FX Strategy

USD: *Under pressure*

AUTHOR

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Looking into next year, we expect several structural factors to keep the US dollar vulnerable to further weakness. These include: 1) macroeconomic and monetary policy divergences between the US and Euro Area, as the Fed and ECB pursue distinct paths; 2) an ongoing adjustment in the US current account from near-historic lows, driven by post-tariff shifts; 3) continued rebalancing by global investors away from the dollar and into other major currencies; and, 4) persistent uncertainty surrounding Federal Reserve independence, including Powell's expected departure in May next year Altogether, these factors point to continued EUR/USD upside through 2026.

Tactically, we turn LONG on EUR/USD and short DXY (from NEUTRAL). In line with the rhetoric at Jackson Hole and following unexpected weakness in recent labour market data as well as substantial downward revisions to NFP for 2024-2025, the FOMC adopted a more dovish tone at its September meeting, with Powell's priorities shifting from inflation concerns towards the labour market.

Strategically, our outlook for the dollar remains bearish. We remain LONG on EUR/USD and SHORT on DXY. By 2026, we anticipate several factors will continue to weigh on the dollar: macroeconomic and policy divergences between the US and the Euro Area; ongoing rebalancing of the US current account following the impact of tariffs; a sustained trend of FX reshuffling among market participants into other major currencies; and, finally, persistent uncertainty surrounding Federal Reserve independence, particularly in light of Powell's planned departure in May.

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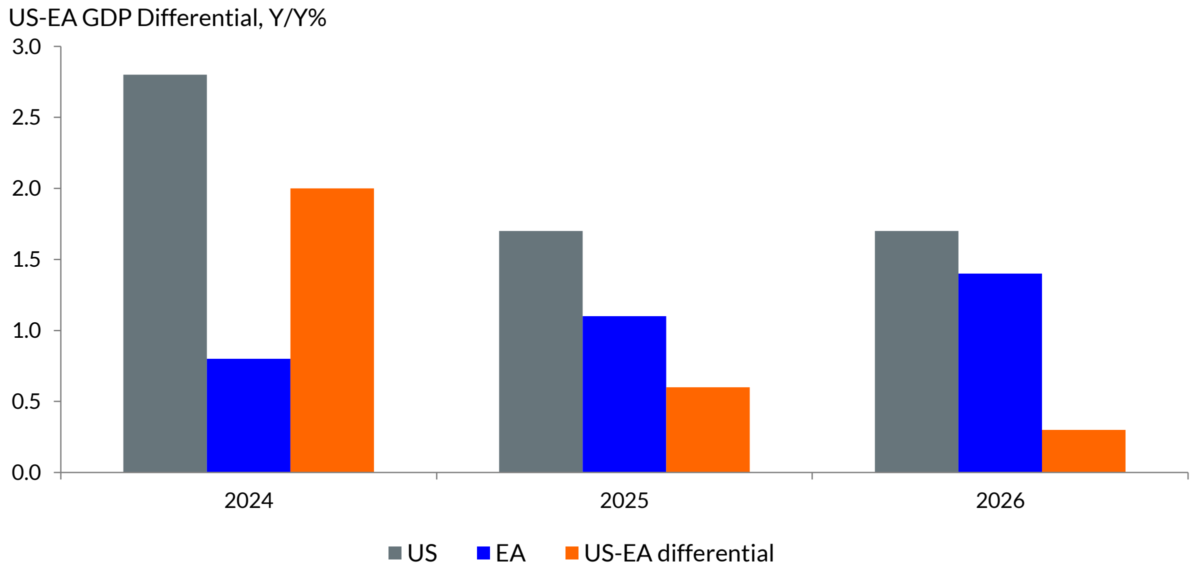
Four reasons to remain long EUR/USD in 2026

1. **US/EA macro and monetary policy divergences to push EUR/USD higher next year.** We expect simultaneous divergences in growth and monetary policy between the US and the Euro Area to be the key drivers of the EUR/USD uptrend in 2026. On the one hand, the US economy is likely to slow below potential as its period of exceptional outperformance fades, while Eurozone growth momentum is expected to reaccelerate in 2026 (Figure 1).

Figure 1

Growth differential between US and EA on a downward path...



