RBC Global Asset Management

Global currency outlook

NEW YEAR 2026

Emerging-market currencies poised to shine amid U.S.-dollar weakness

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The two-year-long fall in the U.S. dollar appears to have temporarily halted, challenging our forecasts that the greenback would continue to decline through 2025 and into next year. The dollar's modest rally since September stems from a view that stronger-than-expected U.S. economic growth and continued technology investments will pull capital flows into the U.S., at least in the short term. We note that the dollar is still down by 9% so far this year, and there is good reason to expect a resumption in the greenback's weakness sometime in 2026. Emerging-market currencies, in our opinion, will continue to be the main beneficiary of further U.S.-dollar depreciation given improving fiscal situations and attractive bond yields.

Mid-2025 seems to have marked a distinct shift in the currency markets. Having spent the first half of the year in relentless freefall, the dollar suddenly stabilized as concerns about U.S. policy credibility eased somewhat and as resilient economic growth and strong equity markets sustained demand for the currency. At the same time, the fate of the greenback was hotly debated during the latter half of the year because factors that traditionally drive currency markets were pointing toward further declines. For one, the higher yields offered by Treasuries versus German bunds were gradually shrinking (Exhibit 1), meaning that relatively high U.S. interest rates provided less support for the greenback.

Exhibit 1: U.S. yield advantage over Germany is shrinking

Note: As at December 2, 2025. Source: Bloomberg, RBC GAM

Commodity markets also suggested further U.S.-dollar declines, as gold and other precious metals went on a tear (Exhibit 2). And yet exchange rates in Europe, the UK and Canada have spent most of the past six months in relatively tight ranges, and most measures of currency market volatility have fallen this year (Exhibit 3).

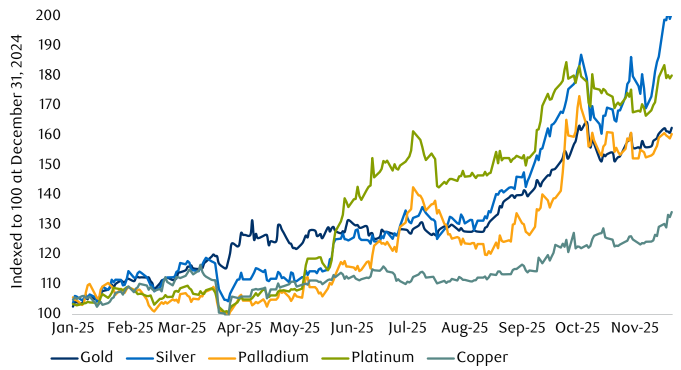
It is not that there has been a dearth of news or market narratives on hand to drive currencies: central banks globally have been slashing interest rates, which should encourage movements of capital in search of higher returns, and governments are increasingly challenged by investors over unbridled fiscal spending. So how do we make sense of such small fluctuations in currency markets? One possibility is that developed-market currencies face more or less the same problems, and it is therefore unclear to investors which currency should be bought or sold. We acknowledge that the case for a significant drop in the U.S. dollar against the pound and yen has become somewhat tenuous – largely due to fiscal and political challenges in Britain and Japan. Concerns about bloated budgets and expanding debt loads in the U.S. UK, Japan and France have brought fiscal concerns to the forefront in every region. This nervousness stems less from expectations of a sudden debt default and more from concern that currency weakness and/or inflation will gradually erode the purchasing power of investors' assets.

The term "debasement" has been floated to describe a policy-driven decline in the real purchasing power of a currency, and its use as a label resonates with investors for a number of reasons:

- Governments have found it difficult since the pandemic to keep up with snowballing debt.
- Inflation has become more palpable for households in recent years and is taking root as a more persistent element of investor expectations.
- There is a sense that central banks have become subject to pressure from politicians to reduce interest rates in support of economic growth and lower debt-service costs. Questions about central-bank independence have been most notable in the U.S. and Japan as monetary authorities in those countries seem to be more accepting of elevated inflation.
- Central-bank bond buying, capital controls and taxes on foreign investors are entering policy discussions, and such measures would keep currencies weak and/or depress longer-term interest rates.

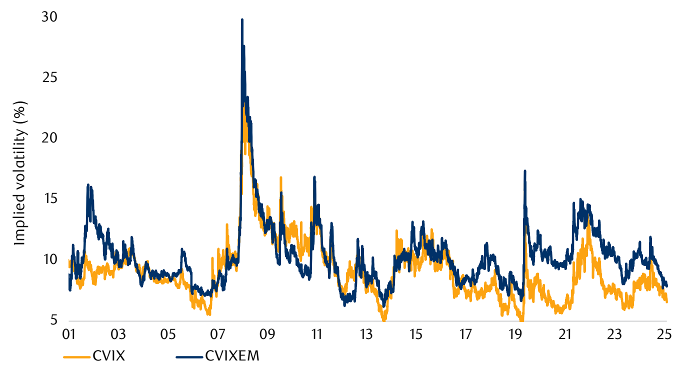
It seems that the debasement theme has turned out to be more broad-based in nature than we had expected, affecting developed-market fiat currencies globally rather than just the greenback.

