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ALEJANDRA GRINDAL, CHIEF ECONOMIST
PATRICK AYERS, SENIOR ANALYST

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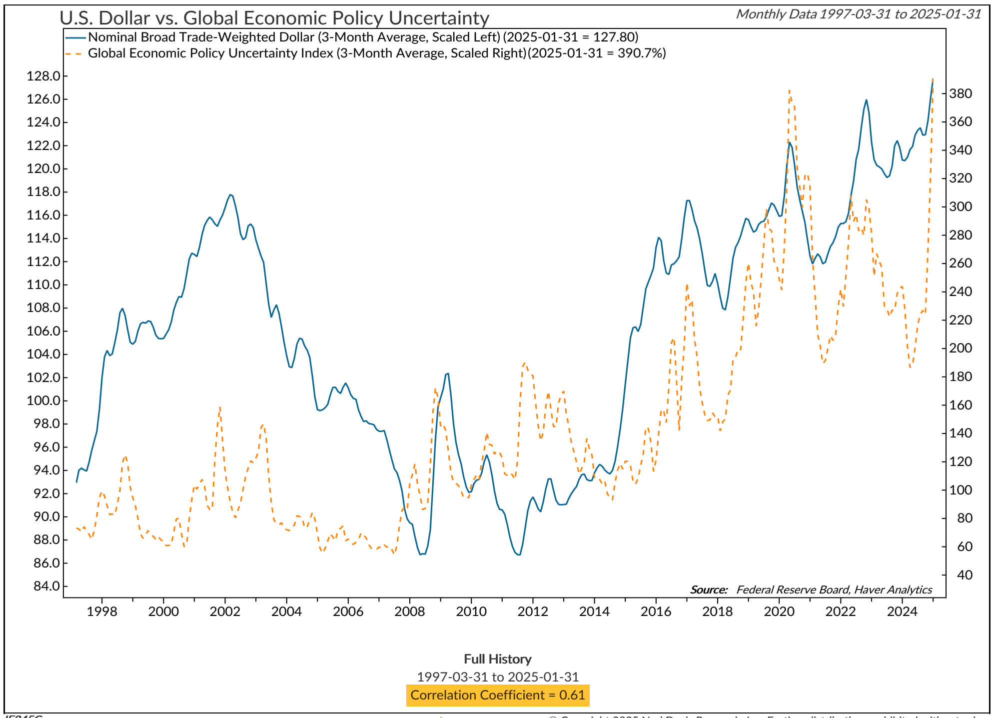
What do tariffs mean for currencies?

Key Takeaways

- Tariffs are positive for the dollar due to self-correcting mechanisms, consequences of central bank action, and increasing global policy uncertainty.
- But the ongoing global economic expansion is associated with dollar weakness.
- The current balance of risks is neutral for the dollar, in line with our models.

Higher policy uncertainty associated with stronger dollar



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U.S. President Trump has often expressed the need for a weaker dollar. Agitated by the U.S.'s large trade deficit, a weaker dollar would be a factor that could improve that shortfall as it would reduce the cost of U.S. goods and services to foreigners.

Even in a purely free trade world, the dollar weakness doesn't last due to self-correcting mechanisms. The weaker currency would likely increase demand for the economy's products (holding all else constant). But this, in turn, raises demand for the country's currency, eventually driving up its value. Unfortunately, the use of tariffs to close the trade gap just accelerates the process.

But there's more. The higher tariffs are likely to increase U.S. inflation, which could slow the Fed's easing. At the same time, U.S. tariffs on Chinese goods could see China dumping cheap goods into other economies, bringing down their inflation. A relatively more hawkish Fed also suggests dollar strength.

Economic policy uncertainty, which spiked to the second highest on record in January, is also associated with dollar strength. Even if tariffs are just used as a negotiating tool for other concessions to the U.S., uncertainty will abound.

