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Chief Investment Office GWM
Investment Research

Currency markets: Risks ahead for the USD

Currency markets

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- After slumping all year, the USD has stabilized in recent weeks. We find current levels attractive to position for further USD weakness in 2H25.
- Given the trade-war and economic event risks on the horizon, we wouldn't use low-yielding safe-haven currencies like the CHF and the JPY extensively as funding currencies.
- We continue to like being long the EUR, NOK, AUD, and MXN against the USD.

Source: UBS

Trade war remains a USD risk

Since the sharp market sell-off following "Liberation Day," financial risk sentiment has rebounded, with equity markets in some countries reaching new all-time highs. Volatility in FX markets has also largely normalized. The White House de-escalated its tariff threats over the past month, agreeing to delays and/or lower rates for China and the EU and temporarily reducing "reciprocal" tariffs on other countries to 10%. Chinese tariffs peaked at 145% before dropping to around 40%, and the EU faced the threat of 50% tariffs until a deal postponed their implementation to 9 July.

Important to note is the tariff implementation has been delayed, not resolved. Significant uncertainty remains, which we believe warrants a cautious approach. With the 9 July deadline for "reciprocal" tariffs approaching, the options are to either extend the pause or impose tariffs on countries without trade agreements. As the deadline nears, markets may become more risk averse, as seen before the initial 2 April deadline. However, the various court rulings in recent days put the legal capacity of these tariffs into question.

Given the challenges the US faces in reaching agreements with multiple countries at the same time, we believe any renewed escalation in the trade war would continue to weigh on the USD. Countries that sign deals with the US early may feel a first-mover-disadvantage because the US administration could offer better terms at a later stage, as pressure mounts to demonstrate progress. This raises the risk of tariff escalation before deals are made, thus raising the risks to the USD.

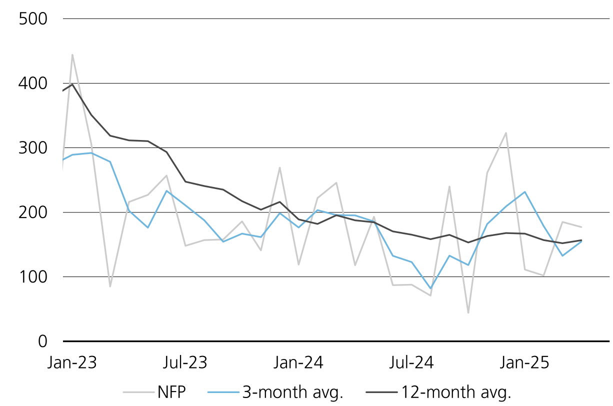
Economic data and Fed pricing

When the US announced a truce with China, the USD briefly rebounded but then weakened again. This suggests that a positive resolution to the trade war could support the dollar. However, we see limited scope for sustained USD strength.

Markets generally expect tariffs to push US inflation higher and dampen US growth. Since the tariff uncertainty began last October—when Trump's polling numbers started to surpass Kamala Harris'—corporate decision makers worldwide have struggled to make longer-term business decisions. Extending tariff deadlines by 90 days does little to resolve this uncertainty for purchasing and HR managers. As a result, the risk of weaker economic activity, a slowdown in the US economy, and eventual layoffs continues to rise. With the early-year front-loading boom fading, economic softness is likely to emerge in the US in the coming months.

Labor market stabilized on weaker level

Monthly non-farm payrolls (NFP)

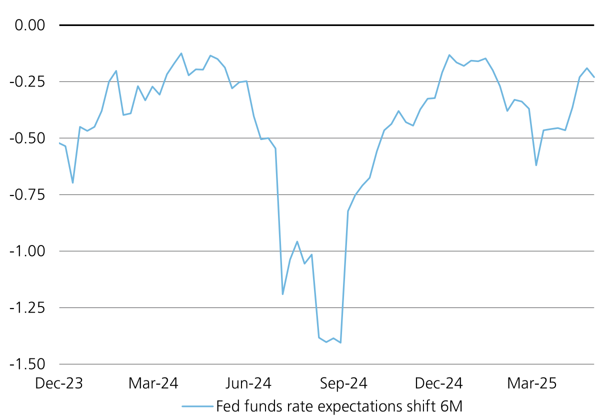


Source: Bloomberg, UBS as of June 2025

Regarding Federal Reserve policy, we see clear downside risks for the USD. Current market pricing anticipates two rate cuts this year. Even if economic data surprises to the upside, it is unlikely to prompt rate hikes, limiting the potential for higher US rates from here. Conversely, as seen in August 2024, a sudden deterioration in the labor market could trigger faster and deeper rate cuts than currently expected, despite any temporary inflationary effects from tariffs.

