

FX Viewpoint

USD: Still bearish after all these months

Key takeaways

- Still bearish USD post-China truce. US growth headwinds remain, & real money re-think of USD exposure just getting started.
- USD remains overvalued, and positioning is not be a hindrance. Real money has ample space to sell. US Admin prefers a weak \$.
- FX Quant: DXY off to its worst start of the century. Historical analogs point to 2007, and suggest more room to run.

Cyclical headwinds: A matter of time

Despite the temporary tariff reprieve with China, cyclical headwinds remain in the pipeline, albeit likely to a lesser degree. Even at the new tariff rates, the US growth outlook—a pillar of the USD's appreciation over the years—will still be impacted. The justified pricing out of near-term Fed cuts has only supported the USD on the margin, though the looming potential cuts into next year keep it in check.

Structural headwinds: Early days

The overwhelming market theme over the past several weeks has related to the re-think of large USD exposures by global investors. Signs of risk premia on the USD persist, likely reflecting these concerns going forward. The administration's perceived desire for a weaker dollar also should not be dismissed. That said, while some aspects of the USD's "safe-haven" status have been damaged, it is premature to wholly write-off this status or the dollar as the top reserve currency.

Positioning: Ample space for USD to sell off more

The market may have turned short USD from very long at the start of the year, but we see room for the USD to sell off more, especially among Real Money clients. Officials is another key group: had it not been for them, EURUSD would have likely traded higher.

Valuation: Yup, still overvalued

Despite the USD being the weakest in G10 FX this year, it remains overvalued according to our estimates. This is because it started the year at an all-time high. According to our estimates, the USD REER remains overvalued by 22%.

Quant: 2025 USD price action rhymes with 2007

Year-to-date USD selloff has already surpassed all years since 1999 and is on track for one of the worst starts since 1973. Our current FX forecast and 2025 macro backdrop are akin to the 2007 analog, which would suggest 2-3% more USD downside for the year vs the low from April 21 2025. We watch US vs global equity ratio and USD price action outside of US hours to gauge whether the USD could sell off more aggressively for rest of the year like it did in the 2002-2003 analog.

15 May 2025

G10 FX Strategy
Global

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Still bearish after all these months

The dollar's selloff has garnered significant attention in markets, just as administration attempts to de-escalate trade tensions. The latter events have given it some support more recently, as the perception of more near-term cyclical tail-risks recede. ([White smoke in Geneva 12 May 2025](#)) While some further FX market relief seems reasonable, we remain broadly bearish the USD's overall, albeit with a likely slower bumpier outlook compared to what was observed in March/April.

While the worst-case economic outcomes for the US may have been avoided, key factors that point to a weaker dollar include:

- A still less certain policy outlook, with the potential for more trade tensions as these temporary pauses come due later this summer
- The likely outcome of a slower US economy than would have been the case ex-trade war, as business confidence/investment will take time to recover amid still erratic policy implementation
- A narrowing current account filtering back into reduced investment flows to the US
- The collective re-think of US asset and currency exposure by foreign real money
- An uncertain fiscal outlook that can have mixed implications for the USD
- An administration that likely prefers a weaker dollar and overtly prefers lower US interest rates, all else equal.

Consensus has turned bearish too

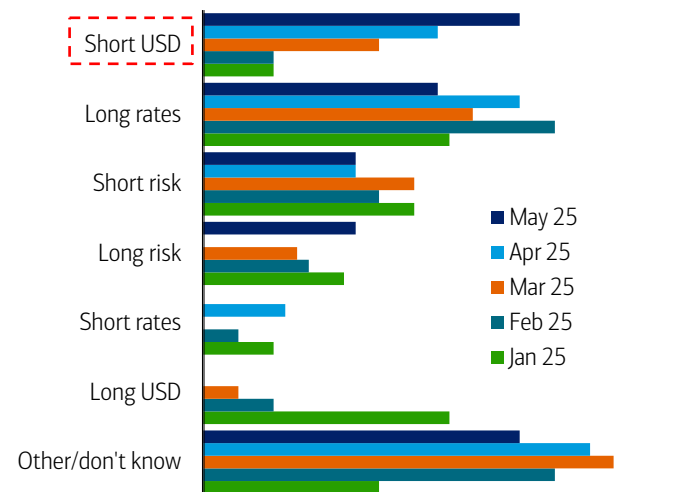
We must first acknowledge that broad market consensus has shifted significantly this year. As we covered in [G10 FX outlook update: against the consensus 27 March 2025](#), the consensus in Q1 was overly bullish dollars, while we remained bearish. Even before "Liberation Day", we viewed the market as underappreciating the growth risks in the US economy that would reverberate from a wide-spread trade war.

This shift is no more evident than in our latest FX & Rates Sentiment Survey. Although conducted before the current deal with China, clients nonetheless viewed "short USD" as the highest conviction trade for 2025, regardless of it being perceived as the most crowded macro trade. (Exhibit 1, Exhibit 2). Other findings from the survey point to a total of 87% of respondents seeing either both the DXY and S&P500 lower this year or the DXY lower and S&P 500 higher this year. ([FX and Rates Sentiment Survey: I'm a dollar short 09 May 2025](#))



Exhibit 1: FXRS - My highest conviction trade for 2025:

Short USD exceeds long rates as highest conviction trade for the first time

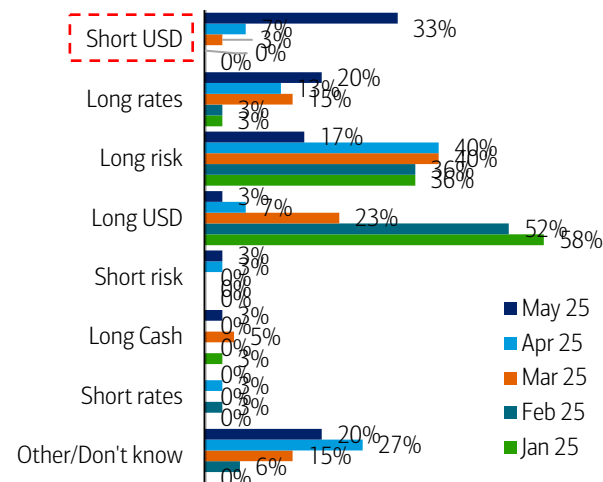


Source: BofA Global Research FX and Rates Sentiment Survey

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Exhibit 2: FXRS - Most crowded trade:

Short USD now perceived as the most crowded trade



Source: BofA Global Research FX and Rates Sentiment Survey

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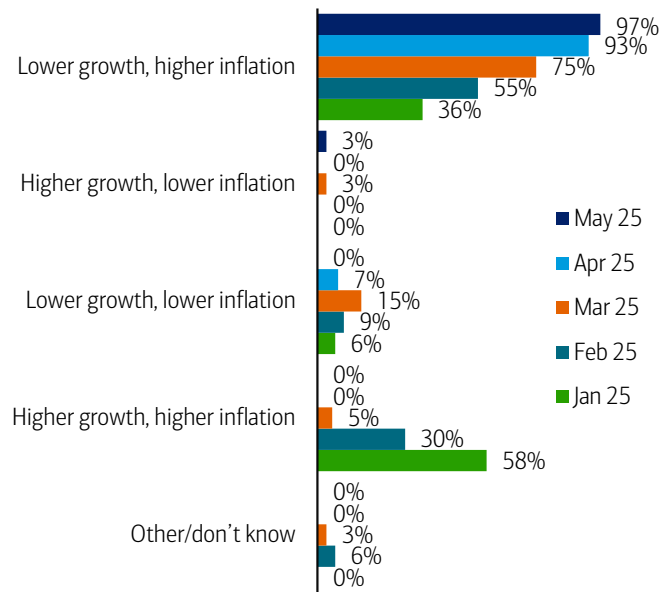
Coupled with a notable swing in positioning metrics, particularly from hedge funds (see section below), this suggests that investors do not view faster-money positioning as a hinderance to a broader USD bearish view. As we will discuss, real money is a different beast, and largely holds the keys to the dollar's outlook.

