RBC Global Asset Management

Global currency outlook

FALL 2025

Time to capitalize on the U.S. dollar downtrend

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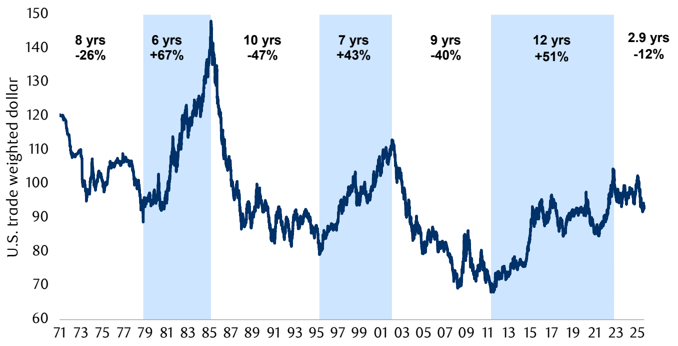
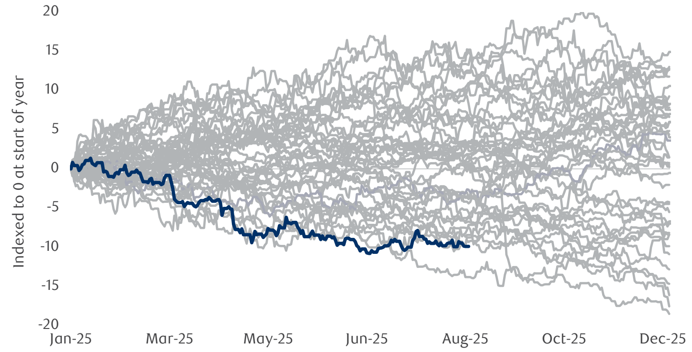
The U.S. dollar fell by 10% in the first half of 2025, marking its largest six-month decline since 2009 and one of its worst yearly starts since the greenback's link to gold was abandoned in the early 1970s (Exhibits 1 and 2). This is certainly not what most investors expected at the beginning of the year, when the U.S. dollar was basking in the glow of higher interest rates, better performing stocks and a stronger economy than other developed-market nations. Following so closely on the heels of this so-called "U.S. exceptionalism," the currency's slide was especially surprising to investors who believed the greenback would be propelled even higher by Trump's plan to raise tariffs. In the months that followed Trump's inauguration, investors universally flipped from bullish to bearish on the greenback, as can be seen from the large swing in futures positions (Exhibit 3).

Exhibit 1: Long-term cycles in the U.S. trade-weighted dollar



Note: As at August 22, 2025. Source: Bloomberg, U.S. Federal Reserve, RBC GAM

Exhibit 2: Weakest annual U.S. dollar trend since the 1970s



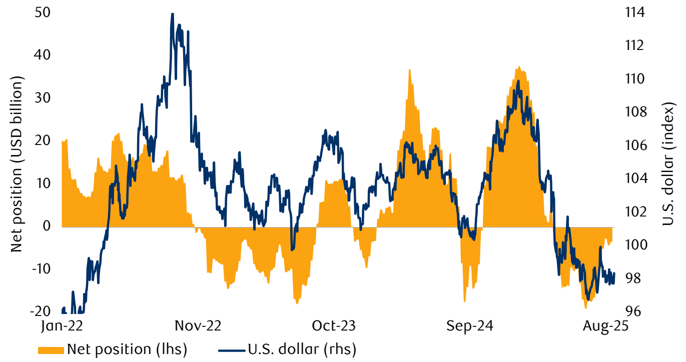
Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

A comparison to past calendar years is a bit arbitrary because the capital flows that drive exchange rates are more dependent on investment themes than on seasonality. It's more fitting to compare this year's decline in the dollar with past bear markets, and the current episode looks remarkably similar to the dollar's past two multi-year declines if we designate the start of the sell-off as this year's high on January 13 (Exhibit 4). Starting from this point, we can see that the bulk of the dollar's decline tends to materialize within the first three years, and investors need to be quick to call the dollar's peak if they are to capitalize on its subsequent decline. This chart suggests that it's better to be too early than too late in betting against the greenback at this point in the U.S.-dollar cycle, especially since the currency's overvaluation near such turning points limits further gains.

