FX Strategy

US current account put pressure on the dollar

AUTHORS

Valerio Ceoloni
Senior FX/EM Strategist
valerio.ceoloni@animasgr.it

Tactically, we maintain a neutral tactical stance on the dollar (NEUTRAL EUR/USD and DXY) as major near-term risks appear broadly balanced: fading trade tensions and eased Fed concerns are negative for the dollar, but US economic and labour market strength relative to the euro area supports the dollar (recent jobs data point to mild downside risks and potential short-term softness in the dollar, however).

Strategically, we remain bearish on the dollar (LONG EUR/USD and SHORT DXY). By 2026, we anticipate macroeconomic and monetary policy divergences increasingly to favour the euro. Moreover, with the US current account deficit hovering near historic highs, we expect its gradual return toward the long-term norm to act as a structural catalyst for sustained dollar depreciation against FX peers.

We remain bearish on the USD

Tactically, we remain NEUTRAL EUR/USD (NEUTRAL on the DXY). We view near-term risks as broadly balanced. On one side, trade tensions (typically negative for the dollar) are fading, and concerns about Federal Reserve independence, also negative for the dollar, appear overstated. On the other hand, heading into Q4, we expect the US economy and labour market to continue outperforming the euro area's momentum, supporting the dollar. However, recent labour market data have signalled some downside risks to the growth outlook, which could trigger some short-term dollar softness.

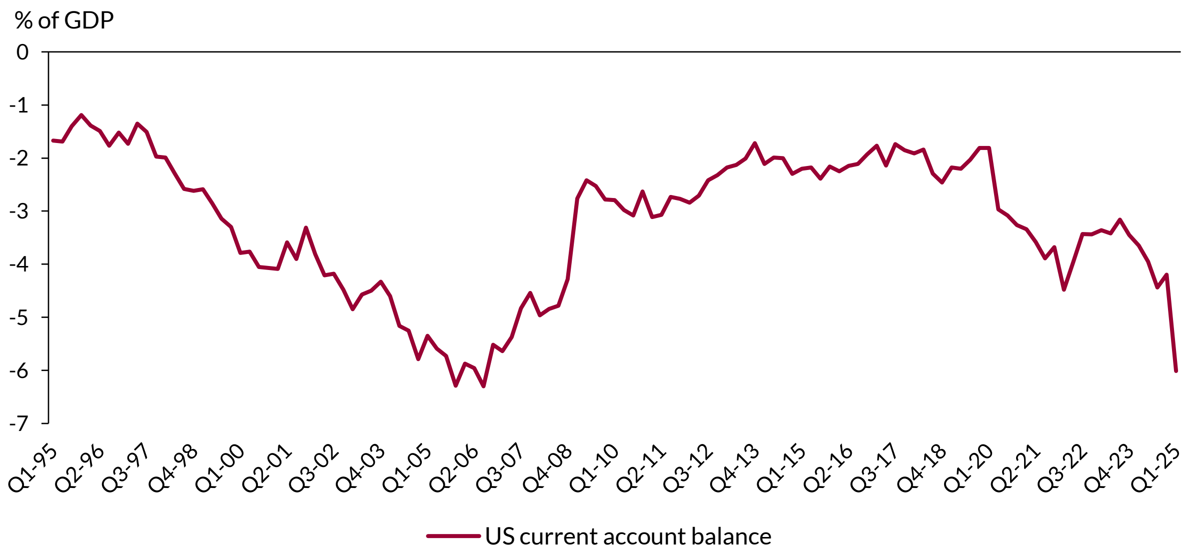
Strategically, we remain LONG on EUR/USD (SHORT on the DXY). Looking ahead to 2026, we continue to expect the macro divergence between the US and the Euro Area (in both the growth-inflation mix and monetary policy) to increasingly favour the euro, supporting a gradual rise in EUR/USD. In addition, a forthcoming rebalancing of the US current account should act as a structural driver of broader dollar depreciation across FX markets.

Rebalancing US current account = softer dollar

In the near term (over the next 12-24 months), current account rebalancing will imply, cœteris paribus, a gradual weakening of the dollar. Over the past five years, the US current account deficit has widened by over 4.2% of GDP, nearing a record low of -6% of GDP (see Figure 1).