Cyclical risks receding; but not gone

Stagflationary risks in the US from tariffs remain a key component to the broadly bearish dollar view. Evidence of these concerns are wide-spread, even if the risks have diminished. Going back to our FXRS, when asked what impact the administration's policies would have on both inflation and growth, 97% pointed to lower growth/higher inflation. (Exhibit 3) FOMC members presumably feel the same. In the Fed's March SEP release, the committees' views on economic risks were the most stagflationary on record. (Exhibit 4)

Exhibit 3: FXRS - My view on the overall impact of the administration's economic policy changes to the US outlook in the next year:

Trump policies widely viewed as stagflationary



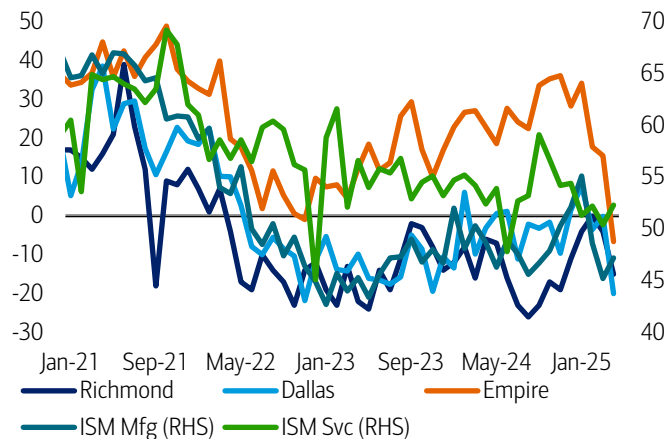
Source: BofA Global Research FX and Rates Sentiment Survey

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This is also quite evident in the components of the so-called “soft” data. While not historically a perfect predictor of “hard data”, soft data is inherently more forward looking, and is painting a concerning picture. Both ISM Manufacturing and Services, as well as regional Fed surveys, have broadly pointed to elevated “prices paid” components amid declining “new orders”. (Exhibit 5, Exhibit 6).

Exhibit 5: New orders are down...

Regional Fed Indices: New Orders

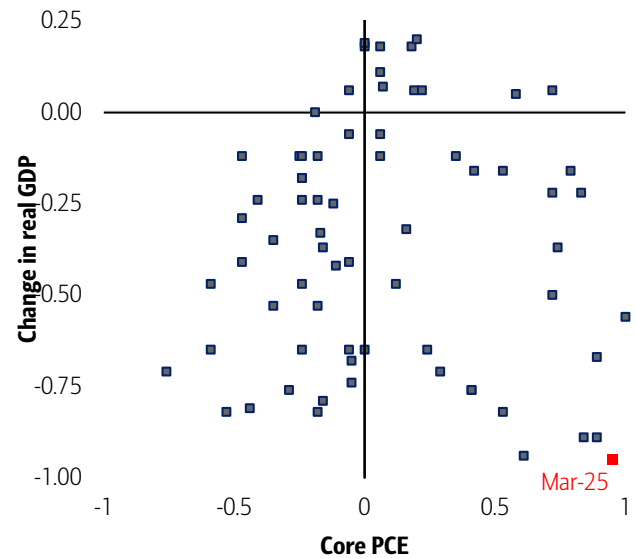


Source: Bloomberg; BofA Global Research

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Exhibit 4: March SEP reflected the most stagflationary risks on record

Diffusion indexes of FOMC's core PCE and GDP risk weightings

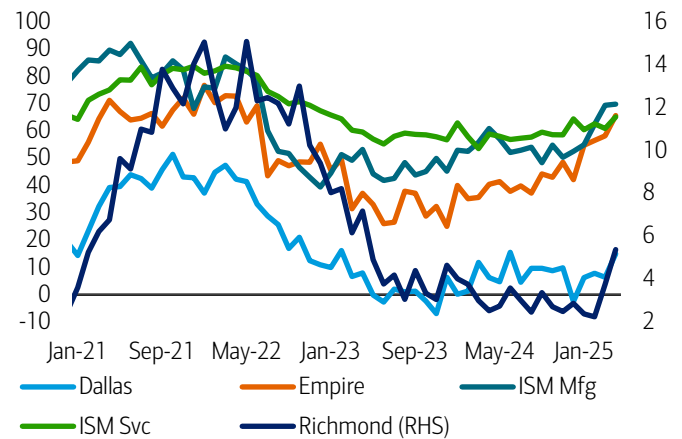


Source: Federal Reserve; quarterly SEP data since Oct 2007

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Exhibit 6: ...And prices paid are up

Regional Fed Indices: Prices Paid



Source: Bloomberg; BofA Global Research

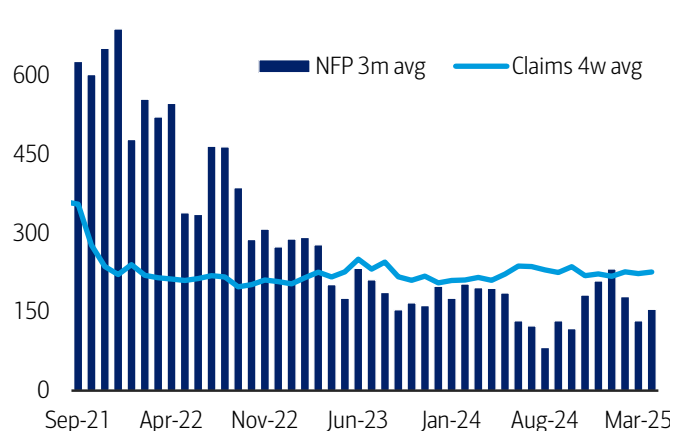
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That said, as of now the hard data points to a still resilient US economy. April employment report came in relatively strong, and unemployment claims have shown no signs of material acceleration. (Exhibit 7) Meanwhile, market-based inflation expectations have been notably more contained than some survey-based measures. (Exhibit 8)



Exhibit 7: Resilient "hard" data: Claims and NFP both relatively steady

NFP 3m avg & Initial Claims 4wk avg



Source: Bloomberg; BofA Global Research

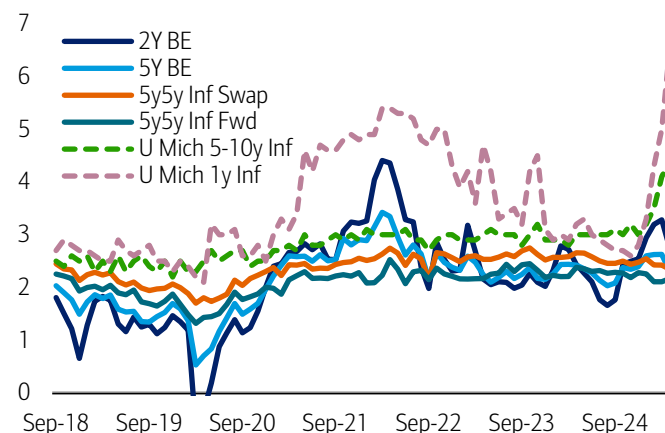
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Many of these indicators cover the pre-pause period on Chinese tariffs, and our economists suggest that if the newly stated regime sticks, the effective tariff on imports will move from 20% to 12%. Meaningful? Yes. Enough to prevent economic disruption? Unlikely. These levels are still notably higher than was the case ex-ante, and could still be moved higher from here if the negotiations prove difficult.