Another feature of these bear-market roadmaps is a tendency for the dollar to experience temporary bouts of strength. Such counter-trend moves cause some investors to buy back their short U.S.-dollar positions, and in doing so contribute to a further acceleration of the greenback's gains. We saw such a move this past July, when the dollar rallied 4% in the month to above its 50-day moving average – a level that has limited the currency's gains since February. As it happens, these kinds of early-stage bounces tend to average around 4% to 6% and should be viewed as opportunities for investors to sell dollars if they haven't already done so. These opportunities are not easy to time, however, as market narratives tend to make it appear as though the greenback bounce could be much larger. This was indeed the case in July, when a few important U.S.-dollar negatives were seemingly eliminated, such as the removal of a proposed levy on foreign holders of U.S. assets in Trump's One Big Beautiful Bill. The idea of a Mar-a-Lago accord to co-ordinate a weaker U.S. dollar also fizzled. Additionally, the signing of tariff deals with the UK, Japan, South Korea and others was good news for the U.S. economy and for business investment, since some of those agreements include a requirement for trade partners to invest capital in the U.S.

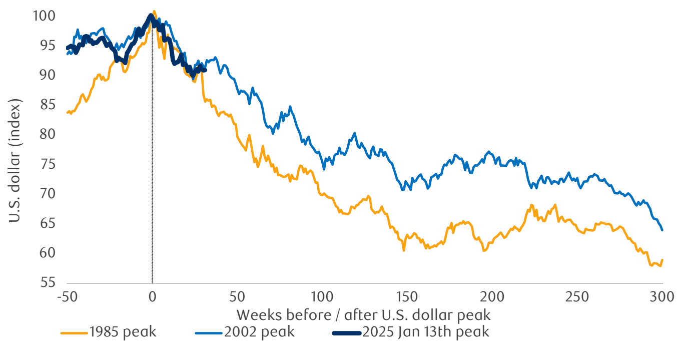
We think it likely that the greenback makes new lows in coming months. In fact, it seems to have returned to its declining trend, knocked lower by a trio of events that hit within hours of each other on the first day of August. First, weaker jobs data revealed a softer U.S. labour market and had investors boosting expectations for a September rate cut from the U.S. Federal Reserve (Fed) (Exhibit 5). Second,

Exhibit 3: Futures positions in the U.S. dollar have swung from bullish to bearish



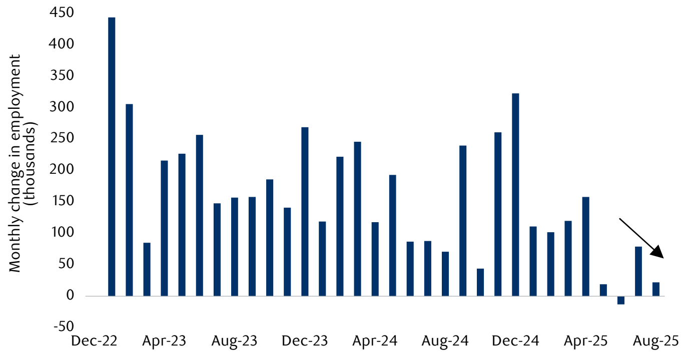
Note: As at August 29, 2025. Source: Bloomberg, CFTC, RBC GAM

Exhibit 4: The dollar's decline compared to past bear markets



Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

Exhibit 5: U.S. labour market softening



Note: As at September 5, 2025. Source: U.S. Bureau of Labour Statistics, RBC GAM

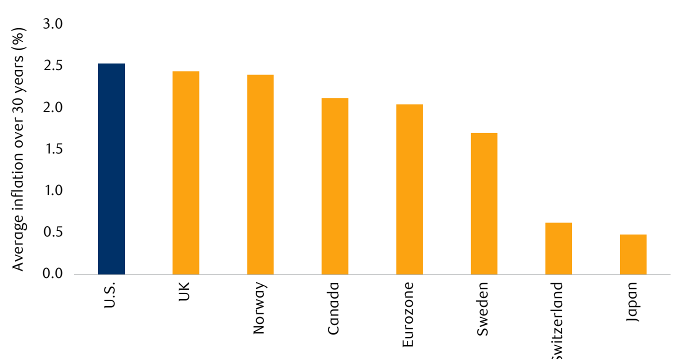
President Trump fired the head of the agency responsible for compiling the softer employment numbers, raising concerns about the integrity and independence of U.S. institutions. Third was an announcement by Fed Governor Adriana Kugler that she would step down before her term was up, allowing the White House to nominate Trump loyalist Stephen Miran to serve the remainder of Kugler's term. Miran is a well-known advocate of a weaker U.S. dollar and in a paper published last fall proposed a framework for weakening the currency. He has also called for reforms that would allow the White House to exercise greater influence over the central bank.

