Economic Research Unit

Economics Weekly

Bank of Ireland

Still expecting dollar to depreciate over the medium-term

US financial markets have seen a remarkable rebound in May, as signs of progress in trade negotiations and a more conciliatory approach from the White House has emerged. The dollar has appreciated to $1.12 against the euro, vs a $1.15 peak in April. However, the Trump administration's 10% baseline tariffs, and 30% on China, remain in place and their negative impact on the US economy has yet to be fully felt or become apparent in macroeconomic data. There is also the unresolved question of how the US will fund the enormous Federal deficit, expected to equal 6% of GDP in 2025, amidst signs of strain in the Treasury market. It's also worth remembering that by any historical standard, or measure of purchasing power parity, the dollar looks overvalued. So despite the rally this week, we are sticking with our view the dollar will depreciate gradually through 2025, likely to trade in a $1.15-$1.20 range by year end.

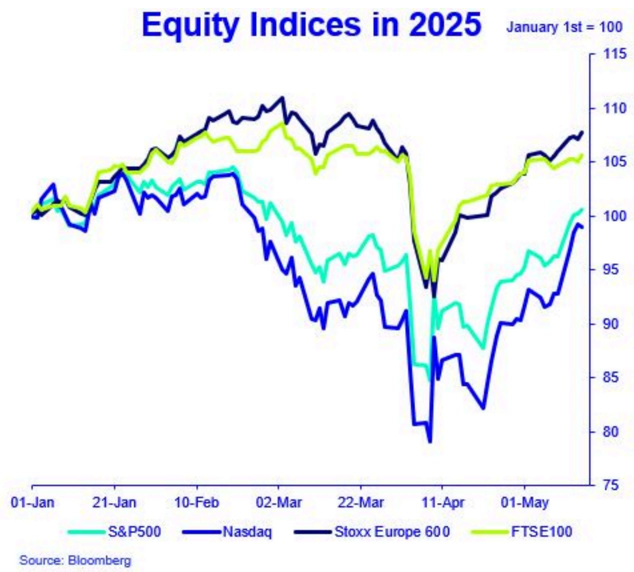
US markets pare back losses as US-China trade talks show signs of progress: Since the news on Monday, May 12th that the US and China will reduce tariffs on each other to 30% and 10% respectively, US asset prices have rebounded. Remarkably, the S&P 500 has not only fully recouped the losses that followed President Trump's tariff announcements on April 2nd, but is now actually up 0.2% since the beginning of 2025 (see chart below). Similarly, the Nasdaq is now just 0.2% off it's January 1st level, having being down 20% in April. That said, the dollar is still weaker, at $1.12 against the euro, but has appreciated from the $1.15 peak in the exchange rate on April 21st.

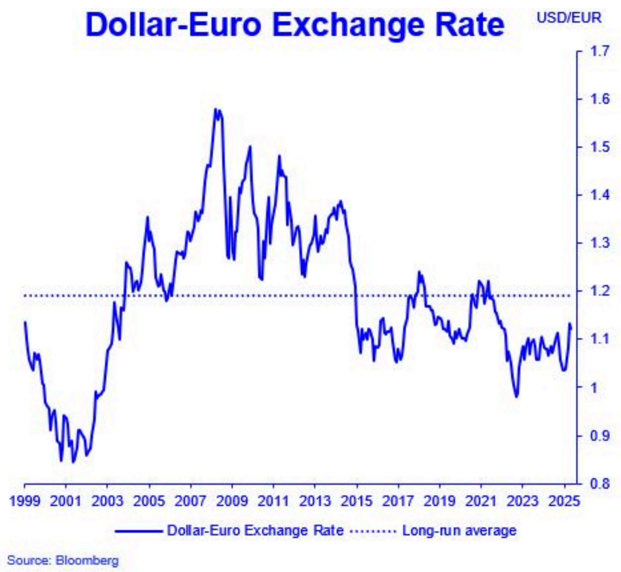
Rebound in equity markets looks overdone: It's worth remembering the US' 10% baseline tariffs remain in place, Chinese imports still face a 30% tariff and the 90-day delay to '*reciprocal*' tariffs will expire in early July. The negative impact of these tariffs onto the US economy has yet to be felt. The Yale Budget Lab calculates the effective US tariff rate will still rise to 18%, the highest level since 1934 and will raise consumer prices by 1.7% in the coming months, a $2,800 cost for the average US household. Despite revising up their projections for US GDP growth to 1% and 0.6% (Q4 2025 / Q4 2024) respectively, Goldman Sachs (35%) and JP Morgan (<50%) still see a substantial probability of US recession in the next year.

Policy uncertainty will weigh on dollar: A belief the US administration is inexorably set on a more conciliatory approach, concluding trade deals to reduce tariffs, has underpinned the recent rally in equity markets. However, there are other challenges. US budget negotiations will progress through the summer. The Congressional Budget Office has forecast the Federal government deficit will equal 6% of GDP in 2025, with the debt/GDP ratio rising to 100%. With few concrete proposals from Republicans to rein-in this borrowing, investors will remain concerned how the United States will fund the twin fiscal and current account (external) deficits. Talk of unorthodox policies to address these deficits (e.g. the Mar-a-Lago accord) or doubts on Treasury policy on the exchange rate, may also weigh on the dollar.

Dollar exchange rate against the euro looks stretched: Since it's inception in 1999, the dollar-euro exchange rate has averaged $1.19. So by any historical standard, or relative to measures of the purchasing power parity exchange rate, the current $1.12 level under-values the euro. This is another reason we expect the dollar to depreciate gradually over the next 12-months against the euro, despite the recent rally. So we are sticking with our view the dollar-euro exchange rate will rise gradually to a $1.15-$1.20 range by the end of 2025, as set out in our recent Global Markets Watch.

Read the full Global Watch publication here





Contact Us at economics@boi.com