So while the magnitude of concerns over the translation into "hard" (ie realized) data may have lessened as part of the tariff pauses, many still anticipate some impact to be a matter of "when" not "if". Consensus growth expectations, while our economists have likewise downgraded the near-term outlook. ([Surfing the tariff wave 21 April 2025](#)) (Exhibit 9, Exhibit 10) in the US continue to converge towards the rest of the world. This is what has both contributed to the consistent pushing back of Fed cut expectations, as well as the persistent expectations of an eventual cutting cycle, even as inflation remains above target.

Exhibit 8: While survey based inflation expectations are on the rise, market based measures are more contained

Various measures of inflation expectations

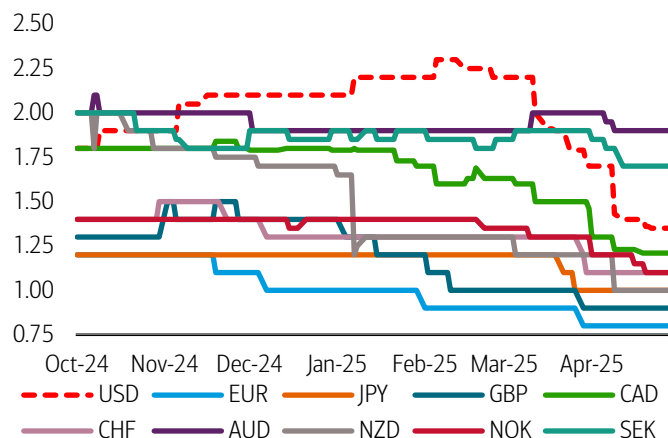


Source: Bloomberg; BofA Global Research; dashed lines=survey data

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Exhibit 9: US growth expectations have been downgraded notably in recent months

Consensus 2025 real GDP forecasts

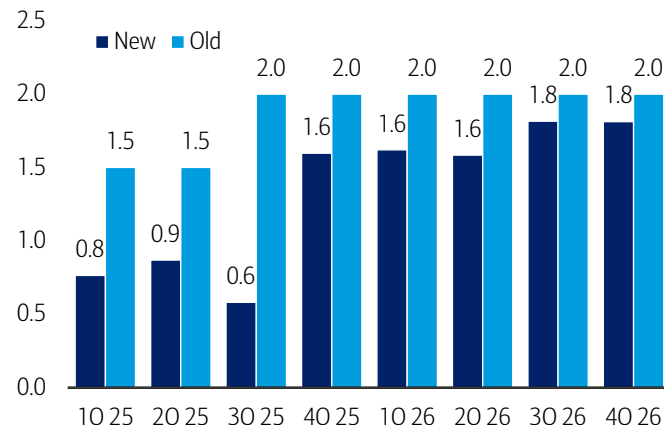


Source: Bloomberg; BofA Global Research

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Exhibit 10: We have lowered 4Q/4Q GDP growth to 1.0 % and 1.7% in 2025 and 2026, respectively

BofA old vs. new GDP forecasts (q/q % saar)



Source: BofA Global Research

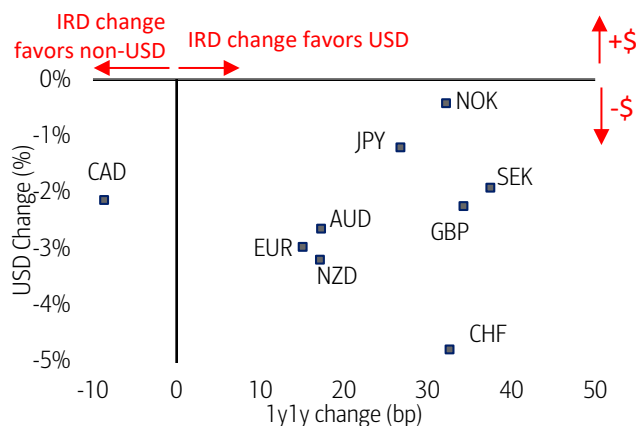
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USD has decoupled from near-term Fed expectations

This hard data resilience, and last weekend's trade deal with China have continued to push out expected Fed pricing. The dollar's most recent support has been directionally consistent with this on the margin, though it has notably decoupled from policy expectations over the past month, as evidenced by its lack of sensitivity to the pricing out of the Fed's June cut, and on a bi-lateral basis, its broad depreciation despite more favorable G10 rate differentials (Exhibit 11, Exhibit 12).

Exhibit 11: USD has underperformed despite rate differentials moving in its favor

FX & IRD Changes since pre-Liberation Day (2 April)

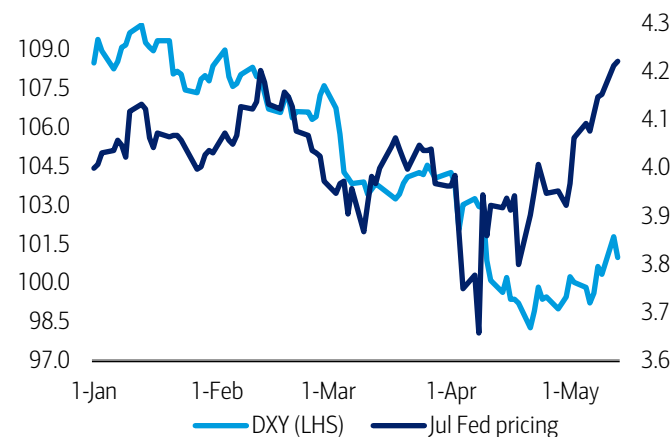


Source: Bloomberg; BofA Global Research

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Exhibit 12: USD has notably lagged the recent paring back of Fed pricing through July

DXV & implied fed funds at the July FOMC (OIS)



Source: Bloomberg; BofA Global Research

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This lack of USD support from near-term Fed pricing is notable, and reflective of the challenges of stagflation risks. If inflation is above target and the aforementioned "hard data" reflect a stable economy, the Fed has made clear they will not be cutting. This approach appears appropriate, given their mandate. However, combining this near-term hawkishness with the potential growth drag in the pipeline from tariffs (and possibly other policies) can act as a headwind for the USD, particularly if tighter financial conditions elevate economic risks.



Structural asset/FX exposure rethink just getting started

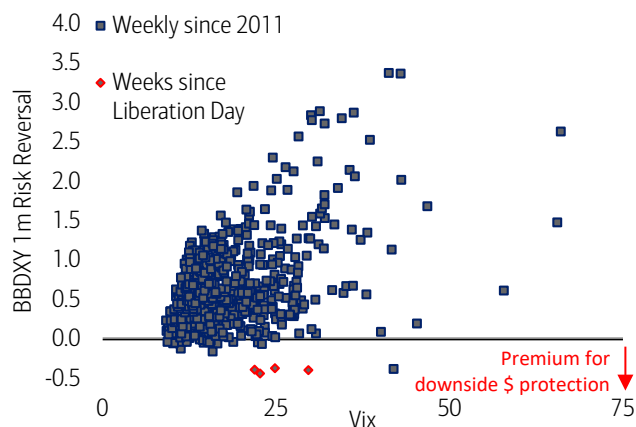
While the market remains in wait-and-see mode on the cyclical side, the bigger picture relates to how structural ownership of the USD and USD denominated assets could be altered by the tariff events. Indeed, even as the dollar consolidates higher amid tariff optimism, the real money allocation/hedging story remains lurking in the background, albeit with seemingly less urgency.

