AmBank Group

AmBank Economics

#WhatWeThink

Tariffs, tariffs, tariffs — Revising our USD and UST projections

22 May 2025

EXECUTIVE SUMMARY

We revise down our DXY forecasts. Following the recent easing of market volatility after announcement of the 2 April US reciprocal tariffs (RT) and growing optimism for a trade agreement between the US and China, we now feel more confident in revising our USD and UST forecasts. Our FX projection for the USD will consider the following factors:

- Growth risks remain on the downside. In our previous forecast, we did not fully consider the impact of tariffs;
- We maintain our outlook for US inflation to decline progressively towards the Fed's 2.0% target by the end of 2027;
- Lowering the factor of the USD as a safe-haven currency. Previously, our expectations assumed trade war risks would elevate the USD as a safe-haven. This notion, however, is shrouded in doubt based on the past month's reported trend of fleeing from USD and USD-denominated assets. The US sovereign credit remains a function in our forecast model, whereby higher debt-to-GDP contributes to a higher USD value as investors pick up US government debt. On the other hand, higher debt-to-GDP lifts US Treasury yields, as seen in this month's episode when yields rose on the back of Moody's US credit rating downgrade from AAA; and
- Interest rate differentials of USD vs majors will progressively be negative for the USD, as we assume continued gradual Fed rate cuts.

UST forecasts. In addition to our USD revisions, we do the same to our UST yield forecasts. In particular, our UST revision includes:

- Sustained fiscal impact. Due to fiscal policy direction, there will be pressure for net selling of UST due to sustained large government bills, notes, and bond issuances (due to continued high fiscal deficits); and
- We need to rebalance our view of demand for USD assets (stocks, bonds, and FX) vis-à-vis other major currencies after seeing the mid-April USD assets sell-down, including UST. Nevertheless, we are not inclined to think the USD asset sell-down was due to a lessening of the importance of the US as a trading partner/global economic power, but was more due to global investor repositioning as the US was central to the ongoing global tariff war. We do price in the recent rise in UST yields on the back of net selling post-Moody's downgrade of the US sovereign rating, but we opine that longer-term sentiment should normalise and bring down UST yields as we assume the net selling is overdone.

AmBank's updated forecasts

	3Q2025	4Q2025	1Q2026	2Q2026	3Q2026
DXY Index					
AmBank forecast	**99.8**	**100.0**	**98.6**	**98.0**	**97.4**
Previous AmBank forecast	*108.0*	*106.0*	*NA*	*NA*	*NA*
Bloomberg Consensus	100.2	99.3	98.3	NA	NA
AmBank worst-case scenario	98.9	99.2	97.7	97.1	96.5
10Y UST yield (%)					
AmBank forecast	**4.40**	**4.30**	**4.20**	**4.10**	**3.90**
Previous AmBank forecast	*4.40*	*4.20*	*4.30*	*4.32*	*4.32*
Bloomberg Consensus	4.18	4.10	4.04	4.03	4.03
AmBank worst-case scenario	4.20	4.10	4.00	3.90	3.70

Revising our USD projections

New forecasts amid another Trump tantrum

We revise down our DXY forecasts. Following the recent easing in volatility after the announcement of the 2 April RT and increasing hopes for a trade agreement between the US and China, we now have greater confidence to revise our USD and UST forecasts. In doing our revision for USD, we also note increased hopes for trade agreements between the US and countries affected by the RT. We also consider the latest central bank (i.e., the Fed) narrative and signalling of incoming rate cuts into our projections.