Figure 1

US current account balance has widened since 2020, almost reaching its highest level since 1995

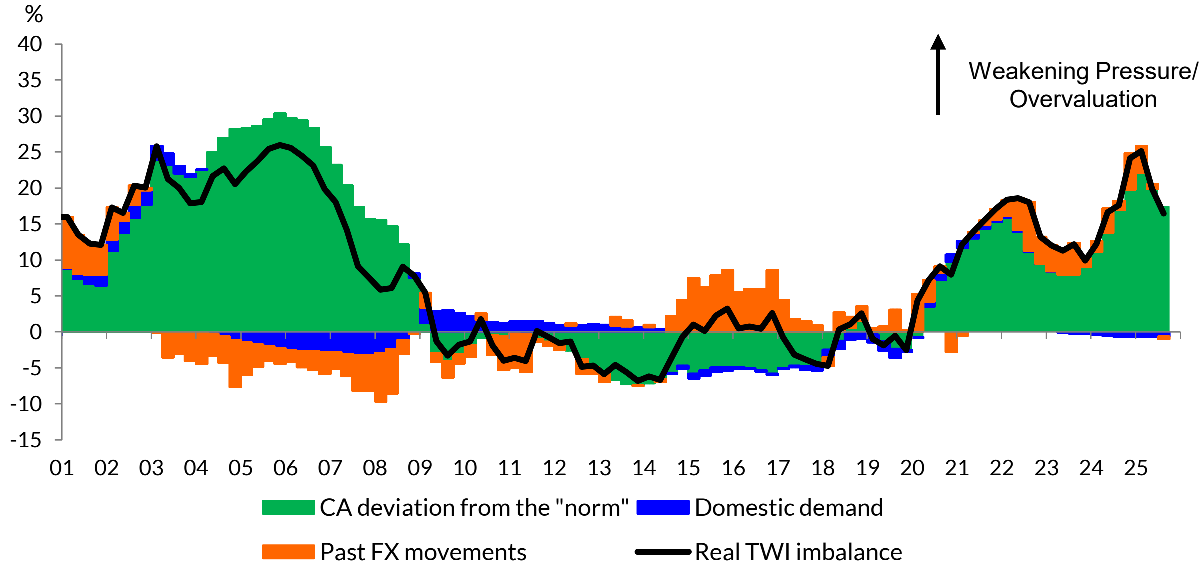


Source: Datastream Refinitiv, ANIMA Research

As a general rule, financing a growing deficit requires net capital inflows, which for the US have typically come from fixed income investments (i.e. mainly purchases of USTs). These inflows have accelerated in line with the expansion of the deficit over the past five years. As a rule of thumb, a 10% depreciation of the USD is needed to reduce the current account deficit by 1 percentage point. Moreover, fundamental equilibrium models indicate that the current account deficit is roughly 15% percentage points above its long-run "norm" (Figures 2, 3).

Figure 2

The growing US current account deficit looks like the main reason of USD weakening pressure



Source: Datastream Refinitiv, Goldman Sachs, ANIMA Research

Against this backdrop, if market pressures are for the current account deficit to return to its long-term average (i.e. around 1.5pp above the current level) then, all else being equal, the entire adjustment would need to occur via the currency.

Put another way, maintaining today's current account deficit without implying dollar depreciation would require non-US investors to increase purchases of US assets at current prices. Thus, when foreign demand softens, a weaker dollar becomes mechanically necessary to maintain equilibrium.

Therefore, if the deficit gradually reverts to its long-term norm (around -4.5% of GDP), further dollar weakness is inevitable.