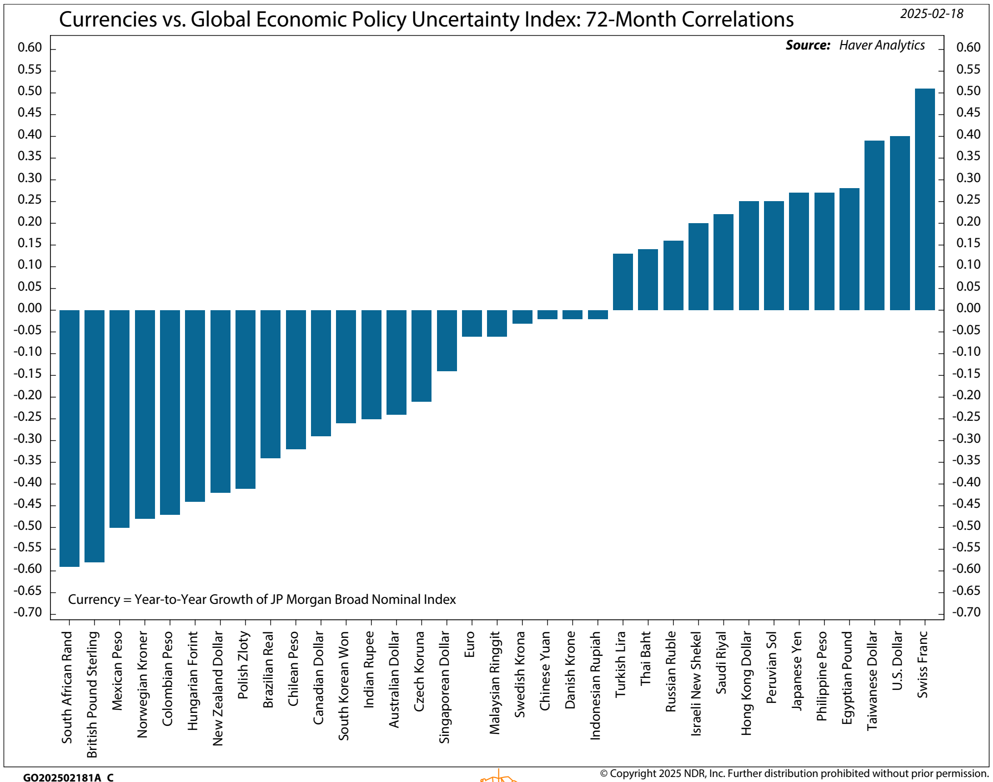
Offsetting this risk, however, is the global economy. As we've discussed in recent publications, the global economy remains on solid footing. Dollar weakness tends to prevail when the economy is in a sustained slowdown, and even more when the global economy is in recession.

Given that so far tariffs have been used as a negotiating tactic and the global economy remains in a constructive state, **we maintain a neutral stance on the dollar**, confirmed by our technical models. But if tariffs are enacted in a large way, and even to the point of derailing the economic recovery, the dollar is likely to strengthen further.

