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US policy uncertainty calls for more forecast adjustments

Currency markets

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- Trump's tariff decisions have weakened the USD swiftly since the beginning of April and pushed it down to our long-term forecasts for key exchange rates.
- US policy uncertainty is likely to stay high, weighing further on US exceptionalism. It also leaves the currency market with a wider-than-usual range of outcomes for different exchange rates.
- Our new forecasts still leave room for the USD to consolidate in the short term. However, the longer-term point of gravity suggests a mid-single-digit move lower.

Source: UBS

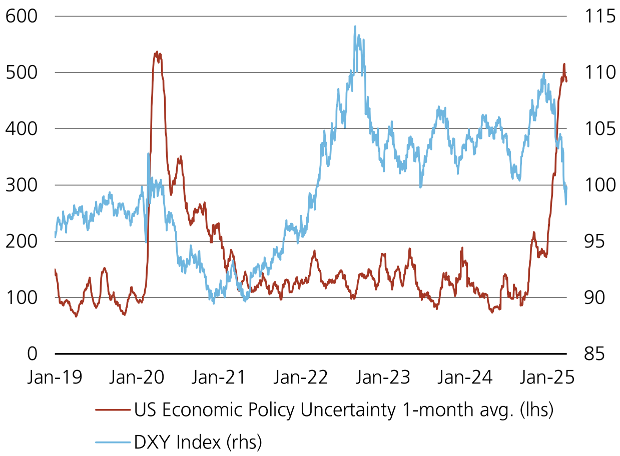
More layers of uncertainty
Tariff risks seem to have found a peak, but US policy uncertainty remains high, as evidenced by the latest messages from the Trump administration with regard to the Federal Reserve chair. Comments about the possibility of Jerome Powell's removal, followed by a step back from such a move, have left investors with a bitter aftertaste. Not surprisingly, gold prices temporarily soared above USD 3,500/oz, while the DXY index slipped below the 100 mark.

The Fed chair story matters…
Even before his election, US President Donald Trump had said that he was not Powell's biggest fan. In recent weeks, Trump has entered unchartered territory, by officially criticizing Powell and doing legal checks on how to remove him from his post. However, we think Powell's removal before the end of his term is unlikely for three reasons:

1) His term ends in May 2026, which gives Trump the opportunity to name a successor as early as 3Q or 4Q this year;

2) Trump and his economic advisors should know that removing the central bank chair could spark unwelcome financial stability risks; and

US policy uncertainty has been weighing on the USD
Daily data



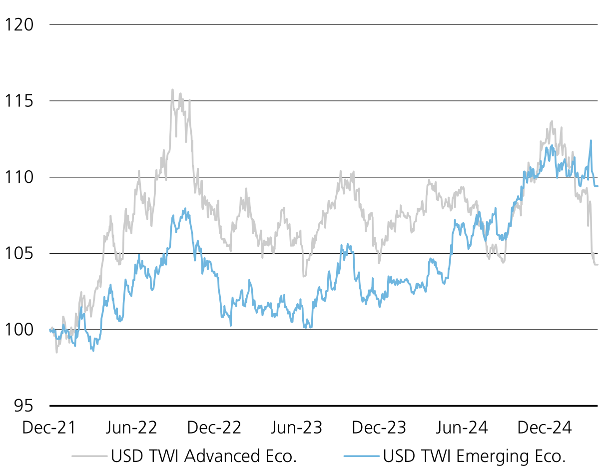
Source: Bloomberg, UBS, as of April 2025

3) The pressure on Powell is likely to ease naturally as weaker US economic data should allow the Fed to cut rates based on sliding macroeconomic activity and the Fed's dual policy mandate.

The end of Powell's term will bring its own challenges as Trump comes closer to naming a successor of his liking and thinking. The mere idea that Fed independence could be at risk adds another layer of US uncertainty that we can't just put aside. Tariff dynamics since "Liberation Day" have reminded investors to be prepared for the unthinkable. We believe this adds to investors' tail risk considerations with regard to the Fed at a time that "US exceptionalism" and the USD are already under pressure.

As for the currency market, the Fed chair debate is likely to motivate institutional investors to increase their FX hedges. Notably, European investors have greatly increased their exposure to US equities in recent years amid the underperformance of risk assets in Europe. Keeping this in mind as well as the fact that incremental cash flows could be invested outside the US, we see reduced potential for a USD rebound in the short term, and expect the currency to drift lower over time.