Exhibit 2: Precious metals have surged this year



Note: As at December 1, 2025. Source: London Metal Exchange, London Bullion Market Association, London Platinum & Palladium Market, Gavekal, RBC GAM

Exhibit 3: Muted volatility in emerging- and developed-market exchange rates



Note: As at December 1, 2025. Source: Deutsche Bank, Bloomberg, RBC GAM

This explains, perhaps, why exchange rates are so stable amid the surge in gold prices and why investors in a number of jurisdictions are demanding higher interest rates on longer-term bonds relative to shorter-term ones (Exhibit 4). We still expect the greenback to resume its general decline as businesses find more attractive investment and trade opportunities in countries with undervalued currencies, and as the build-up of hedge positions on U.S. stocks results in massive U.S.-dollar selling.

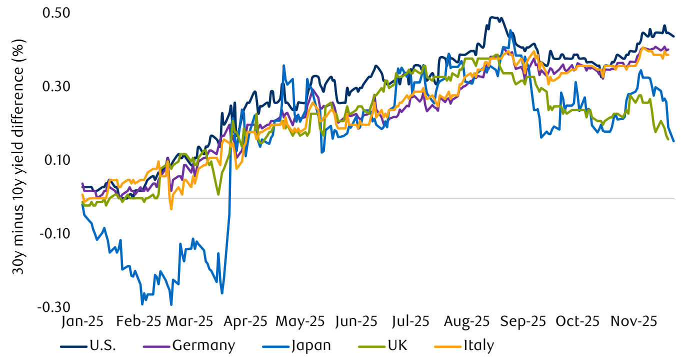
The outperformance of emerging-market currencies (Exhibit 5) tells us that the U.S. dollar is vulnerable, and it has indeed been weakening. The currencies of China, Brazil, Mexico, Hungary and South Africa have continued to strengthen in the second half of 2025, in part because they tend to be undervalued and offer bonds with more compelling yields relative to inflation. These emerging-market countries are also enjoying newfound fiscal and monetary credibility stemming from quick and aggressive central-bank rate hikes in 2022. While those actions were painful for the economy, the steady decline of inflation (Exhibit 6) affords emerging-market central banks the luxury of cutting interest rates without the perception that the reductions are politically motivated.

Interest in owning emerging-market assets and currencies remains robust even amid the October and November pullbacks in global equity markets. It helps that Chinese policymakers have continued to signal to investors that they intend to strengthen the renminbi and support economic growth with fiscal and monetary measures. We expect relatively strong demand for emerging-market currencies to continue, in part fueled by the current low level of market volatility that makes owning higher-yielding currencies more appealing.

We believe that it will be emerging-market currencies that perform best versus the U.S. dollar in the months and years ahead, whereas both emerging- and developed-market currencies benefited equally from the U.S. dollar's decline during the first half of 2025.

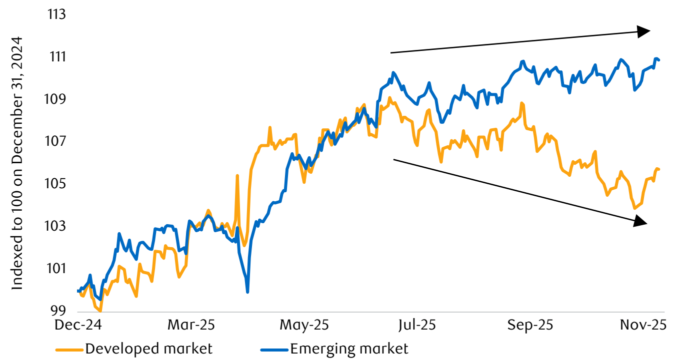
As we look into 2026, we see several big events that could shape how the U.S. dollar performs. First, the U.S. government will resume releasing economic data following the end of the shutdown, though investors will be reluctant

Exhibit 4: Investors demand higher yields to own longer-maturity bonds



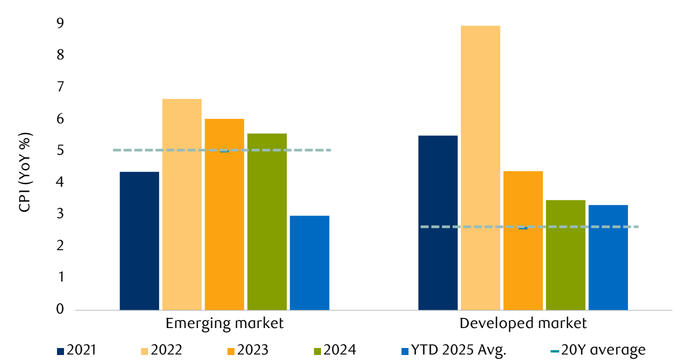
Note: As at December 1, 2025. Source: Bloomberg, RBC GAM