Weak labor data in mid-2024 led to Fed repricing

Daily data



Source: Bloomberg, UBS, as of June 2025

Risks clearly to the downside

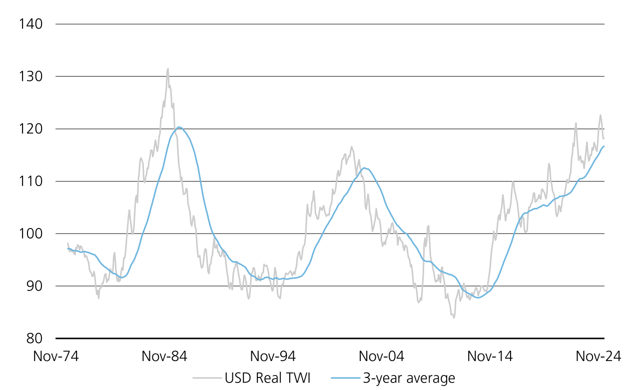
Even if new trade deals are reached soon, much of the economic and reputational damage to the US has already been done and is likely to show in upcoming data, weighing on the dollar. If US economic data surprises to the upside, there would be limited room for the Fed to tighten further; but if data disappoints, markets could quickly price in more easing.

Following the "Liberation Day" announcements, equities and the dollar both sold off. But since the de-escalation, equities have recovered while the USD has only stabilized at lower levels. Should tariffs escalate after 9 July, the dollar is likely to come under renewed pressure, while another extension of the tariff pause is unlikely to provide much support.

Moreover, the USD remains expensive relative to the trade-weighted index and based on various valuation metrics. While valuation mismatches alone do not guarantee currency weakness, the combination of poor long-term fundamentals—such as the sizable US twin deficits—and a president opposed to a strong dollar is prompting global investors to reassess their USD exposure.

The USD remains expensive

USD real trade-weighted index (TWI), monthly data



Source: Bloomberg, UBS as of June 2025

USD remains a sell on rallies

Given the number of downside risks facing the dollar, we think international investors are likely to use rallies to reduce or hedge their dollar positions—thus limiting any potential upside. We expect EURUSD to move into the 1.15-1.20 range soon and think a move toward 1.10 is far less likely and would only be temporary. We therefore like using levels in EURUSD between 1.12 and 1.14 to take long positions, targeting a move into the 1.15-1.20 range. We think AUDUSD below 0.64, GBPUSD below 1.34, and USDCHF above 0.83 are attractive levels to position for a weaker USD going forward.

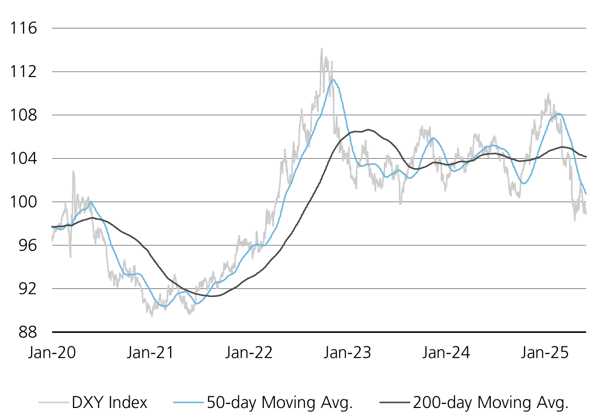
USD-based positions

After the dollar index's (DXY) drop from 110 in January to 98 in the middle of May, the USD has since consolidated around the 100 level. The postponement of tariffs until 9 July led to a sharp recovery in global equity markets, but the USD didn't follow suit. In our view, the combination of higher tariffs and ongoing uncertainty is going to hurt the US economy—and therefore the US dollar—more than most other economies. As a result of weaker US economic data, we expect the Fed to resume its easing cycle in the second half of the year. This should occur when the ECB is set to finish its easing cycle, leading EURUSD gradually higher toward 1.20.