Our FX projection for the USD will consider the following factors:

Risks to growth remain on the downside

Inflation progress continues

Lowering the USD allure as a safe haven

Interest rate differentials are progressively against the USD

- **Risks to growth remain on the downside.** Our previous forecast did not fully account for the tariff impact. Our USD forecast model uses the US current account balance and goods and services trade balance as variables.
- **We maintain our outlook for US inflation to progressively decline towards the Fed's 2.0% by the end of 2027.** Our model uses the monthly core PCE y/y rate.
- **Lowering the factor of the USD as a safe-haven currency**. Previously, our expectations assumed trade war risks would elevate USD as a safe haven, which has been placed with some doubt based on the past month's reported trend of fleeing away from USD and USD assets. However, the US sovereign credit remains a function in our forecast model, whereby higher debt-to-GDP contributes to a higher USD value as investors pick up US government debt. On the other hand, higher debt-to-GDP lifts US Treasury yields, as seen in this month's episode when yields rose on the back of Moody's US credit rating downgrade from AAA.
- **Interest rate differentials of USD vs. majors** will progressively be negative for the USD, as we assume the Fed's continued gradual interest rate cuts. For the purpose of our model, we used the 12M T-bill rate and the Fed Funds Rate (FFR) as variables for interest rates.

Worst-case scenario. That being said, we also present a worst-case scenario for US macro conditions, which assumes the tariff situation continues to deteriorate (with US and China tariffs on each other sustained near the 100% level), and lower, but still substantial, RT on other countries. Meanwhile, we assume a larger quantum of interest rate cuts by the Fed. In our base case, our assumption is for the FFR to reach 4.00% (upper bound) (now 4.50%) by end-2025 and may quickly reach 3.25% by mid-2026 and end 2026 at 3.00%. For our worst-case scenario, looking at sustained tariff impact on growth, we assume 3.75% FFR end-2025 (4.00% base case) and down to 2.75% end-2026 (3.00% base case). Short-term rates (12M T-bills used in our model) should see ensuing declines accordingly, and thus contribute to lessened interest rate differential advantage for USD vs. other major currencies. We note that real FFR remains near 10-year highs, thus providing ample room for Fed rate cuts in a 1- to 2-year time horizon, in our opinion.

Both our refreshed USD and UST projections are tabulated on **Page 1** of this research note.

Revising our UST projections

In addition to our USD revisions, we revise our UST yield forecasts. Our UST assumptions take into account the following factors:

Taking account of the macro outlook, which we underweighted before

- **Continued weak economic data and outlook,** which we underweighted before, including anticipated effects of the trade war on the US economy.

Fed rate cuts will continue

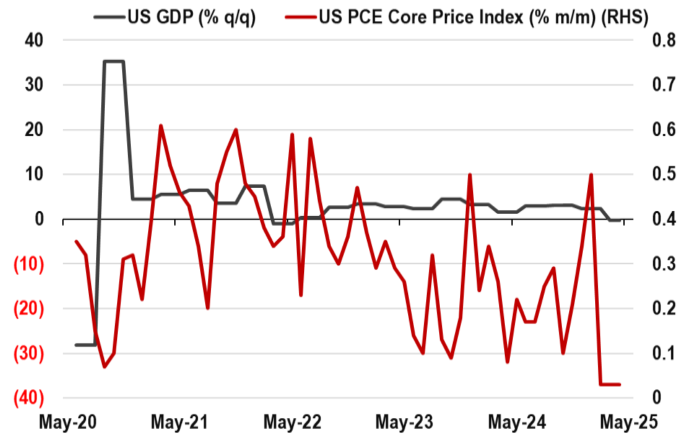
- **The pace of Fed interest rate cuts remains as per our current expectations: two (2) 25 bps cuts in the remaining months this year and two (2) cuts in 1H2026.** Nevertheless, despite our FFR expectations, we think bond markets will sustain pent-up expectations for more cuts, which we think will press bond yields lower vis-à-vis shorter-term rates such as the T-bill levels.

