QNB Economics
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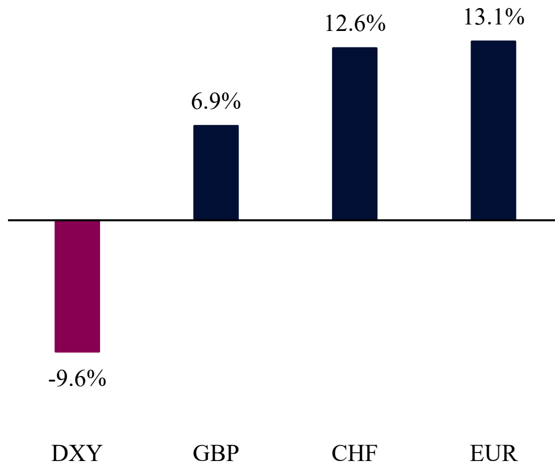
What to expect from the USD going forward?

Foreign exchange (FX) markets are the clearest expressions of global macro trends, being at the centre of capital flows and the allocation decisions behind them. Last year, major FX markets have presented significant volatility. The USD Index (DXY), a traditional benchmark that measures the value of the USD against a weighted basket of six major currencies, has experienced an 9.6% depreciation in 2025, one of the worst performances for the greenback in almost a decade. In contrast, the Euro (EUR), the Swiss Franc (CHF) and the Pound Sterling (GBP) appreciated markedly against the USD.

Major FX movements in 2025
(USD index and currencies versus USD, % change)

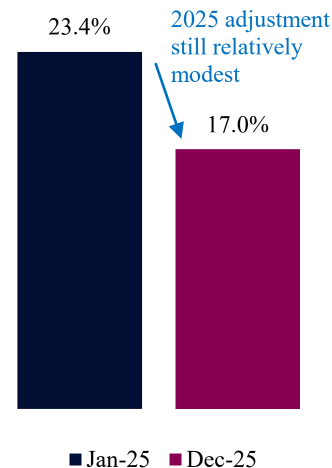


Sources: Bloomberg, QNB analysis

After such a significant USD selloff, analysts and investors debate the direction of the USD going forward. There is currently no clear consensus when it comes to the USD. Bulls believe that the USD should be well supported by continuous US “exceptionalism” underpinned by higher productivity growth and a superior supply of high-quality assets. In our view, however, there is room for further USD adjustments to the downside. Three main factors support our assessment.

First, despite the significant depreciation in 2025, the USD still remains “overvalued” according to some standard metrics, suggesting the need for more long-term adjustments. A common way to look at currency “valuations” is to analyse trade-weighted, inflation-adjusted exchange rates, i.e., the real effective exchange rates (REER), and compare it to their own long-term averages or historical norms. This REER metric is more robust than traditional FX rates as it captures changes in trade patterns between countries as well as economic imbalances in the form of inflation and inflation differentials. The REER picture for December 2025 suggests that the USD is indeed the most overvalued currency in the advanced world, by more than 17% of its notional “fair value.” Importantly, while the USD depreciation last year was significant, it accounted for only a modest adjustment of USD overvaluation. In fact, from peak USD strength in January 2025, the overvaluation had only declined by 640 basis points or less than 30% of the value needed for a full adjustment. A higher US inflation than what is observed in important US trade partners in Asia and Europe also make a full adjustment more difficult. In other words, structurally, both due to accumulated imbalances and higher relative inflation, the USD is expected to remain under pressure.

Currency deviation from REER 20-year average
(in %, beginning and end of period, 2025)



Sources: Haver, QNB analysis

Second, shifts in the drivers of major advanced economies could narrow their growth and interest rate differentials with the US. In recent years, the US has been more aggressive than its peers in applying expansionary fiscal policies, pushing its deficit to

around 7% of GDP and bolstering economic performance. Currently, the US has limited space for further fiscal expansion whereas other advanced economies lean toward more expansionary measures. This should diminish the US growth advantage. A narrower growth differential ultimately favours other currencies over the USD.

Third, global investor's overall positioning suggests that portfolio rebalancing could favour increased capital allocations to non-US assets. Over the past decade, portfolios have become highly concentrated in US assets, reflecting a long period of US economic outperformance, strong US equity market returns and the central role of US Treasuries in global finance. As a result, many global investors are structurally overweight US assets, while allocations to other advanced economies remain comparatively low. Hence, even relatively small changes in global asset allocation, such as marginal reductions in US exposure for diversification or risk-management purposes, could translate into sizeable capital flows towards under-allocated asset classes, which imply USD selling pressure. In addition, lower USD interest rates widen the premium of higher yielding currencies, particularly in emerging markets, favouring further outflows from the US.

All in all, we see scope for further USD adjustments beyond current levels. The currency is likely to move toward more "fair" levels, supported by a "normalization" of the US exceptionalism and broader moves of portfolio re-balancing.

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