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Chief Investment Office GWM
Investment Research

Introducing our 1Q26 forecasts

Currency markets

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- Our forecasts for key currency pairs remain largely unchanged. Select changes were made where macro news or the exchange rate warranted a shift, such as for the JPY, the AUD, and the Scandies.
- We reiterate our view that the USD should be a story of two halves in 2025—one of strength, followed by one of weakness. We also penciled in additional JPY appreciation potential.
- We believe US tariff risks in 1H25 are underpriced; hence, the USD should see another period of strength. However, we reckon that US macro data are unlikely to remain robust over the full year, favoring a USD reversal in 2H25.

Source: UBS

Our view

The market's more relaxed stance on US tariff risks, US macro data failing to surprise to the upside, and peace deal talks with Russia on the war in Ukraine triggered a USD consolidation in the low to mid-single digits. The USD pullback has been uneven with the CAD, CHF, and EUR lagging, while the SEK, JPY, and the GBP have been leading. EM gains were also diverse, with the RUB and the BRL performing the best.

Our current forecasts keep our currency market narrative unchanged. Tariff and macroeconomic data should keep the USD well bid. March and April will bring key tariff news, which can easily trigger renewed bouts of USD strength—testing the highs seen this year. The CNY is particularly at risk from this perspective. Since the USD requires strong macro data to stay at lofty levels, which is not guaranteed over the full year, we also reiterate that there are limits to USD strength and room for the greenback to give up ground as the year progresses. Our new 1Q26 forecasts reflect this. Our select forecast changes are linked to the JPY, the AUD, and the Scandies. Firmer inflation and macro data favor more BoJ action and a stronger JPY on a broader basis. For the AUD, we account for a highly gradual rate cut cycle and further underpricing of China stimulus measures, while for the Scandies, some domestic and some general European macroeconomic factors speak to a recovery.

Our new FX forecasts

FX Pair	26-02-25	Jun 25	Sep 25	Dec 25	Mar 26
EURUSD	1.048	1.02	1.04	1.06	1.07
USDCHF	0.896	0.91	0.89	0.88	0.88
GBPUSD	1.264	1.23	1.25	1.29	1.30
EURCHF	0.939	0.93	0.93	0.93	0.94
EURGBP	0.829	0.83	0.83	0.82	0.82
GBPCHF	1.133	1.12	1.12	1.13	1.15
EURNOK	11.68	11.5	11.3	11.2	11.1
EURSEK	11.14	11.3	11.2	11.1	10.9
USDJPY	149.5	148	148	145	142
AUDUSD	0.631	0.65	0.66	0.67	0.68
NZDUSD	0.569	0.56	0.57	0.58	0.60
USDCAD	1.435	1.44	1.42	1.40	1.40

Source: Bloomberg, UBS, as of February 2025

Focus: Introducing our 1Q26 forecasts

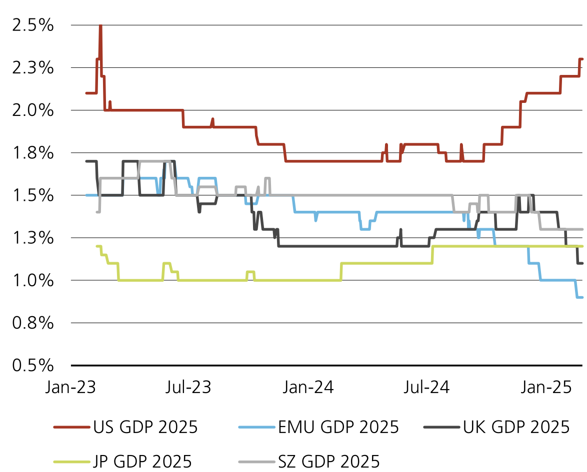
We shifted our forecast window by one quarter from 1Q25-4Q25 to 2Q25-1Q26. When such changes happen, it is an opportunity to take stock of the current backdrop and to give guidance about the longer-term trajectory of currency markets.

Taking stock of the current backdrop

We think the broader macro backdrop today versus last month is largely unchanged, and this also applies to the near-term outlook. US growth should remain robust with little room to cut interest rates by the Fed in the short run. Meanwhile, the ECB has more room to cut rates further as Europe is struggling to grow. Contrary, the BoJ is likely to hike interest rates further amid plenty of inflation and a more robust activity backdrop. This is reflected in rates expectations, which have strongly driven currency markets.

