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Explaining the US dollar's depreciation in the first half of 2025

Apollo Global Management

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Conclusions

- The dollar has depreciated more in the first half of 2025 than yield differentials would have predicted.

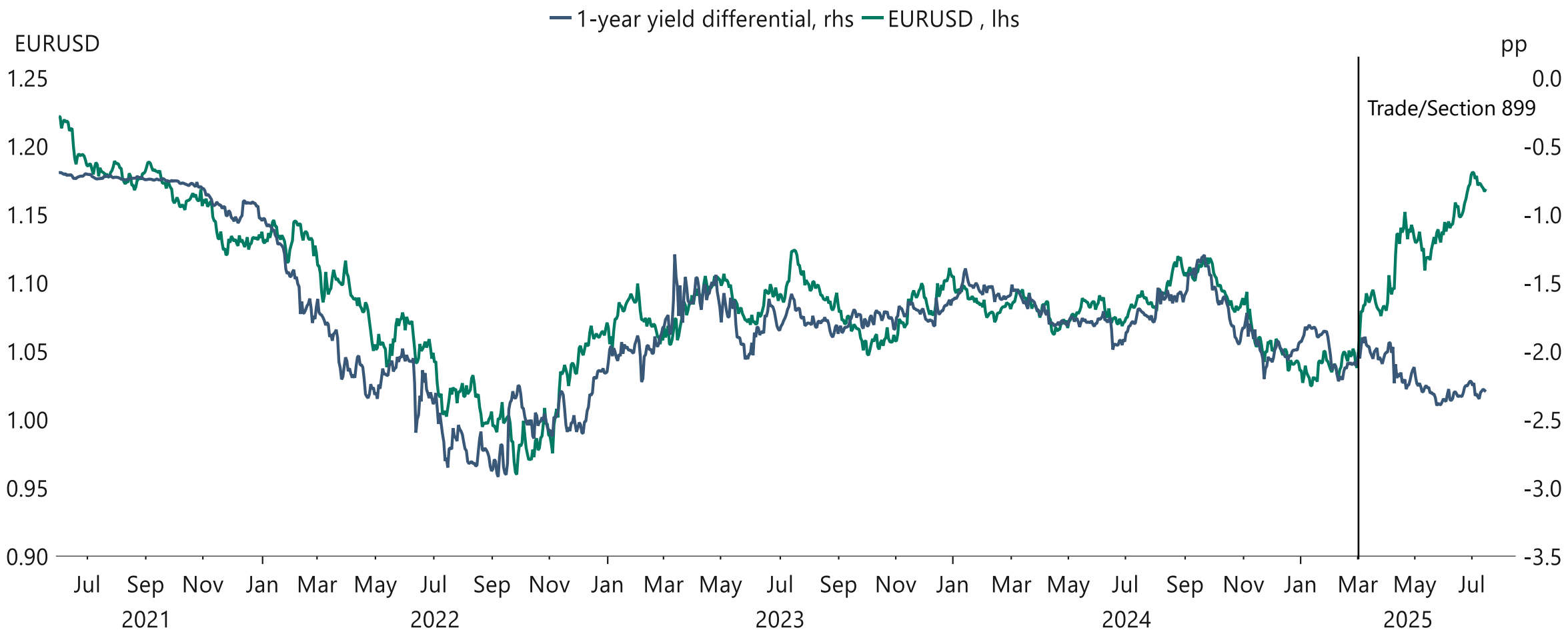
- Regression models indicate that this was due to the trade war and economic policy uncertainty, including concerns among foreign investors about Section 899 and the Mar-a-Lago Accord.

- Looking ahead, with Section 899 behind us and the trade war likely to be resolved within the next couple of weeks, the US dollar is expected to appreciate again.

- Renewed strong appetite for US assets after Liberation Day is also visible in the TIC data for May.

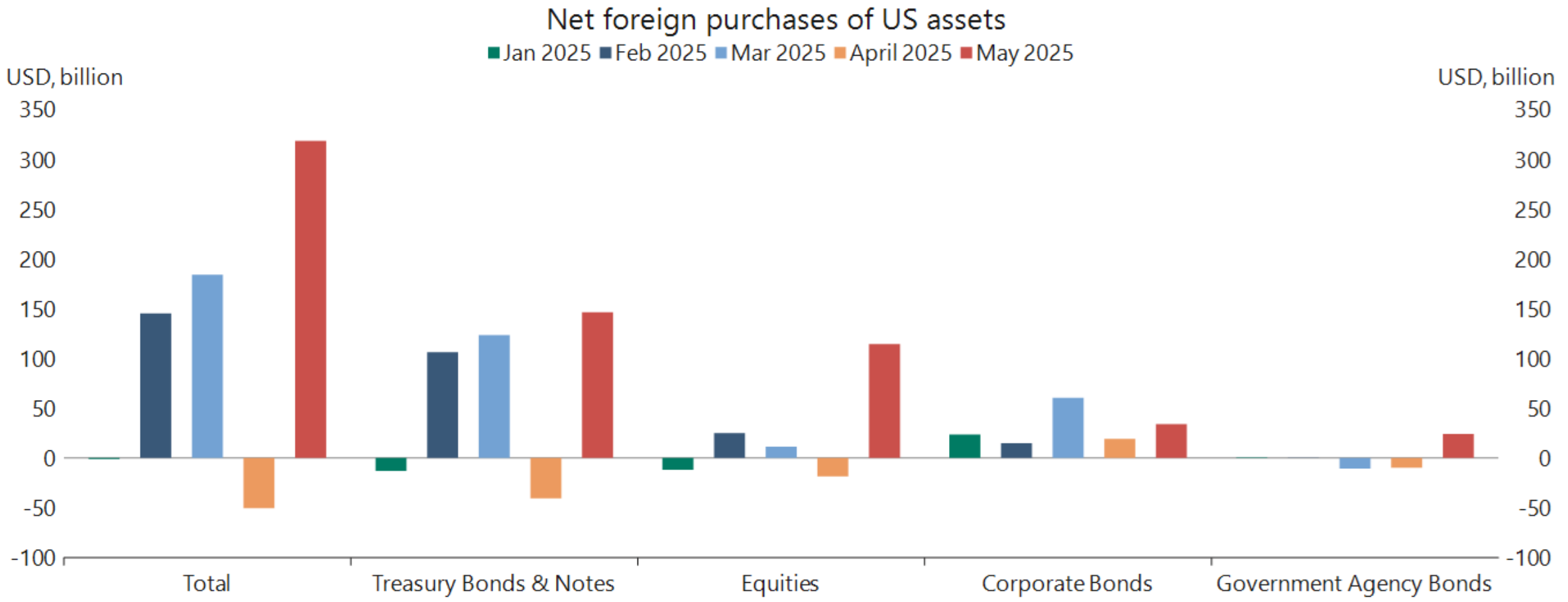
Source: Apollo Chief Economist

Why did the relationship between the dollar and interest rate differentials break down?