The replacement of Fed governors is an especially touchy subject given Trump's criticism of Chairman Jerome Powell for being too slow to ease monetary policy. As it stands, we think financial markets have not fully factored in concerns about the threat to Fed independence. Trump has made clear that he intends to control a majority of the seven governors, which could allow him to influence appointments of Fed regional presidents who make up the remaining five monetary-policy voters. Bond and currency investors should be concerned that politically motivated rate cuts could prolong a period of high inflation, which would almost certainly erode fixed-income returns and the value of the greenback. Trump's recent move to fire Governor Lisa Cook for reasons unrelated to her role at the Fed did little to alleviate these concerns. In the event that Trump's actions survive the legal challenges that are surely coming, he will be emboldened to meddle further – both in the affairs of the Fed and other U.S. institutions.

Our longer-term outlook remains firmly bearish on the U.S. dollar and is reinforced by structural negatives that will persist for at least several years:

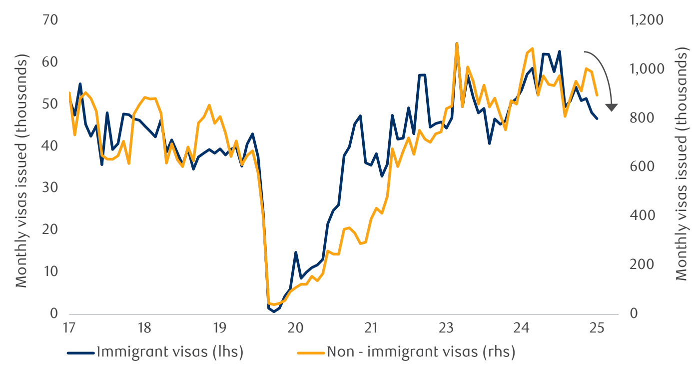
- Significant overvaluation of the U.S. dollar.
- Large trade and fiscal deficits that gradually increase U.S. indebtedness to the rest of the world.
- Higher inflation than other developed-market nations, which erodes the dollar's purchasing power over time (Exhibit 6).
- Policy unpredictability, which slows economic growth as households and businesses shy away from spending and investing.
- Falling immigration and rising retirements, which shrink the pool of productive workers (Exhibit 7).
- A loss of global influence, damaged trade relations and a pullback from international co-operation leaves the U.S. with fewer friends on which it can rely for UN Security Council votes or in standing up to emerging geopolitical rivals. Importantly, de-globalization and the withdrawal from global co-operation also leaves the U.S. with fewer buyers of Treasuries.
- A worrying attack on the credibility and independence of the country's key institutions as Trump looks to exert more influence over all aspects of American life. While attacks on the Fed are the ones making headlines, Trump has also undermined institutions spanning education, justice, nuclear energy, labour unions, healthcare, statistical agencies and media.

Exhibit 6: U.S. inflation higher than other developed market countries



Note: As at July 31, 2025. Source: Bloomberg, RBC GAM

Exhibit 7: Pool of workers shrinks as immgration falls



Note: As at May 30, 2025. Source: U.S. Department of State, RBC GAM

Tempering our pessimism is the fact that the U.S. dollar still enjoys many advantages. For one, its status as the primary reserve currency allows the country to borrow more cheaply and to run larger fiscal deficits than it could otherwise. Energy independence is also of importance in that a secure source of domestic oil and gas keeps prices stable and prevents the kind of energy crisis that Europe experienced after Russia's invasion of Ukraine. The U.S.'s leadership in innovation, while largely responsible for the country's huge wealth divide, is also a spectacular engine for economic growth. From that innovation has come many of the world's leading technology companies, making the U.S. well situated to benefit from the initial investment in AI technology as well as the productivity gains that it will eventually unlock.

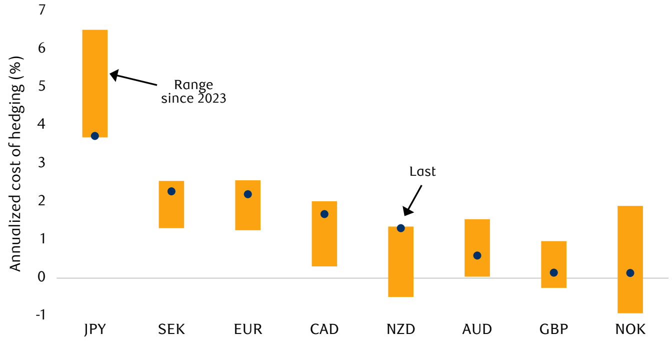
As a result, foreign investors are likely to keep investing in these U.S. technology companies given their superior performance and ability to generate cash. They may also choose to keep buying stocks in other industries that will profit from business-friendly measures coming into force next year, namely U.S. financial deregulation and the accelerated depreciation allowance.