As we expect the USD to weaken from here, we like building up AUD, NOK, and EUR long exposure on bouts of USD strength. The AUD and the NOK should see further spot appreciation and have no carry disadvantage to the USD. While having more than 2% carry disadvantage, the EUR remains the default currency when looking for a USD-alternative due to its liquidity and market depth. We expect the pair to move into a 1.15-1.20 range later in the year. In general, as event risks mount, we like hedging long positions in the US dollar over the next few months. We like selling the USD upside potential versus the AUD, NOK, EUR, or JPY for a yield pickup, given our negative USD view, despite currency volatility having normalized in recent weeks.

Dollar index consolidating before the next move lower

Daily data



Source: Bloomberg, UBS as of June 2025

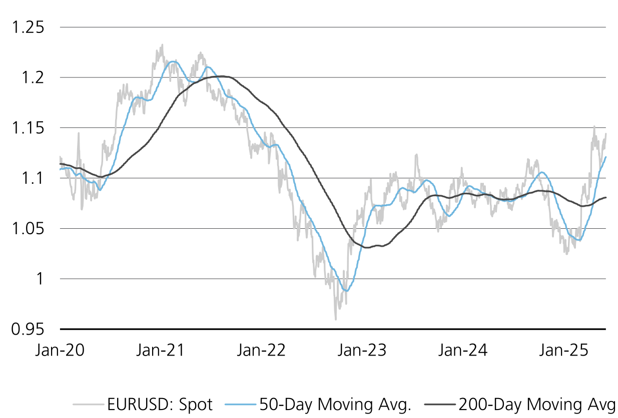
EUR-based positions

Since the beginning of the year, the EUR has benefited from two main sources: first the German and European fiscal packages, and second the trade war moving from being USD supportive to USD negative. The EUR, being the most liquid alternative to the USD, has profited accordingly. In our view, portfolio flows out of the USD are likely going to continue in the coming months and quarters, thereby supporting the EUR against the USD and leading the pair toward 1.20. In the crosses, the EUR is likely to stay flat against the CHF and GBP but lose ground against the recovering Scandies.

We continue to like using EURUSD between 1.12 and 1.14 to lighten USD exposure, to position outright for a higher EURUSD exchange rate, and to increase USD hedge ratios. In the crosses, we see the biggest opportunities in the two Scandies—the NOK and SEK—as well as the AUD. The NOK and the AUD also have an attractive carry against the EUR, which does not exist for the SEK. Other G10 pairs, such as EURCHF, EURGBP, and EURJPY, have remained in their established ranges in recent weeks, and we don't expect them to experience outsized moves in either direction in the absence of a renewed spike in market uncertainty. Given the expectation of further EUR strength down the road, we are more selective on yield-enhancement strategies in the EUR—for example, against the USD, CHF, and GBP. However, against the NOK, SEK, and AUD, we continue to like selling the upside in the EUR.

EURUSD moving into 1.15-1.20 range

Daily data



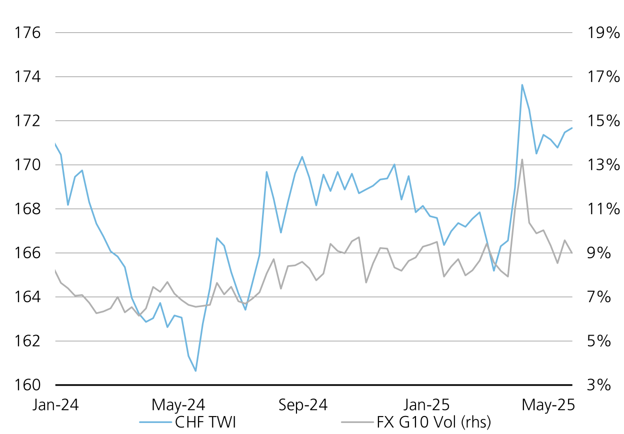
Source: Bloomberg, UBS as of June 2025

CHF-based positions

After a strong performance in April, the Swissie has stabilized as markets gained confidence amid the tariff de-escalation. USDCHF rebounded to 0.82 after the dip, while EURCHF returned to its long-standing 0.935 level. From here, we believe the direction for the CHF remains one of moderate appreciation against the USD, as growth uncertainty lingers and with US investors starting to rebalance their share of US assets in their portfolios. We expect USDCHF to continue grinding down slowly, while EURCHF shouldn't rise above 0.95, in our view. That said, the total returns in terms of CHF-based positions are likely to be limited, as we believe the Swiss National Bank is set to lower rates by 25bps to 0% in June. SNB Chair Martin Schlegel reasserted the central bank's readiness to use negative rates again, which could curb the Swissie's gains.