Source: Bloomberg, Macrobond, Apollo Chief Economist. Note: 1-year yield differential = 1-year German government bill minus 1-year US T-bill. pp = percentage points

Strong rebound in foreign demand for US assets in May



Source: U.S. Department of Treasury, Macrobond, Apollo Chief Economist

Model 1

Explanatory variables:

- **Difference in yields**

Exchange rates can no longer be accurately predicted from differences in yield

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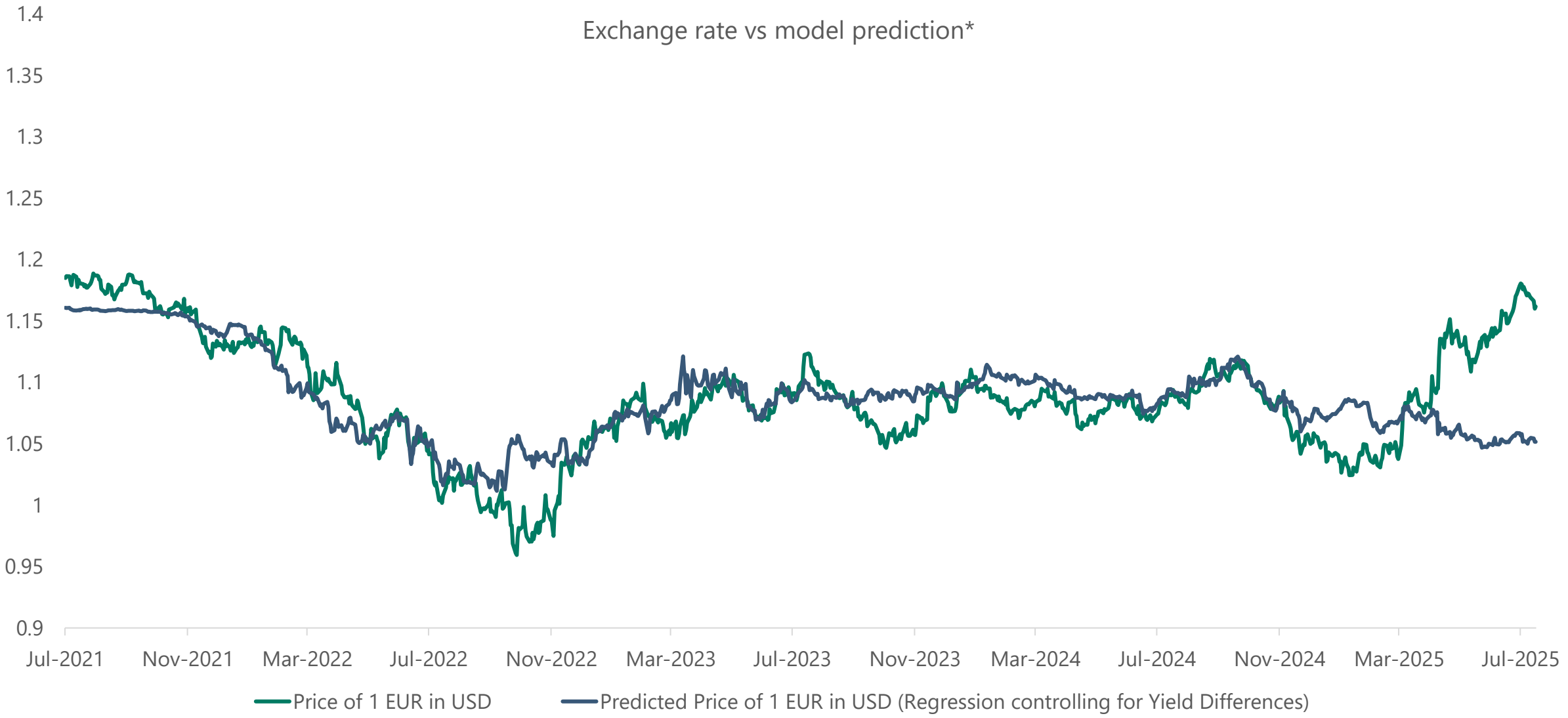
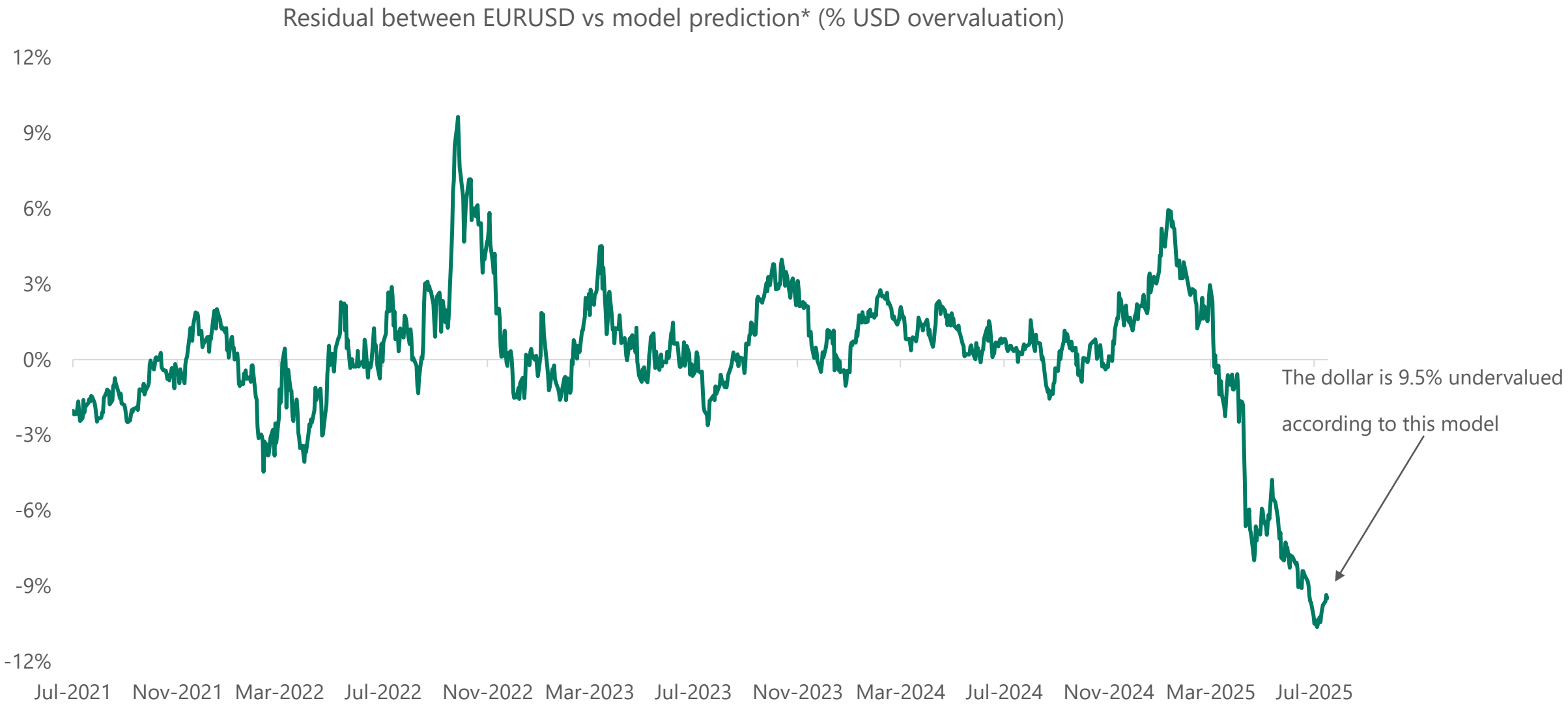


Source: Bloomberg, Apollo Chief Economist

* $Price\ of\ 1\ Euro\ in\ USD = 1.209 + 0.067 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield)$ R-squared: 0.54

Based purely on interest rate differentials the USD is currently 9.5% undervalued



