

Are foreign investors more cautious over the US dollar?

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The US trade tariffs announced in April 2025 initially triggered declines in US equities, Treasury bonds and the US dollar. Equities and bonds have since recovered rapidly, but the dollar's depreciation is proving more persistent and is pushing international investors to hedge their dollar currency risk.

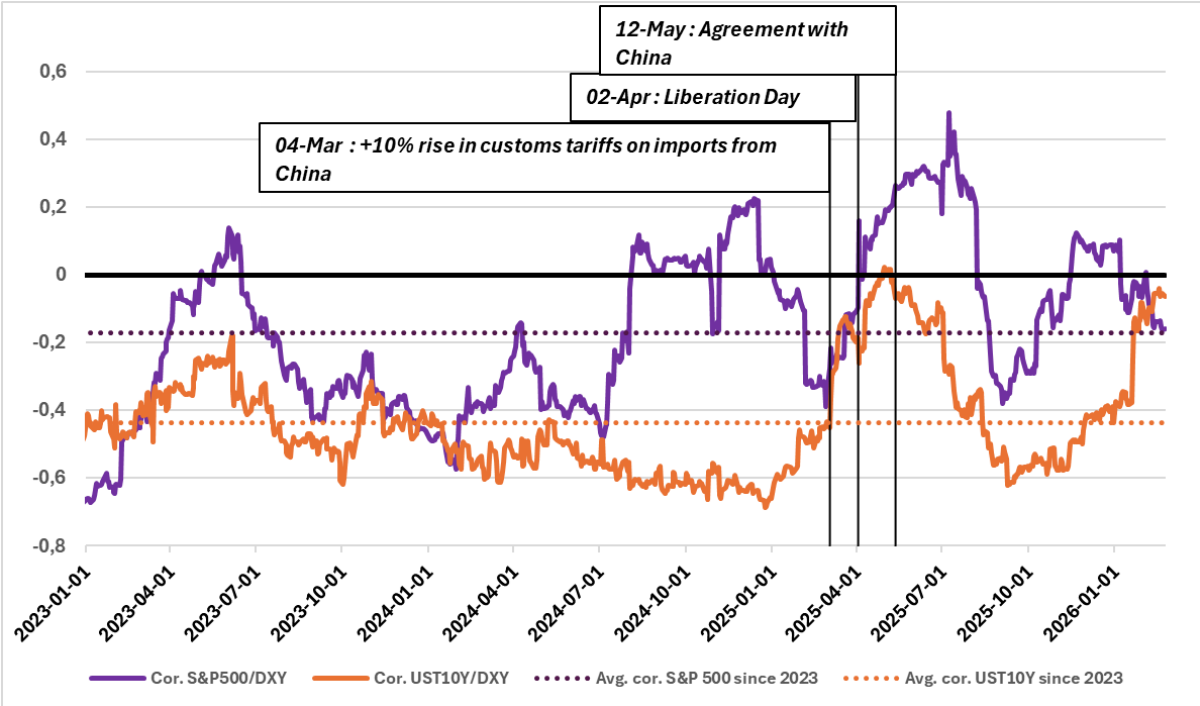
What happened after Liberation Day?

The “dollar’s natural hedge” refers to the longstanding negative correlation between US asset prices (notably those of equities and medium and long-term bonds) and the dollar exchange rate. For a non-US investor, a negative correlation between the S&P 500 and the dollar (against a basket of currencies) means that losses on US assets tend to be cushioned by a rise in the dollar against the investor’s local currency. Naturally, this also means that non-US investors earn lower returns than US investors on dollar-denominated assets when markets rise.

This implicit natural hedge began to weaken as of 4 March 2025, following the announcement of a 10% increase in US tariffs on China. The trend intensified on 2 April, when President Trump said he would apply reciprocal tariffs to the rest of the world. In the two weeks that followed, the S&P 500 shed 5%, while yields on 10-year Treasuries rose by 20 basis points to 4.33%, implying a price fall of around 1.7%. At the same time, the dollar fell by 3.5% against a basket of currencies (the DXY index, comprising six currencies: the euro, the pound sterling, the Swiss franc, the Canadian dollar, the Swedish krona and the Japanese yen). This combination of falling equity and bond prices alongside a depreciation of the dollar is unusual, and deprives non-resident investors of the natural hedge that typically mitigates their losses (see Chart 1).

Conditions began to normalise on 12 May, when the US administration said it was pausing certain tariffs on China and Hong Kong. However, the natural hedge only fully reestablished itself towards the end of August 2025. The relationship also appears more fragile than before, as seen at the start of 2026 when the correlation between the dollar and US Treasuries increased sharply amid tensions over Greenland. These developments may have prompted institutional investors and asset managers to hedge their portfolios against currency risk.