Exhibit 5: Emerging-market currencies have outshined developed market ones since the summer



Note: As at December 1, 2025. Source: Bloomberg, RBC GAM

Exhibit 6: Emerging market inflation is falling and below its long-term average

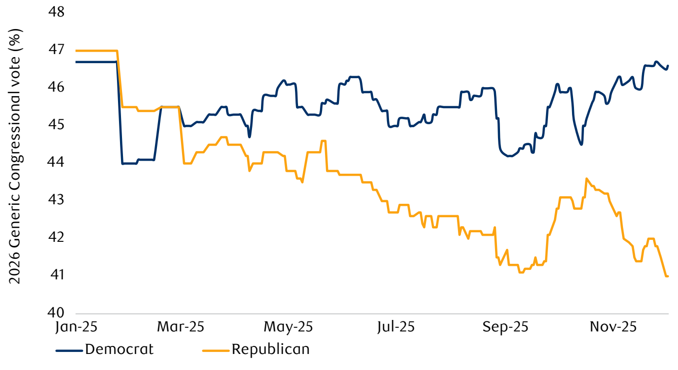


Note: As at September 30, 2025. Source: Bloomberg, RBC GAM to draw conclusions given the exceptional uncertainty around hiring and economic activity during the fall. The labour-market report released in late November, for example, showed a relatively strong hiring picture, but this was largely dismissed by equity markets. October's jobs report is set to be released in mid-December and is likely to show considerable weakness, but investors may again dismiss this statistic. Investors will be skeptical about how much of the employment slowdown is due to the temporary impact of the government shutdown and how much stems from job cuts by technology giants. Amazon, for instance, said in October that it cut 14,000 positions.

A second area of focus will be the number and spacing of U.S. interest-rate reductions in 2026. Based on market indicators, the benchmark interest rate will fall about 90 basis points to 3% between now and the end of next year, and the outlook depends in part on whether President Trump can sway the committee to ease policy more forcefully. Already, his administration has filled a vacant Fed seat with Trump loyalist Stephen Miran, who has voted twice in favour of 50-basis-point rate cuts. The White House is also trying to oust Governor Lisa Cook with an eye toward adding another board appointee who may support the president's wishes. Investors will also focus on the fact that the term of the current chairman, Jerome Powell, expires in May and that his successor, when confirmed by the Senate, will have significant influence over monetary policy. The nomination of a dovish candidate could reignite concerns about the Fed's independence and push the greenback lower.

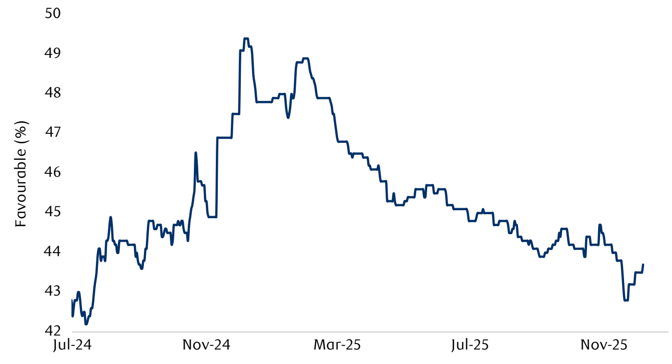
Another important consideration for 2026 is the U.S. mid-term election. Democrats seem to be enjoying the momentum of a few recent victories, including Zohran Mamdani's win of the New York mayoral election and a flip in the governorship of Virginia to Democrats by a wide margin. Opinion polls and approval ratings (exhibits 7 and 8) show that President Trump and his Republican Party are losing ground. How the president reacts next year will be important for financial markets. His instinct may be to lean more extreme, pinning blame on China (increased tariffs), cracking down further on immigration (more inflation, less economic growth), issuing "tariff" cheques to households (further stoking fiscal concerns) and leaning hard on the Fed to cut rates (loss of Fed independence). These things would clearly be negative for the dollar.

Exhibit 7: Mid-term polls favour Democrats



Note: As at December 2, 2025. Source: RealClearPolitics, Bloomberg, RBC GAM

Exhibit 8: Trump's approval rating has fallen since he took office



Note: As at December 1, 2025. Source: RealClearPolitics, RBC GAM

Trump may opt for a more conciliatory path in a bid to appeal to a wider voter base by focusing more on rebuilding U.S. industry, picking a more inflation-focused candidate as Fed chair and taking a softer tone on global trade. Such a path would suggest higher interest rates and stronger economic growth, which could cause the dollar to remain resilient and again delay what we believe will be its eventual decline. Historically, the U.S. dollar tends to fall in the 10 months leading up to mid-term elections, particularly against European currencies (Exhibit 9).