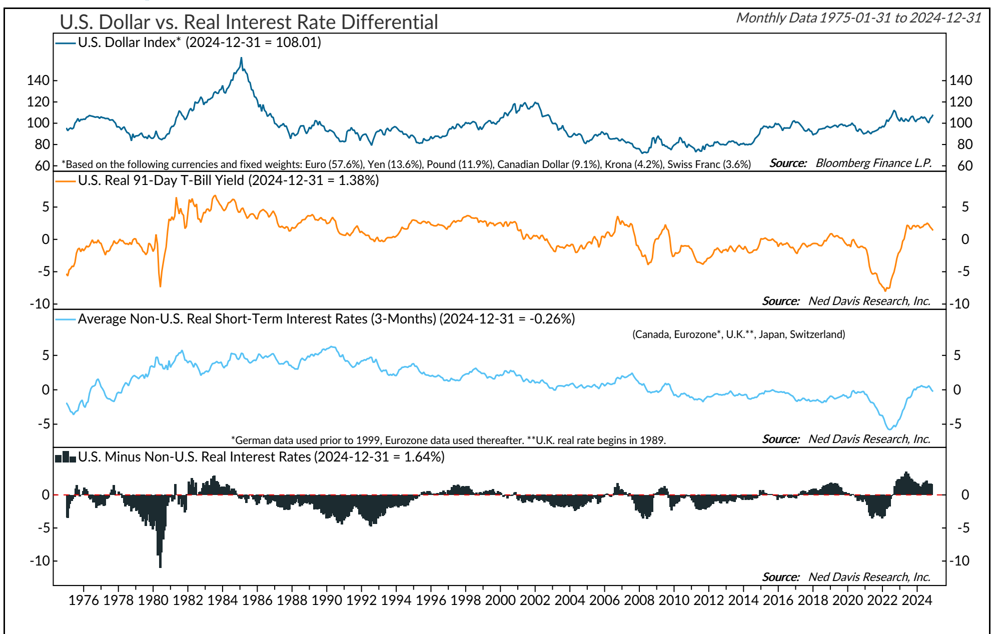
The chart at right shows the correlation between the global economic policy uncertainty index and various currencies. According to our analysis, the currencies most negatively impacted by global policy uncertainty are the South African rand, the pound sterling, and the Mexican peso.

Meanwhile, safe-haven currencies such as the U.S. dollar and the Swiss franc are more likely to see gains when policy uncertainty increases.

Global policy uncertainty affects currencies in different ways



Relatively more hawkish Fed bullish for the dollar



U.S. Dollar Index Gain/Annum Performance
Full History: 1975-01-31 to 2024-12-31

Non-U.S. Interest Rate Differential	% Gain/ Annum	% of Time
Above 0.0	1.33	34.06
Below 0.0	-0.31	65.94

Buy/Hold = 0.24% Gain/Annum

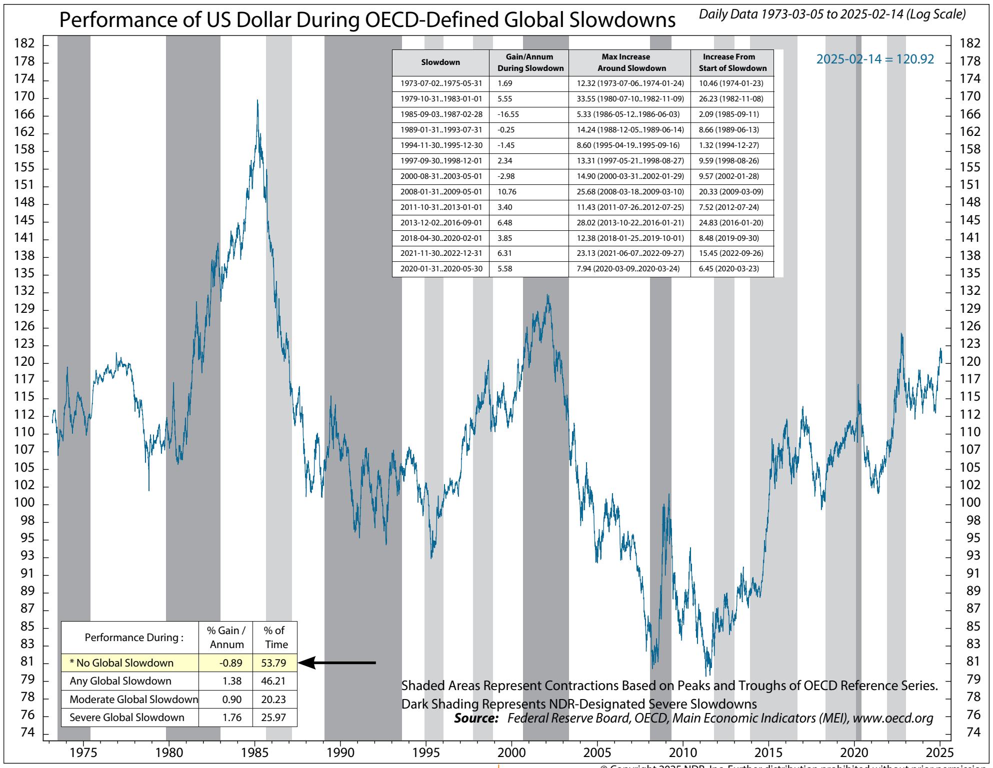
As Veneta Dimitrova wrote last week, tariffs are likely to increase U.S. inflation, with a stronger dollar only offsetting that risk modestly, making it more difficult for the Fed to ease policy.