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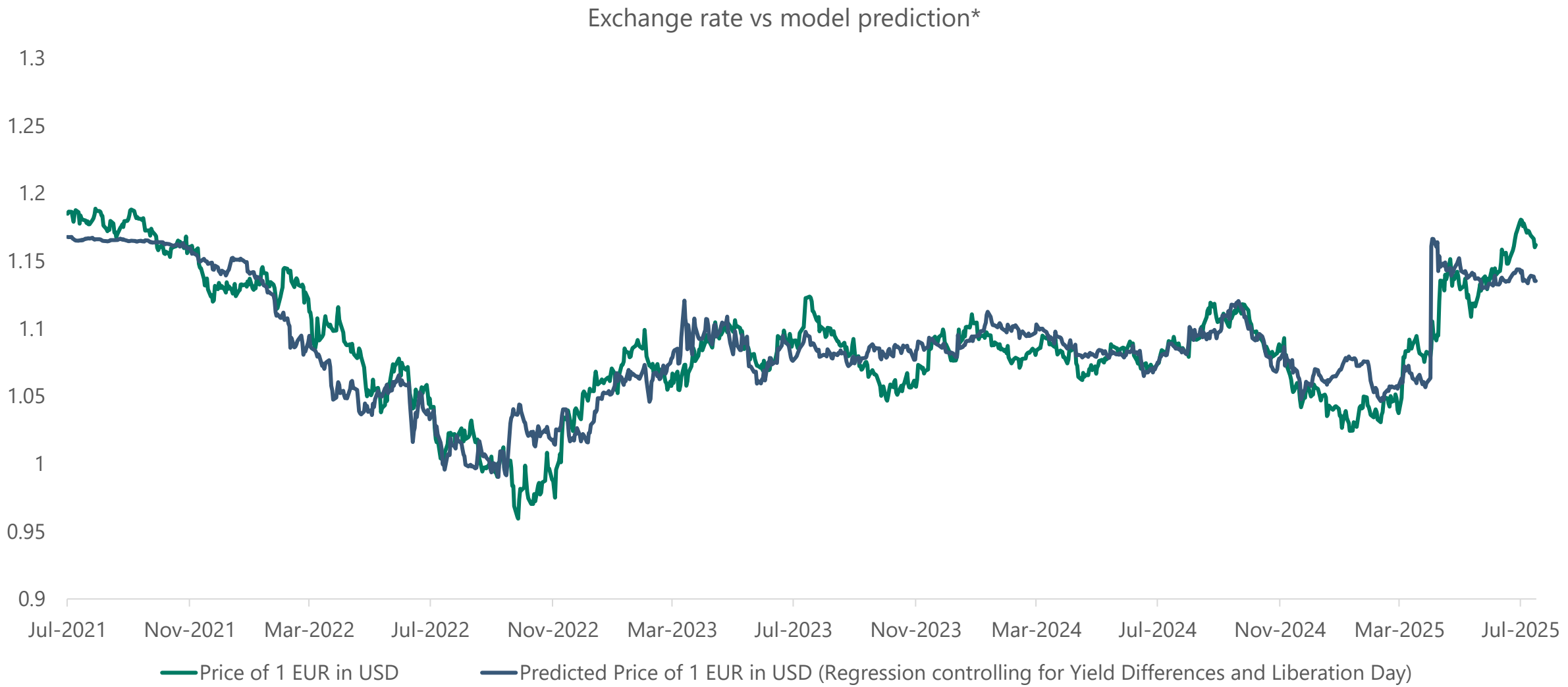
Model 2

Explanatory variables:

- **Difference in yields**
- **Pre/Post Liberation Day variable**

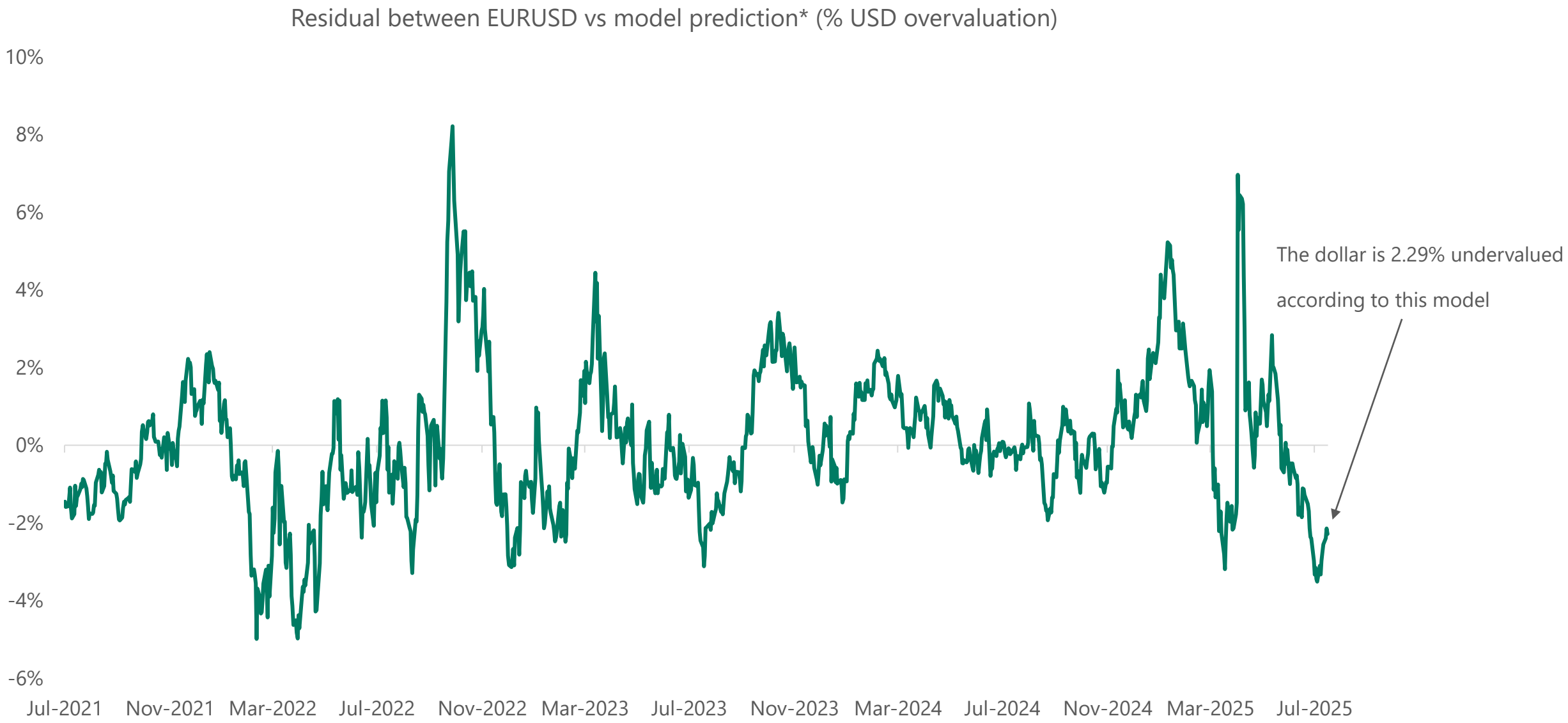
Adding a 0 / 1 variable for pre/post 'Liberation Day' helps explain EURUSD



Source: Bloomberg, Apollo Chief Economist

* $Price\ of\ 1\ Euro\ in\ USD = 1.225 + 0.08 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) + 0.097 * (Pre\ or\ Post\ Liberation\ Day)$ R-squared: 0.81

