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FX Focus: DXY – Disorderly Decline In USD Not In Anyone's Interest

FIGURE 1: FX Forecasts

Forecast (Apr 2025)	Spot	0-3m	6-12m	Long-term
DXY Index	99.30	99.06	95.06	99.16

Source: Citi Wealth Investments as of Apr 2025.

Risk assets have been shaken by President Trump's much larger-than-expected US reciprocal tariffs that are stagflationary for the US and disinflationary for the rest of the world (RoW). Yet, the dollar has not strengthened to rebalance global inflation risks (US vs RoW) nor has it found a safe haven bid on the back of sharply rising global risk aversion – that privilege has gone to CHF, JPY, Gold and the newly minted safe-havens EUR and GBP.

Meanwhile, the dollar has dropped sharply, with DXY losing ~10.0% YTD in 3 distinct phases:

1. The drop in early March following the unexpected announcement by the euro area/ Germany of its massive fiscal spending plans on defense/ infrastructure – this took EURUSD up 4% and DXY down 3.5% in a matter of days
2. A further 2.6% decline following the April 2nd tariff announcement. Markets reacted by downgrading US exceptionalism vs the rest of the world (RoW) and further weakening DXY
3. A 3.9% drop taking DXY below the 100 level, following the recent loss of confidence in the safe haven appeal of dollar assets.

Loss of confidence in the safe haven appeal of USD is concerning on 3 fronts:

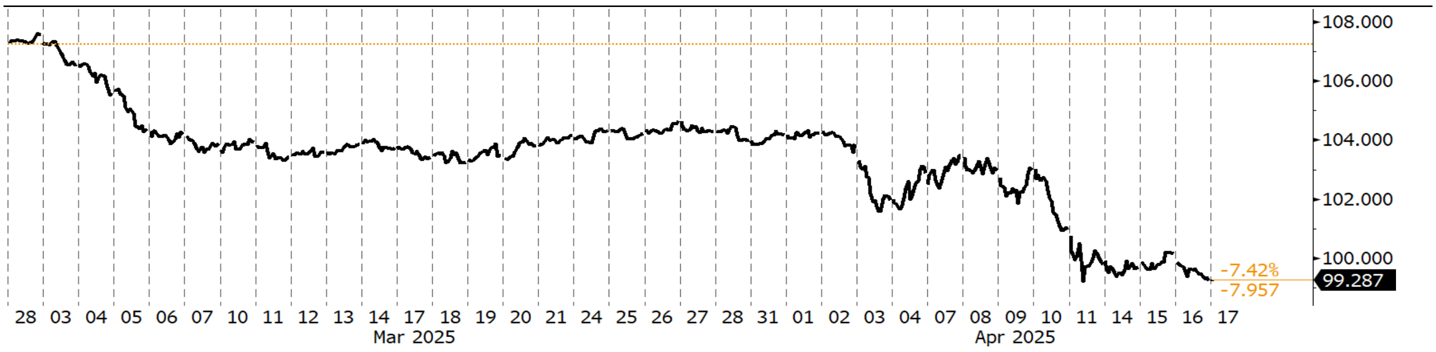
1. The fear trade often exaggerates the price action and there is little policymakers can do near term to restore the safe haven appeal of USD assets. The Fed has the tools to stabilize the Treasuries market but cannot bring back the offshore buyers
2. The capital flight out of USD has not only been carried out by private but state actors as well – notably, a number of central banks reducing USD in the FX reserves as US – China trade tensions reach new heights;
3. RoW investors (both public and private) may continue to unwind structurally overweight US asset positions quicker than tariffs can rebalance the goods deficit, potentially creating further weakness for USD.

The downgrade to US exceptionalism vis-à-vis the rest of the world (RoW) is negative for USD but the loss of safe haven appeal for Treasuries and USD in particular, potentially represents a much bigger threat. Capital flows dwarf trade flows and the loss of safe haven appeal could potentially have greater consequences for the foreign owners of USD 62trn in US assets.

On the other side of the pond, DXY's move below the key 100 level sees EURUSD testing 1.1400 (levels last seen in March 2022), GBP (1.32+) at levels last seen in October 2024 and CHF trading at highs last seen when the SNB removed its peg in early 2015. The sharp tightening in financial conditions in the euro area, UK and Switzerland from the strengthening in their currencies further adds to the disinflationary headwinds posed by tariffs while a weaker USD will likely add to the already rising inflation expectations in the US.

President Trump wants to see a weaker dollar, but such a disorderly decline is probably not what he had in mind given his stated objective of preserving dollar's status as the world's reserve currency.

FIGURE 1: DXY has dropped in 3 phases since early March 2025



Source: Bloomberg, April 17, 2025.

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