1 OCTOBER 2025

More dollar weakness

More downside for the USD going forward – New 12m target of 1.24

The key drivers of the dollar over a 12-month period are i) the appetite for "safe-haven" currencies linked to increased political and economic uncertainty and ii) the interest rate differential.

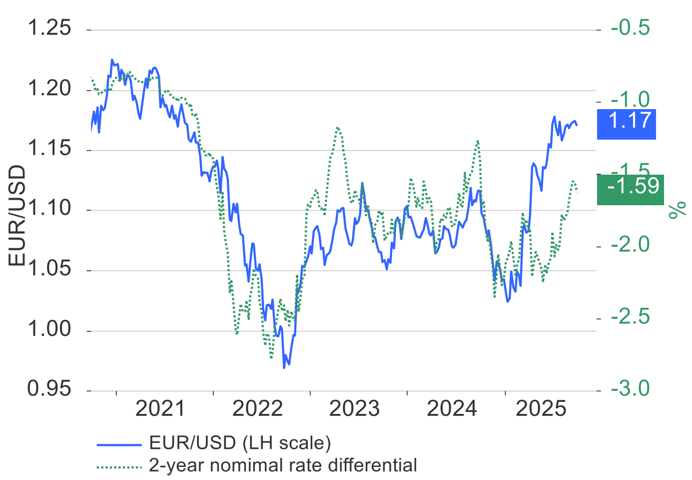
It is no longer clear that the USD retains its traditional safe-haven status, given issues around debt sustainability and Fed independence. Both could be a source of long-term inflation and a loss of purchasing power of the dollar. Regarding the interest rate differential, the key will be policy decisions of the US Federal Reserve Bank and the European Central Bank. For the ECB we stick to the assumption that the rate cut cycle is over and the deposit rate will stay at 2% for the coming year. The risks on the growth side are balanced, and inflation is on target. The real deposit rate (deducting inflation) is zero and this is supportive in such an environment. For the Fed, there is a dilemma though.

On the inflation side, the muted impact of higher tariffs so far appears to reflect lagged effects. The statistics for the first few months of the year showed a sharp rise in inventories in anticipation of the application of customs duties. This explains why duty-related costs have not yet had a major impact at this stage. However, some companies are expected to start re-pricing as inventories fall over the coming months. Inflation could thus stay high for longer. The US labour market has weakened noticeably in recent months, with both labour demand and supply easing. This is partly due to weakening activity, and stricter immigration rules shrinking the available workforce. The Fed seems worried about a further deterioration in lab labour market conditions.

This is why the Fed is expected to cut rates further despite sticky inflation. We also note that persistent political pressure on the Fed has shifted the focus towards supporting growth and employment rather than prioritising price stability.

We have changed our outlook and expect a total of 4 rate cuts, taking the terminal rate to 3.25%. This is one more rate compared with our previous outlook. As mentioned above, we do not see any more cuts for the ECB and this would imply a further reduction in the interest rate differential over the coming months. Markets have already priced such an evolution as the differential between the 2-year yields has been falling (see figure below).

EUR/USD & 2Y NOMINAL RATE DIFFERENTIAL



Source: LSEG Datastream, 01/10/2025

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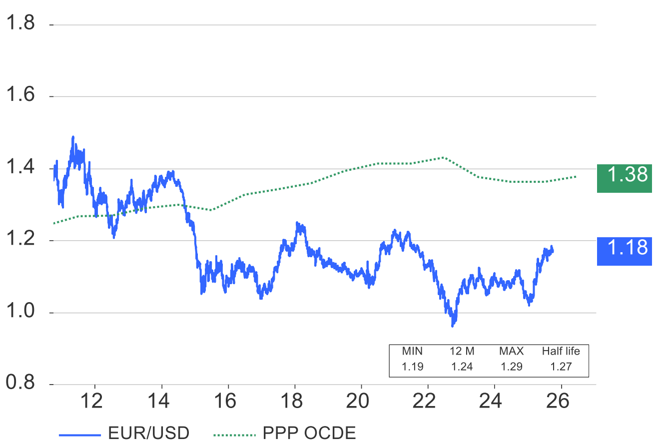
Taken together, we thus see rising risks of renewed USD weakness in the months ahead, driven by policy uncertainty, the erosion of its safe-haven appeal, and a dovish Fed outlook. Accounting for these factors, we change our 3-month target from 1.15 to 1.16 and our 12-month target from 1.20 to 1.24 (value of one EUR).

