are likely to weaken against the USD in the months ahead

In summary, **the USD is likely to remain strong over the coming months**. While the GBP has been stronger than expected so far this year, supported by buoyant risk appetite and relatively high yields, it is likely to be on a path of gradual weakness over the coming months when the BoE starts cutting rates. We expect the EUR to weaken against the USD, reflecting yield differentials and more recently a pick-up in political risk, among others.

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