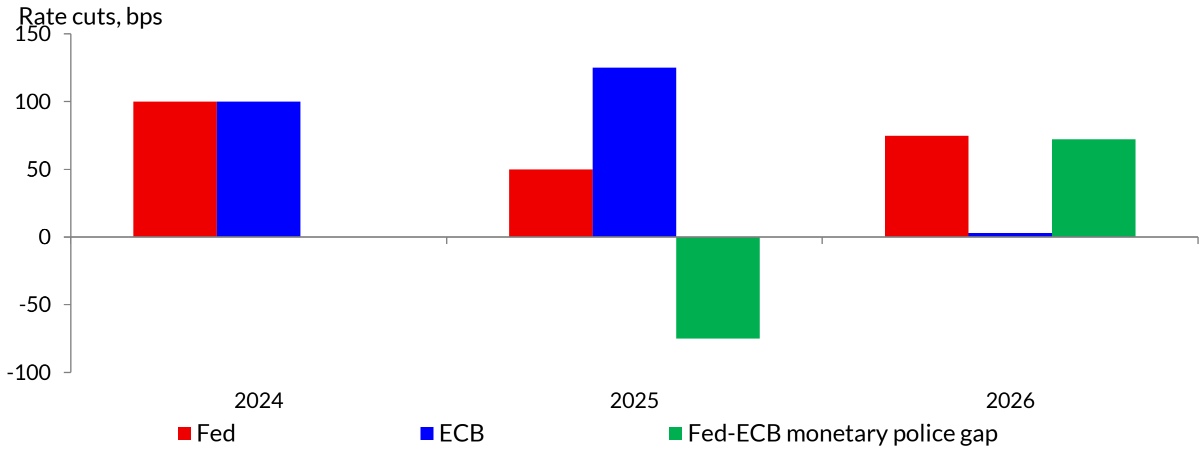
Source: Datastream Refinitiv, ANIMA Research

On the other hand, in terms of monetary policy, we expect the Fed to shift its focus from inflation to labour market conditions, resulting in a cumulative 75 basis points of rate cuts in 2026. By contrast, with inflation at target and growth gradually resuming sequentially after three quarters of near stagnation, we anticipate the ECB will cautiously remain on hold throughout 2026 to avoid triggering exogenous inflationary pressures (Figure 2).

2. **In 2025/2026, post-tariff US current account rebalancing should imply gradual dollar weakening.** Over the past five years, the US current account deficit has expanded by more than 4.2% of GDP, nearing -6%, which is close to record lows (Figure 3). As a rule of thumb, a 10% USD depreciation reduces the current account deficit by roughly 1 percentage point. Current equilibrium models suggest the deficit is about 1.5pp larger than its long run "norm." Therefore, to revert towards its long-term level, the bulk of the adjustment must occur through the currency: when inflows slow, a weaker dollar becomes a mechanical requirement to restore external balance. Should the deficit gradually narrow towards -4.5% of GDP, some degree of dollar depreciation appears inevitable. In this sense, structural current account dynamics argue for sustained dollar weakness throughout 2026.

