CUSTOMER TREASURY SERVICES
Economist's Weekly Market View
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Dollar remains prone to volatility

The world's most transacted currency pair, euro/dollar (EUR/USD) had an eventful first half of 2025. It is currently up by over 10% from where it commenced the year. This represents quite a turnaround for the euro after a weak opening two months, when EUR/USD fell to a low of $1.015 in February. As the months progressed though, the single currency saw a significant reversal of fortunes against the dollar. However, this had more to do with weakness on the part of the dollar rather than any standout euro strength.

From a dollar perspective, the currency started to come under sustained downward pressure from early March onwards. There were a few factors that came together to put the greenback on the defensive. Towards the end of Q1, amid the impending announcement of a new US tariff policy and concerns over the precarious fiscal position of the world's largest economy, the previous optimism on the US economic outlook turned to pessimism.

This, coupled with increasing tensions between the White House and the Federal Reserve over interest rate cuts, weighed heavily on the dollar. EUR/USD finished the first half of 2025 above the $1.18 threshold, trading up to a 4-year high at $1.1829.

Over recent weeks though, the dollar has regained some ground. This has been against the backdrop of better-than-expected US macro data, including for the labour market (albeit the underlying payroll details were not as strong as the headline metric suggested), and signs in the latest CPI numbers of some tariff related upward pressure on inflation, resulting in a firming in US rate expectations.

The EUR/USD pair has tested back below the $1.16 handle. Another factor could involve the market having to re-evaluate its near-term outlook for the dollar. Market positioning was exceptionally stretched short for the currency (i.e. high number of trades were expecting further dollar weakness). Therefore, the better than anticipated US macro news may have prompted some reversal of these positions, and in turn provided a support to the greenback.

Dollar volatility is likely to remain a feature over the coming months. We saw a stark example of that last Wednesday. Speculation over Fed Chair Powell's position saw EUR/USD surge up from $1.156 to $1.17 and back down below $1.16 within a short space of time. President Trump is likely to continue to deploy a strategy of 'talking down' US rates until the Fed resumes its cutting cycle. This on-going conflict remains a source of instability for the dollar, as does the raft of trade negotiations, including the US/EU talks.

If the current resilience in the US macro data starts to wane, this could put the dollar on the defensive again and push EUR/USD back up along $1.16-1.18 territory. This is still a relatively solid position for the dollar versus the euro though. The pair has not traded consistently above the $1.20 level since 2014. To sustain a break above this mark, will likely require a combination of dollar weakness and some outright euro strength.

From a euro viewpoint, political risks remain bubbling just below the surface and could act as headwinds for the currency. This includes the French minority government facing an uphill struggle to pass a Budget this autumn, while we have seen signs of tension emerge in Germany's new coalition.

Overall, though, assessing the respective economic growth trajectories (Eurozone modestly picking up, US slowing) and monetary policy outlook, we lean towards EUR/USD resuming its uptrend over the remainder of the year, although a sustained break above $1.20 may be a step too far for now.

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