Exhibit 9: The dollar tends to weaken in years with mid-term elections

	Average spot return			% of time returns are positive		
	Midterm	Presidential	No election	Midterm	Presidential	No election
DXY	**-1.6%**	**4.4%**	**0.7%**	**33%**	**69%**	**60%**
EUR	3.4%	-5.0%	-0.5%	58%	23%	48%
GBP	1.4%	-6.4%	0.9%	50%	38%	56%
JPY	5.7%	1.3%	-0.1%	67%	54%	56%
CHF	7.0%	-3.2%	1.3%	67%	38%	52%
AUD	-1.0%	-2.5%	-0.2%	42%	46%	40%
CAD	-2.3%	-1.4%	1.8%	33%	46%	56%
NOK	1.0%	-3.9%	-0.2%	58%	31%	36%
NZD	-0.6%	-5.8%	0.3%	50%	31%	40%

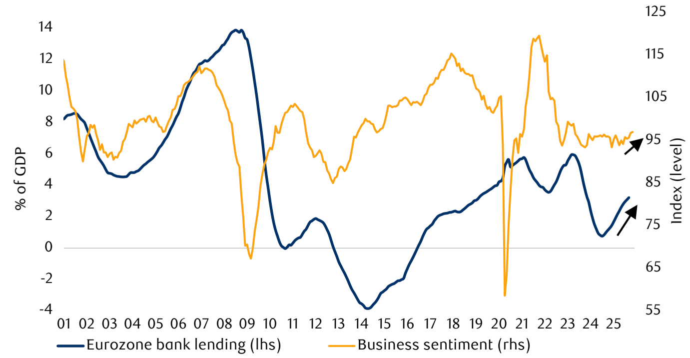
Note: As at December 31, 2024. Data begins in 1976. Source: HSBC, Bloomberg, RBC GAM

Euro

Europe's political and economic challenges have stood in the way of investors being sold on the euro's prospects. The region is plagued with too many economic and geopolitical issues, including some that have been around for years: low productivity, a lack of fiscal flexibility and a single "one-size-fits-all" monetary policy. More recently, it is a lack of leadership on artificial intelligence that is offered as a European disadvantage in an investment world dominated by U.S. technology giants. Fierce Chinese competition in the auto industry adds to Europe's macroeconomic woes, and while low oil prices are helping to cheapen the eurozone's import bill, limited stockpiles would not be sufficient to keep prices in check should the winter be unseasonably cold.

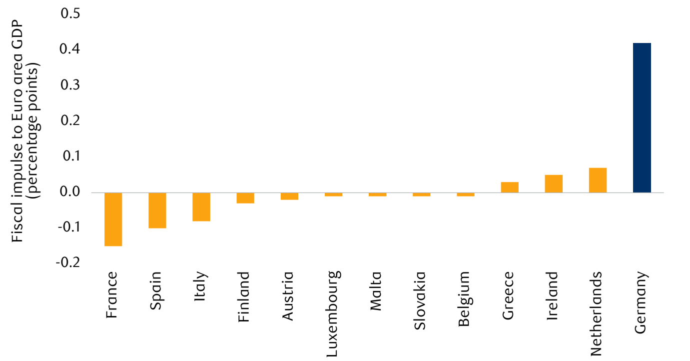
With all the focus on Europe's long-term negatives, it is easy to miss the region's more constructive near-term cyclical developments. The European economy is slowly improving, with business-sentiment indicators and bank lending picking up (Exhibit 10). Both should accelerate over the coming year as tax cuts, defense spending and infrastructure investment come online in 2026. It appears as though the tariffs imposed on European goods, as well as President Trump's threats to withdraw support for NATO, served to engender solidarity among European nations. While slow to get started, the bulk of this additional fiscal spending will take effect in early 2026, and RBC GAM economists are projecting that Europe's economy will operate beyond capacity over the next year or two. Higher government spending in Germany, for example, is deemed significant enough to boost overall eurozone GDP growth by 0.4 percentage point, more than offsetting any fiscal tightening in France, Spain and Italy (Exhibit 11).

