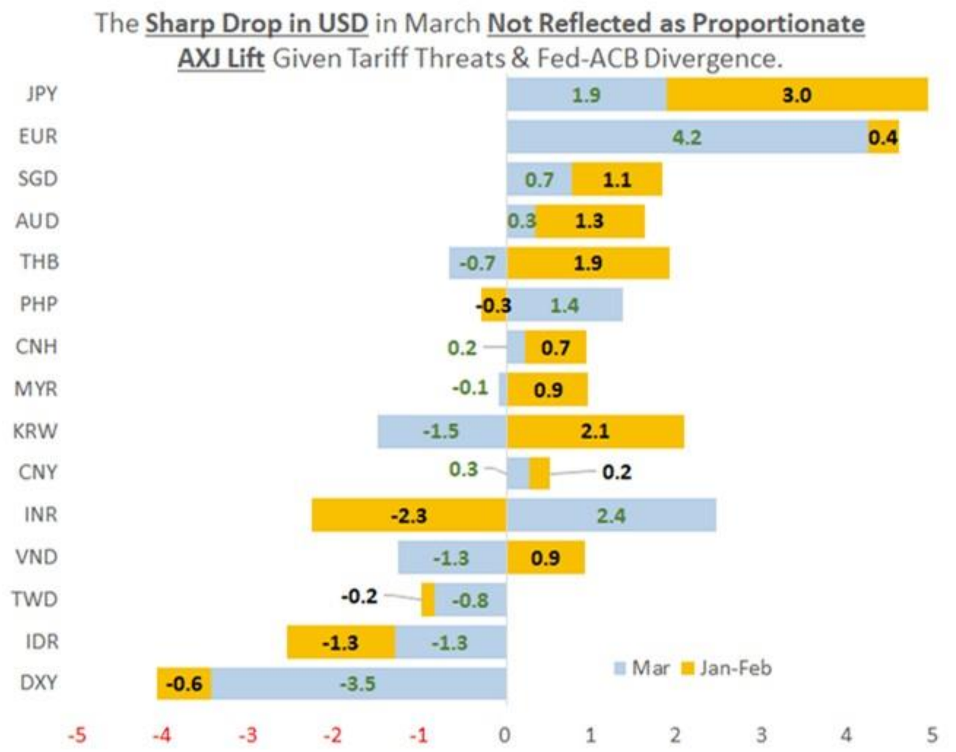
Mizuho Brief: USD Risks

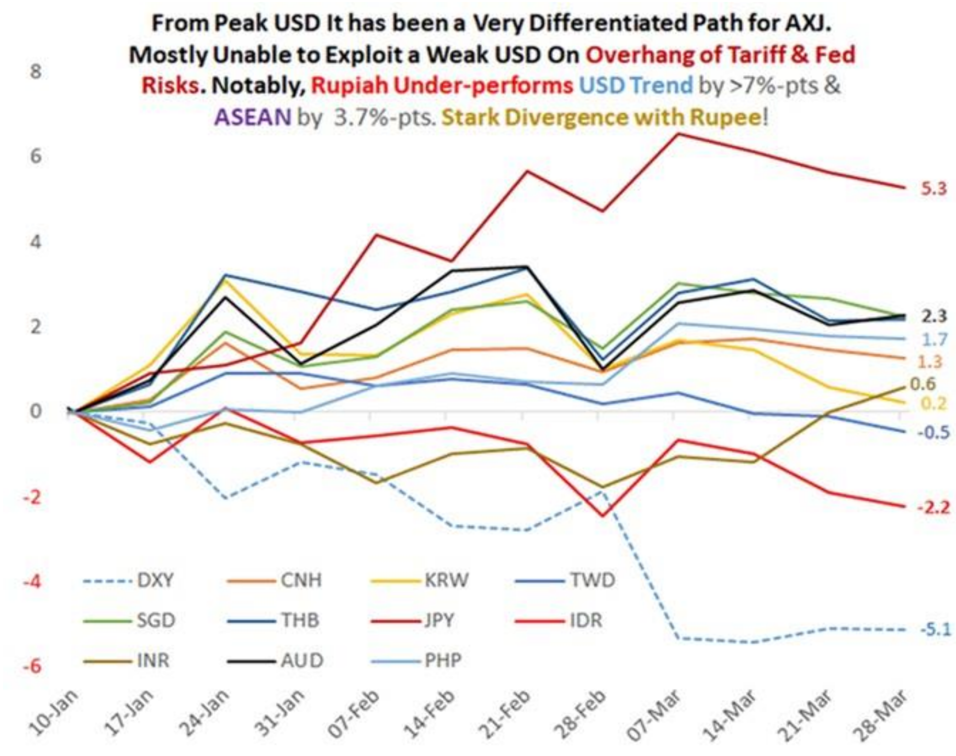
Economics & Strategy | Asia ex-Japan

1 April 2025 |
Vishnu Varathan | Head Macro Research, Asia ex-Japan

Has the USD Lost Its Mojo?

