



(UBS)

Will the US dollar dip further as America's rate advantage fades?

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Central banks had little scope to start holiday season early last week, as policymakers from the European Central Bank, Norway's Norges Bank, Sweden's Riksbank, the Bank of England, and the Bank of Japan all revealed their latest monetary policy decisions.

The Bank of England and Bank of Japan stood out, with the former lagging the global rate-cutting cycle and the latter in the process of hiking. The UK central bank cut interest rates by 25 basis points on Thursday in a 5-4 vote, with Governor Andrew Bailey changing his stance from his November position. The tone of the minutes and Monetary Policy Committee member views, however, had hawkish overtones. In Japan, policymakers raised interest rates on Friday to a three-decade high of 0.75%, the first increase since January this year. They justified the move by citing a modest recovery in Japan's economy, a tight labor market, and high levels of corporate profits despite the impact of tariffs. Governor Ueda said the rate is still some distance from the lower end of a neutral range, signaling that the BoJ is open to further tightening. Still, the Japanese yen weakened to near 156.90 against the US dollar, as markets did not perceive Ueda as hawkish without guidance on the pace and target of rate hikes.

Overall, however, the broad theme of the week was that easing outside the US is largely over. With the Fed expected to ease further into 2026, this is eroding the US interest rate premium versus global peers and looks likely to add pressure on the US dollar. The DXY index, which tracks the currency against six major peers, is now down roughly 9% in 2025.

Our view is that the US dollar will face headwinds from its elevated valuation, the twin fiscal and current account deficits, as well as a move by central banks to diversify away from the US currency. We foresee US dollar weakness will

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extend into the first half of 2026. Our current forecast is for the euro to strengthen to about 1.20 against the dollar in the first quarter, from around 1.17 at present. We recommend investors review their currency allocations to align exposure with their liabilities and spending plans. Tactically we like the euro, the Australian dollar, and the Norwegian krone. We also see opportunities in select high-yielding emerging market currencies such as the Brazilian real, Mexican peso, Indian rupee, and South African rand.

Original report - [What to watch in the week ahead, 22 December 2025.](#)

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