Based on interest rate differentials and pre/post 'Liberation Day' variable EURUSD is 2% undervalued



Source: Bloomberg, Apollo Chief Economist

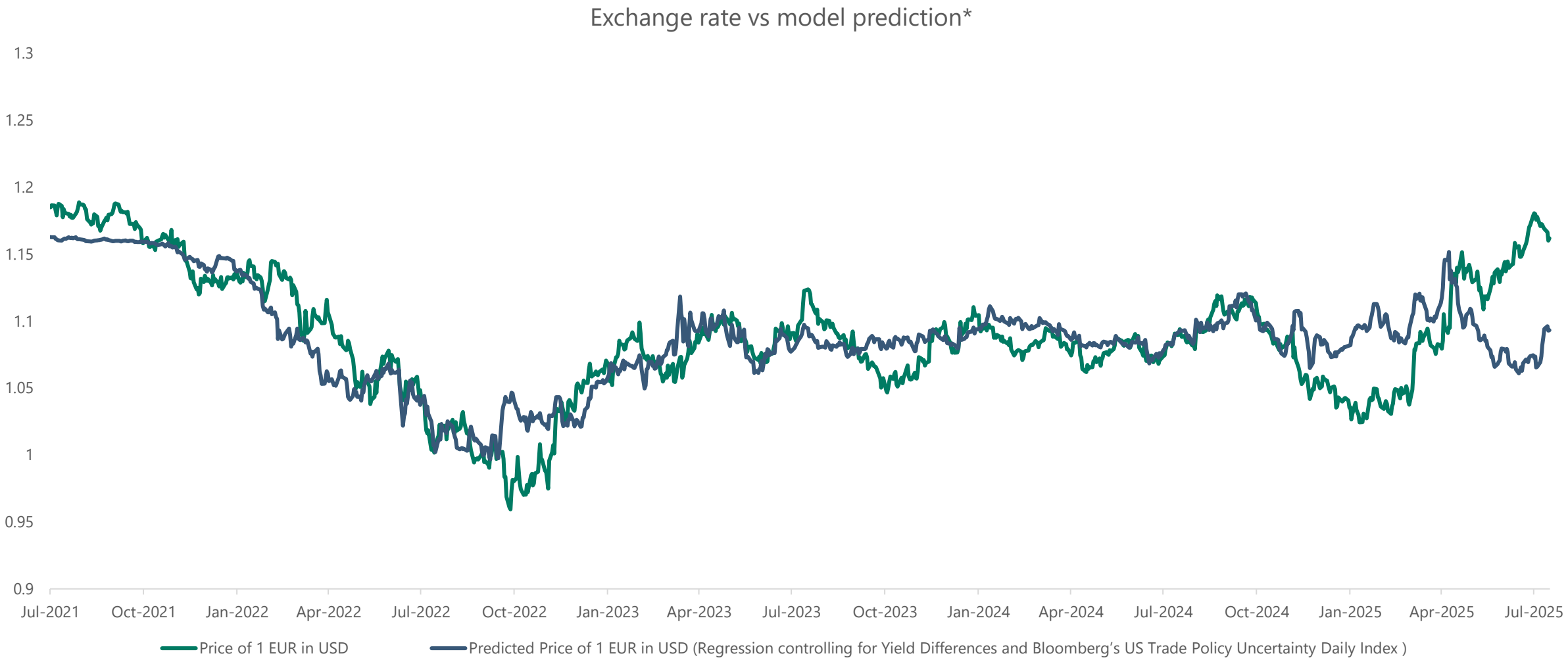
* $Price\ of\ 1\ Euro\ in\ USD = 1.225 + 0.08 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) + 0.097 * (Pre\ or\ Post\ Liberation\ Day)$ R-squared: 0.81

Model 3

Explanatory variables:

- **Difference in yields**
- **Bloomberg Economics US Trade Policy Uncertainty daily index**

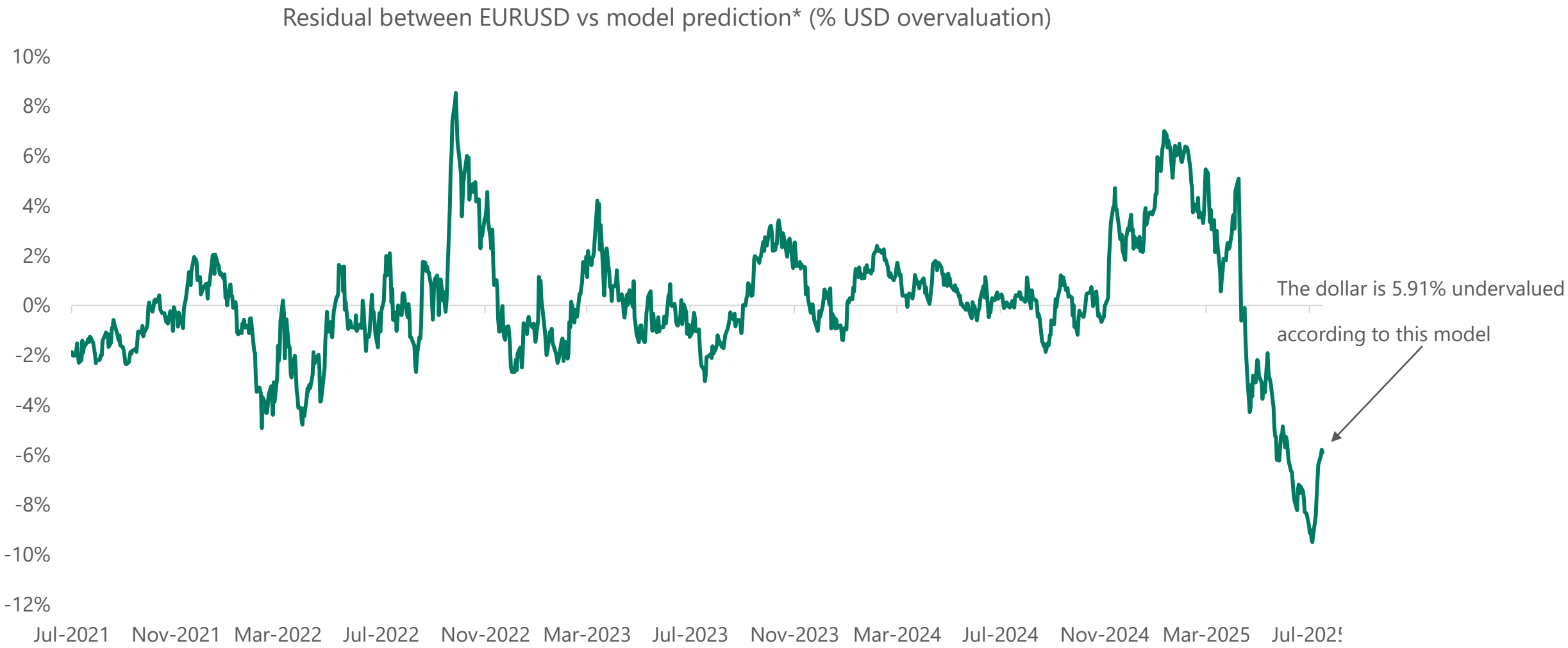
Using Bloomberg's US Trade Policy Uncertainty Daily Index as an explanatory variable in addition to yield differential also shows the dollar as undervalued