Growth expectations continue to shift in favor of the US

Bloomberg consensus estimates



Source: Bloomberg, UBS, as of February 2025

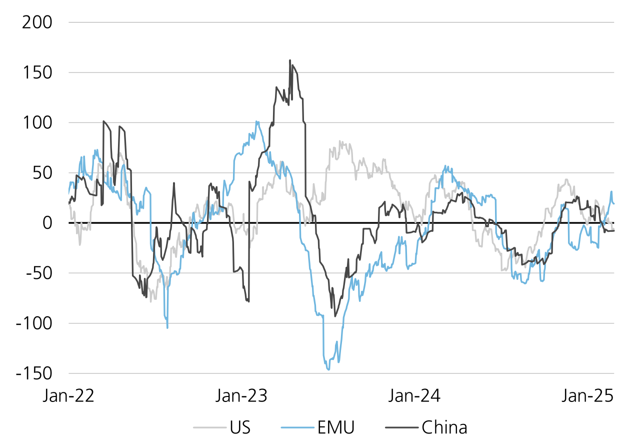
But as we all know, it is not just about the big picture, as small incremental changes matter too. There has been a lot of talk about tariffs in recent weeks, but little implementation so far. As a result, markets, including the currency market, have become more insensitive toward tariff news while not pricing in any negative growth impact. We think this is a bit shortsighted considering that we are just six weeks under a Trump administration, and actual tariffs can still shift higher in the coming months—focus is on March (Mexico and Canada) and April (Rest of the World).

This matters for currencies where the underlying growth is weak, like in the Eurozone. Moreover, US economic activity should stay robust in 1H amid a healthy labor market and stable investment activity. Hence, the patches of weakness in sentiment indicators are less of a concern for now, while the story for the second half may look different.

Sentiment data in Europe, while still being on the weak side, has slightly improved and surprised to the upside compared to very downbeat expectations. At the same time, political developments in France have averted the worst-case scenarios, in Germany a new two-party coalition should have a positive economic impact, and ceasefire talks for Ukraine also add to more positive sentiment around the Eurozone. Less downside risks to the Eurozone have given the pro-growth currencies in the region a lift, especially the SEK but the GBP and NOK have also outperformed the EUR.

We have seen positive economic surprises in the Eurozone, mainly on survey data

Daily data



Source: Bloomberg, Citi, UBS, as of February 2025

Elsewhere, the Bank of Japan has grown increasingly confident of its policy normalization plans, owing to continued resilience in Japan economic data. But at the same time, Japanese officials are trying to orchestrate an orderly rise in JGB yields, with Finance Minister Kato warning that rising bond yields will strain the finances of the debt-laden government, while BoJ Governor Ueda said that the central bank will purchase JGBs if bond yields rise sharply. As long as both JGB yields and JPY are rising in an orderly manner without undermining domestic financial stability, we expect the BoJ to stay on its course of policy normalization, i.e., short-term rates reaching 1% this year.

Staying in APAC, Australia in particular, AUDUSD has staged a modest recovery after the RBA made its first cut in four years. Governor Michele Bullock pushed back on more aggressive market expectations for a quicker easing cycle given that inflation remains above the target band and the labor market is still tight. We agree with this observation and thus see very limited room for the RBA to cut rates.

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USDCHF	0.93	0.91	0.89	0.88
GBPUSD	1.19	1.23	1.25	1.29
EURCHF	0.93	0.93	0.93	0.93
EURGBP	0.84	0.83	0.83	0.82
GBPCHF	1.11	1.12	1.12	1.13
EURNOK	11.8	11.7	11.6	11.5
EURSEK	11.5	11.4	11.3	11.3
USDJPY	160	156	153	149
AUDUSD	0.62	0.63	0.65	0.66
NZDUSD	0.54	0.54	0.55	0.56
USDCAD	1.46	1.44	1.42	1.40

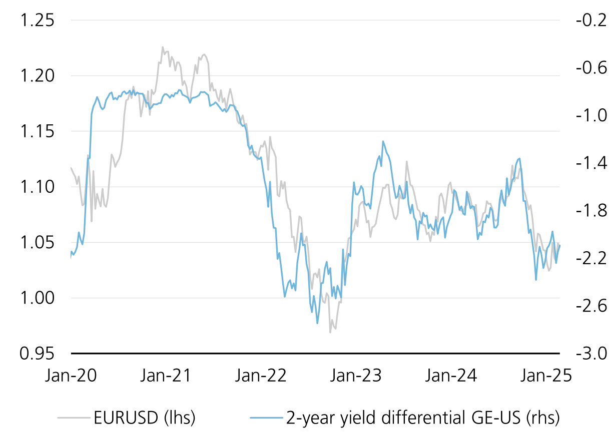
Source: Bloomberg, UBS, as of February 2025

What lies ahead

A move below parity in EURUSD has become less likely. However, equally, we do not think that the time has come to position on the other side and sell USD outright. The tariff deadlines for Canada and Mexico loom at the beginning of March, the US global trade review is on 1 April, and we are convinced that higher tariff rates will be implemented in the coming months. With this view in mind, we still look for bouts of USD strength. We keep our forecasts unchanged for June until December at 1.02, 1.04, and 1.06 respectively.