With our view of an extended decline in the dollar very much in place, we like to hedge USD long positions over the next few months, despite the elevated hedging costs, given the event risks on the horizon. In the crosses, some of the more risk-sensitive currencies, like the NOK, the SEK, and the GBP, have recouped some of their losses against the CHF. We think they are candidates to outperform the CHF in 2H25 in terms of spot and carry, along with the JPY, which still has some room to strengthen due to diverging monetary policy.

Volatility has receded, but the CHF remains strong
Weekly data



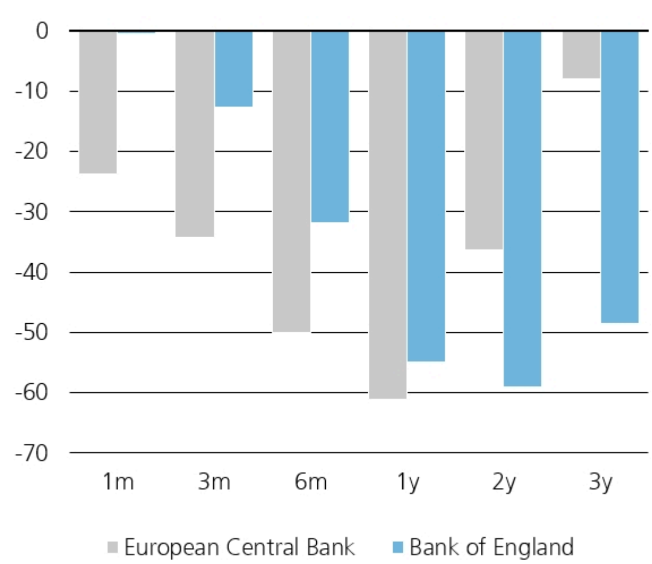
Source: Bloomberg, UBS

GBP-based positions

The British pound has benefited from continued weakness in the greenback. Further, the latest UK growth-inflation data mix speaks against swift policy easing by the Bank of England (BoE), which should help preserve the GBP's attractive carry in the near term. We continue to forecast quarterly Bank of England rate cuts and see risks in GBPUSD as skewed to the upside from here. Our cautious outlook for the USD plays an important role here. As for EURGBP, the pair has re-established its tight trading range, and we expect it to remain rangebound until year-end. In 2026, the EUR might get the upper hand with the ECB at the end of its easing cycle and the BoE likely to still need to loosen policy. The UK's fiscal situation remains a risk that could weigh on the GBP's outlook.

The active FX opportunity set for GBP-based positions remains rather limited. We like to hedge USD positions against the GBP, given our view that a more substantial setback in GBPUSD is unlikely to last. Furthermore, we continue to prefer hedging positions in the CHF given our positive spot outlook in the short run and positive hedging gains. We would increase exposure in the EUR should EURGBP dip below 0.8250 and decrease exposure above 0.8600 over the next 1-6 months. On a 6- to 12-month horizon, we see upside in other European risk proxies such as the NOK and SEK against the GBP. In GBPNOK, we also like selling upside risks in the short term for a yield pickup. However, we would refrain from such strategies in GBPSEK.

BoE's policy easing expected to be "back-loaded"
Market pricing for policy rates over time vs. current level, bps



Source: Bloomberg, UBS, as of June 2025

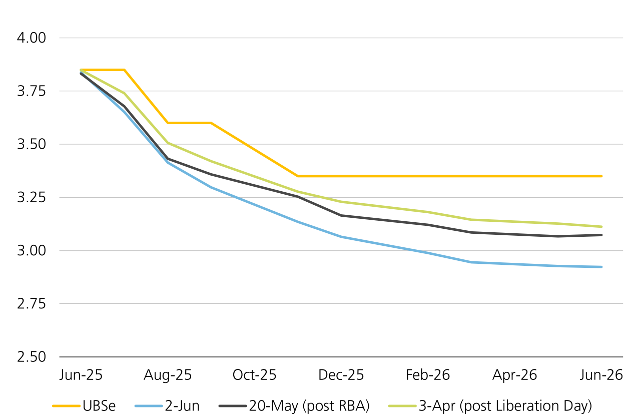
AUD-based positions

The AUD has found its feet, but AUDUSD is yet to sustainably break out of the 0.64-0.65 range as key domestic data events approach and tensions between the US and China are on the rise again. While a dovish shift by the Reserve Bank of Australia at its 19-20 May meeting did surprise, the interpretation of these adjustments depends on whether you see a more protracted slowdown or if you believe the domestic economic recovery is already underway; we argue for the latter. The RBA lowered its trimmed mean CPI forecasts to 2.6% y/y from 2Q25 onward (versus 2.7% y/y previously), but Governor Michele Bullock still judged the labor market as "a bit tight." Moreover, we also note national house prices increased by 0.5% m/m in May, which is the fastest pace since June 2024—a net positive for household consumption down the road.