Exhibit 10: Eurozone economic indicators show improvement



Note: Eurozone bank lending is a 12m rolling sum of net new loans to the non-financial private sector. As at September 30, 2025. Source: European Commission, Gavekal, RBC GAM

Exhibit 11: German fiscal spending expected to support the Eurozone economy



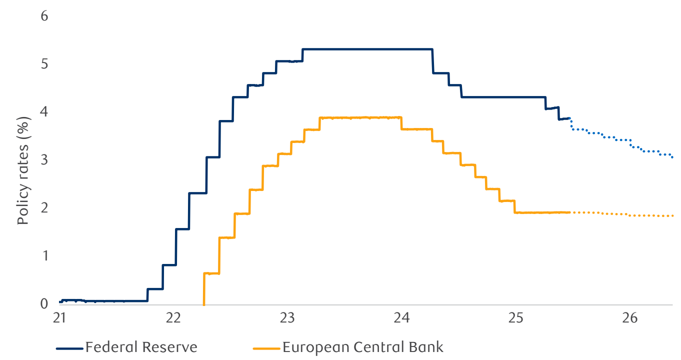
Note: As at December 1, 2025. Source: European Commission, Eurostat, RBC Capital Markets, RBC GAM

Faster European growth would be positive for the euro because it improves earnings and stokes demand for stocks. Economic growth beyond Europe's normal speed limit would be inflationary, and such a course would tend to dissuade the European Central Bank (ECB) from following its peers in cutting rates. This was seemingly confirmed in September by ECB President Christine Lagarde, who emphasized that eurozone monetary policy "is in a good place" and consistent with the fact that the ECB is guided only by the outlook for inflation rather than the dual inflation/growth mandate of the Fed. If anything, we suspect that the ECB's next action might eventually be a rate hike – a move that would certainly be euro-positive given that it is not widely anticipated by investors. Rising rates in the eurozone would quicken the narrowing of Europe's interest-rate disadvantage that is already underway (Exhibit 12), further cheapening the cost for Europeans to hedge U.S. assets and removing the one major barrier that stands in the way of another leg down in the dollar.

Another major potential positive for the value of the euro is a proposal tabled last year by Mario Draghi, the former ECB governor and past Italian prime minister. The 73-page proposal is aimed at outlining measures to boost Europe's competitiveness and productivity by improving energy security, streamlining supply chains and encouraging investments in digital infrastructure. According to the European Policy Innovation Council, only 10% of the proposed reforms have been fully implemented, but an impressive 65% of these measures are either partially implemented or in progress.

The euro has risen 11% against the greenback this year after stalling in early summer, and has kept to a fairly tight 4.5% range since. A more convincing push beyond the year's highs is needed to support a more significant rally, but a breakout of the euro seems unlikely to be driven by European factors alone. A broad-based decline in the U.S. dollar would support our outlook for a rally to US$1.24 per euro from US$1.16.

Exhibit 12: Narrowing yield gap between U.S. and Germany



Note: As at December 2, 2025. Source: U.S. Federal Reserve, European Central Bank, Bloomberg, RBC GAM

"A broad-based decline in the U.S. dollar would support our outlook for a rally to US$1.24 per euro from US$1.16."

Japanese yen

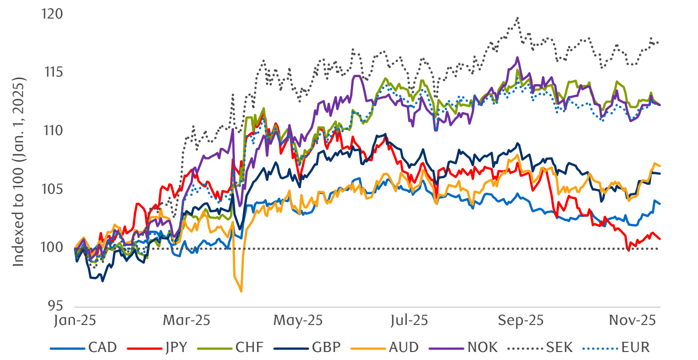
The Japanese yen is nearly unchanged this year versus the dollar, making it one of the worst-performing currencies in a year where U.S.-dollar weakness buoyed most other developed and emerging-market currencies. With its persistent slide since late spring, the Japanese currency stands apart from its European peers and now ranks below the Canadian dollar, which had been the main laggard for most of the year (Exhibit 13).

The yen's weakness stems partly from political uncertainty. The country's Liberal Democratic Party (LDP) has been in power for all but a few years since the 1950s, but the party's leadership has been unable to respond effectively to popular discontent about the rising cost of living. The new era of rising prices in the aftermath of the pandemic has squeezed household finances because wage gains have not kept pace. Snap elections last year caused the LDP to lose its majority, leading to the resignation of then-Prime Minister Shigeru Ishiba after less than a year in office.

Fiscal concerns are another reason for the yen's weakness. In order to strike a governing coalition with one of Japan's smaller political parties, the new prime minister, Sanae Takaichi, had to make concessions including additional fiscal spending that the government hopes will offset the impact of higher prices of goods and services. However, it is noteworthy that the proposal and passage of an 18.3 trillion yen (US$118 billion) fiscal spending plan (approximately 3% of GDP) might actually worsen inflation because it stands to weaken the yen and thus boost the price of necessities imported from abroad such as oil and natural gas.