Going forward, we think foreign investors will increasingly choose to hedge the currency exposure on new purchases as well as existing holdings of U.S. stocks. While the academic literature around currency hedging for equities is mixed, we note that there are three factors that have led investors to mostly leave currency risk unhedged. All three of these are now shifting in ways that suggest at least a marginal increase in hedging.

1. The cost of hedging U.S. dollars is high, but has been getting cheaper for Japanese investors, and will be lessened for all global investors as the Fed reduces interest rates in the coming year (Exhibit 8).
2. Investors were previously optimistic on the dollar's prospects, but the theme of U.S. exceptionalism has faded and sentiment toward the greenback has clearly soured.
3. The dollar's safe-haven status had previously provided a source of insurance for global investors because the greenback tended to gain when stocks fell. This stock-dollar correlation has flipped in 2025 (Exhibit 9) and investors this year (in April and in August) have twice experienced losses that were magnified by synchronized sell-offs in equities and the dollar.

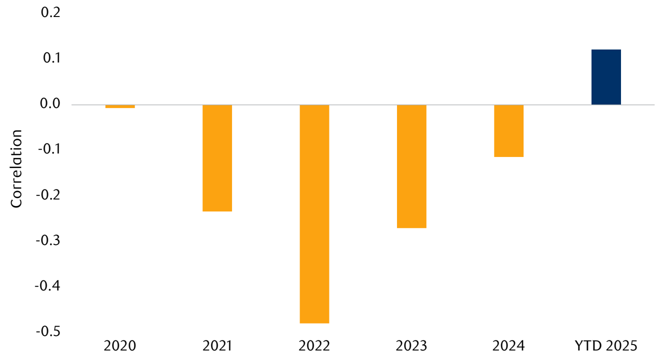
There is already some evidence that investors have begun to reduce their U.S.-dollar exposure. This is a difficult theme to monitor because there is little public data on the holdings of insurers or pension funds, which are among the largest holders of U.S. assets. The Danish central bank publishes

Exhibit 8: Cost of hedging remains high



Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

Exhibit 9: U.S. dollar's correlation with the S&P 500 is now positive

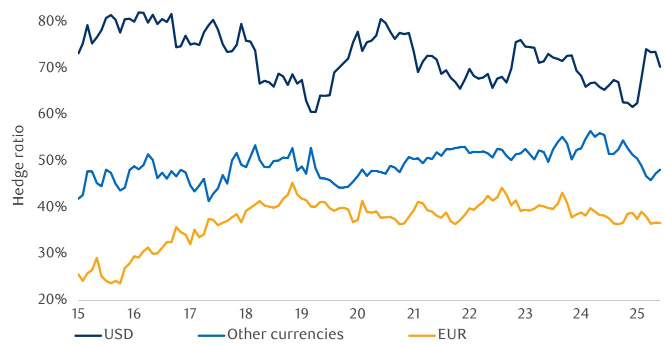


Note: As at August 29, 2025. Uses daily data. Source: Bloomberg, RBC GAM aggregate statistics showing that the country's pensions have raised hedges on U.S. investments (Exhibit 10), and according to a press report in early August, a Canadian pension fund has more than halved its exposure to the greenback. A more broad-based indicator of industrywide trends is the aggregated client activity published by State Street's custodial arm, but this metric shows no sign yet of a broader increase in U.S. dollar hedge ratios. We are not surprised. It takes months for investment committees to meet, analysis to be commissioned and hedging policies drawn up. Hedging activity will likely pick up into the fall as Europeans return from vacation and pension boards meet to plot strategy for the next year. The more the dollar weakens and interest rates fall in the coming months, the more urgent it will become for investors to consider these hedging decisions. Such hedging flows could amount to hundreds of billions of dollars – surely enough to fuel the next leg of U.S.-dollar weakness.

In an environment where the dollar continues to fall, which currencies would perform best? The Japanese yen should lead among developed-market currencies, we think, while the euro, as the main alternative to the dollar, would surely benefit as well. We also think emerging-market currencies could begin to benefit more broadly in the coming year given reduced trade and geopolitical uncertainty as well as the general U.S.-dollar weakness. We have noted that investors are increasingly willing buyers of emerging-market assets and currencies, according to surveys and financial asset-positioning data.

Optimism about emerging-market currencies also stems from a newfound willingness by the People's Bank of China (PBOC) to let the renminbi appreciate. This is important because the dollar could be pushed weaker should depositors choose to convert some of the US$1 trillion worth of U.S. currency that they hold in the Chinese banking system (Exhibit 11). Given the extent to which the renminbi is controlled by the government, we doubt this would stoke a runaway appreciation of the yuan, but we do think the conversion of these U.S. dollar balances into renminbi could push up the Chinese currency and cause a more widespread rise in emerging-market exchange rates.