Overall, with these current fundamentals, we believe the level of net-short non-commercial positions in the AUD is overdone, albeit it also signals a relatively limited downside from a positioning standpoint. We retain our forecast that AUDUSD will rise to 0.70 in 1H26, but outside the USD, we see opportunities to right-size or hedge exposures to major low yielders like the SGD, CHF, and CNY (against the AUD). We expect a combination of spot gains and positive carry over six and 12 months in these crosses. Against the GBP, we would also hedge exposure but with a shorter tenor of three to six months. On the risk side, if global developments impart greater downside risks in markets, we would expect the AUD rebound to stall but not retest the post-"Liberation Day" lows.

UBS expect less cuts by the RBA, which supports the AUD

In %



Source: Bloomberg, UBS as of 2 June 2025

JPY-based positions

We expect the JPY to continue benefiting from safe-haven demand. The medium-term downtrend in USDJPY remains intact, in our view, supported by global investors' ongoing efforts to reduce USD exposure amid heightened US policy uncertainties, including risks related to tariffs, fiscal sustainability, potential shifts in currency policy reminiscent of the Plaza Accord, and questions surrounding future Fed leadership. Furthermore, lower US interest rates and the convergence of US growth with that of other major economies should also weaken the USD. Domestically, the recent rise in long-term Japanese government bond yields underscores the Bank of Japan's need for a cautious approach to policy tightening, suggesting that any yen appreciation is likely to be gradual. We expect USDJPY to gradually move below 140, targeting 136 in June 2026.

For JPY-based positions, the forecast of a broader yen recovery against the USD remains a challenge when engaging in foreign currencies. However, due to the yen's relatively low interest rates, we see value in owning certain higher-yielding currencies for local investors. We still believe AUD or NOK long exposure should provide positive total returns versus the JPY over the next 12 months. As for USDJPY, we favor using a short-term rebound toward 146-148 levels to add hedges for USD exposure. We would hedge CHF long exposure at this point, as JPY holders are paid for hedging versus the CHF, and we expect spot appreciation for the JPY against the CHF. Alternatively, we see value in selling the upside potential in the JPY versus the AUD and the NOK.

Long-end Japanese yields on the rise

Monthly data

Source: Bloomberg, UBS as of June 2025

Beyond G10 currencies

Latin America and Central and Eastern Europe, Middle East & Africa (CEEMEA)

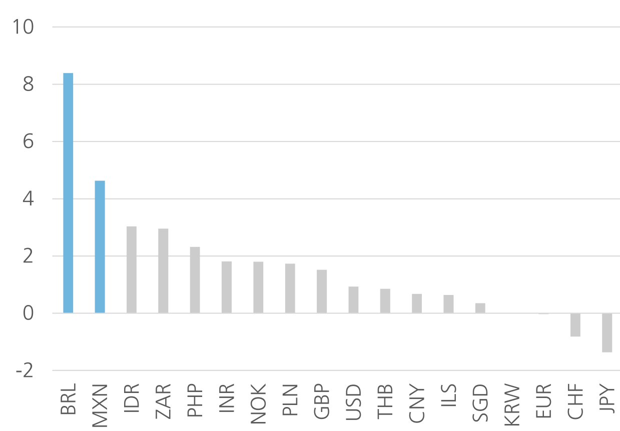
More moderate tariffs now seem likely, supporting a less challenged global economic outlook. US cyclical and structural trends point to a weaker dollar. Emerging market currencies have benefited, especially after the retreat from major tariffs, and have outperformed developed market peers lately amid improving global growth.

We see opportunities in Latin America, where high interest rate carry remains attractive. In Mexico, President Claudia Sheinbaum's diplomatic approach has kept US relations constructive. Despite Banxico's current rate-cutting cycle, the peso still offers appealing nominal and real yields, making it a preferred currency. In Brazil, the spread between Brazilian and US rates remains historically high, supporting the real's carry trade appeal. Inflation forecasts for 2025 are falling, and we think recent signals suggest rates have peaked.