A more direct method of combating inflation would be for the central bank to hike interest rates, and the Bank of Japan (BOJ) has indeed tightened policy somewhat. The most recent increase in interest rates was in January, though, and the glacial pace of tightening seems insufficient to rein in rising prices. The fact that inflation in Japan has remained above the BOJ's target for about 3 ½ years raises concerns that the bank is being pressured by politicians to keep policy loose. The possibility that politicians are meddling in monetary policy is a serious concern for investors, much as it is in the U.S.

Exhibit 13: The Japanese yen is now the worst performing developed-market currency



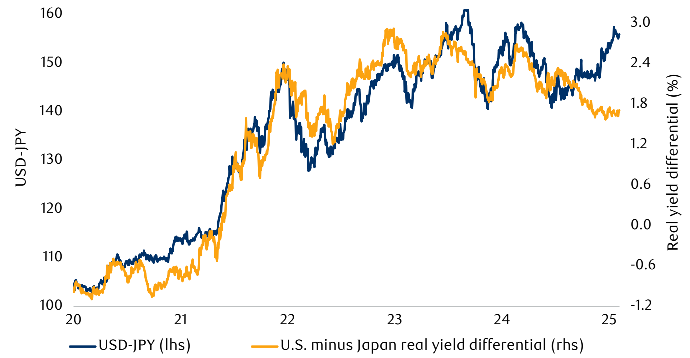
Note: As at December 2, 2025. Source: Bloomberg, RBC GAM

"The possibility that politicians are meddling in monetary policy is a serious concern for investors, much as it is in the U.S."

In this environment, it is easy for investors to be bearish on the yen. But it is also worth recognizing that the Japanese currency is among the most undervalued in developed markets based on purchasing power parity and also cheaper than the level of interest rates would suggest (exhibits 14 and 15). Moreover, the yen would likely be the biggest beneficiary of Fed rate cuts as it has historically been the most sensitive to Fed action. A narrower yield gap lowers the appeal of investing abroad and could encourage Japan's large insurers and pension funds to ramp up their hedges on foreign-currency exposure.

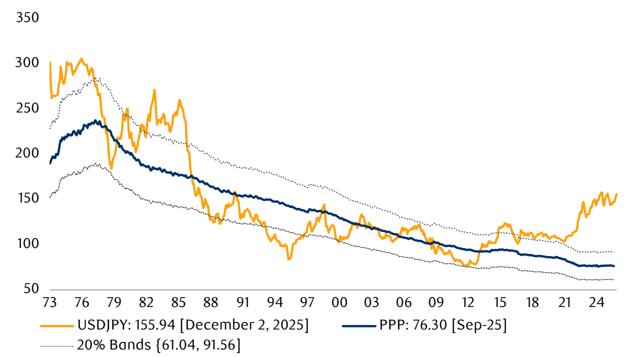
A final yen-positive effect could come in the form of intervention to strengthen the currency. Decisions to intervene come at the behest of the finance ministry, and Takaichi's finance chief has already vocalized displeasure with the yen's recent losses. Past instances of intervention have taught investors that the finance ministry's comments in the lead-up tend to follow a choreographed sequence (Exhibit 16), and it's clear that authorities are getting closer to tapping the country's large foreign-exchange reserves in an attempt to reverse the yen's course. While we aren't expecting imminent action, we would not be surprised if intervention materialized in 2026 and think that it would likely be timed in co-ordination with BOJ hikes and Fed cuts to deliver maximum impact. Alongside a weaker U.S. dollar overall, these factors should help the yen achieve our 12-month forecast of 135 per U.S. dollar, up from the current level of 156.

Exhibit 14: The yen is trading cheap to where rates would suggest



Note: As at December 2, 2025. Source: Bloomberg ,RBC GAM

Exhibit 15: USD-JPY – Purchasing Power Parity



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 16: Japanese officials often interevene when there are large currency moves

Ministry of Finance language on Yen ahead of intervention	
Urgency level	Example of statement
NO CONCERN	No Comment
NOTING VOLATILITY	It's desirable for exchange rates to reflect Japan's economic fundamentals
NOTING VOLATILITY	We continue to monitor foreign exchange market's impacts on the economy
WATCHING	Carefully watching developments in currency markets / watching FX rates closely
DISCOMFORT	Sudden movements in exchange rates are undesirable
DISCOMFORT	Monitoring with vigilance
MODERATE CONCERN	Seeing rapid FX moves
MODERATE CONCERN	Yen movements are excessive and/or one-sided
HIGHLY CONCERNED	Will take appropriate action if needed
HIGHLY CONCERNED	Won't tolerate speculative moves
WARNING	Not ruling out any options to combat excessive movements
WARNING	Prepared to take action at any time
WARNING	Ready to take decisive action

