US Dollar Quick Take: Catalysts for Weakness and Implications for Investors

September 2025

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Catalysts for US dollar weakness

The US dollar's future trajectory is now at the forefront of global investment considerations. After a decade of strength, underpinned by US economic and equity market leadership, the dollar currently stands overvalued against a broad range of currencies. In our analysis, this overvaluation is unlikely to persist. Several emerging catalysts point to a period of sustained weakness for the US dollar, with significant implications for investors and currency managers worldwide.

One of the most decisive factors is the anticipated slowdown in the US economy, driven largely by a historic rise in tariffs. The magnitude of these tariff increases, not seen since the 1930s, will be felt primarily by US consumers and is expected to depress demand and slow growth. We anticipate that this environment will prompt the Federal Reserve to resume interest rate cuts, narrowing the gap with other central banks and removing a key support for the dollar.

Investor sentiment is also shifting. Heightened uncertainty around US policy – ranging from trade decisions to the broader stance of the administration – has begun to erode traditional relationships between the dollar and US asset returns. This signals a reassessment of the dollar's perceived role as a safe haven currency.

Compounding these cyclical and sentiment-driven factors is a concerning fiscal outlook. The US is projected to sustain fiscal deficits of 6–7% of GDP, far exceeding those of peer economies, alongside a persistent current account deficit. This "twin deficit" scenario increases reliance on foreign capital at a time when institutional investors and central banks are likely to reduce their exposure to US assets. The result is a structural headwind for the dollar that is expected to persist over the medium term.

Key considerations for investors

- The US dollar remains the dominant global reserve currency, but its overvaluation and mounting headwinds suggest a gradual, persistent weakening trend.
- Investors and currency managers should consider active positioning to capture potential alpha from dollar weakness.
- Non-US domiciled investors should evaluate US dollar exposure, considering increased strategic currency hedges.

While we do not foresee a sudden collapse in the dollar's global role, even incremental changes in investor attitudes and cross-border flows can have meaningful effects on returns and risk management. In this evolving environment, prudent currency strategy and vigilant monitoring of macroeconomic developments will be essential for navigating the challenges ahead.

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