Source: Bloomberg, Apollo Chief Economist

* $Price\ of\ 1\ Euro\ in\ USD = 1.216 + 0.075 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) + 0.009 * (Bloomberg\ US\ Trade\ Policy\ Uncertainty\ Daily)$ R-squared: 0.63

Using Bloomberg's US Trade Policy Uncertainty Daily Index as an explanatory variable in addition to yield differential also shows the dollar as undervalued



Source: Bloomberg, Apollo Chief Economist

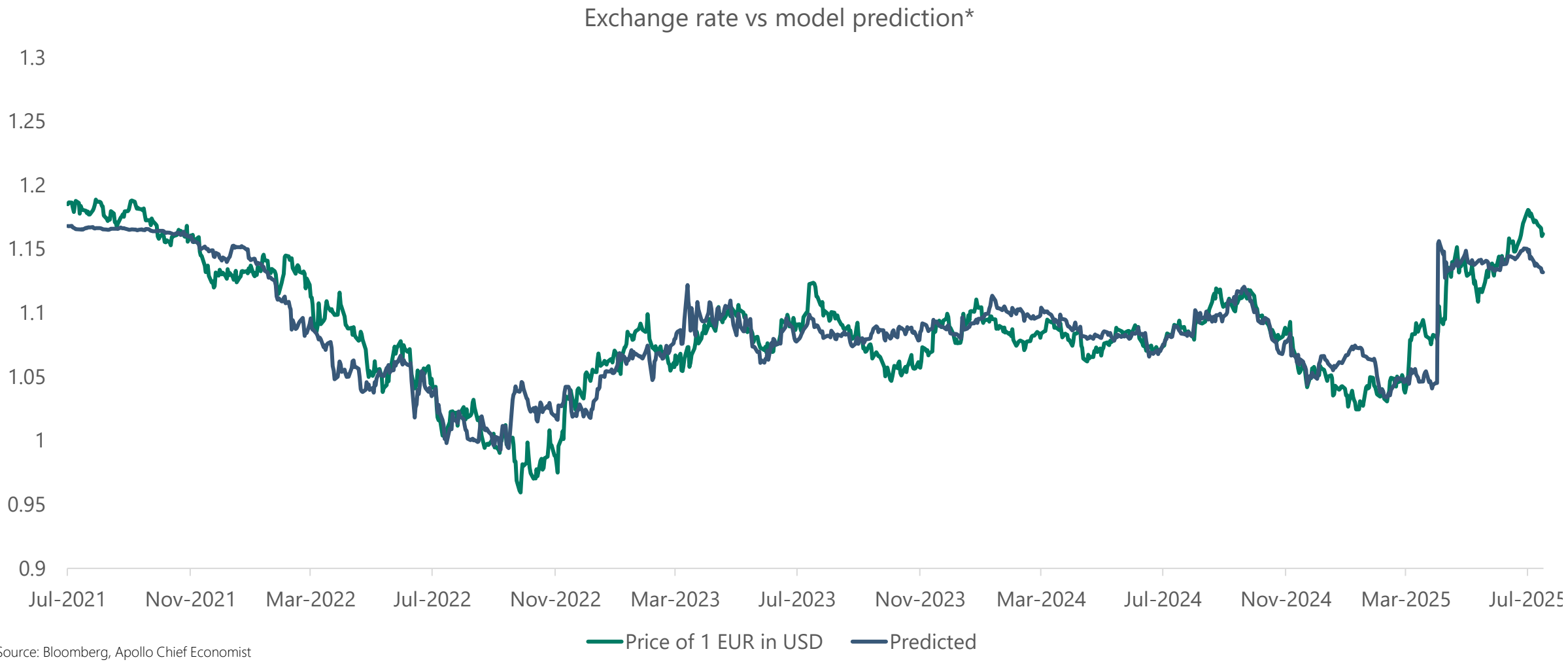
$* \ Price\ of\ 1\ Euro\ in\ USD = 1.216 + 0.075 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) + 0.009 * (Bloomberg\ US\ Trade\ Policy\ Uncertainty\ Daily)$ R-squared: 0.63

Model 4

Explanatory variables:

- Difference in yields
- Pre/Post Liberation Day
- Bloomberg Economics US Trade Policy Uncertainty daily index

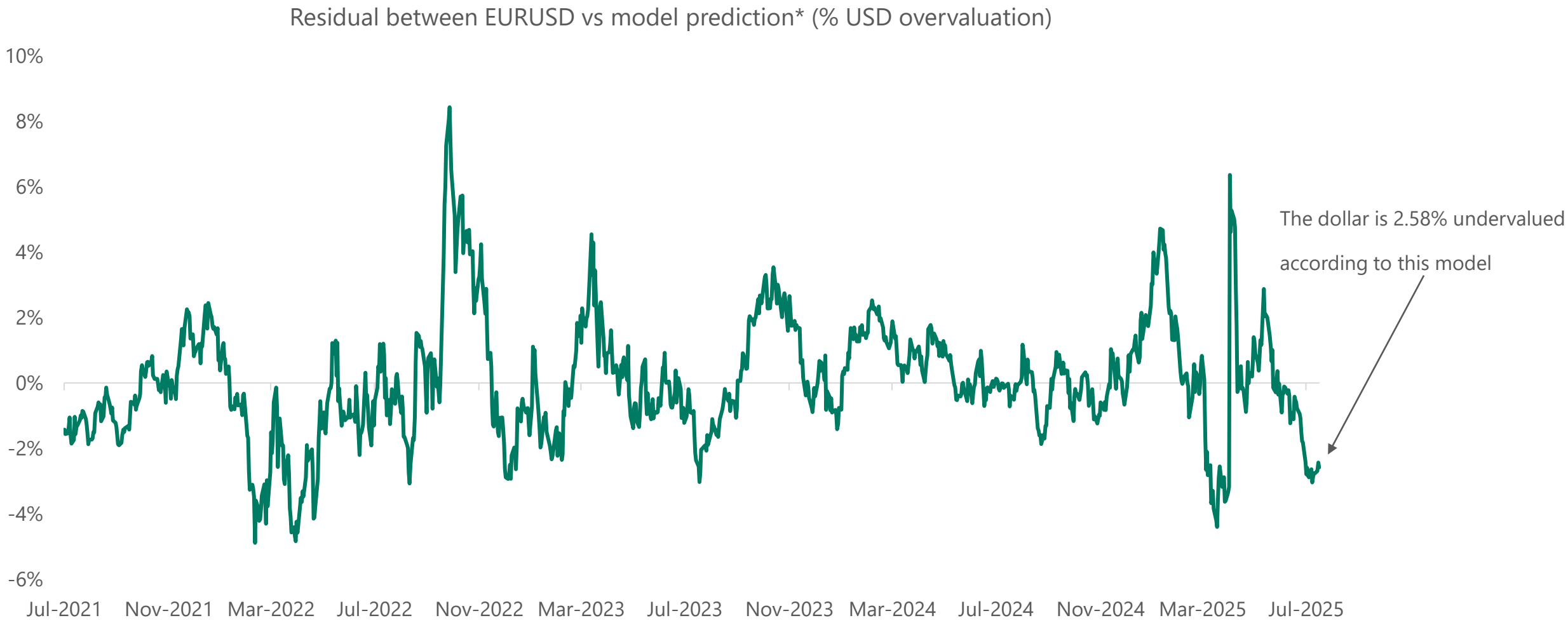
Combining the three previous controls (yield differentials, Liberation Day, and trade policy uncertainty) also shows the dollar as undervalued