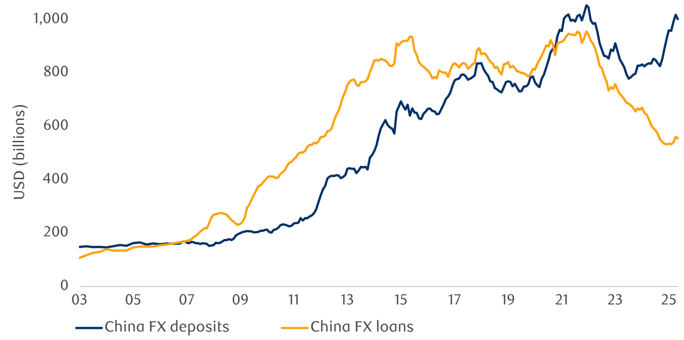
Exhibit 10: Danish pensions have raised U.S. dollar hedge ratios



Note: As at July 31, 2025. Source: Central bank of Denmark, RBC GAM

> "We think the conversion of the U.S. dollar balances into renminbi could push up the Chinese currency."

Exhibit 11: Large stockpile of U.S. dollars in the Chinese banking system



Note: As at July 31, 2025. Source: PBOC, RBC GAM

Canadian dollar

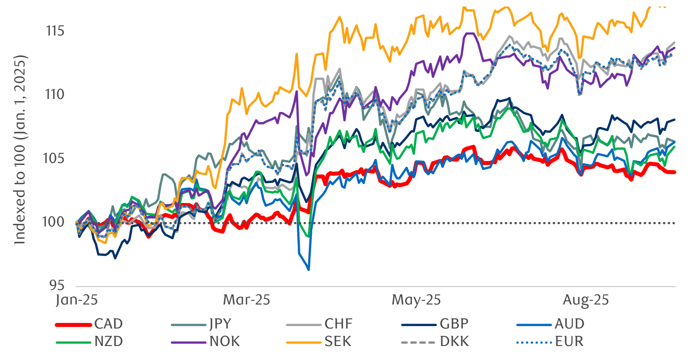
Like other G10 and emerging-market currencies, the Canadian dollar will benefit from a weaker U.S. dollar. How and why the greenback weakens, however, will partly determine how well the loonie performs. If the U.S. currency falls because of the macroeconomic factors listed earlier, the Canadian dollar would perform well. However, the loonie's sensitivity to the pace of economic growth means that a broad and sustained slowdown would make it difficult for the loonie to keep up with its developed-market peers.

The loonie has been a notable underperformer this year among its peers (Exhibit 12). This is partly owing to a weaker labour market, with the country's unemployment rate rising faster than others (Exhibit 13). Economic uncertainty has also played a role, as trade relations with the U.S. remain strained ahead of next year's re-negotiation (or possible cancellation?) of the U.S.-Mexico-Canada (USMCA) trade pact. A third factor that has kept the loonie from rallying more is the Bank of Canada's dovish stance. The central bank was quicker than the Fed to cut interest rates, and lower yields on government bonds have dented demand for the loonie.

On a more positive note, the actual tariff impact on Canadian exports has been muted so far by the fact that most goods are currently exempted under the USMCA agreement – so Canada actually faces a lower average rate of tariffs than do many other U.S. trading partners. Moreover, we believe that the economic threat posed by Trump may cause Canadian politicians to do what is necessary to enact much-needed reforms. Prime Minister Carney's plans for greater infrastructure spending and the removal of inter-provincial trade barriers would be a key ingredient in boosting Canada's overall productivity. Finally, the Canadian dollar is attractively valued based on purchasing power parity as well as a wide variety of other valuation models (Exhibit 14).

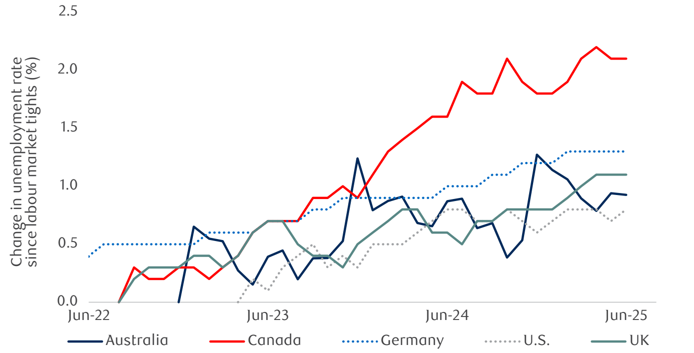
Our 12-month forecast for the Canadian dollar sits at C$1.32 per U.S. dollar, compared with about C$1.37 currently. This factors in some gains relative to the U.S. dollar but also implies a period of underperformance relative to other major developed-market currencies.