Figure 2

...while we expect the Fed to cut more forcefully than the ECB in 2026

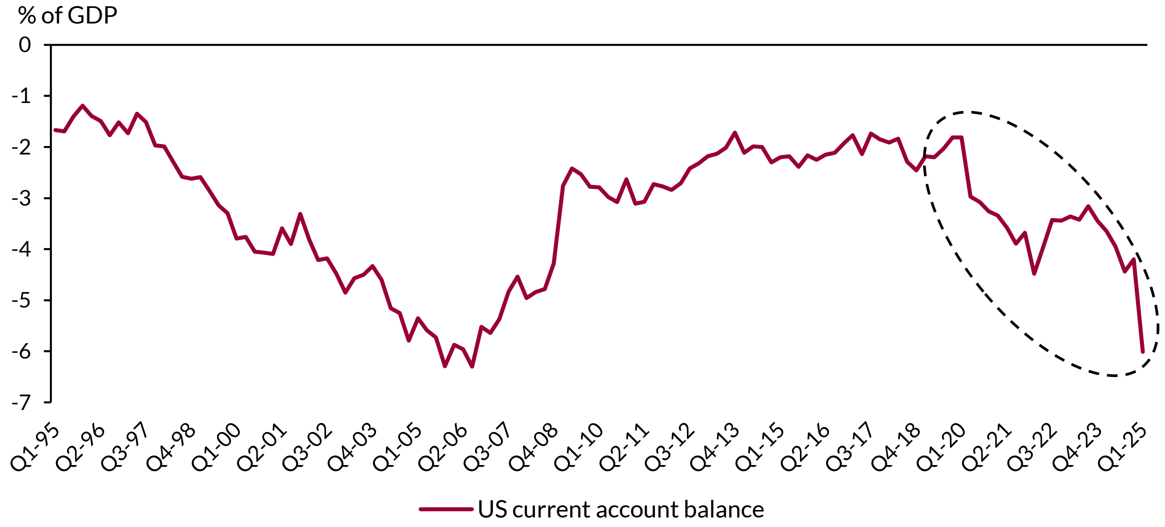


Source: Datastream Refinitiv, ANIMA Research

3. **Dollar remains the global reserve currency, but FX rebalancing is set to continue next year.** In the first half of the year, the turbulent start to Trump's second term disrupted long-standing market correlations, undermining the US dollar's traditional role as a safe-haven asset during periods of market stress. Typically, risk-off episodes are characterised by an inverse relationship between the USD and equities, with the dollar strengthening as equity markets fall. However, following Liberation Day, this relationship broke down as investors reassessed their exposure to the currency amid heightened policy uncertainty and trade tensions. We believe this period of significant reassessment of USD exposure has largely run its course: Trump's more conciliatory approach to ongoing tariff disputes has created a less volatile backdrop, allowing traditional correlation patterns to gradually reassert themselves. As a result, aggressive hedging against long US equity positions via the dollar has eased, though it has not disappeared completely. In our view, de-dollarisation pressures have peaked but are unlikely to vanish entirely in 2026, as market participants may add a further layer of FX rebalancing in the coming quarters (Figure 4).

Figure 3

The growing US current account deficit is one of the main reasons behind the weakening pressure on the USD

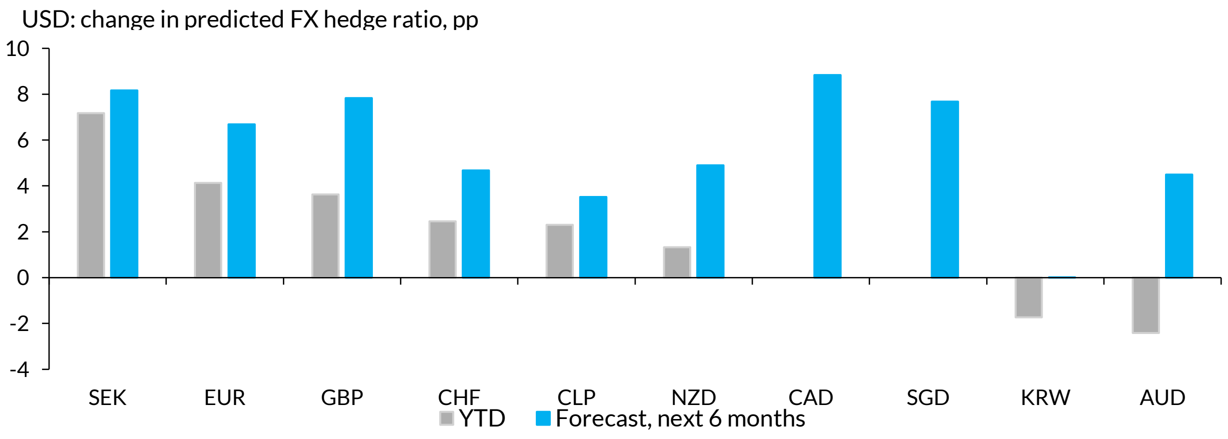


Source: Datastream Refinitiv, Goldman Sachs, ANIMA Research

4. **Challenges and noise surrounding the Federal Reserve's independence are likely to persist in 2026, keeping the dollar under pressure.** Growing - and in many respects unprecedented - political interference in the FOMC's mandate could undermine the perception of the Fed acting with full autonomy. In this environment, risks appear tilted towards an excessively dovish stance, as the central bank may feel pressured to prioritise short-term political goals over long-term stability. Such a shift would increase the likelihood of monetary settings that maintain persistent pressure on the dollar. In our view, putting the Fed's independence at risk (or even casting doubt over it) could amplify volatility in currency markets and extend the downward trend in the USD.

Figure 4

The shock following the Liberation Day triggered a rise in predicted hedge ratios



Source: Datastream Refinitiv, Goldmans Sachs, ANIMA Research

Bottom line

Tactically, we turn LONG on EUR/USD and short DXY (from NEUTRAL). In line with the rhetoric from Jackson Hole and following unexpected weakness in recent labour market data alongside substantial downward revisions to NFP for 2024-2025, the FOMC adopted a more dovish tone at its September meeting, with Powell's priorities shifting from inflation concerns towards the labour market.

Strategically, our outlook for the dollar remains bearish. By 2026, we anticipate several factors will continue to weigh on the dollar: macroeconomic and policy divergences between the US and the Euro Area; US current account rebalancing following the impact of tariffs; a sustained trend of FX reshuffling among market participants into other major currencies; and, finally, persistent uncertainty surrounding Federal Reserve independence, particularly with Powell's planned departure in May.

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