# Exploring the Dynamics of a Weaker Dollar: Consequences and Opportunities

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## THE U.S. DOLLAR ERODES

One of the most unexpected developments of the beginning of 2025 has been the weakening of the U.S. dollar. In contrast to Donald Trump's first term, the greenback has experienced a depreciation of -4.4%, according to the ICE dollar index. Despite significant uncertainty stemming from the management of the new American administration, the U.S. dollar has failed to maintain its status as a safe haven. Conversely, gold prices have surged by over 12% since the start of the year, reaching $3,000 an ounce, reflecting growing pessimism regarding the outlook for the U.S. economy.

**We anticipate that the greenback will continue to weaken in the coming months. Shifts in U.S. foreign policy, coupled with rising geopolitical risks are prompting investors to reconsider their reliance on the greenback.** Additionally, an economic slowdown in the U.S. is expected, which should lead the Federal Reserve to ease its monetary policy over the year. This dynamic could narrow the interest rate differential between the United States and the rest of the world, further exerting downward pressure on the U.S. dollar.

**In this context of heightened uncertainty, diversification is key.** The United States accounts for 70% of the MSCI World Index. International equity markets, particularly those from emerging markets, should benefit from the greenback's weakness. The undervalued yen is also expected to strengthen against the U.S. dollar. The yuan should benefit from the narrowing interest rate differential with the US and the fiscal focus on consumption. Emerging market external debt, which has the highest duration among spread assets, should also benefit from the decline in American interest rates, but only on one condition: that financial conditions do not tighten further. Gold prices are expected to continue their ascent, supported by strong demand from central banks in emerging countries and concerns over potential American tariffs.

## OPPORTUNITIES IN EMERGING CURRENCIES

The downward revision of U.S. growth has led to a significant correction in both U.S. equities and the U.S. dollar in March. The interest rate differential still largely favors the U.S. dollar among developed countries, but it is diminishing as American exceptionalism comes into question. The acceleration of this trend in March can also be attributed to a market that was heavily positioned for a stronger greenback, anticipating U.S. tariffs.

**Which currencies are benefiting from this correction in the U.S. dollar?** First and foremost, the euro, which rebounded by 5% to 1.09 following the announcement of a massive fiscal plan in Germany and its positive implications for growth across the eurozone. The yen, which remains significantly undervalued against the U.S. dollar, is also benefiting from the normalization of Japanese monetary policy. Finally, the yuan, although it is tightly controlled, is supported by China's announced growth target of 5% for 2025. This should please the U.S. administration, which has accused China and Japan of manipulating their currencies to gain a competitive advantage over the U.S. dollar.

**Certain emerging market currencies, which are less impacted by U.S. trade policies and benefit from high nominal and real interest rates, along with limited external vulnerability, have potential for appreciation against the U.S. dollar.** The Brazilian real, still significantly undervalued, offers an attractive yield of nearly 15% (in nominal terms) and 10% in real terms. Central bank interventions in the foreign exchange market and rapid interest rate hikes have helped stabilize the currency, even though fiscal issues persist. The South African rand, with its high real interest rates, is also expected to benefit from a weaker U.S. dollar and a rebound in activity in China.

Even the Mexican peso, which was oversold following the announcement of 25% tariffs, is rebounding after a new extension was granted for the implementation of these tariffs. The U.S. dollar has become a "risky asset" once again.

## THE U.S. DOLLAR STILL AT RISK ON THE SHORT TERM

In a *Multi Asset* portfolio, the U.S. dollar serves as a hedge, just like gold, especially during periods of positive (Govies/Equity) correlation. However, it seems risky to increase its exposure right now.

The U.S. dollar is a counter-cyclical currency that appreciates in times of economic downturn and high risk aversion. We can legitimately ask why the U.S. dollar is not appreciating as the uncertainties surrounding the Trump administration increase. **The reason is that investors do not believe in a change of macroeconomic regime in the United States (US), at least not yet.** While it is true that the US macroeconomic momentum is weakening, this is more a temporary correction of past excesses than a shift to a structurally less favorable regime. In any case, this seems to be confirmed by the *Conference Board*'s leading indicators, the *Jolts* labor market survey and inflation figures: the US remain in a regime of positive growth and disinflation, historically associated with attractive risk appetite.

In this context, the current growth decorrelation between the US –which is losing momentum– and the rest of the world –which is stabilizing, slightly emerging from several quarters of technical recession– does not pave the way for a widespread market *sell-off* but rather for *a geographical and sectoral rotation* towards markets and sectors showing a valuation gap compared to the US technology market –on which investors have strongly concentrated their portfolios. The speculative positions (CFTC) on the U.S. dollar –high–, and the Nasdaq –in the process of ongoing normalization–, suggest that this *deleveraging* could not be over yet and could justify further depreciation of the U.S. dollar in the short-term.

**In the long-term, the U.S. dollar will depend on the magnitude and duration of the trade war.** If ideology prevails over rationality, world trade will suffer, leading to a marked slowdown in global activity –not only in the US –and the return of the greenback's safe haven status. If so, European currencies –EUR, GBP–, and cyclical currencies –CAD, AUD– would be the most at risk; the risk-averse currencies –JPY, CHF– could act as a shock absorber.

# ADDITIONAL NOTES

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