Many other developed economy central banks are on easing paths and with their economies in weaker shape, some like the ECB, BoC, and BoE are already poised to ease faster than the Fed and could even more so in the event of hefty tariffs. Tariffs would likely slow their growth rates more than the U.S., whose economy is less reliant on trade, while a potential dumping of cheap Chinese goods on these non-U.S. economies could be disinflationary.

As shown in the chart at left, a relatively more hawkish Fed is dollar positive.

The good news is that the global economy remains in solid shape, as we highlighted in our February 12 and February 5 publications. As shown in the chart at right, global economic expansions have historically seen a per annum decline in the dollar. Meanwhile, sustained global slowdowns have tended to see the dollar strengthen, and even more so when the slowdown has been severe.

Global economic expansions associated with weakening dollar



Our currency models rank the dollar essentially neutral

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Currency Market Relative Strength Ranking

- **Report:** ICS_2.RPT
- **Run Date:** 2025-02-14
- Report through: 02/17/2025

Rank	Currency Market	Total Composite
1	Japanese Yen	72.9
2	Canadian Dollar	62.5
3	Australian Dollar	59.7
4	Swedish Krona	52.6
5	U.S. Dollar	47.0
6	Euro	45.6
7	Swiss Franc	36.1
8	British Pound	30.8

Given the balance of risks, we maintain our neutral position on the dollar. This is confirmed by our technical currency models, shown at left, which has the dollar ranked in the middle compared to other major currencies.

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Economic Summary Report for the World

- **Report:** ICS_250_GLBL.RPT
- **Run Date:** 2025-02-18
- Download Chart Bundle

Economy: World
Date: Today
Submit

Click here for historical gauge reading

Economic Activity | Economic Sentiment | Inflation | Inflation Surveys | Debt

Green = Improving, Red = Worsening, (Download Economic Activity Chart Bundle)