EURUSD remains highly sensitive to changes in relative rates

Weekly data



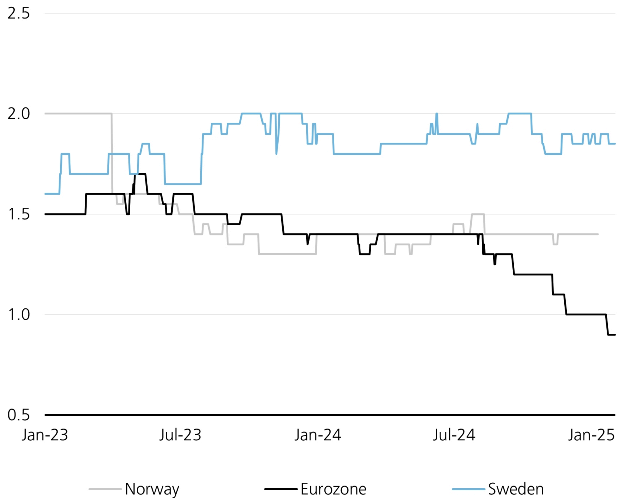
Source: Bloomberg, UBS, as of February 2025

Later this year, however, we do expect a recovery of EURUSD, once the ECB has concluded its easing cycle and the Federal Reserve has resumed its expected cutting activity. Furthermore, we expect the previous ECB easing of around 200bps to contribute positively to the European economy later this year and help offset the negative impact of export headwinds due to US tariffs. Thus, our forecast for 1Q26 stands at 1.07 and underpins a peak in US strength in 1H. Our EURCHF, EURGBP, USDCHF, and GBPUSD forecasts remain broadly unchanged.

Staying in Europe, we think the Scandies can gain more ground. Global financial conditions have eased, and regional growth improvement has been supportive. This drives a shift down in our forecast, as we see the Scandies as better able to capture strength amid growth outperformance over the euro area in 2025. We shift the EURSEK forecast to 11.30, 11.20, and 11.10 for 2Q-4Q25 (from 11.40, 11.30, and 11.30) and add the 1Q26 forecast of 10.90. The EURNOK forecast shifts to 11.50, 11.30, and 11.20 for the same period (from 11.80, 11.70, and 11.60), and we add 11.10 for 1Q26. Near-term risks persist: tariffs are still in the air, and a peace-deal with Ukraine is going to be a lengthy process, so we remain cautious.

Norway and Sweden expected to outgrow the Euro Area in 2025

Bloomberg GDP consensus estimates for 2025 (%)

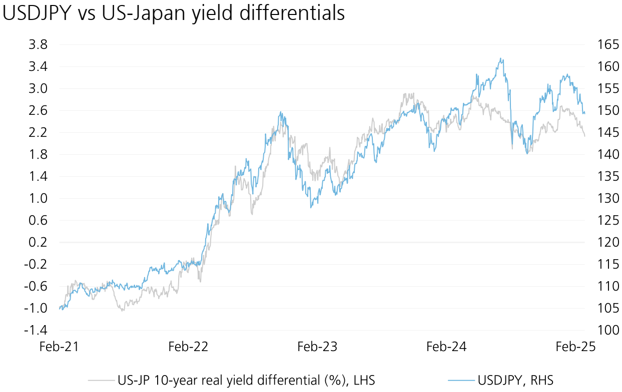


Source: UBS, Bloomberg as of February 2025

In Asia, we made more adjustments on the JPY side. We now expect the USDJPY to reach 148 by June 2025 (previously 156), 145 by year-end (previously 149), and introduce a target of 142 for March 2026. This shift underpins our view that rates in Japan could rise more than the market is expecting. We see room for short-term rates to reach 1% this year. Moreover, the JPY is the most sensitive currency to lower rates in the US into year-end.