Source: Bloomberg, Apollo Chief Economist

$* \ Price\ of\ 1\ Euro\ in\ USD = 1.2224 + 0.079 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) + 0.112 * (Pre\ or\ Post\ Liberation\ Day) - 0.0034 * (Bloomberg\ US\ Trade\ Policy\ Uncertainty\ Daily)$ R-squared: 0.82

Combining the three previous controls (yield differentials, Liberation Day, and trade policy uncertainty) also shows the dollar as undervalued



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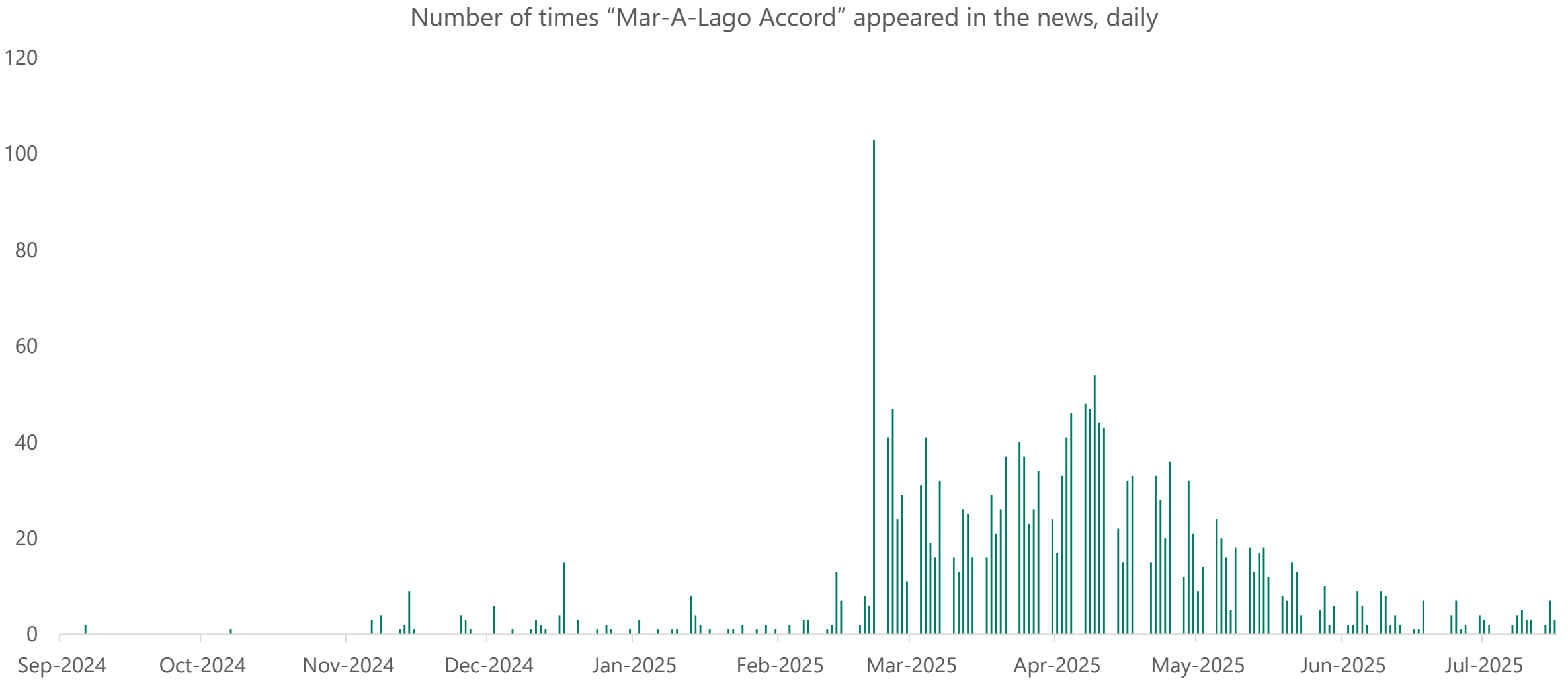
Model 5

Explanatory Variables:

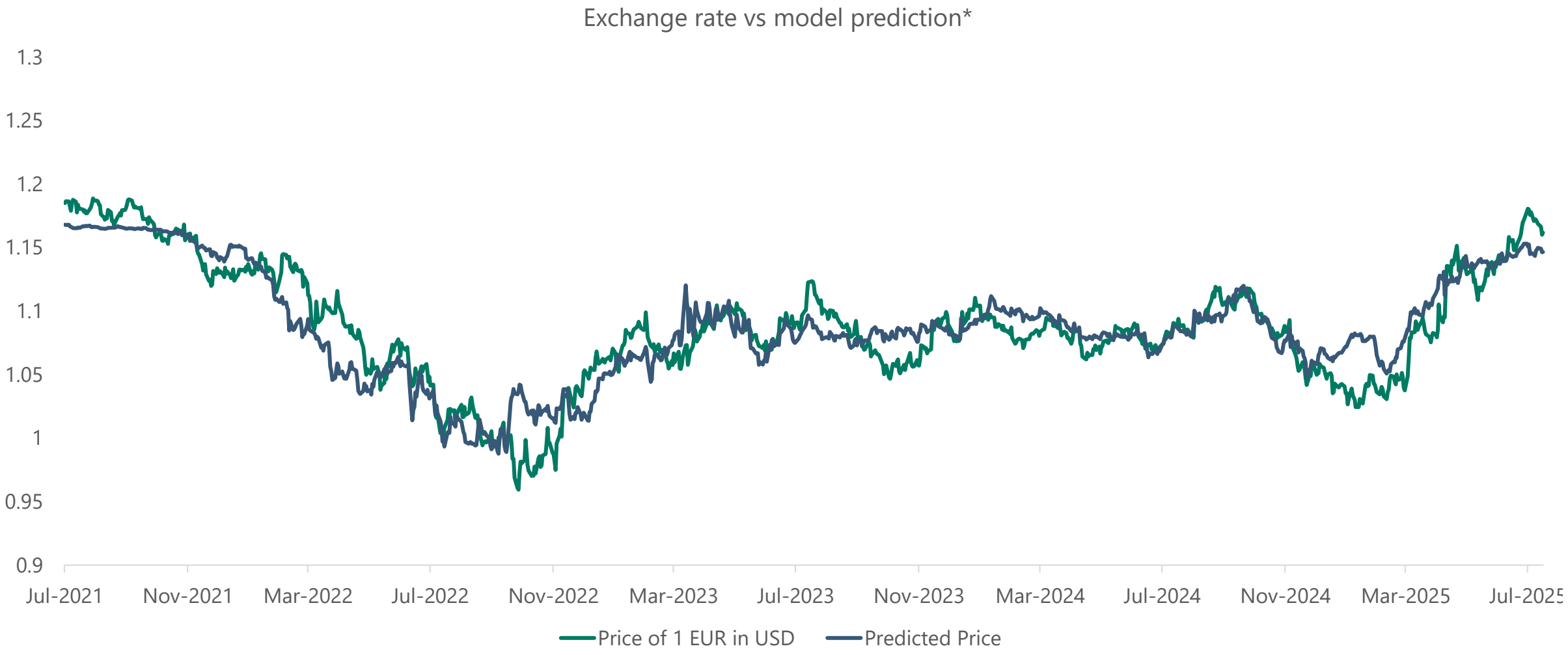
- **Difference in Yields**
- **Daily Mentions of "Mar-a-Lago Accord" in news stories**