"I find your lack of faith disturbing." - Darth Vader, Star Wars: A New Hope





It may be tempting to suggest that the USD has lost it mojo when confronted with evidence of the Greenback's loss of haven allure amid tariff-related "risk off". But such a dismissive (of USD) conclusion may prove hasty. Especially if applied indiscriminately to AXJ outcomes in the context of elevated trade uncertainty ahead.

<u>USD Strength into Tariffs Uncertainty Challenged</u>: To be sure, the intuitive idea that Trump tariffs will boost USD at the expense of its more trade-reliant counterparts (such as EUR, CNH, CAD, MXN and AXJ more widely), which held up extremely well in early "Trump trades" has been challenged, if not overturned in recent weeks.

<u>USD Wobbles on "Reciprocal Tariffs"</u>: In fact, ahead of a sweeping application of "reciprocal tariffs" (on 2nd April), which Trump has flagged as the "big one", the USD has tumbled 5-6% (from 110 tests in early-January to around 104 as at the point of writing).

<u>Haven Allure Suspended</u>: What's odd is that USD wobbles have uncharacteristically coincided with risk retrenchment, flying in the face of received wisdom that USD rises amid "risk off" (in accordance with the "left-half" of "USD Smile*" hypothesis). In other words, the USD's haven allure is suspended, possibly supplanted.

<u>Trade Risks Flipped:</u> Harder to square yet, is that amid "risk off" triggered by trade-related uncertainty, typically trade-sensitive currencies EUR and JPY have gained traction at the expense of the USD. This ostensibly flips trade/tariff-related FX risks on the head.

<u>USD Not Unscathed</u>: Admittedly, the recent loss of DXY altitude quite rightly accounts for the fact tariffs are not exclusively one-sided, impacting on US trade partners to the exclusion of the US. Instead, it acknowledges that US will not be unscathed in a global trade turmoil that results from its own trade assault. Correspondingly, flawed views (earlier) of an impervious USD are being calibrated lower to account for more two-way risks.

<u>Accounting for Retaliation Pain</u>: Arguably more so as US trade partners retaliate. Fact is, the likelihood and impact of retaliatory tariffs on the US by trade partners, and the attendant economic hit to the US economy, was obviously under-estimated earlier. And is now being priced in more dynamically.

<u>(USD) Mania Checked, Not Mojo Lost</u>: Nonetheless, looking past the initial USD recoil from rich valuations, it is hasty, if not negligent, to assume persistent, one-way USD descent through the next few months of elevated trade uncertainty. USD merely has mania checked, not necessarily suffering a devastating loss of mojo.

<u>Low-Hanging Fruits</u>: For one, the initial calibration from excessive USD strength must be recognized as

"low-hanging fruits". Especially as undervalued EUR and JPY (on rate spread dynamics) accentuate a case for bottom-pickers to get to buy EUR and JPY. But this is not a template for linear projection of elevated trade uncertainties ahead.

AXJ Compromised: What's more, it is evident that AXJ have struggled to exploit the corresponding, broad-based USD pullback. Certainly in magnitude. And perhaps more revealingly, AXJ have revealed a greater degree of vulnerability to a suite of risks from i) policy divergence (more restrained Fed vis-a-vis relatively greater, albeit highly differentiated, easing bias of Asian central banks); ii) fiscal slippage, and; iii) specific trade (tariff) exposures.

USD Bears Must Watch Their Backs: Our view of more mellowing in the USD is a longer, non-linear course into late-2025/early-2026. And is crucially contingent on a confluence of; 1) a dovish Fed turn later; 2) negotiated trade compromise (further out as coming months of exceptionally elevated trade uncertainties settle), and; 3) China risks are durably subdued with sufficient stimulus. Whereas premature, one-way bearish USD bets remain vulnerable to episodes of painful squeeze.

Trading Risks & Trafficking in Fear: The upshot is that the potential for more softening in the USD later this year is neither linear nor guaranteed. Exceptional threats to global trade and shifting (but not fading) geopolitical fears amid elevated uncertainty means that markets will continue to dynamically trading (trade) risks and at times trafficking in fear. And these conditions typically serve as stark reminders that even if the USD mellows, it may not have lost its mojo. Not just yet.

** The 'USD Smile' refers to the market hypothesis that USD tends to gain in a very pronounced manner under intense economic stress/risk aversion and extreme optimism that lifts US assets first and is propelled by corresponding hawkish Fed lift for the Greenback*