Title	Value	Units	Monthly % Change	Quarterly % Change	Year-to-Year % Change	Date	Compare Globally
Manufacturing PMI[1]	50.1 (33.8 – 57.6)	Index	0.5 (-7.7 – 5.5)	0.7 (-11.3 – 11.0)	0.1 (-18.1 – 20.9)	2025-01-31	ICS_212
Services PMI[1]	52.2 (23.5 – 63.8)	Index	-1.6 (-13.0 – 12.8)	-0.9 (-29.3 – 27.3)	-0.2 (-29.5 – 33.4)	2025-01-31	ICS_213
Composite PMI[1]	51.8 (26.0 – 62.8)	Index	-0.8 (-12.9 – 11.5)	-0.5 (-26.2 – 25.1)	-0.1 (-26.3 – 30.6)	2025-01-31	ICS_214
PMI: Capacity Utilization[1]	49.7 (38.7 – 60.9)	Index	0.4 (-3.1 – 5.1)	0.0 (-6.7 – 6.4)	0.3 (-12.3 – 15.0)	2025-01-31	N/A
Share of Manufacturing PMIs Above 50[1]	47.2 (0.0 – 100.0)	%	5.6 (-41.2 – 27.8)	5.6 (-67.3 – 66.7)	8.3 (-96.3 – 92.3)	2025-01-31	N/A
OECD Composite Leading Indicator for G20 Economies[1]	100.4 (89.6 – 104.7)	Index	0.1 (-4.7 – 3.7)	0.3 (-9.7 – 8.5)	0.6 (-9.7 – 11.8)	2025-01-31	ICS_200
Share of OECD CLIs Above 100[1]	82.4 (0.0 – 100.0)	%	5.9 (-50.0 – 37.5)	0.0 (-100.0 – 66.7)	52.9 (-100.0 – 100.0)	2025-01-31	N/A
OECD Area Unemployment Rate[1]	4.9 (8.8 – 4.8)	%	0.0 (3.2 – -0.6)	0.0 (3.5 – -1.1)	0.0 (3.3 – -2.2)	2024-12-31	ICS_204
Real GDP	25.8 (17.0 – 25.8)	Trillion Chained USD	N/A	0.5 (-8.3 – 11.3)	2.8 (-10.6 – 23.7)	2024-06-30	N/A
Global Economic Conditions Indicator[1]	41.9 (-417.7 – 134.4)	Index (bp)	24.8 (-308.1 – 422.6)	24.6 (-376.6 – 492.2)	23.2 (-420.8 – 552.0)	2025-01-31	N/A
Industrial Production	106.7 (46.4 – 106.7)	Index	0.3 (-8.5 – 4.7)	0.7 (-8.5 – 9.5)	1.8 (-12.8 – 17.7)	2024-11-30	N/A
Global Industrial Commodity Market Activity Index[1,2]	-45.4 (-161.5 – 189.3)	Index	-34.0 (-100.2 – 84.9)	-58.6 (-217.1 – 112.3)	-84.6 (-256.5 – 177.4)	2024-12-31	N/A
World Trade Volume	105.1 (26.5 – 105.2)	Index	0.4 (-12.2 – 7.4)	-0.1 (-16.5 – 15.2)	3.6 (-19.7 – 25.9)	2024-11-30	N/A
Tanker 12-Month Time Charter Rate	51.5 (16.0 – 100.0)	Thous. USD/day	-4.6 (-35.8 – 88.2)	33.8 (-54.4 – 100.0)	33.8 (-65.7 – 207.7)	2025-02-14	N/A
Drewry WCI Composite Container Freight Benchmark	3,095.1 (658.2 – 10,377.2)	USD/FEU	-19.7 (-41.9 – 148.3)	-10.1 (-60.2 – 190.7)	-18.2 (-80.5 – 367.8)	2025-02-13	N/A
Contex Index	1,415.0 (237.0 – 3,578.0)	Index	-1.0 (-48.6 – 43.4)	4.3 (-72.5 – 107.9)	105.1 (-79.4 – 668.6)	2025-02-18	N/A
Global House Price Index	189.8 (99.3 – 189.8)	Index	N/A	0.5 (-0.5 – 4.1)	3.1 (-0.5 – 16.0)	2024-09-30	N/A

Sources

- Bank for International Settlements, Long series on credit to the private non-financial sector
- Fearnleys.com
- Food and Agriculture Organization of the United Nations, www.fao.org
- Haver Analytics
- OECD, Main Economic Indicators (MEI), www.oecd.org
- S&P Global PMI
- The Hamburg Shipbrokers Association

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NDR HOUSE VIEWS (Updated February 13, 2025)

For global asset allocation, NDR recommends an overweight allocation to stocks, marketweight allocation to cash, and an underweight allocation to bonds. Our recommendations are in line with our Global Balanced Account Model.

Equity Allocation

U.S. | Our U.S. asset allocation recommendation is 70% stocks (15% overweight), 25% bonds (10% underweight), and 5% cash (5% underweight). On an absolute basis, we are overweight the S&P 500 (year-end 2025 target of 6600). We are neutral on small-caps versus large-caps (implicit overweight to mid-caps) and neutral on Growth versus Value.