UST to continue to be impacted by fiscal and trade policy

- **Continued fiscal policy pressures and worsening global trade policy and outlook.** We think the bond market will continue to price in Fed cuts (i.e., decline in UST yields), but this will be heavily balanced by the pricing in of continued Trump policy.
    - Due to **fiscal policy** direction, there will be pressure for net selling of UST due to sustained large government bills, notes and bond issuances (due to continued high fiscal deficits). Our reading of the Securities Industry and Financial Markets (SIFMA) data stated that in 2024, the estimated net issuance of UST securities was USD1.9 trillion. Going into 2025, the Congressional Budget Office placed a 6.5% fiscal deficit to GDP and, in dollar terms, will be USD1.94 trillion. Hence, the net issuance of UST securities will likely be similarly large in 2025, at least USD2.0 trillion.
    - In addition, there remains pressure for net selling of USD assets in view of perceived Trump **trade policy** errors, which could:
        a) be inflationary; <u>and</u>
        b) rebalance our view of demand for USD assets (stocks, bonds and FX) vis-à-vis other major currencies, after we saw the mid-April sell-down of USD assets, including UST. Nevertheless, we are not inclined to think the USD asset sell-down was due to a lessening of the importance of the US as a trading partner/global economic power, but was more due to global investor repositioning as the US was central to the ongoing global tariff war. We do price in the recent rise in UST yields on the back of net selling post Moody's downgrade of the US sovereign rating, but we opine that longer-term sentiment should normalise and bring down UST yields as we assume the net selling is overdone.

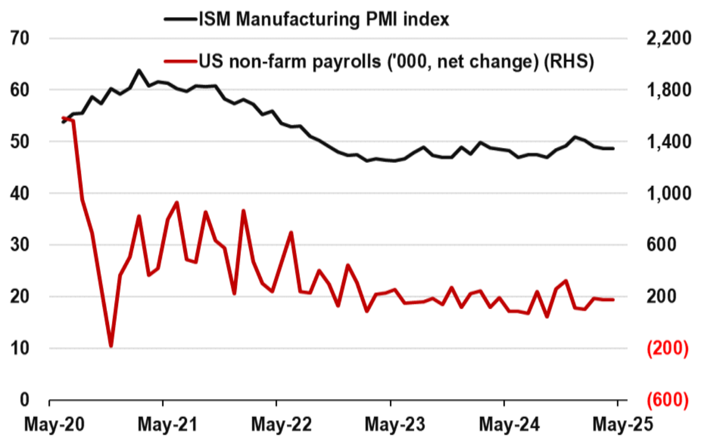
Last, we also present a worst-case scenario for UST on the side. We assume the tariff situation will continue deteriorating, including US and China tariffs, and still substantial RT remaining on other countries. Our assumptions on FFR policy/rate cuts for our base-case vs. worse-case UST projections are similar to those in our base-case vs. worse-case USD revisions.

Exhibit 1: Deteriorating US macro indicators



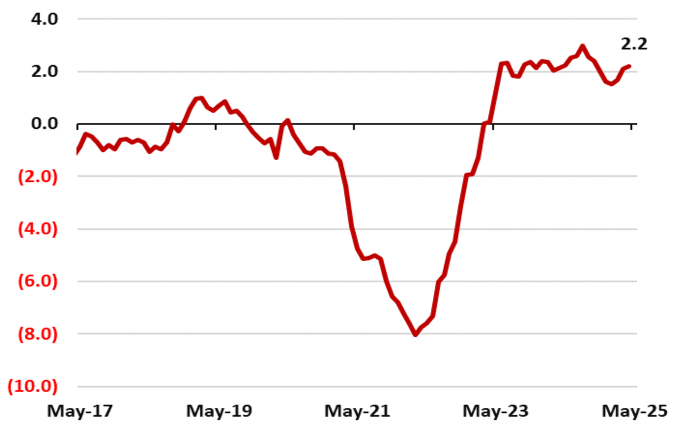
Sources: Bloomberg, AmBank Economics

Exhibit 2: Deteriorating US macro indicators



Sources: Bloomberg, AmBank Economics

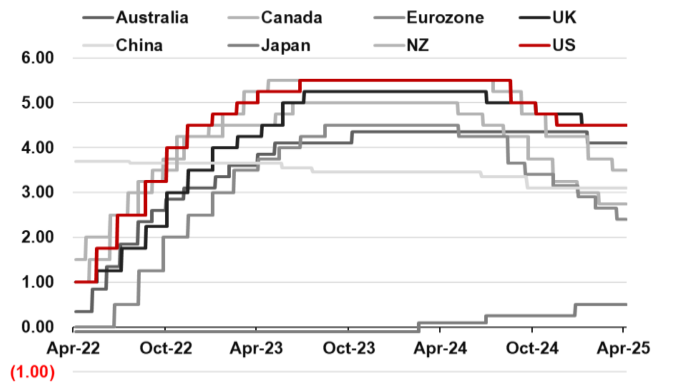
Exhibit 3: Real FFR remains near 10-year highs