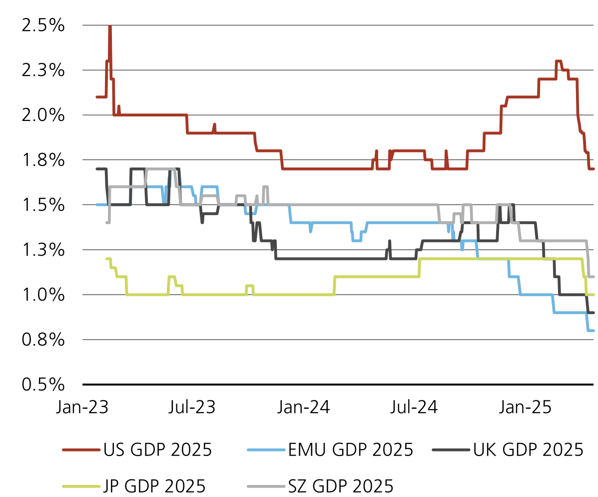
USD weakness has been uneven, mainly versus advanced economies (G10 currencies)
Daily data



Source: Bloomberg, UBS, as of April 2025

… as well as the US economy's landing zone
Our base case calls for a tariff deescalation from here as trade deals are struck. But the lack of certainty, which is affecting companies' investment plans, is likely to leave its mark on gross fixed capital formation and thus the overall US economy. We reckon that investment growth could almost stall this year, bringing US GDP growth down to 1.5%, with negative quarter-over-quarter data readings later in the year. The risk to this view is to the downside, in our view, with a growth landing zone around 1%. We think this leaves room for more Fed rate cuts than what markets are currently pricing. In short, we would not be surprised if short-term US yields fall toward 3% by year-end. As the Fed is likely to start another easing cycle, while the European Central Bank (ECB) and other central banks are nearing or have reached the end of their easing cycles, yield differentials are likely to compress. With the US policy risk premium attached to the USD remaining unchanged, the point of gravity for the USD should move lower.

Global growth expectations have yet to find a real floor
Daily data, Bloomberg consensus estimates

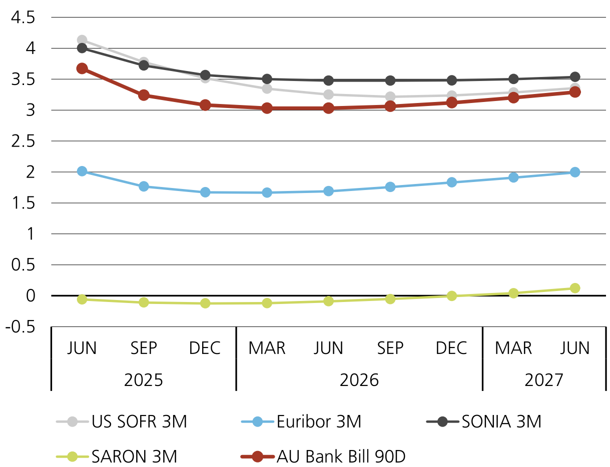


Source: Bloomberg, UBS, as of April 2025

The macro narrative outside the US
Economic growth is set to slow outside the US as well, from an unfavorable starting point. How big the growth hit will be in the different economies of the US, Europe, or Asia (China) is difficult to forecast at this stage as we lack historical references. We think this also means markets can reinterpret the current macroeconomic and policy backdrops from opposite perspectives. So, investors should have an open mind about the near-term economic outlook.

But despite all this uncertainty, the ongoing tariff spat between China and the US could make Europe a relative winner. Europe is not very high up on the US tariff list and the Trump administration is likely to strike a trade deal of some sort with the Eurozone in due course—most likely earlier and on better terms than with China. Second, the ECB has more than halved its policy rate over the past 12 months and is already close to its neutral policy rate. We think this should provide a lift to the economic outlook. Furthermore, recent announcements of meaningful fiscal easing in Germany and the rest of the Eurozone mean fiscal support is already in the pipeline. All this leaves the EUR and its regional peers in a better position than the USD, in our view. Some regional currency peers like the Scandis, which have suffered from the recent market sell-off, find themselves at an even better starting point to profit from the European fiscal and monetary stimulus measures.

Rate-cut dynamics in 2H could be uneven
Values in %, daily data



Source: Bloomberg, UBS, as of April 2025

Our new forecasts in short
We lowered our US dollar forecasts across the board. The EURUSD forecasts have been lifted to 1.14 in June, 1.16 in September, 1.16 in December, and 1.18 in March 2026. As we left our EURCHF and EURGBP forecasts unchanged, this translates into new USDCHF forecasts of 0.83, 0.82, 0.82, and 0.81 and new GBPUSD forecasts of 1.36, 1.38, 1.38, and 1.39 for the same forecast periods. Our USDCAD forecasts were lowered to 1.40, 1.38, 1.38, and 1.36.

