Economic Research Unit

Economics Weekly

Bank of Ireland

Euro-Dollar pushes through $1.15 on trade/deficit fears

A key call in our May 'Global Market Watch' was that the dollar would depreciate to trade in a $1.15-$1.20 range against the euro by the final quarter of 2025. This week the exchange rate pushed into this range, earlier than expected, reflecting concerns on US tariffs, the Federal debt/deficit and the administration's dollar policy. Specifically, questions surrounding the Mar-a-Lago accord but now also the Republican's Section 899 Budget Proposals that would allow President Trump to target foreign investors from countries deemed to be imposing unfair taxes on US companies. These factors should continue to weigh on the dollar through 2025, pushing it into the $1.15-$1.20 range against the euro. That said, as CPI inflation accelerates due to US tariffs, the current market view that the Federal Reserve will cut interest rates by 100bps by end-2026 will be tested, potentially providing some limited short-term support to the dollar.

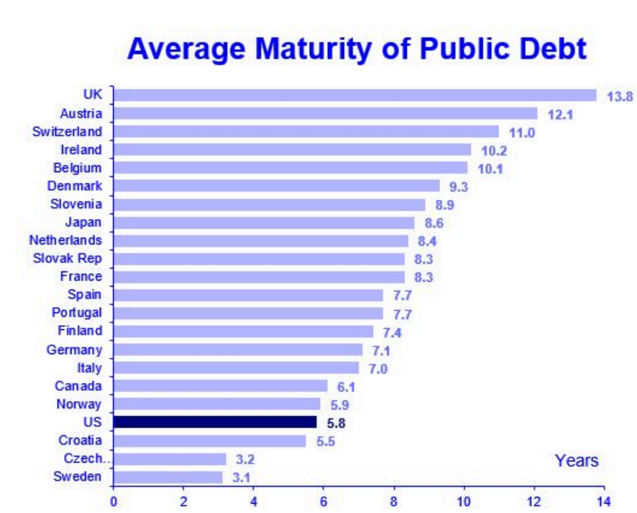
Dollar pushes through $1.15 against the euro: A key call in our May 'Global Markets Watch' was that the US dollar would depreciate, trading within a $1.15-$1.20 range by end-2025. However, the exchange has pushed into this range faster than expected, at $1.157, a three-and-a-half year low, on June 17th, albeit trading at $1.147 this morning, following the Fed's June policy meeting. In recent weeks softer US CPI inflation but also fears of escalating trade tensions have weighed on the dollar. Specifically, President Trump said he will soon send letters to trading partners outlining new tariffs that will take effect once the current 90-day delay to reciprocal tariffs ends on July 9th. However, beyond US tariffs, a range of factors look likely to keep the dollar under pressure in 2025; the Federal debt/deficit position and concerns on Trump administration policies targeting foreign investors.

Concerns on US fiscal position will continue to weigh on dollar: Prior to current budget negotiations the Congressional Budget Office (CBO) had forecast a Federal deficit of 6% of GDP in 2025, with the debt/GDP ratio rising to 100%. President Trump's '*One Big Beautiful Bill*' adds a further $2.4trn to the deficit out to 2034, supposedly offset by back loaded spending cuts. The immediate issue is whether investors will still have the appetite to fund the growing US Federal debt. The short-maturity structure means an enormous $7.4trn of US Federal debt, or 25% of the total, must be refinanced by end-2025 (see chart below) and 40% by end-2026. The deteriorating debt position recently led Moodys rating agency to downgrade the United States, removing the triple-A rating.

Section 899 an unwelcome feature of budget proposals: That Stephen Miran, new chair of the White House's Council of Economic Advisors, is a key proponent of the 'Mar-a-Lago' accord has raised fears on the administration's dollar policy. The *'Liberation day*' tariffs themselves and concerns President Trump may undermine the Federal Reserve's independence have added to uncertainty. Attention has now turned to Section 899 of the budget proposals. These provide the President with powers to tax foreign investors - should their home countries be deemed to unfairly tax US companies. For example, those countries with Digital Services Taxes (DSTs) or perhaps those that implement recent OECD corporate tax reforms. Whilst Section 899 may still be whittled down as it passes through the Senate this summer, it is another unwelcome risk for investors in US financial assets to consider.

Market view that ECB close to finished cutting rates helping the euro: The ECB's June policy meeting saw the governing council decide to cut the deposit rate to 2%. However, in her press conference ECB president Christine Lagarde repeatedly said that rates were now "*well positioned*". This language, alongside the ECB's forecast that HICP inflation would be 2% in 2027, was interpreted as a sign the council is close to finished cutting rates. In contrast, last week's US CPI inflation release at 2.4% in May, has bolstered expectations the Fed will cut rates in H2 2025. Options are now fully pricing-in three rate cuts from the Federal Reserve over the next 12-months. So the narrowing of rate differentials may also support the euro.

Source: Bloomberg



Source: IMF Fiscal Monitor

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