Negative risk premia still evident in the dollar

This theme has been reflected in the excess risk premium that has been embedded in the USD. Exhibit 13 plots the weekly levels of the BBDXY weighted risk reversal against levels of the VIX. In the weeks since “Liberation Day” options markets have priced the biggest premium for downside dollar protection for a given level of the VIX in the history of the data. Exhibit 14 shows the DXY vs. a 90day rolling regression of the DXY based on a simple weighted 1y1y rate differential. The residual, indicating the dollar’s deviation from rates, reached the biggest level since the GFC before partly retracing, and currently stands around -4%.

Exhibit 13: “Liberation Day” has produced the biggest downside premium in the dollar for given levels of VIX since 2011

Weekly levels of the VIX & Risk Reversals on BBDXY

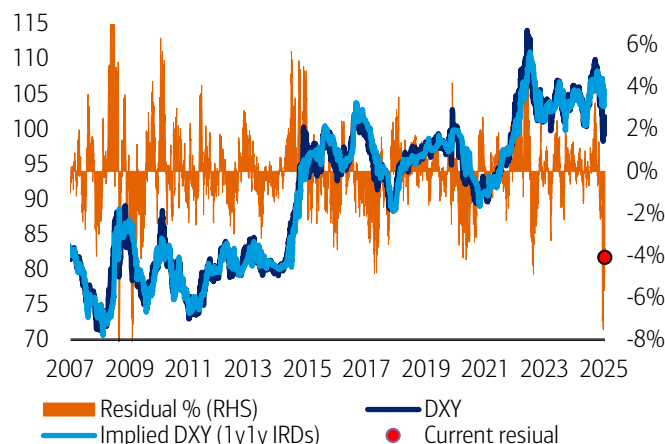


Source: Bloomberg; BofA Global Research

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Exhibit 14: Dollar has notably under-shot rate differentials since April 2nd

DXY & Rolling regression DXY model*



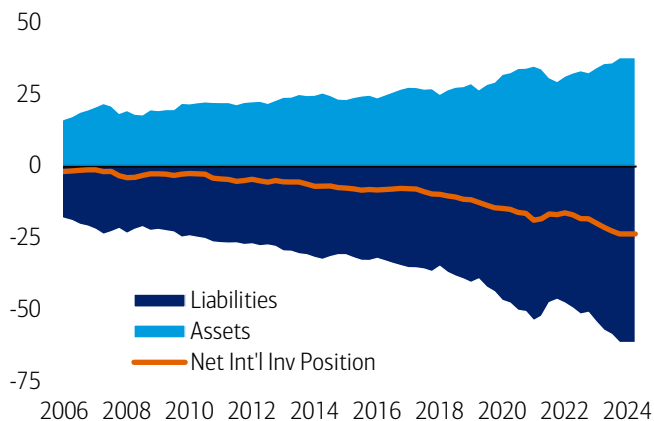
Source: Bloomberg; BofA Global Research; *90-day rolling regression based on 1y1y rate differentials

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There are several components to this market theme. As we covered in depth in [Swimming USD-naked as the tide goes out 14 April 2025](#), and [Balance of Payments: Tariffs & US Fire Sale 06 May 2025](#), years of exuberance for US assets is undergoing a broader re-think from global investors. Indeed, over the past decade+, foreign investment in the US has accelerated, as evidenced by the widening net international investment position and overall foreign ownership of US assets, particularly equities. (Exhibit 15, Exhibit 16)

Exhibit 15: Foreign ownership in the US (liabilities) has accelerated over the past decade+

US net international investment position (\$Tn)



Source: Bloomberg; BofA Global Research; Bureau of Economic Analysis

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As the market increasingly identifies policy (and policy implementation) risks emanating from the US, along with a broader push for economic and foreign policy isolationism, many long-standing tenets are increasingly being questioned.

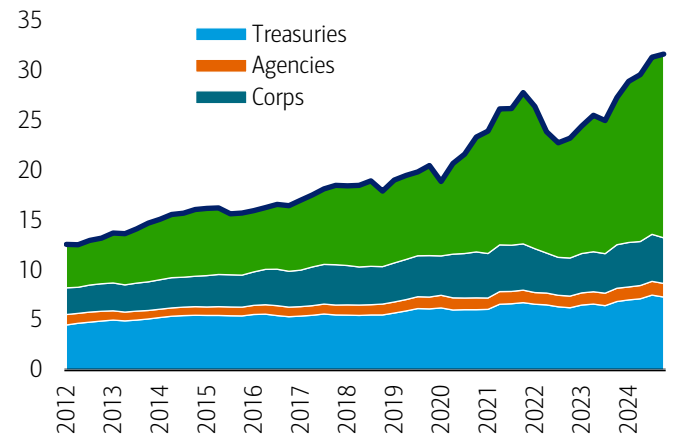
Regardless of exactly where US tariffs eventually land (the range of outcomes remains wide), the US administration is making a concerted effort to reduce trade/current-account deficits. Mechanically, this should ultimately result in less demand for US financial assets, as less dollars (exchanged for foreign goods) will be available to cycle back into the US. This can happen both from the foreign public and/or private sector. As we see in Exhibit 17, periods of narrowing US current accounts have been associated with decelerating net portfolio flows from foreign investors into the US. This could mean some combination of two things:

1. Either this reduced demand is reflected in US asset price declines, amid a steadier USD, or
2. The dollar depreciates in order to attract foreign capital.

Also of note, this is all occurring amid expectations for even larger US deficit and debt levels. Historically, rising US debt-to-GDP levels have not been a hinderance to the dollar. (Exhibit 18) However, if the US is actively deterring foreign investment in the US at a time of fiscal expansion, investors need to be clear-eyed about this possible paradigm shift and the potential downside USD risks it poses.

Exhibit 16: US equity ownership by non-US residents have grown materially since COVID

Holdings of U.S. Long-term Securities by Foreign Residents (\$T)

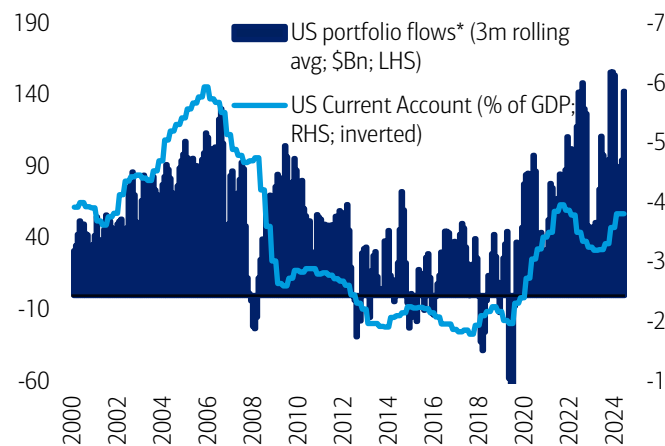


Source: Bloomberg; US Treasury TIC data; BofA Global Research

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Exhibit 17: Narrowing current account associated with reduced purchases of US assets

US current account & foreign portfolio flows into US

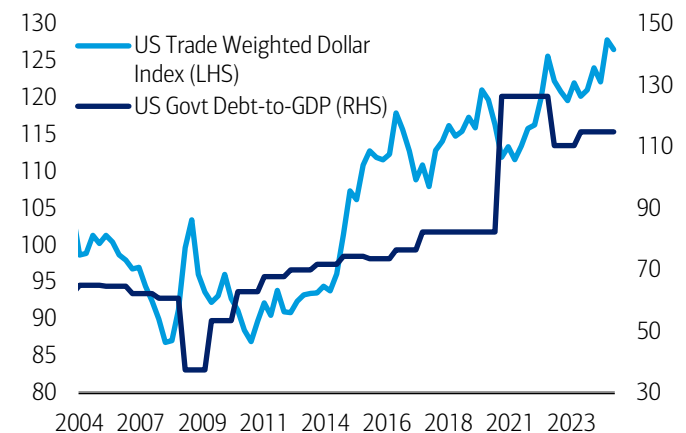


Source: Bloomberg; BofA Global Research; US Treasury TIC data; *includes: Treasury, Agency, Corporate, and Equities

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Exhibit 18: Rising US government debt levels have not been a hindrance to USD appreciation

Trade-weighted USD index & US debt-to-GDP



Source: Bloomberg; BofA Global Research

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Currency accord?

