

Waiting for the US dollar turn

Sim Moh Siong
 Currency Strategist

- **The case for meaningful USD frailty not yet compelling as Fed is less keen to ease further...**
- **...even as reflation hopes, especially for non-US economies, on diminishing geopolitical stress have eroded support for the greenback**
- **Material USD depreciation requires EUR and CNY appreciation which is constrained due to a lack of proactive Euro area fiscal policy and low likelihood of tariff rollbacks**

The case is building but not yet compelling for the USD to turn materially lower in 2020.

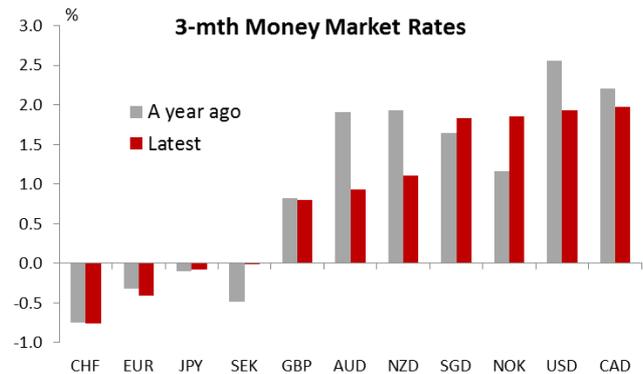
USD's safe haven status, especially against trade sensitive currencies, seems to be eroding amid a risk-supportive market environment. The USD has recently weakened on perceived decline in global risks – lower threat of no-deal Brexit and potential US-China trade truce -- which should help the global economy, especially non-US economies, to reflate.

An inverted US yield curve is possibly the most reliable indicator of an oncoming recession and it is no longer inverted. The G-3 flash Purchasing Managers' Index (PMI) for October suggests a possible stabilisation in global manufacturing growth, but it is not yet clear if a decisive recovery is in sight.

While the Fed has delivered a third consecutive 25bp rate cut, its unwillingness to commit to ease further, should cause investors to be cautious when chasing after broad-based USD weakness. Fed Chair Powell reinforced this optionality, neither suggesting a future cut or an end to the mid-cycle adjustment. We expect the Fed to remain on hold for the rest of 2019 although the Fed's sufficiently open-minded rhetoric should allow the market the luxury of pricing in a further 25bp rate cut in 2020.

The USD yield advantage has been overtaken by the CAD. However, with the Fed signalling a higher hurdle to further rate cuts, the USD's status as "too expensive to sell" is set to linger. The Fed has begun to increase its balance sheet size again to deal with front-end funding market distress. But this is unlikely to be a strong headwind for the USD as the Fed has been careful to downplay changes to balance sheet policy as "technical" in nature and not constituting Quantitative Easing (QE).

USD yield advantage has been overtaken by the CAD but it is still "too expensive to sell"



Source: Bloomberg, Bank of Singapore

A meaningful USD decline is also dependent on EUR and CNY appreciation which is constrained by the lack of a more proactive Euro area fiscal policy and comprehensive US-China trade agreement.

A Brexit resolution would help the EUR but is only one piece of the puzzle. A sustained EUR rebound also requires a convincing pivot toward fiscal stimulus in the major Euro area member states to enable EUR to overcome its status as a funding currency. While the EU's draft budget plans suggest a somewhat larger fiscal stimulus in 2020, a decisive shift to more proactive fiscal policy seems to be still politically challenging given the rhetoric from policymakers, particularly in Germany.

We have revised the 3m/6m/12m USDCNY forecast to 7.10/7.10/7.10 (from 7.25/7.25/7.20), reflecting a more neutral view, as US-China trade talks continue to signal progress. This could result in US-China Phase I trade deal being signed soon although officials will have to look for an alternate venue after Chile cancelled the APEC summit.

A sustained break of USDCNY below 7 may be difficult unless existing tariffs on China's imports is rolled back by the US – the hurdle for this to happen is high for now. We are also mindful of the potential tensions from the possible introduction and passage of the Hong Kong Human Rights and Democracy Act in the US Senate, a bill which the US House of Representatives has already passed.

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