In Asia-Pacific, we have lowered our forecasts for key currency pairs. USDJPY targets have been shifted lower to 144, 142, 140, and 138. As for the AUDUSD and the NZDUSD, our new quarter-end forecasts through March 2026 stand at 0.64, 0.66, 0.68, and 0.70; and 0.60, 0.61, 0.62, and 0.64, respectively. Our USDCNY forecasts were changed slightly to 7.30, 7.25, 7.20, and 7.15.

With these forecasts in place, we like to sell the USD on strength. Our currencies of choice would be the laggards like the AUD, NOK, or GBP. Risk-off currencies, which have performed particularly well recently, should underperform as their safe-haven appeal fades and investors focus more on their negative carry. Alternatively, we like the higher option-volatility backdrop for volatility-selling strategies. In particular, we like to sell the USD's upside potential for yield pickup. The aforementioned currencies (AUD, NOK, and GBP) can also be used against the EUR or CHF to beef up meager money market returns.

New FX Forecasts

FX Pair	24-Apr-25	Jun 25	Sep 25	Dec 25	Mar 26
EURUSD	1.139	1.14	1.16	1.16	1.18
USDCHF	0.825	0.83	0.82	0.82	0.81
GBPUSD	1.331	1.36	1.38	1.38	1.39
EURCHF	0.939	0.95	0.95	0.95	0.95
EURGBP	0.855	0.84	0.84	0.84	0.85
GBPCHF	1.098	1.13	1.13	1.13	1.12
EURNOK	11.85	11.5	11.3	11.2	11.1
EURSEK	10.94	10.9	10.8	10.7	10.6
USDJPY	142.4	144	142	140	138
AUDUSD	0.639	0.64	0.66	0.68	0.70
NZDUSD	0.598	0.60	0.61	0.62	0.64
USDCAD	1.384	1.40	1.38	1.38	1.36

Source: Bloomberg, UBS, as of April 2025

Old FX Forecasts

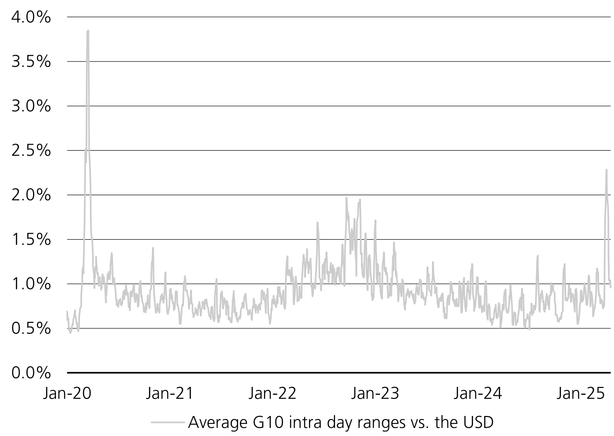
FX Pair	Jun 25	Sep 25	Dec 25	Mar 26
EURUSD	1.10	1.12	1.12	1.14
USDCHF	0.86	0.85	0.85	0.83
GBPUSD	1.31	1.33	1.33	1.34
EURCHF	0.95	0.95	0.95	0.95
EURGBP	0.84	0.84	0.84	0.85
GBPCHF	1.13	1.13	1.13	1.12
EURNOK	11.5	11.3	11.2	11.1
EURSEK	10.9	10.8	10.7	10.6
USDJPY	148	148	145	142
AUDUSD	0.62	0.64	0.66	0.68
NZDUSD	0.56	0.57	0.58	0.60
USDCAD	1.46	1.44	1.42	1.40

Source: Bloomberg, UBS, as of April 2025

Risks around our forecasts
First and foremost, the dynamics of exchange rates have become more volatile and intraday ranges have doubled lately across G10 currencies. Hence, exchange rate fluctuations around our forecasts are naturally larger.

Daily exchange rate ranges in USD currency pairs temporarily more than doubled compared to long-term averages

Daily data



Source: Bloomberg, UBS, as of April 2025

If the US administration strikes sooner and makes more meaningful trade deals in the coming weeks, bringing US policy uncertainty down sharply, we could see a rebound of the USD to our previous forecasts of 1.10 for the EURUSD and 0.86 for the USDCHF, while the USDJPY could move to 150 again.

Conversely, a quicker or more severe weakening of the US economy, or in the worst-case scenario the removal of the Fed chair by the president leading to the central bank losing itss independence would push the EURUSD quickly into a 1.20-1.25 range, which would bring the currency pair to its purchasing power parity fair value near 1.25. In such a situation, safe-haven currencies would likely lead the performance table again, with the EURCHF falling further and the EURGBP grinding higher, while the USDJPY would approach the 130 level faster and the USDCHF would gravitate into a 0.75-0.80 range.

Appendix

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