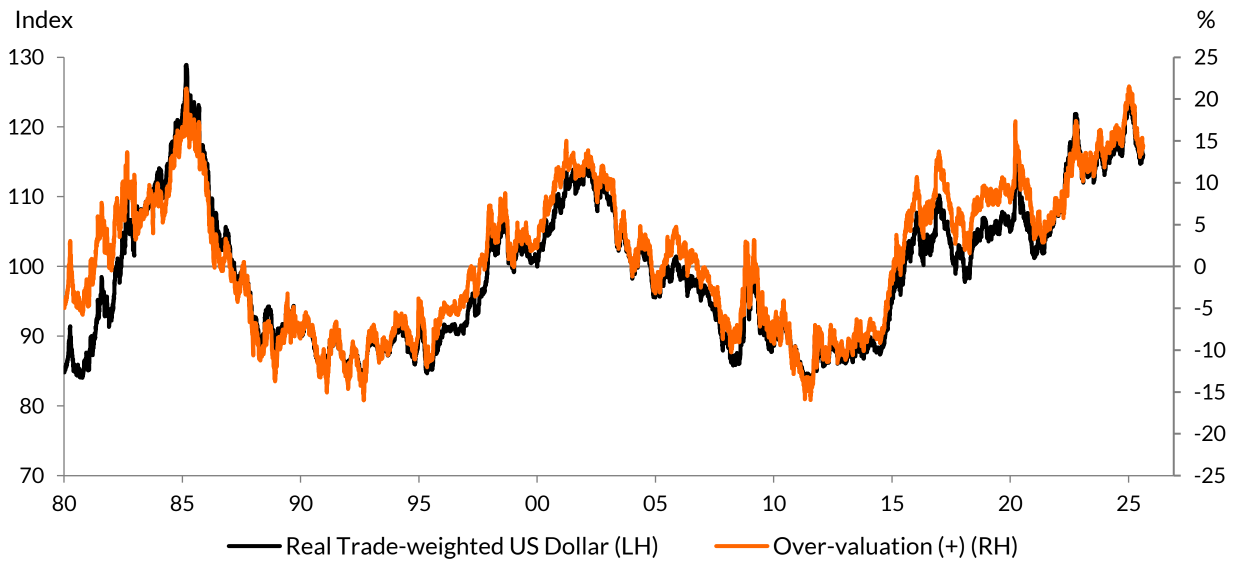
US tariffs might end up helping (a bit) the dollar

At the margin, Trump's tariff could *provide marginal support for* **the dollar by narrowing the US trade deficit through lower imports and higher exports.** The trade balance is a key component of the current account balance, alongside net factor income (e.g., interest, dividends, remittances) and transfers from abroad, which typically represent a small proportion.

If Trump's effort in narrowing the US trade deficit through tariffs prove successful (which is not guaranteed, in our view) not all current account adjustment would need to come from dollar depreciation: higher exports and lower imports would share the adjustment burden (Figure 4).

Figure 3

According to the real trade-weighted measure, the USD appears 15% overvalued



Source: Datastream Refinitiv, Goldmans Sachs, ANIMA Research

Assuming his policies achieve some success, we estimate trade deficit improvement could reduce the current account deficit by about 0.4% of GDP, providing modest support for the dollar.

Figure 4

US trade deficit has widened as imports and exports decoupled visibly since the end of 2024

Source: Datastream Refinitiv, ANIMA Research

Bottom line

Tactically, we stay NEUTRAL on EUR/USD and the DXY. Near-term risks are balanced: fading trade tensions and eased Fed concerns are negative for the dollar, but US economic and labour market strength relative to the euro area supports the dollar. Recent jobs data point to mild downside risks and potential short-term softness in the dollar, however.

Strategically, we remain LONG EUR/USD (SHORT DXY). By 2026, macro divergence should shift in favour of the euro, and US current account rebalancing will likely be a structural driver of broader dollar depreciation.

ANIMA INVESTMENT RESEARCH

FABIO FOIS
Head of Investment Research & Advisory
fabio.fois@animasgr.it

CHIARA CREMONESI
Senior Rates Strategist
chiara.cremonesi@animasgr.it

FRANCESCO PONZANO
Junior Equity Strategist
francesco.ponzano@animasgr.it

VALERIO CEOLONI
Senior EM/FX Strategist
valerio.ceoloni@animasgr.it

MATTEO GALLONE
Junior Macroeconomist
matteo.gallone@animasgr.it

COSIMO RECCHIA
Senior Equity Strategist
cosimo.recchia@animasgr.it