Interest in the Mar-a-Lago Accord and Section 899 started in March



Source: Bloomberg, Apollo Chief Economist

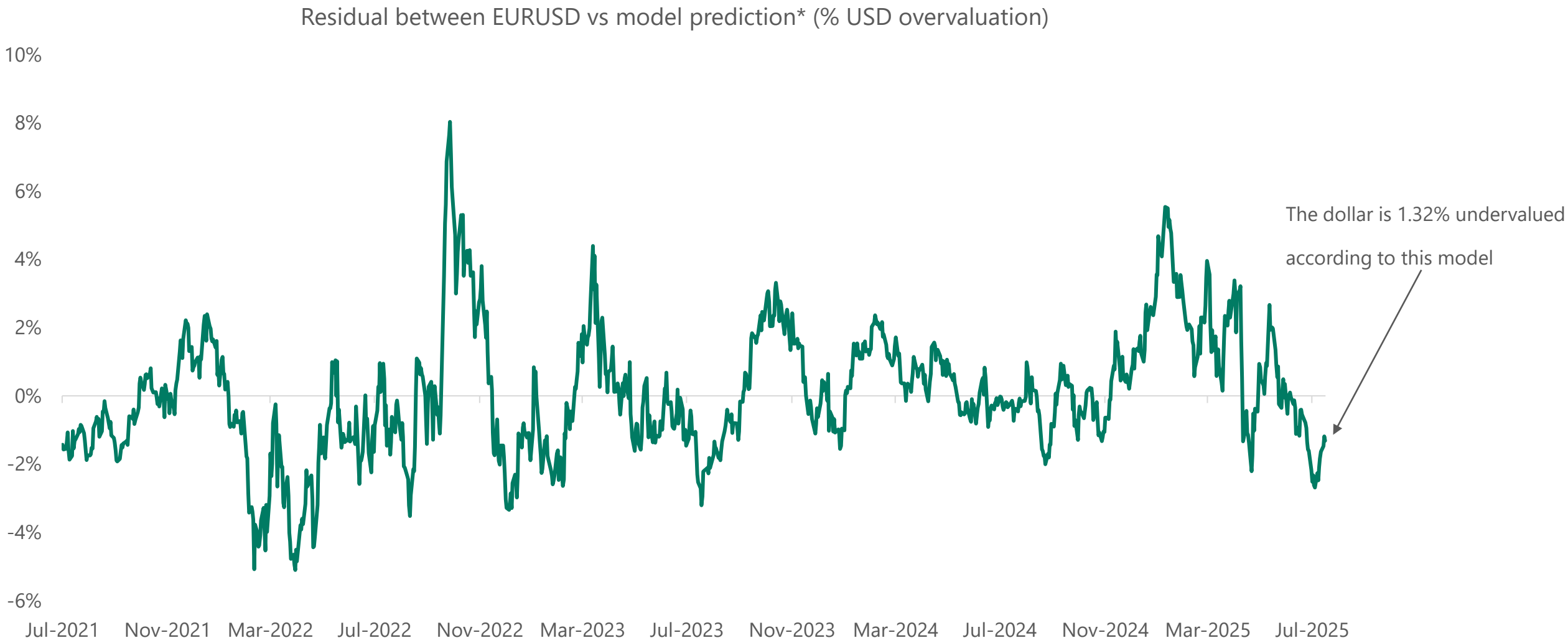
Using cumulative daily news mentions of "Mar-a-Lago Accord" in addition to yield differentials as controls puts the predicted exchange rate closer to the actual EURUSD rate



Source: Bloomberg, Apollo Chief Economist

$^{*}\ Price\ of\ 1\ Euro\ in\ USD = 1.226 + 0.081 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) - 0.000056 * (cumulative\ mentions\ of\ "Mar\ a\ Lago\ Accord")$ R-squared: 0.82

Using daily mentions of "Mar-a-Lago Accord" in addition to yield differentials as controls puts the predicted exchange rate closer to the actual rate



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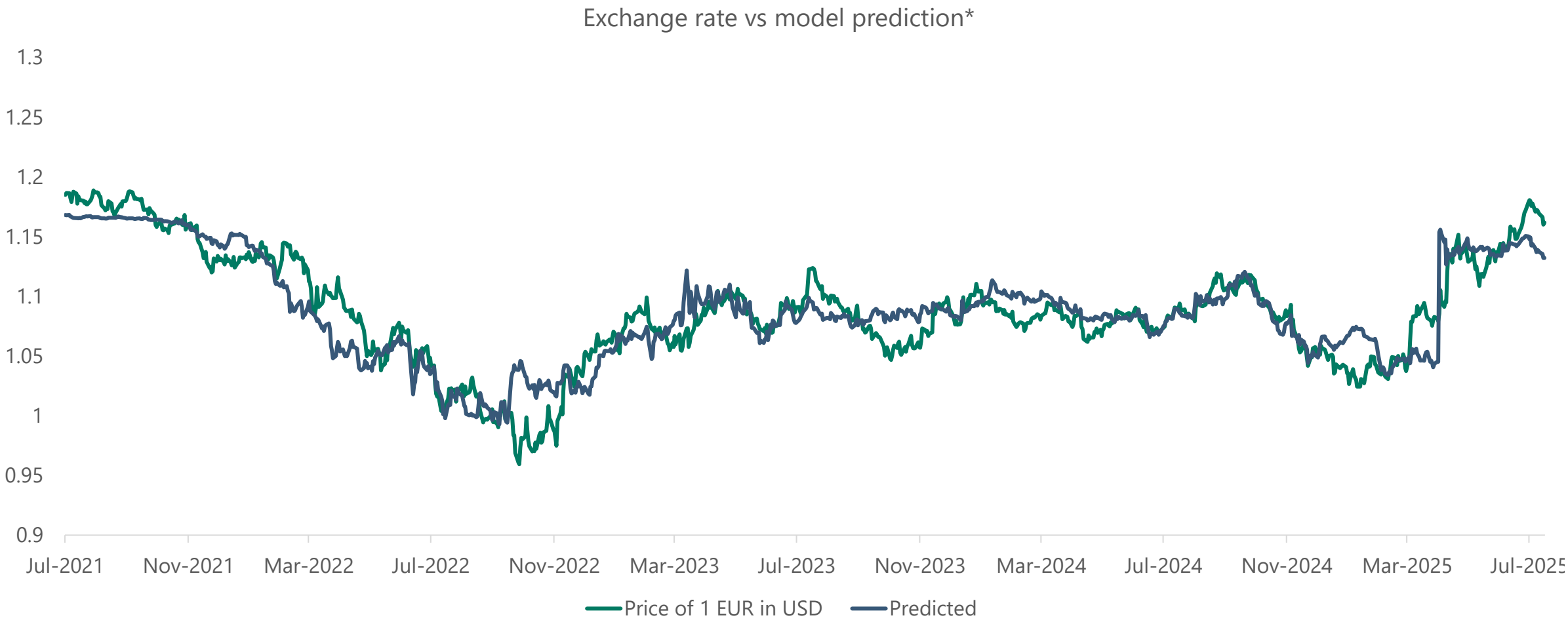
Model 6

Explanatory variables:

- Difference in yields
- Pre/Post Liberation Day
- Bloomberg Economics US Trade Policy Uncertainty daily index
- Daily Mentions of “Mar-a-Lago Accord” in news

Combining all the previous explanatory variables explains movements in the dollar