Finally, recent events such as the significant appreciation of the Taiwanese dollar, and reports that the US and South Korea, in particular, have discussed FX rates as part of broader trade negotiations has brought on speculation that broader FX accords could be more likely. As we noted in [Mar-a-Lago accord: framing & impact 11 March 2025](#), we view a Mar-a-Lago type accord (as initially outlined) as fraught with challenges, and ultimately a low likelihood. That said, it does appear that the Administration desires a weaker dollar as part of their overall economic policy, though it remains unclear exactly what this means and how, if at all, it could be achieved without material collateral damage. Most likely this will play out on a more bi-lateral basis, or with the eventual placement of a Fed Chair next year who has a bias for accommodative monetary policy. Even if there is no multi-lateral accord, this remains another downside risk for the dollar.

USD's "Safe Haven" Status: Bent but not Broken

For several days in early April, the simultaneous selling of the USD, US Treasuries, and US stocks (the so-called "Sell US" theme) drew parallels to EM market behavior. This ushered in a wide-spread discussion over the USD's so-called "safe haven" status and questions over if it has been lost or damaged. This debate paralleled another debate on the so-called "de-dollarization" theme, related more to how reserve managers would approach holdings of USD assets. ([De-dollarisation: Fire sale? 10 April 2025](#)).

Here it is critical to point out that nuances exist between what is considered a "safe haven" asset, a "reserve currency" and a currency central to the global financial system. Some perceived "safe-haven" currencies are not considered prominent reserve currencies (JPY and CHF) and some emerging reserve currencies are not considered "safe-haven" currencies (CNY, AUD, CAD, etc). The dollar traditionally has fit in both buckets, while also playing a singularly unique role as the most prominent currency at the center of the global financial system. (Exhibit 19)

Exhibit 19: The dollar's longer-term characteristics remains unmatched

Select statistics for key reserve currencies

	USD	EUR	JPY	CHF	GBP	CNY
Govt. Bond Market Size* (\$T)	29.3	12.8	8.9	0.1	3.7	8.6
Rule of Law (percentile)	88.7	82.2	92.5	98.6	89.2	52.8
Open Capital account (index)	0.8	0.9	0.9	0.9	0.8	0.1
20y avg correl with S&P500**	-0.4	0.2	-0.2	0.1	0.3	0.1
Share of Reserves (%)	57.8	19.8	5.8	0.2	4.7	2.2
Share of SWIFT payments (%)	49.1	21.9	3.9	1.0	6.6	4.1
FX Turnover (%***)	88.5	30.5	16.7	5.2	12.9	7.0

Exhibit 19: The dollar's longer-term characteristics remains unmatched

Select statistics for key reserve currencies

USD	EUR	JPY	CHF	GBP	CNY
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Source: Bloomberg; BofA Global Research; IMF (capital account openness, reserve share), SWIFT; World Bank (Rule of Law measures); BIS (FX turnover) *for EUR: sum of Ge, Fr, Sp, It, Ne, Au, Po, Gr, Fi, Ir; **20Y average of rolling 26-week correlation of weekly returns; *** BIS 2022 Triennial- share of 200%

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In [Bent but not broken: FAQ on the USD's "safe haven" status 08 May 2025](#), we covered many of the overlapping attributes of "safe haven" and reserve currencies, and here the USD for now stands alone. Importantly, it is the USD's role as the center of the global financial system that in many ways allows it to appreciate amidst declining risk appetite. This is based on its use as a funding currency, not just for short-term carry trades (which depends on relative rate regimes) but the Eurodollar system results in wide-spread USD liabilities that underpin global trade and finance. When shocks become big enough this creates a demand for dollars that can spill into the FX spot market if large enough.

Importantly, the dollar need not completely lose all of its reserve or "safe haven" status in order to depreciate. The current situation remains unique to the US, as it is growth-negative US policy choices that are weighing on the dollar. While this does call into question the durability of the features that give the dollar this special role, it is not something that disappears overnight, and likely is a decades long process, contingent on viable alternatives. Two things can be true at once.

USD upside risks- considering alternatives

While our core view remains USD-bearish, we see upside dollar risks—and thus risks to our core view— potentially emanating from a few different scenarios.

Scenario 1: Hard data stays resilient

As noted above, the resilience of the hard data in the US has kept Fed policy expectations elevated, while the expectations of a weakening has kept the USD on the back foot. The market has been able to dismiss some of this data under the expectation that it will turn, but what if it doesn't? the US labor market has been best characterized as "low-hire, low-fire". If it is shown in the data this summer that tariffs have had a limited impact on spending, businesses may eventually be embolden to reengage in capital projects and labor force expansion. Such a scenario should see the USD correct higher, though likely not to the multi-decade highs observed in 2022 or even 2025.

Scenario 2: Further Tariff Relief

The temporary 90-day agreement with China surprised us in terms of:

1. the speed in which it was put together,
2. the specificity of what was agreed upon in the first round, and
3. the magnitude of the tariff reduction.

In the few short days since this occurred, the USD's positive reaction has been tempered, though the situation remains fluid. Should further relief come, either by a definitive ruling out of any higher tariff rate, or by additional deals made with a critical mass of relevant countries that meaningfully reduces tariff rates even further, the clouds of uncertainty over the US would begin to dissolve even further.

However, such an outcome would both contradict the clear agenda of the trade-hawks in the administration, and would be the antithesis of its long-stated policies. Furthermore, it would mechanically result in less customs revenue than was assumed ex-ante. This in turn could limit the amount of fiscal support that could be provided in the years to come.



Scenario 3: Fiscal expansion keeps the party going

Loose fiscal policy has been a cornerstone of the so-called “US exceptionalism” theme that produced both an elevated dollar and appreciating US assets more broadly over the past several years. This will be a key theme in the 2nd half of the year, as congress looks to extend (and even surpass) the tax cuts in the expiring Tax Cuts and Jobs Act. While Secretary Bessent has long championed deficit reduction current proposals point to an even larger deficit ([Fiscal flippancy 13 May 2025](#)). Fiscal stimulus is typically associated with USD appreciation, though further advances towards even more unsustainable debt levels could eventually weigh on the USD over time. It remains unclear how this will all play out. The bond selloff from April serves as a warning.

Scenario 4: Something breaks elsewhere

Renewed global optimism in the face of a global trade war has come in no small part from the fiscal rethink in Germany/EU, as well as the spending outlook among countries with apparent capacity (Canada, Sweden, Australia, China, etc). We make no predictions here, but anything that throws cold water on this theme, or any other unknown-unknown shock that specifically hits global growth should still see the USD appreciate. As noted above, part of the tarnish to the USD’s status comes from the uniqueness of the current trade-war, and the fact that it is the sole byproduct of US policy choices, rather than something more global in nature. The USD can and should still outperform when shocks come from outside the US, as tempting as it might be to think otherwise.