As US-Japan yield differentials narrow further, USDJPY should drift lower over the coming quarters

USDJPY vs US-Japan yield differentials

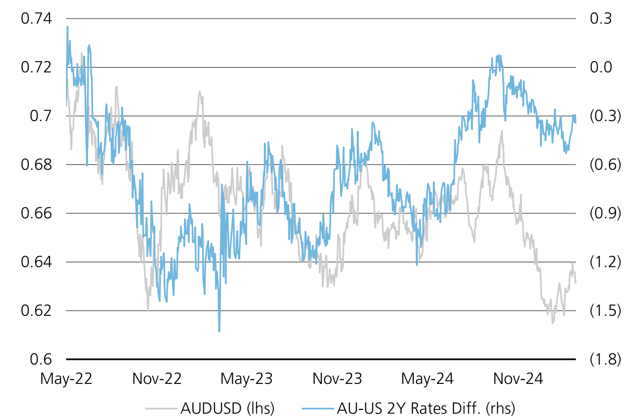


Source: Bloomberg, UBS, as of February 2025

Downunder we shifted the forecasts for AUD and NZD. Less rate cuts by the RBA should give the AUD underlying support. We think the RBA will cut just once more in 2025, while a further 25bps cut in 2026 leaves the cash rate at our current estimate of the terminal level at or above 3.6%. Alongside major rates spreads, solid commodity prices signal a fair value for the pair in the high 0.60s. Hence, we forecast the pair to be 0.65 by end-June (from 0.63), 0.66 by end-September (from 0.65), 0.67 (from 0.66) by end-2025, and 0.68 by end-March 2026.

We think there is room for AUDUSD to catch up with relative AU-US yields

Daily data



Source: Bloomberg, UBS, as of February 2025

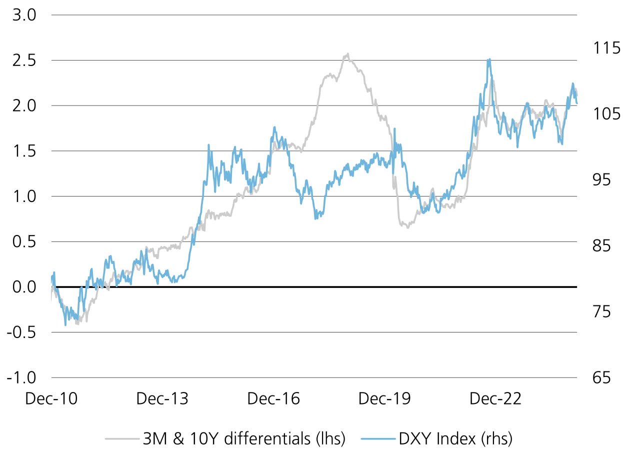
As for NZDUSD, we think the pairing has troughed but still expect the pair to underperform many of its G10 peers, including the AUD, for the remainder of 2025. With elevated short positioning and market expectations converging on a terminal rate around 3%, we observed the pair bounce despite the Reserve Bank of New Zealand (RBNZ) cutting the cash rate by 50bps to 3.75%. RBNZ Governor Adrian Orr signaled more modest reductions in interest rates over the months ahead by which time the RBNZ likely pauses as more tangible signs of a growth recovery emerge. As such, we rebase the forecasts to 0.56 by end-June (from 0.54), 0.57 by end-September (from 0.55), 0.58 by end-2025 (from 0.56), and 0.60 by end-March 2026.

Risks to our forecasts

The main risks to our outlook and forecasts come from macroeconomics and politics. If US economic growth stays buoyant amid weakness elsewhere, the USD is likely to stay well-bid into year-end. More attractive returns for US assets would not give investors an incentive to reduce or hedge their dollar asset exposure. Trump's tariff plans remain a wildcard for markets as well. A larger scale trade war is likely to be USD-positive initially. This could push EURUSD toward parity or lower and prolong USD strength beyond 1H25. In the longer term, a full-out trade war would still be harmful for the US economy and the USD if it triggers lower US yields.

Elevated US yields vs. key currencies has been essential behind broad USD strength

Weekly data, lhs values (relative rates DXY weighted) are in %



Source: Bloomberg, UBS, as of February 2025

Lastly, escalating geopolitical developments could also boost the USD in a flight-to-safety rush. We regard this risk factor as rather small, with geopolitical risks being biased to toward deescalation. On that front, a quick resolution to the Ukraine war, which potentially includes Europe importing cheap Russian gas, would be an upside surprise for the euro. Furthermore, a bigger European defense fund and a relaxation of fiscal rules in Europe could also strengthen the euro beyond our current forecasts and would potentially lead EURUSD toward 1.10 more quickly.

Appendix

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