Medium-term drivers

In the medium term, the key driver will remain the Purchasing Power Parity (PPP). It measures the exchange rate that equalises the price of a representative basket of goods when calculated in dollars. The estimated long-term fair value for one euro ("Purchasing Power Parity" or PPP) provided by the OECD is around 1.38 dollars (based on Germany's figures). Deviations from the PPP can, however, be seen over a long period. Some academic studies suggest that a more relevant approach would be the so-called notion of half-life*. Following Craig (2005) "a half-life represents the amount of time that elapses before a discrepancy between the PPP level and the current exchange rate is half its current size". He found that for large differences, that period could be around 12 to 18 months. Currently, the notion of half-life suggests a fair value of one euro of around 1.27.

EURUSD LONG-TERM FAIR VALUE



Source: LSEG Datastream, 01/10/2025

* For example, see B. Craig (2005) "The Growing Significance of Purchasing Power Parity", Federal Reserve Bank of Cleveland, Economic Commentary.

FX forecast tables

	Country		Spot 30/09/2025	Trend	Target 3 months (vs. EUR)	Trend	Target 12 months (vs. EUR)
	United States	EUR / USD	1.18	Neutral	1.16	Negative	1.24
	United Kingdom	EUR / GBP	0.87	Neutral	0.87	Neutral	0.87
	Japan	EUR / JPY	173.53	Positive	168	Neutral	174
	Switzerland	EUR / CHF	0.93	Neutral	0.94	Neutral	0.94
	Australia	EUR / AUD	1.77	Neutral	1.76	Negative	1.82
	New-Zealand	EUR / NZD	2.02	Positive	1.93	Negative	2.07
	Canada	EUR / CAD	1.63	Positive	1.60	Negative	1.67
	Sweden	EUR / SEK	11.05	Neutral	11.00	Positive	10.70
	Norway	EUR / NOK	11.72	Neutral	11.60	Positive	11.30
Asia	China	EUR / CNY	8.36	Neutral	8.29	Negative	8.80
	India	EUR / INR	104.33	Positive	102.08	Negative	109.12
Latam	Brazil	EUR / BRL	6.26	Neutral	6.26	Negative	7.07
	Mexico	EUR / MXN	21.54	Neutral	21.34	Negative	22.32

	Country		Spot 30/09/2025	Trend	Target 3 months (vs. USD)	Trend	Target 12 months (vs. USD)
	Eurozone	EUR / USD	1.18	Neutral	1.16	Positive	1.24
	United Kingdom	GBP / USD	1.35	Neutral	1.33	Positive	1.43
	Japan	USD / JPY	147.69	Neutral	145.00	Positive	140.00
	Switzerland	USD / CHF	0.80	Neutral	0.81	Positive	0.76
	Australia	AUD / USD	0.66	Neutral	0.66	Positive	0.68
	New-Zealand	NZD / USD	0.58	Positive	0.60	Positive	0.60
	Canada	USD / CAD	1.39	Neutral	1.38	Positive	1.35
Asia	China	USD / CNY	7.12	Neutral	7.15	Neutral	7.10
	India	USD / INR	88.79	Neutral	88.00	Neutral	88.00
Latam	Brazil	USD / BRL	5.33	Neutral	5.40	Negative	5.70
	Mexico	USD / MXN	18.33	Neutral	18.40	Neutral	18.00
EMEA	South Africa	USD / ZAR	17.25	Neutral	17.25	Neutral	17.00
	USD Index	DXY	97.78	Neutral	98.32	Negative	92.64

Source: BNP Paribas, Refinitiv Datastream. As at 1 October 2025

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