14 February 2025

FX Viewpoint

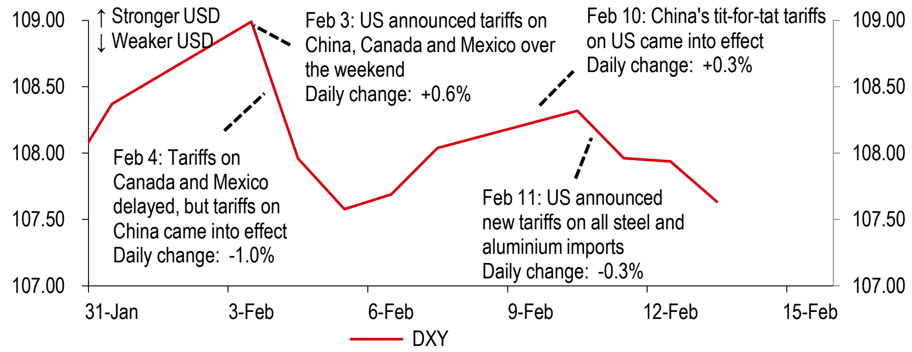
Currencies
Global

USD and tariff headlines

- Tariff headlines appear to be less provocative for FX markets
- Perhaps, markets assume that some deals could be struck...
- …which creates an upside risk for the USD

The law of diminishing returns seems to be in play, as **tariff-related headlines seem less provocative for FX markets** (see the chart below).

DXY and tariff headlines



Source: Bloomberg, HSBC

Tariff trauma started and the USD jumped only briefly

On 1 February, US President Donald Trump announced a 25% tariff on imports from Canada and Mexico (a 10% tariff on Canadian energy) and a 10% additional duty on Chinese products. The US Dollar Index (DXY) jumped briefly following the weekend's tariff headlines. **There is still a great deal of uncertainty about how the situation will unfold, with moves on Mexico and Canada delayed to 4 March** (*Bloomberg*, 4 February 2025). The DXY erased its earlier gain. That being said, the new 10% tariff on all Chinese imports to the US came into effect on 4 February and China's tit-for-tat import taxes on some US goods came into effect on 10 February. The DXY hovered around the 108 level (*Bloomberg*, 10 February 2025).

FX markets reacted with a shrug to more tariff headlines

The USD was basically unchanged on the day against most other G10 currencies, despite US President Donald Trump's confirmation on 11 February that the 25% tariffs will be imposed on US steel and aluminium imports without exceptions, and with an indication from Trump that they may go higher (*Bloomberg*, 11 February). Markets also shrugged off various promises of retaliation, including from politicians in Canada and the EU. Perhaps, FX markets are once again assuming a deal will be struck with key trading partners before they actually go into effect on 4 March. Whether one views the lack of market action as complacency or pragmatism, it creates **an upside risk for the USD, should these latest tariffs end up being implemented.** It also shows that **the risk of a tit-for-tat escalation is prominent, heightening the stagflationary threat for the global economy.**

The USD no longer enjoys a premium relative to its rate differential, but fundamentals remain favourable

It is also worth noting that the prior premium in the USD relative to its rate differential, potentially reflective of a Trump policy uncertainty premium, has been mostly erased. **Whether the premium re-emerges may hinge on whether tariff threats transform into tariff reality**. FX markets will probably remain tied to headlines about US policies, like reciprocal tariffs. **We still believe the USD is likely to strengthen further**, amid the divergence in both growth and monetary policy between the US and other economies, among other factors.

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