Note: As at December 2, 2025. Source: Bloomberg, RBC GAM

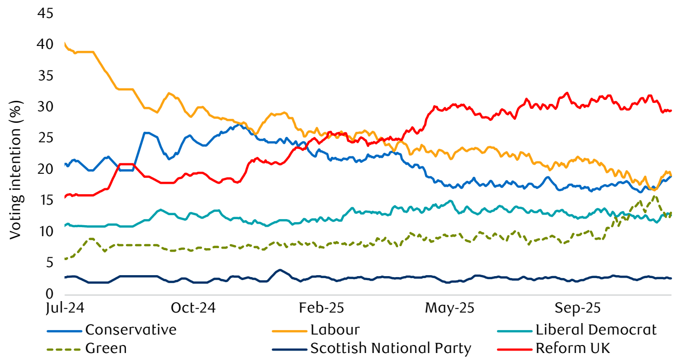
British pound

The pound is another currency that has been under attack this year, although it has performed somewhat better than the yen and the Canadian dollar. Fiscal concerns are weighing on the pound, largely because slow economic growth and high debt levels don't allow much leeway for avoiding a debt crisis. Not entirely helpful to the situation is the new Labour government's failure so far to address Britain's long-term fiscal challenges. The budget presented in November by Prime Minister Keir Starmer and Chancellor of the Exchequer Rachel Reeves aimed to thread the needle between raising taxes and cutting government expenses.

The electorate is increasingly dissatisfied with the UK's economic trajectory, and recent surveys suggest that three quarters of the British were pessimistic about the country's economic prospects. For the first time since World War II, voters are leaning toward supporting a third party over both Conservative and Labour (Exhibit 17). This third party was founded by Nigel Farage, the leading proponent of Brexit, to which economists attribute many of today's economic and fiscal challenges.

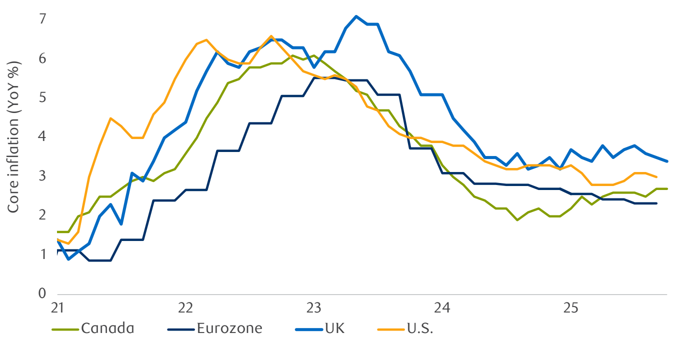
The Bank of England (BOE) is itself constrained to a similar degree as politicians. The weakened state of the economy would warrant an interest-rate reduction, but this may be prevented by stubborn UK inflation that is more persistent than in other major developed economies (Exhibit 18). The fact that benchmark interest rates have come down more slowly than in the U.S., Europe and Canada may explain why the pound hasn't lost more ground. But the currency has underperformed against the euro, and we expect this trend to continue. So, while the greenback is set to fall against most other G10 and emerging-market currencies, we suspect that the pound will benefit less than its peers. We forecast only a modest gain in the pound to US$1.38 from US$1.32.

Exhibit 17: Discontented voters shun Conservative and Labour parties in favour of the Reform



Note: As at November 28, 2025. Data smoothed using 10-day moving average. Source: Europe Elects, RBC GAM

Exhibit 18: Inflation in the UK remains elevated



Note: As at October 31, 2025. Source: Bank of Canada, UK Office of National Statistics, Bureau of Labour Statistics, Bloomberg, RBC GAM

