

FX Viewpoint

Currencies
Global

USD: At a crossroads?

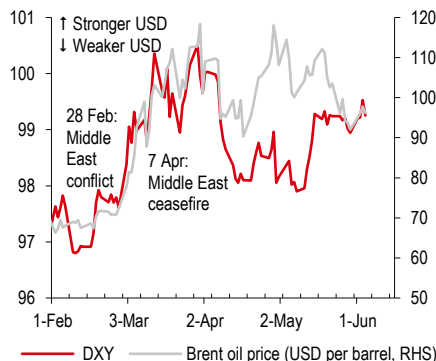
- ◆ Middle East developments remain a key driver for FX, while US trade policy is back in focus following the USTR's proposal
- ◆ Attention is increasingly turning to the new Fed Chair's policy stance and guidance ahead of the 16-17 FOMC meeting
- ◆ Our base case continues to be a softer US dollar over the longer term, notwithstanding near-term event risk

Developments in the Middle East remain a key market focus. So far, periods of escalating tension have generally been associated with higher oil prices and a firmer US dollar, while any easing has tended to produce the opposite effect (Chart 1). At present, there is no clear assurance of a quick resolution, and ongoing supply disruptions across key commodities continue to weigh on sentiment.

US trade policy is once more on the market's radar following the 2 June announcement from the Office of the United States Trade Representative (USTR). The proposal outlines tariffs of 10-12.5% on imports from 60 economies under investigation for the alleged use of forced labour in relation to import controls. The plan includes exemptions, notably for United States-Mexico-Canada Agreement (USMCA)-compliant goods and further carve-outs may be introduced after the public consultation closes on 7 July.

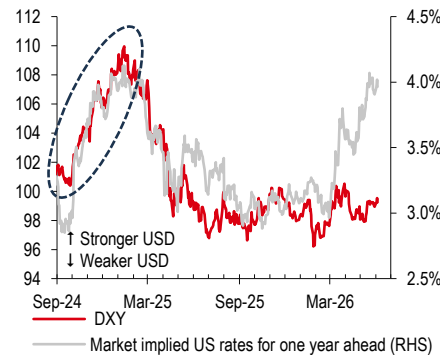
With the **16-17 June Federal Open Market Committee (FOMC) meeting** approaching, **attention is increasingly turning to how the new Chair of the Federal Reserve (Fed), Kevin Warsh, frames the policy outlook.** Markets are becoming more sensitive to the risk of a more hawkish Fed, particularly given **the recent run of upside surprises in US activity data.** Any meaningful shift in the Fed's tone would likely have direct implications for the USD. The last comparable episode of rapid hawkish repricing in Fed expectations – late 2024 – was accompanied by broad-based US dollar strength (Chart 2).

1. US Dollar Index (DXY) and oil prices



Source: Bloomberg, HSBC

2. DXY and market expectations for US rates



Source: Bloomberg, HSBC

Our base case remains that **it would be surprising for the Fed to signal that it is preparing to raise interest rates**, and we continue to anticipate a softer broad USD over the longer term. That being said, any indication that rate hikes are back on the table would likely warrant a more positive USD view. As such, **we are approaching a critical juncture.**

Middle East developments remain a primary focus in FX markets

US trade policy returns to the forefront

Focus shifts to the June FOMC and the new Chair's policy lean

Central scenario: Broad USD to soften over the longer term, but Fed hike signals could strengthen it



Disclosure appendix

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