Chart 1: Disappearance of the natural hedge provided by the US dollar for the S&P 500 index and US 10-year Treasuries



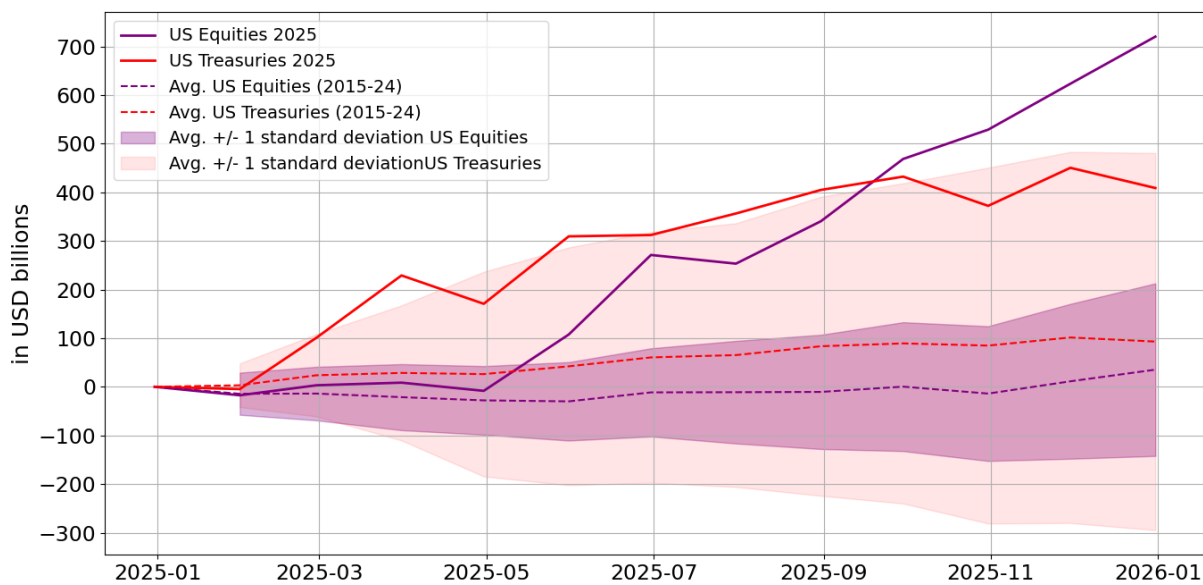
Source: Bloomberg, Banque de France calculations; correlation calculated over the previous 60 days.

Note: A negative correlation between the S&P 500 and the dollar means losses linked to a fall in dollar-denominated assets are cushioned by the dollar’s appreciation.

Foreign investors remain net buyers of dollar-denominated assets

The triple decline in Treasuries, equity markets and the dollar raised fears that non-residents would pull capital out of the United States. However, recent data suggest this is not the case, although there was a slight, temporary fall in net inflows in April 2025 (see Chart 2). According to the US Treasury Department, non-residents’ net purchases of US Treasuries remain high, exceeding the average for 2015-24. The same applies to net non-resident purchases of US equities, which are significantly higher than average (well above a standard deviation from the average).

Chart 2: Cumulative net purchases of US Treasuries and US equities by non-resident investors



Source: Bloomberg, US Treasury Department TIC system.

Note: At the end of July 2025, non-residents purchased a net total (purchases minus sales) of USD 253 billion of US equities and USD 356 billion of Treasury bills, compared with average net sales of EUR -11 billion and average net purchases of USD 65 billion respectively in the 2015-24 period.

Although President Trump’s trade policies have increased uncertainty and made US assets more volatile, a number of factors have continued to support their overall appeal:

- Gross US Treasury yields remain high, as the US bond market is the most liquid in the world and Treasuries are highly rated by credit agencies.
- US equity markets continue to perform well: the S&P 500 repeatedly hit new highs over 2025, driven notably by the “Magnificent Seven” – the seven large tech firms benefiting from the rise of AI.
- International investors see few viable alternatives.