Exhibit 12: Canadian dollar lagging other G10 currencies



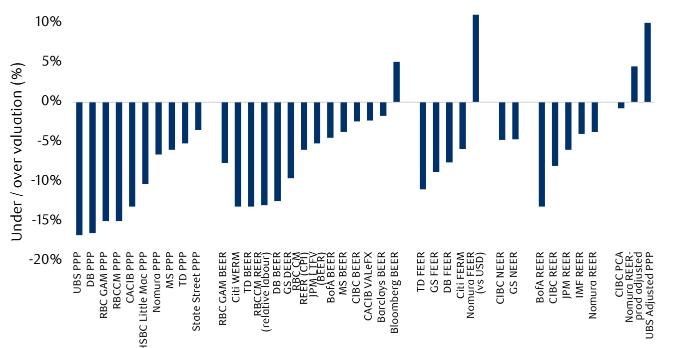
Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

Exhibit 13: Canada's unemployment rate is rising faster than others



Note: As at July 31, 2025. Source: Bloomberg, RBC GAM

Exhibit 14: Canadian dollar cheap across multiple valuation models



Note: As at July 31, 2025. Source: UBS, Deutsche, RBC CM, Credit Agricole, HSBC, Nomura, Morgan Stanley, TD, State Street, Citibank, Goldman Sachs, BofA, CIBC, Barclays, RBC GAM

Euro

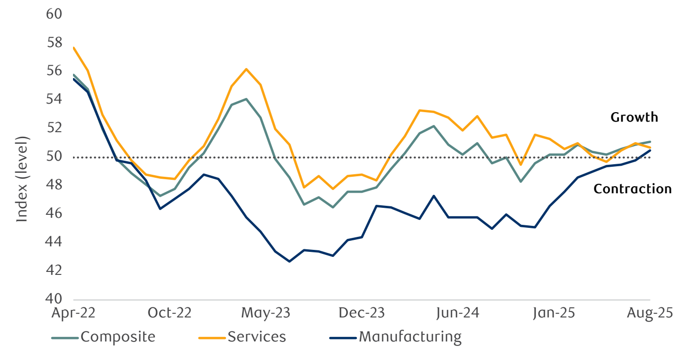
As the second most traded global currency, the euro would certainly benefit from a further weakening of the U.S. dollar. The fate of Europe's single currency also depends on whether we see continued improvement in the regional economy and reforms that set the stage for sustained economic gains. We are encouraged by recent economic data on business sentiment (Exhibit 15) and bank lending.

European equity markets are reflecting the theme of improved eurozone growth as domestically oriented sectors perform better than globally oriented ones (Exhibit 16). We expect this trend to continue as German fiscal and infrastructure spending ramps up next year. There is concern that a strong euro might dent the earnings of European companies that sell autos and luxury goods in foreign markets since about half the revenue brought in by European companies comes from abroad. That said, markets don't seem particularly troubled by this. The fact that Europe's equity indexes have kept pace this year with U.S. stocks suggests that a European economy increasingly driven by domestic strength makes it less sensitive to fluctuations in the exchange rate.

This theory will likely be put to the test in the coming year. While foreign-exchange markets have been unusually stable in recent years, it appears likely that the single currency will trade in an above-average range (Exhibit 17). The US$1.20 level is seen by investors as the one that could slow the eurozone economy and prompt a more aggressive easing from the European Central Bank (ECB), but we note that the ECB has always paid more attention to the pace of gains rather than the level of the exchange rate. The euro's summertime decline, due in part to political and fiscal concerns in France, offered some relief from the negative impact on growth of prior euro strength.

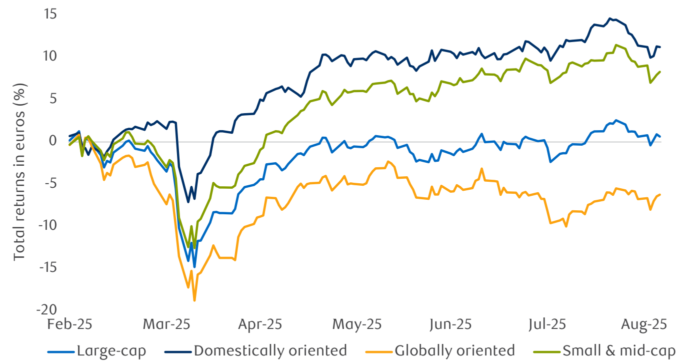
We set our forecast at US$1.24 per euro for the year ahead with the expectation that U.S. dollar weakness will serve as a tailwind and that the single currency will also benefit from a more durable economic recovery. While US$1.20 is the level of technical resistance targeted by many investment banks, we think that US$1.24 could prove to be a conservative forecast if the eurozone economy continues to perform well and political uncertainty in France subsides. More durable progress on ending the war in Ukraine would prompt us to raise our forecasts beyond US$1.30.