INTERNATIONAL | We are overweight the United States, Canada, and Pacific ex-Japan; underweight Emerging Markets, the U.K., and Japan; and makeweight Europe ex. U.K.

Macro

ECONOMY | The global economy has shown notable resilience, with recession chances waning. Risks include monetary and fiscal policy uncertainty, a potential global trade war, sticky inflation, and easing Chinese growth.

FIXED INCOME | We remain 100% of benchmark duration, and are neutral on the yield curve. We are overweight MBS and underweight CMBS and ABS. We are marketweight everything else.

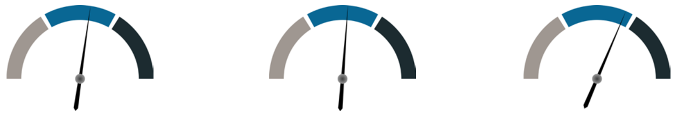
GOLD | We are currently bullish.

CURRENCIES | We are neutral on the U.S. dollar, euro, yen and the U.K. pound.

Economic Summary

February 18, 2025

Near term activity: ● Accelerating ● Neutral ● Decelerating



Global Economy (3.1%) | U.S. Economy (2.0% - 2.5%) | U.S. Inflation (2.75% - 3.25%)

Economic gauges reflect changes in near-term economic activity. Numbers in parenthesis refer to NDR 2025 forecasts.

Global Asset Allocation

● Overweight ● Marketweight ● Underweight

- Stocks (70%)
- Cash (10%)
- Bonds (20%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Equities — Regional Relative Allocation

- United States 69% | Canada (5%) | Pacific ex. Japan (4%)
- Europe ex. U.K. (13%)
- Emerging Markets (5%) | U.K. (2%) | Japan (2%)

Benchmark – U.S. (64.0%), Europe ex. U.K. (11.7%), Emerging Markets (10.2%), Japan (5.3%), U.K. (3.4%), Pacific ex. Japan (2.5%), Canada (2.8%)

Global Bond Allocation

- Europe (35%)
- U.S. (56%) | U.K. (4%)
- Japan (5%)

Benchmark: U.S. (57%), Europe (27%), Japan (12%), U.K. (5%)

U.S. Allocation

- Stocks (70%) | Mid-Cap
- Small-Cap | Large-Cap | Growth | Value
- Bonds (25%) | Cash (5%)

Benchmark: Stocks (55%), Bonds (35%), Cash (10%)

Sectors

- Financials (16%) | Consumer Discretionary (14%)
- Materials (1%) | Real Estate (1%)

Benchmark: Technology (30.5%), Health Care (11.5%), Financials (12.8%), Communication Services (9.4%), Consumer Discretionary (10.7%), Consumer Staples (6.4%), Industrials (8.5%), Energy (3.5%), Utilities (2.3%), Real Estate (2.2%), Materials (2.2%)

U.S. Bonds — 100% of Benchmark Duration

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NDRsales@ndr.com
www.ndr.com
(800) 241-0621

SARASOTA

3665 Bee Ridge Road Suite 306

Sarasota, FL 34233

United States

800 241 0621 (U.S. & Canada)

941 412 2300

NEW YORK

1270 Avenue of the Americas

11th Floor

New York, NY 10020

(800) 241-0621

LONDON

4 Bouverie Street

Temple, London

EC4Y 8AX

+44 20 7779 8454

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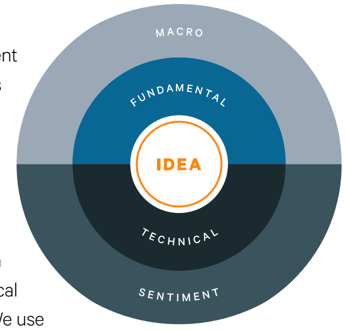

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