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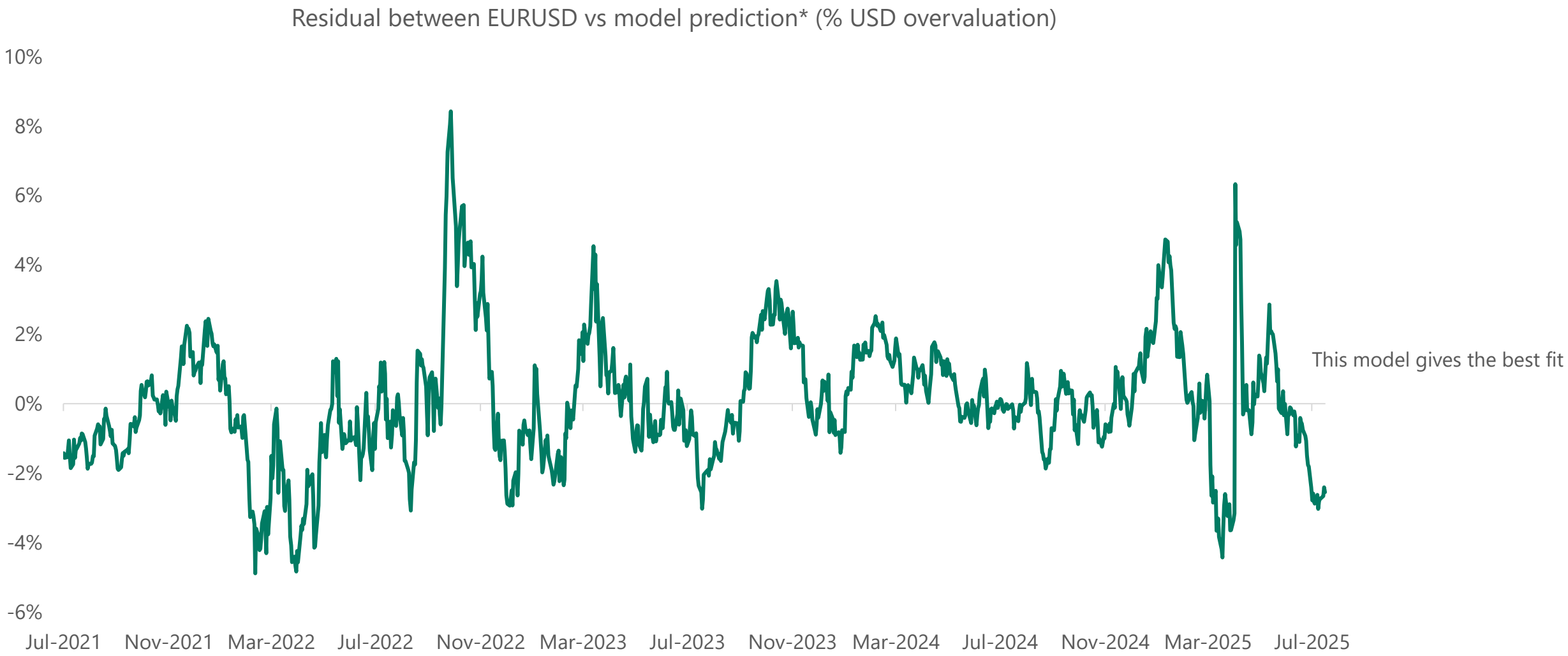
* $Price\ of\ 1\ Euro\ in\ USD = 1.225 + 0.079 * (German\ Treaury\ Yield\ - US\ Treasury\ Yield) + 0.111 * (\ Pre\ or\ Post\ Liberation\ Day) - 0.003 * (Bloomberg\ US\ Trade\ Policy\ Uncertainty\ Daily) - 0.000026\ (cumulative\ mentions\ of\ "Mar\ a\ Lago\ Accord")$ R-squared: 0.82

Combining all the previous explanatory variables confirms the hypothesis that the dollar is undervalued, but only slightly



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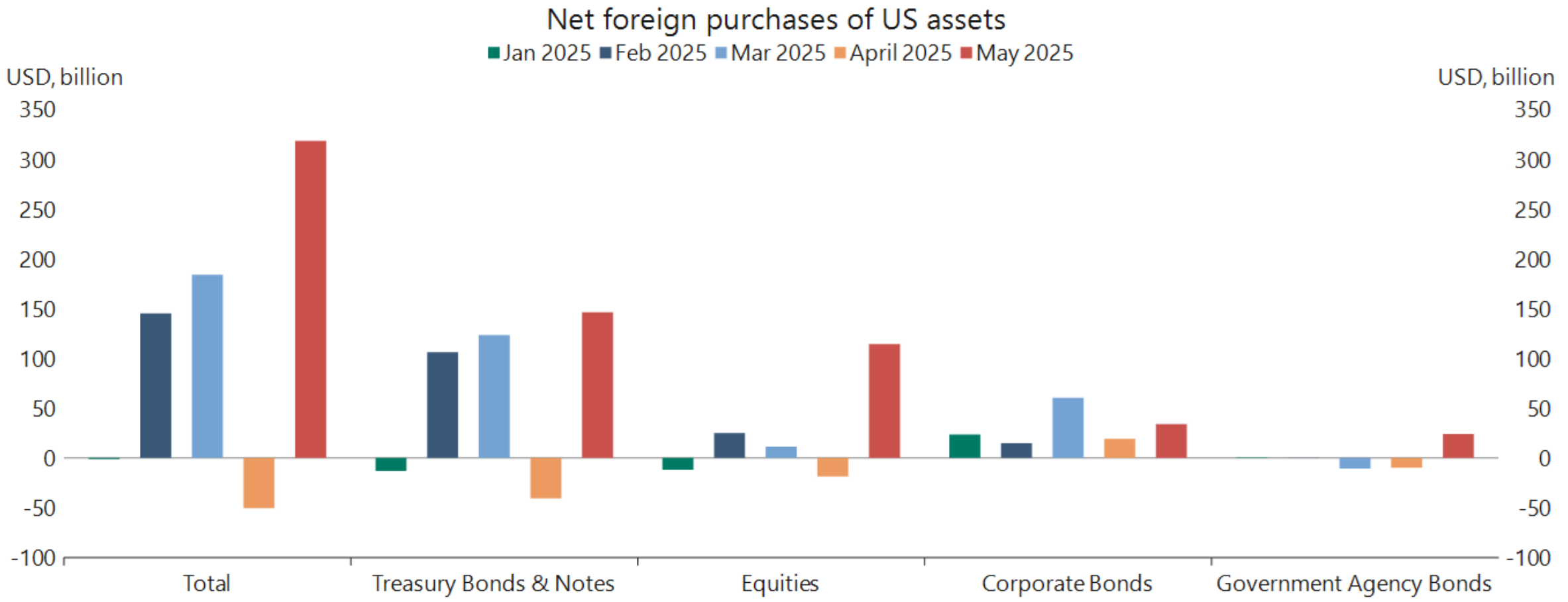
Strong rebound in foreign demand for US assets in May



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Torsten Slok joined Apollo in August 2020 as Chief Economist and he leads Apollo's macroeconomic and market analysis across the platform.

Prior to joining, Mr. Slok worked for 15 years as Chief Economist at Deutsche Bank where his team was top ranked in the annual Institutional Investor survey for a decade. Prior to joining Deutsche Bank Mr. Slok worked at the IMF in Washington, DC and at the OECD in Paris.

Mr. Slok has a Ph.D in Economics and has studied at the University of Copenhagen and Princeton University.