Exhibit 15: European PMI recovery shows improving business sentiment



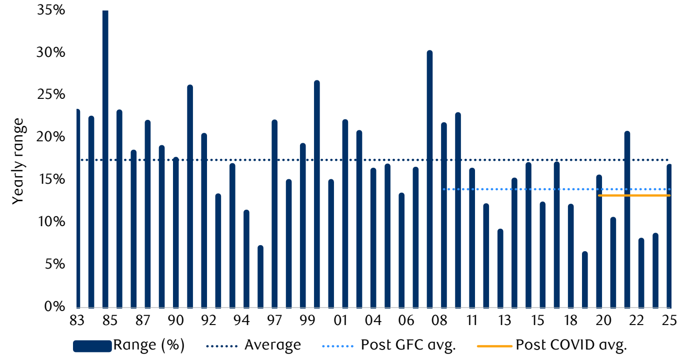
Note: As at August 29, 2025. Source: S&P Global, RBC GAM

Exhibit 16: Domestically exposed equities are leading European equity performance



Note: As at September 5, 2025. Source: MSCI, RBC GAM

Exhibit 17: Euro will likely trade in above average range



Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

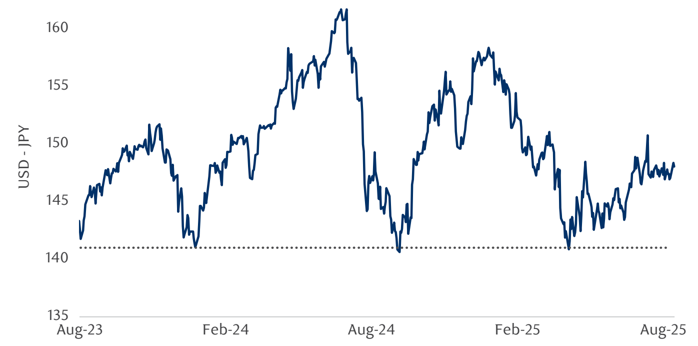
Japanese yen

We have been bullish on the yen for some time and still think it can outperform other developed-market currencies this year. The outlook has been a tough one to maintain, however. The yen has been unable to strengthen beyond 140 per dollar over the past 24 months (Exhibit 18). One factor holding the Japanese currency back is that interest rates are lower in Japan than in many developed markets. In the context of 4.2% Treasury yields, the 3.5% cost of hedging remains prohibitive. Equally, that lower yield means that speculators have been reluctant to hold the yen, even if this year's higher exchange-rate volatility allows them to capture quick trading gains on long yen positions. This attitude is slowly changing, in part because the dollar's persistent decline has begun to convince investors that they can earn more from their hedges than the 3.5% cost, and in part because the cost itself is declining as the Bank of Japan has been hiking rates while other central banks are cutting (Exhibit 19).

Another hurdle for the yen has been political uncertainty, as households associated increasing prices and falling inflation-adjusted wages (Exhibit 20) with the ruling Liberal Democratic Party. Prime Minister Shigeru Ishiba's decision to resign on September 7th opened the door for successors that could boost fiscal policy in support of economic growth, a development that may encourage more rate hikes from the Bank of Japan.

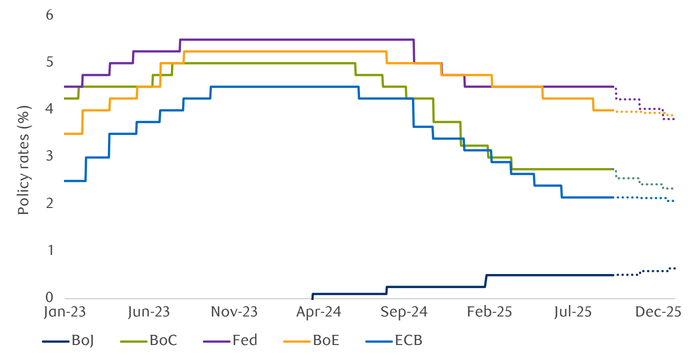
We forecast that the yen will strengthen toward 133 per dollar from 147 currently, implying that the yen will outperform the euro, pound and Canadian dollar over the next year. This conclusion fits well with the fact that the yen is among the world's cheapest currencies based on purchasing power and that Japan runs smaller fiscal deficits than its peers.