Positioning: Ample space for USD to sell off more

The market may have turned short USD (Exhibit 20) from very long at the start of the year but we see room for the USD to sell off more.

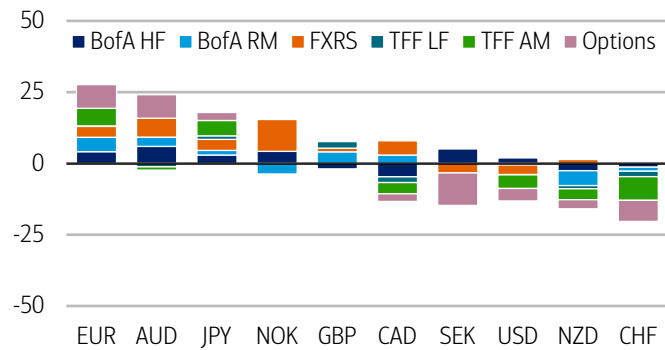
Hedge Funds drove the USD sell-off at the start of the year, having bought it meaningfully in Q4, according to our proprietary flows (Exhibit 21). Real Money investors were more reluctant USD sellers in Q1 – particularly vs. EUR until the German fiscal announcements in early March – but have led the pressure on the USD so far in Q2.

Importantly, we think the USD has ample room to sell-off further, with the short positioning mainly driven by options and futures (again Exhibit 20). For one, Real Money’s USD position stands out as...bullish by their post-2012 standards (again Exhibit 21). The message from our FX & Rates sentiment survey is broadly similar: short USD positioning lags more bearish USD sentiment (Exhibit 22 and [FXRS 9 May '25](#)). In fact, short USD emerged as the highest conviction trade for the first time this year.

Officials is another key group to watch. Had it not been for them, EURUSD would have likely traded higher: according to our proprietary flows, they have been persistently rebalancing into USD this year (Exhibit 23).

Exhibit 20: Market turned short USD from very long at the start of '25

Latest aggregate G10 FX positioning

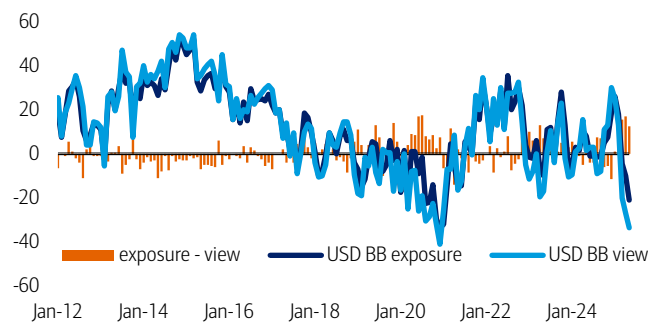


Source: BofA Securities, Bloomberg. +50 (-50) represents max long (short) positioning vs history. Aggregate positioning is the unweighted average of BofA HF, BofA RM, FXRS, TFF LF, TFF AM and FX options. HF: Hedge Funds, RM Real Money, FXRS: FX and Rates Sentiment Survey, TFF: Traders in Financial Futures, LF: Leveraged Funds, AM: Asset Managers.

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Exhibit 22: USD sentiment continued souring but positioning lagging

FX and Rates sentiment survey: USD exposure and view

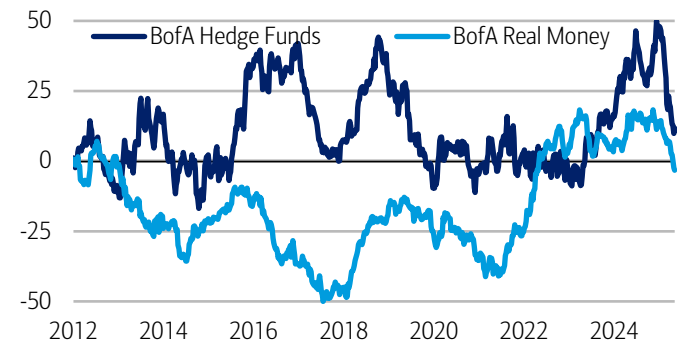


Source: BofA Global Research FX and Rates Sentiment Survey
BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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Exhibit 21: Ample space for USD to sell off more according to our data

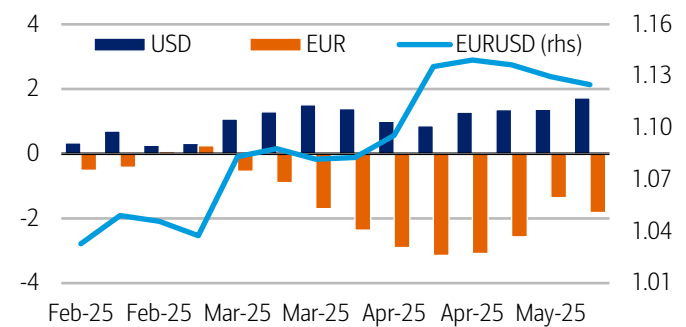
BofA Hedge Funds and Real Money positioning

**Source:** BofA Securities

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Exhibit 23: Officials have been persistently selling EURUSD rallies in '25

BofA Official USD and EUR rolling 4-week flows (2-year z-score) and EURUSD



Source: BofA Securities, Bloomberg. Note: We show end-of week data. Official flows include flows by central banks, by government – including federal, state, and local municipality clients – and by Sovereign Wealth Funds

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USD still overvalued

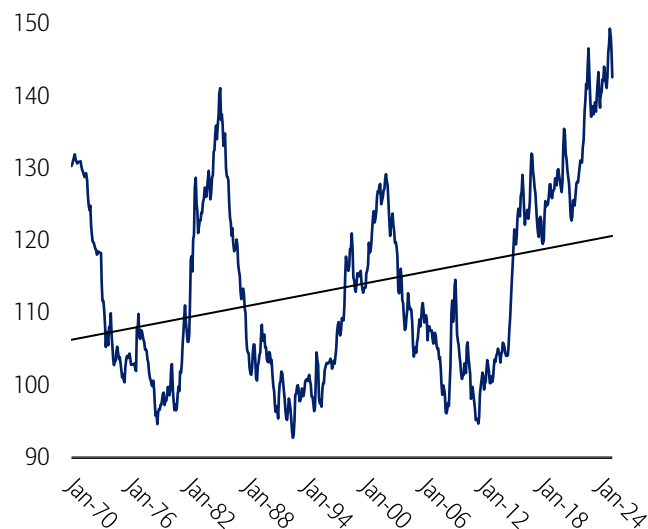
Despite the USD being the weakest in G10 FX this year, it remains overvalued according to our estimates. This is because it started the year at an all-time high.

In real effective terms (REER), the USD is just back to its pre-US election level and still close to historically high levels (Exhibit 24). Compared with the last 20 years, the USD remains the strongest in G10 in real effective terms (Exhibit 25)—this is also the case if we limit the period to the last 10 years, although the ranking of the rest of G10 changes.



Exhibit 24: USD REER

Despite weakness this year, the USD remains historically very strong in real effective terms



Source: BIS, Bruegel, BofA Global Research.