Sources: Bloomberg, AmBank Economics

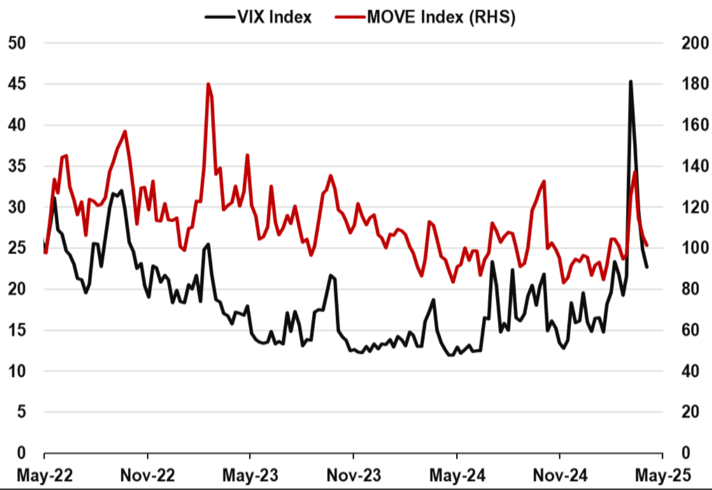
Exhibit 4: Rates differentials not looking good for USD

US interest rate policy lags majors. Our base case assumes FFR to hit 3.00% end-2026.



Sources: Bloomberg, AmBank Economics

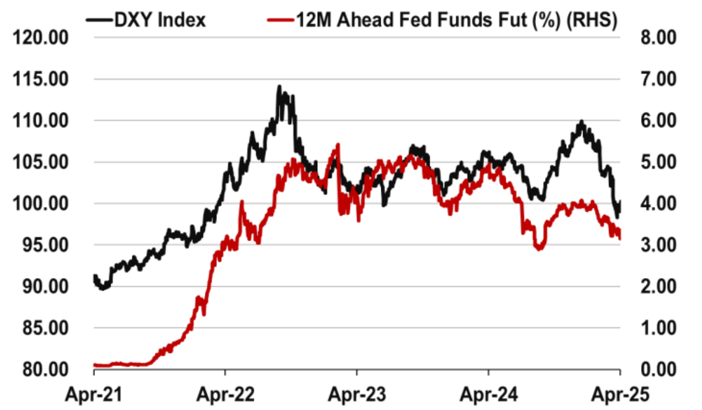
Exhibit 5: Volatility measures fall after blowout in April



Sources: Bloomberg, AmBank Economics

Exhibit 6: Futures continue to price lower FFR

FFR futures pricing in lower rates, set to dampen DXY levels



Sources: Bloomberg, AmBank Economics

AmBank Economics	
Firdaos Rosli	firdaos.rosli@ambankgroup.com
Nik Ahmad Mukharriz Nik Muhammad	nik-ahmad-mukharriz.n@ambankgroup.com
Lee Si Xin	lee.si-xin@ambankgroup.com
Raja Adibah Raja Hasnan	raja-adibah.r@ambankgroup.com
Aman Nazmi Abd Karim	aman-nazmi.abd-karim@ambankgroup.com
Group Treasury & Markets	
Corporate Client Group (CCG)	**+603-2059 8700/8600**
Institutional Client Group (ICG)	**+603-2059 8690**
Azli Bin Abdul Jamil	azli-abd-jamil@ambankgroup.com
Jacqueline E. Rodrigues	jacqueline-r@ambankgroup.com
Ho Su Farn	ho-su-farn@ambankgroup.com
Melisa Lim Giok Ling	melisa-lim@ambankgroup.com
Roger Yee Chan Chung	roger-yee@ambankgroup.com
Nadia Binti Hazmi	nadia.hazmi@ambankgroup.com

DISCLOSURE AND DISCLAIMER