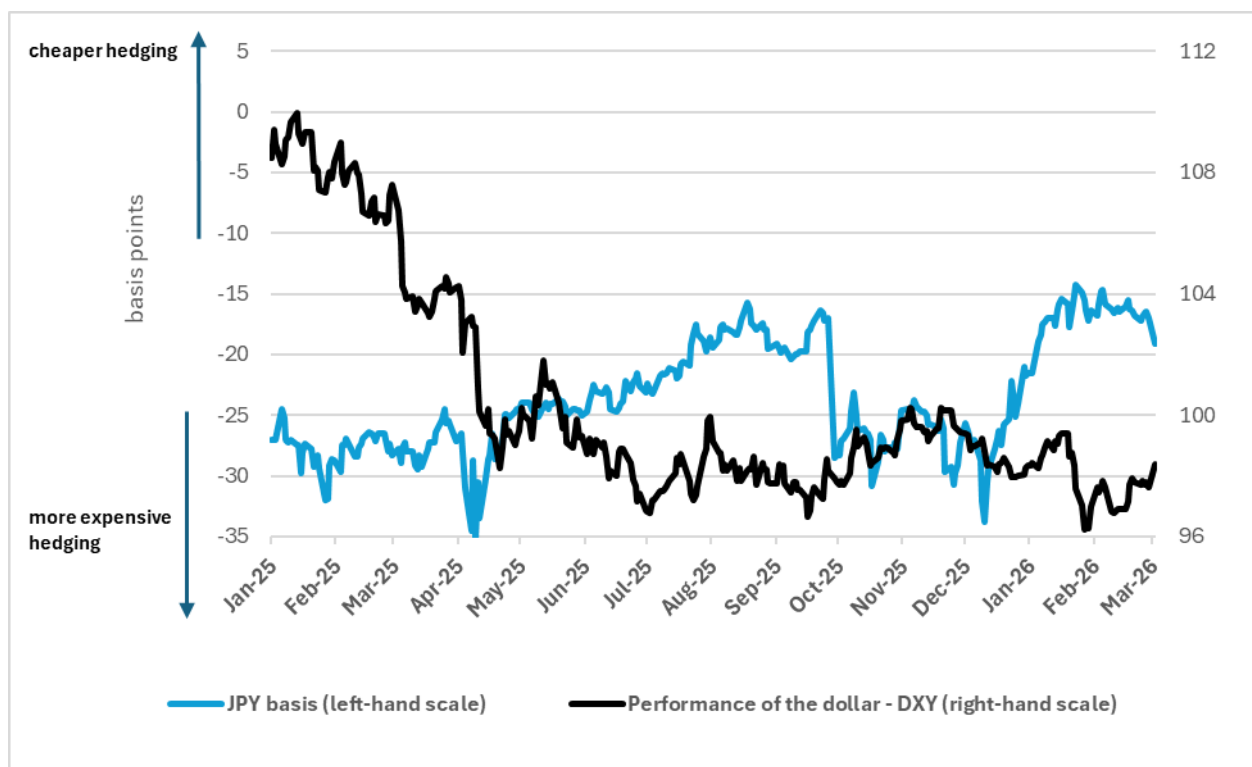
The data should nonetheless be interpreted with caution, as shifts in international portfolio allocations often take time. Regulatory and governance constraints can also slow geographical reallocations. In other words, we need to monitor the data over the longer term to see if international investors change their allocation strategies.

The depreciation of the dollar can be explained by new currency hedges

In the absence of evidence of a lasting and massive withdrawal of international investors from US assets to accompany the dollar’s slide since mid-April 2025, analysts have suggested another explanation for recent currency movements: a rise in demand for FX risk hedging.

When the Fed began raising rates in 2022, international investors showed little appetite for hedges against dollar fluctuations due to their high cost (short-term rates were higher in the United States than in countries such as Germany and Japan) and the natural hedge provided by the dollar at the time. Since the first quarter of 2025, however, and the first signs of an erosion of the dollar’s natural hedge, non-US investors have begun hedging their currency risk, notably using FX swaps. The main determinant of FX swap prices is interest rates. However, another important factor is the cross-currency basis. This basis, which generally stems from an imbalance between supply and demand for a given currency, is the premium or discount required to hedge against currency risk. The more negative the basis, the more expensive it is to hedge against the dollar’s fall. Shortly after Liberation Day, the cross-currency basis against the dollar reached a low for many currencies, reflecting strong demand among non-US investors seeking to hedge existing dollar exposures (see Chart 3). This demand is estimated to have contributed strongly to the dollar’s fall, according to a mechanism described by the [BIS \(Hyun Song Shin & Philip Wooldridge & Dora Xia, 2025\)](#): institutions selling hedges against the dollar (and thus exposed to losses if the dollar falls) hedge their positions by selling dollars in FX spot markets.

Chart 3: 3-month cross-currency basis of the Japanese yen and performance of the dollar



Source: Bloomberg.

Note: On 9 April, a Japanese investor wishing to hedge their FX risk on the dollar for three months had to pay a yield premium of 35 basis points. At the start of 2026, the premium was between 15 and 20 basis points.

Detailed data published by investors confirm this overall observation. Danish institutional investors – notably insurers and pension funds whose exposures are publicly reported and who represent around 9% of the total assets managed by European Union pension funds and insurers – have

significantly increased the hedge ratios on their dollar-denominated assets since Liberation Day in April 2025. Their hedge ratio (the share of dollar-denominated assets hedged against FX risk) has increased from around 60% in January 2025 to over 70% in December 2025.

The same can be observed for investors outside Europe. In a [speech](#) on 16 September 2025, Andrew Hauser, Deputy Governor of the Reserve Bank of Australia, said that Australian superfunds (pension funds managing the equivalent of USD 2.8 trillion) increased their hedge ratios in the second quarter of 2025 and are likely to continue doing so. This appears to be confirmed at microeconomic level in the superfunds' annual reports.

By contrast, Finnish pension funds – accounting for around 7% of EU pension fund assets under management – [kept their hedge ratio fairly stable](#) over 2025. It was already high at the start of the year, at around 70% for all currencies combined.

In conclusion, although the dollar's natural hedge has weakened, US assets remain highly attractive. However, the tariff episode has given international investors a strong incentive to reassess and strengthen their hedging strategies over both the short and long-term.