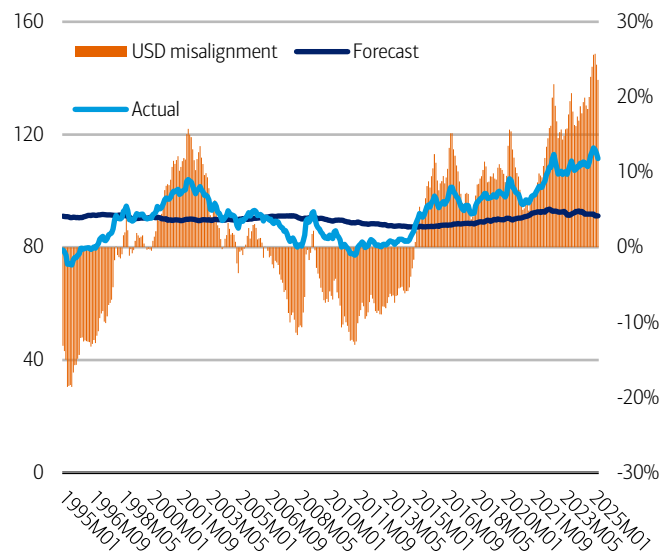
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Our inhouse benchmark equilibrium G10 FX estimates use a Behavioral Equilibrium Exchange Rate (BEER) model. We estimate our model using a panel Dynamic OLS (DOLS) cointegrating regression, in line with the academic literature. Monthly variables are lagged by one month and quarterly variables by one quarter, with previous value interpolation for any variable that does not yet have a new observation at the time of estimation, ensuring no 'look ahead' bias in our estimates.

According to our estimates, the USD REER remains overvalued by 22% (Exhibit 26). This is than 26% in January, which was an all-time high, but still historically very strong. Moreover, the USD REER remains the most overvalued in G10 FX (Exhibit 27).

Exhibit 26: USD REER misalignment from BEER equilibrium

USD remains overvalued vs. with equilibrium despite recent weakness

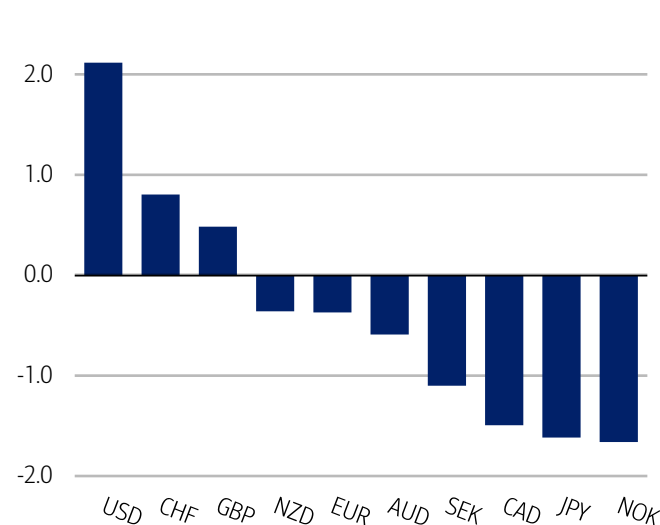


Source:
BofA Global Research.

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Exhibit 25: G10 FX REER z-score difference from 20y average

Despite weakness this year, the USD remains the strongest in G10 in real effective terms

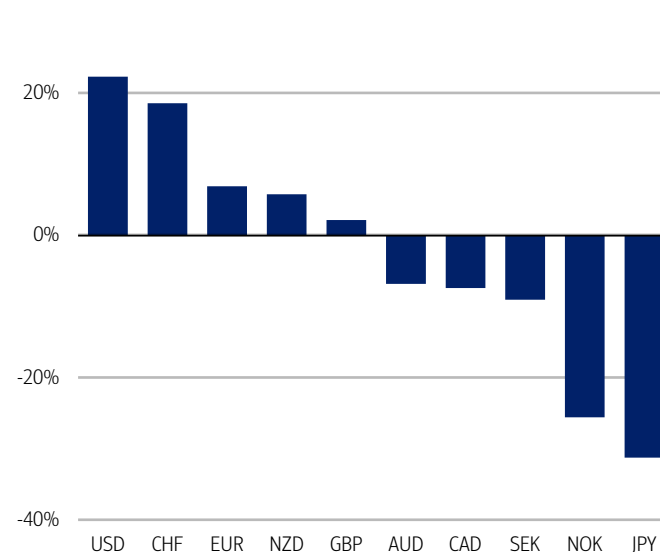


Source: BIS, BofA Global Research.

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Exhibit 27: G10 REER misalignment from BEER equilibrium

USD remains the most overvalued in G10 FX based on BEER model



Source: BofA Global Research.

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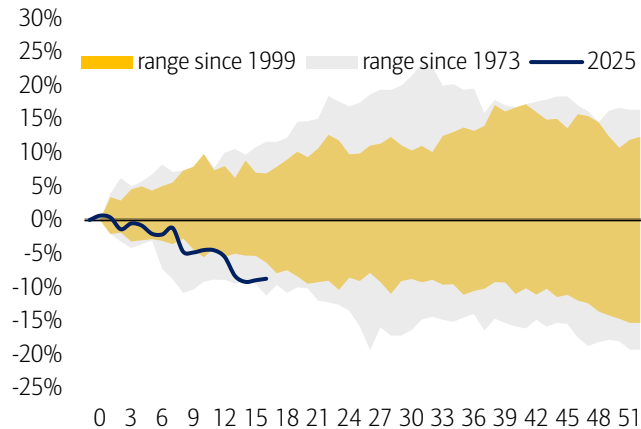
FX Quant: 2025 USD selloff rhyming with historical analogs

USD on track for one of the worst starts in a year

At its weakest point on April 21 2025, the USD had depreciated by close to 10% vs start of the year. Year-to-date USD selloff has already surpassed all years since 1999 and is on track for one of the worst starts since 1973 (Exhibit 28). Given the USD has already weakened by so much this year, we compare the USD's performance in 2025 vs past years to see what may have been the most relevant analog years.

Exhibit 28: USD depreciation in 2025 is tracking its largest selloffs in recent history

2025 DXY return vs historical cumulative return max/min range

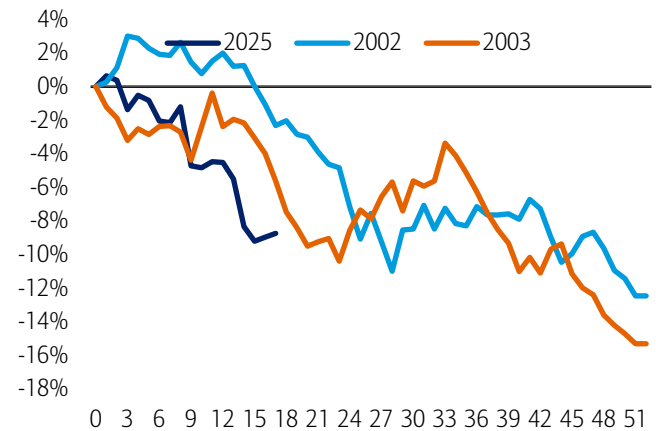


Source: BofA Global Research, Bloomberg. X-axis shows number of weeks (Friday to Friday) since start of the year.

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Exhibit 29: USD selloff continued for rest of the year in 2002 and 2003

DXY return in 2025 vs cumulative returns in 2002 and 2003



Source: BofA Global Research, Bloomberg. X-axis shows number of weeks (Friday to Friday) since start of the year.