Exhibit 18: Yen struggling to strengthen beyond 140



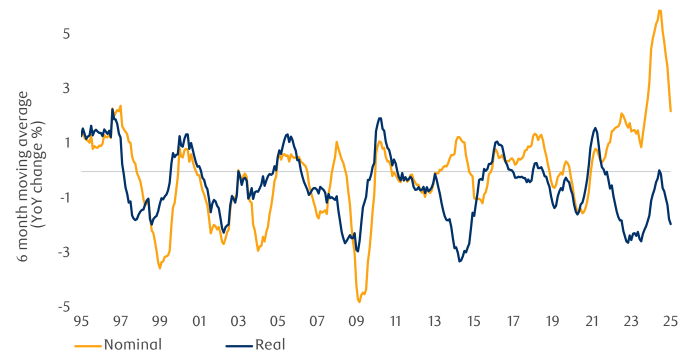
Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

Exhibit 19: Bank of Japan hikes stand out among peers



Note: As at September 10, 2025. Source: Bank of Canada, Bank of Japan, U.S. Federal Reserve, Bank of England, European Central Bank, RBC GAM

Exhibit 20: High inflation eroding wage gains



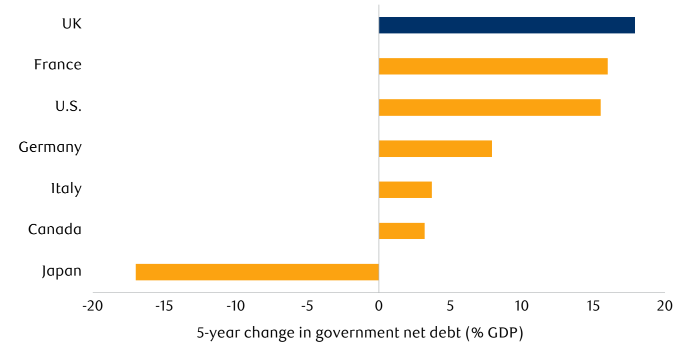
Note: As at June 30, 2025. Source: Japanese Ministry of Health Labour & Welfare, RBC GAM

British pound

The UK economy has been slower to bounce back from the pandemic than other developed-market nations, and its GDP per capita remains below 2019 levels. A variety of social and economic issues are to blame, including a generous social safety net and fiscal support during the pandemic that dissuaded workers from returning to work and left a larger share of the working-age population on long-term sick leave. A combination of higher government spending, rising interest costs and lower tax revenues is stretching the UK's finances (Exhibit 21) and testing the patience of investors. Given the difficulty that Chancellor Reeves is having in passing this year's budget, it's clear that fiscal pump-priming is unlikely to be a source of economic support.

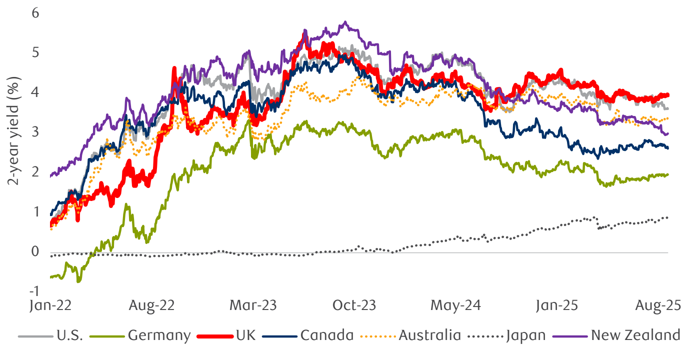
The result is that pressure is mounting on the Bank of England to save the day by cutting interest rates. While lower rates are needed to support growth, they could also stoke inflation that is already the highest among developed countries and damage faith in the pound. The pound has managed to keep pace with other G10 currencies this year only because it is among the highest yielding currencies in the group (Exhibit 22). Removing that yield advantage would likely set the stage for underperformance. This fiscal and monetary dilemma is one of the main reasons we expect the pound to underperform in the year ahead. Our forecast is for the exchange rate to rise only modestly to US$1.38 per pound.

Exhibit 21: UK finances becoming stretched



Note: As at December 31, 2024. Data from 2019 to 2024. Source: Deutsche Bank, RBC GAM

Exhibit 22: UK bonds have highest yield in G10



Note: As at August 29, 2025. Source: Bloomberg, RBC GAM

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