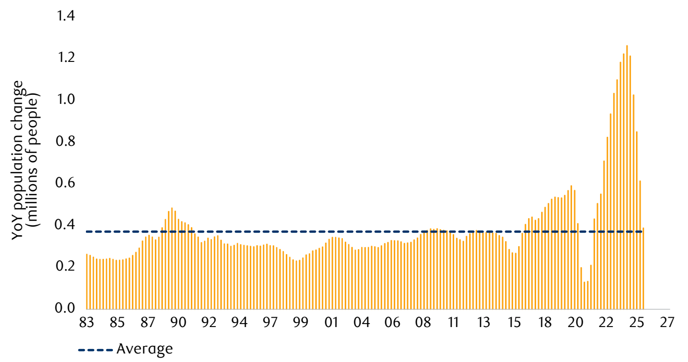
Canadian dollar

We expect the Canadian dollar to continue lagging at least through the first half of 2026. The loonie has generally underperformed in 2025, and the currency's weakness could continue due to factors that are keeping economic growth constrained. For one, immigration had been significantly curtailed in 2025 after nearly a decade of above-average population growth (Exhibit 19). Immigration cutbacks are contributing significantly to a slowdown in household-spending growth. A second big component of the economy – exports – is being challenged by trade tariffs imposed by the U.S., Canada's largest trading partner. Uncertainty about the outcome of talks for renewing the US-Canada-Mexico (USMCA) trade deal is likely to weigh on the loonie until mid-2026, when negotiations begin in earnest. Third, a relatively weak economy means that interest rates are comparably low in Canada versus those in the U.S., the UK and Australia, as the Bank of Canada (BOC) has been aggressive in cutting rates since mid-2024 (Exhibit 20). With low interest rates domestically, the Canadian dollar has been sold to fund purchases of higher yielding currencies in what is known as the "carry trade," an income-generating investment strategy that is especially attractive in times of muted fluctuations in foreign-exchange markets.

On a more positive note, one could argue that the BOC's deep interest-rate cuts will offer a boost to the economy, and indeed we have noticed some improvement in the indices that track economic activity (Exhibit 21). Also, since the BOC has been more aggressive in cutting interest rates than other central banks, it is likely that yields gaps with other countries will narrow as rates drop in other regions. Such a scenario would increase the appeal of the loonie.

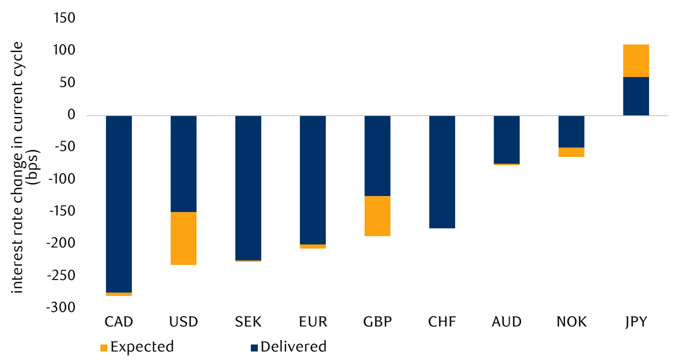
On trade, Canada's abundance of hydro-electricity makes it a good partner for the U.S., whose energy demand is spiking with the construction of data-processing centres for the largest technology companies. This is one reason why we think USMCA negotiations may go more smoothly than expected, and why the loonie could recover some lost ground in late 2026. While the anti-U.S. ad campaign run by Ontario Premier Doug Ford angered the U.S. administration, signs of better relations between the two countries

Exhibit 19: Canadian immigration has fallen off sharply



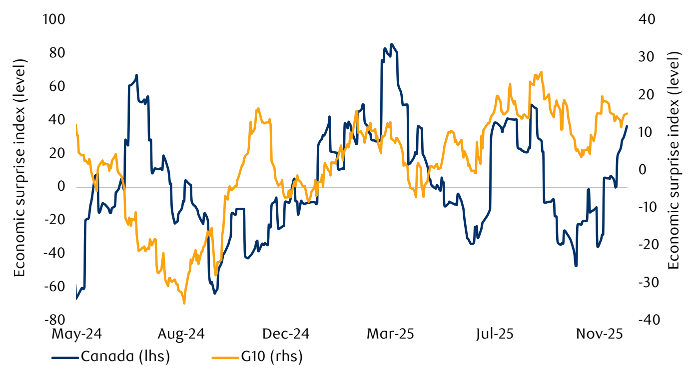
Note: As at September 30, 2025. Source: Statistics Canada, RBC GAM

Exhibit 20: Bank of Canada has delivered aggressive rate cuts



Note: As at December 1, 2025. Source: Bloomberg, RBC GAM

Exhibit 21: Canadian economy showing improvement



Note: As at December 1, 2025. Source: Citigroup, Bloomberg ,RBC GAM emerged later in November when Trump opened the door to easing the punitive 25% steel and aluminum tariffs that were imposed on Canada earlier in the year. We are also encouraged by U.S. industry groups that are lobbying the White House to preserve the existing trade agreement and relax sectoral tariffs on North American trade partners.

At an exchange rate of C$1.40 per U.S. dollar, the loonie sits nearly 20% undervalued based on purchasing power and near levels that are attractive for Canadian investors to hedge U.S.-dollar exposure. For now, Canadian investors have not been rushed in hedging their currency exposure given the high cost of hedging and a fairly stable exchange rate. While the Canadian dollar may continue to lag other developed-market currencies for the first few months of 2026, we suspect that it will rise against most of its peers later in the year. Our forecast is for the Loonie to trade at C$1.32 per dollar by the end of next year.

"Our forecast is for the loonie to trade at C$1.32 per dollar by the end of next year."

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