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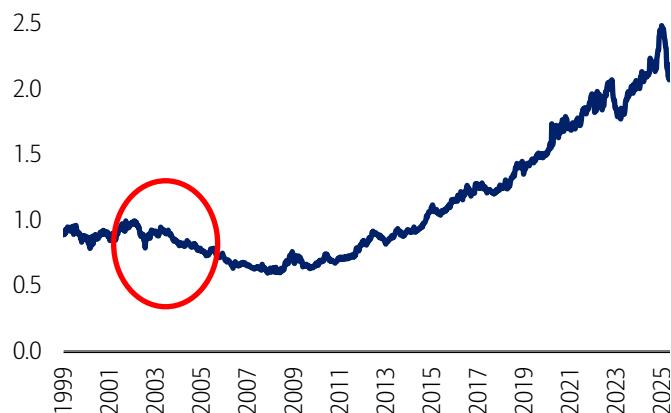
USD selloff continued in 2002-2003 on global equity & growth outperformance

US trade balance widened to a historically negative level in 2025 due to front-loading of imports ahead of tariffs. The US budget deficits also remain persistently high. Rising “twin deficits” would allude to the early 2000s, where the USD saw a multi-year depreciation on the back of similar dynamics. The USD depreciation was particularly notable in 2002 and 2003, as the USD had sold off annually by 13-15% then (Exhibit 29). At the time, global equity had outperformed US equity on the back of global growth outperformance and increasing risk appetite for EM assets (Exhibit 30). The MSCI US vs World ex-US index ratio has been dropping again in 2025. Whether the trend could continue is to be seen. While headline Q1 GDP for US turned out to be negative, final domestic sales remained resilient. US equity also appears to find some reprieve after the sharp rout in the first half of April. Implementation of US reciprocal tariffs may create a near-term negative demand shock for EM countries, limiting how much global equity could rally vs US equity.



Exhibit 30: Global equity persistently outperformed US equity in the early 2000s

Ratio of MSCI US vs World ex-US indices

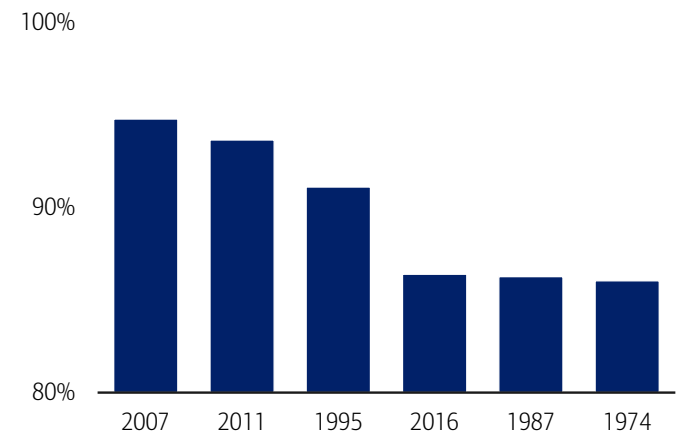


Source: BofA Global Research, Bloomberg

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Exhibit 31: DXY fluctuation in 2025 has highest correlation with 2007

Top correlations between DXY's 2025 return vs historical years



Source: BofA Global Research, Bloomberg

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Fed rate hikes often led to USD appreciation later in the year

Exhibit 31 shows the highest correlations between the DXY index's year-to-date return and historical years. Outside of 2007, the USD's annual return for rest of the analog years would be broadly less negative than its year-to-date loss in 2025. In 2011, emergence of the Eurozone debt crisis around mid-year led to USD appreciation in the second half of 2011. Given the bullish Europe sentiment after the German election this year, the 2011 analog would likely not be relevant. In 1995, 2016, 1987 and 1974, the Fed had conducted rate hikes at some point in the year. Given the Fed's current SEP shows no signs of imminent rate hike despite inflation upside risk from tariffs in 2025, these analog years are likely not relevant either. This leaves 2007 as the most relevant analog.

USD was marginally weaker for rest of the year in 2007 and 2017

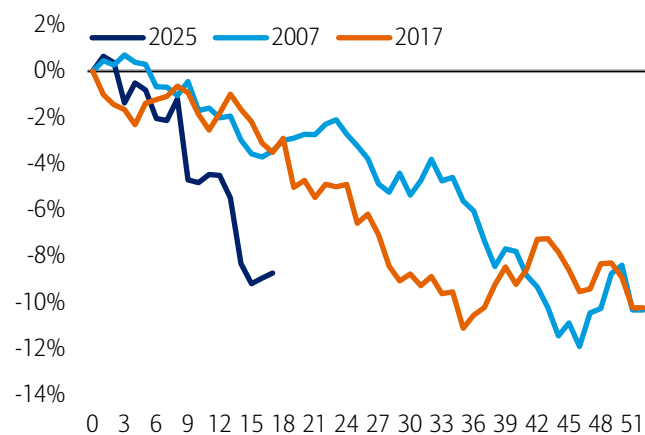
In 2007 and 2017, the USD ended the year marginally weaker than its year-to-date loss in 2025, but not by as much as in 2002-2003. We also include the 2017 analog here as many investors would compare 2025 to the first year of President Trump's first term. The 2007 analog is also close to 2025 from a macro perspective in that US growth data remained resilient for the year, and the Fed rate cut did not kick off until unemployment rate started to rise in Q3 2007.

Forecast closest to 2007 for now; watch equity ratio and USD outside US hours

For now, our FX forecast for rest of 2025 would be the closest to the 2007 analog. In EURUSD, we expect the pair to rally marginally higher to 1.17 by end of the year. In other G10 pairs like USDCAD, we also expect any further USD selloff to be more backloaded in the year once the Fed shows more willingness to cut rates. Two evolving dynamics would likely determine whether 2025 will play out more like the 2007 analog or the 2002-2003 analog. For one, we would continue to monitor the global vs US equity ratio to gauge whether risky asset returns in rest of the world is becoming persistently more attractive for global investors. We would also pay attention to USD price actions outside of US hours in 2025. Since start of the year, the USD has sold off most prominently in Asia trading hours, followed by European trading hours (Exhibit 33). This contrasts with intraday USD price actions from the past two years, where we would find US-hour risk-on USD supply vs Asia-hour USD demand for carry. Whether this is a temporary unwind of existing positions or a decisive regime shift is to be seen. Persistent USD supply outside of the US hours could be a sign of structural USD outflow, potentially leading to price actions that are more akin to the 2002-2003 analog.

Exhibit 32: The USD ended the year in 2007 and 2017 marginally lower than now

DXY return in 2025 vs cumulative returns in 2007 and 2017

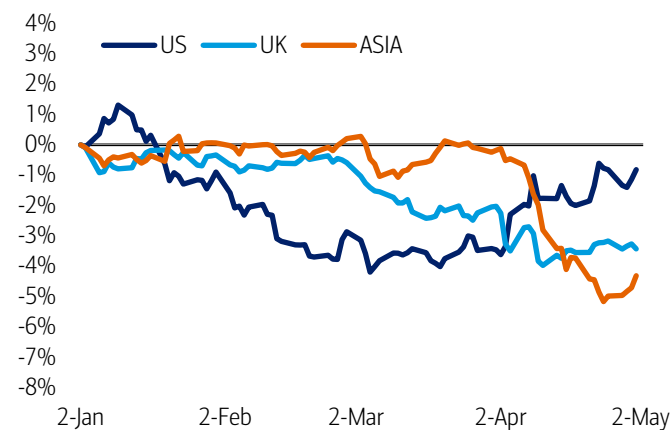


Source: BofA Global Research, Bloomberg. X-axis shows number of weeks (Friday to Friday) since start of the year.

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Exhibit 33: Investors outside of the US drove the USD selloff in April

Year-to-date DXY cumulative return by time zone



Source: BofA Global Research, Bloomberg. We define America time zone as 1pm-12am UTC, Europe time zone as between 8am-1pm UTC, and Asia time zone as between 12am to 8am UTC.
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