While the outlook for emerging market currencies is promising, it's important to keep a broad perspective. US policy shifts have triggered a longer-term reassessment of USD exposure, but we think the US dollar remains a relative safe haven for emerging markets, a role that may strengthen if tariffs stay high, uncertainty lingers, and economic data softens. We favor long USDZAR positions to account for these risks.

Figure 1 - Mexico and Brazil offer high prospective real yields

Real rates proxied as FX forward implied 1-year yield minus Bloomberg consensus forecast for inflation y/y in 1Q26 (in % p.a.)



Source: Bloomberg, UBS, 30 May 2025

Currency forecasts

USD

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
EURUSD	1.13	1.16	1.16	1.18	1.20
USDJPY	144	142	140	138	136
GBPUSD	1.35	1.38	1.38	1.39	1.40
USDCHF	0.82	0.82	0.82	0.81	0.79
USDCAD	1.38	1.38	1.38	1.36	1.34
AUDUSD	0.64	0.66	0.68	0.70	0.70
NZDUSD	0.60	0.61	0.62	0.64	0.64
USDSEK	9.58	9.31	9.22	8.98	8.75
USDNOK	10.14	9.74	9.66	9.41	9.17

EUR

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
EURUSD	1.13	1.16	1.16	1.18	1.20
EURJPY	163	165	162	163	163
EURGBP	0.84	0.84	0.84	0.85	0.86
EURCHF	0.93	0.95	0.95	0.95	0.95
EURCAD	1.57	1.60	1.60	1.60	1.61
EURAUD	1.76	1.76	1.71	1.69	1.71
EURNZD	1.90	1.90	1.87	1.84	1.88
EURSEK	10.87	10.80	10.70	10.60	10.50
EURNOK	11.50	11.30	11.20	11.10	11.00

CHF

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
USDCHF	0.82	0.82	0.82	0.81	0.79
EURCHF	0.93	0.95	0.95	0.95	0.95
JPYCHF	0.57	0.58	0.58	0.58	0.58
GBPCHF	1.11	1.13	1.13	1.12	1.10
CADCHF	0.60	0.59	0.59	0.59	0.59
AUDCHF	0.53	0.54	0.56	0.56	0.55
NZDCHF	0.49	0.50	0.51	0.52	0.51
CHFSEK	11.64	11.37	11.26	11.16	11.05
CHFNOK	12.32	11.89	11.79	11.68	11.58

GBP

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
GBPUSD	1.35	1.38	1.38	1.39	1.40
GBPEUR	1.19	1.19	1.19	1.18	1.16
GBPCHF	1.11	1.13	1.13	1.12	1.10
GBPJPY	194	196	193	192	190
GBPCAD	1.86	1.91	1.91	1.89	1.87
GBPAUD	2.09	2.09	2.03	1.98	1.99
GBPNZD	2.26	2.26	2.23	2.17	2.18
GBPSEK	12.91	12.86	12.74	12.47	12.21
GBPNOK	13.66	13.45	13.33	13.06	12.79

Asia

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
USDCNY	7.19	7.10	7.10	7.00	7.00
USDHKD*	7.84	7.80	7.80	7.80	7.80
USDINR	85.4	85.0	84.5	84.0	83.5
USDIDR	16,290	16,400	16,200	16,200	16,000
USDKRW	1,380	1,360	1,340	1,320	1,300
USDMYR	4.24	4.20	4.15	4.15	4.10
USDPHP	55.62	55.00	54.50	54.50	54.00
USDSGD	1.29	1.28	1.27	1.26	1.25
USDTHB	32.67	32.80	32.50	32.20	31.80
USDTWD	29.92	29.80	29.60	29.40	29.20

EMEA

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
EURPLN	4.24	4.25	4.25	4.22	4.20
EURCZK	24.92	25.30	25.30	25.30	25.30
USDZAR	17.84	19.20	19.50	19.50	19.50
USDILS	3.50	3.55	3.50	3.50	3.50

Latin America

FX pair	Spot	Sep-25	Dec-25	Mar-26	Jun-26
USDMXN	19.32	19.50	19.40	19.30	19.00
USDBRL	5.67	5.70	5.80	5.90	5.90

Source: Bloomberg, UBS, as of June 2025, Note:*HKD is pegged to the USD

Appendix

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