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# Stable But Firm Dollar Set to Continue

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## Key takeaways

- *We expect the dollar to remain relatively stable but firm versus major developed market currencies for the rest of 2019 and into 2020, which is in line with the current price action.*
- *Emerging market currencies may not repeat 2018's large falls, but they are unlikely to recover strongly in the current environment of slowing global growth, rising geopolitical risks, and escalating trade disputes.*

## What it may mean for investors

- *Our stable dollar view suggests limited gains in international equity markets, while deeply negative yields in the euro and yen make the U.S. interest-rate advantage all the more attractive. And although gold has tracked the dollar's move higher this year, platinum and silver may offer more value to investors.*

While the U.S. dollar has appreciated this year, our foreign exchange targets for the euro and yen reflect our view for the dollar to remain steady through the rest of this year and into 2020. This comes as the euro is currently trading near $1.10–1.11, and the U.S. dollar is worth around 106-107 yen. Our year-ahead target ranges are $1.08–1.16 per euro and 100–110 yen per dollar, so current spot rates are near the mid-points of these ranges. The euro and the yen, along with the British pound, are the largest constituents of the U.S. dollar index (DXY), one of the main indices for the dollar's exchange value. Our targets also imply an approximate range for the DXY on twelve-month horizon of 94–102, compared to a current spot level of 98–99.

### Factors affecting the U.S. dollar

Considering the multiple economic, policy, and geo-political risks to markets this year, on top of fears that trade disputes may spill over into currency wars, the dollar has been stable, whilst very gradually edging higher. This does not reflect investor inactivity or lack of interest on the part of traders, but rather what we see as an uneasy balance of market factors that could potentially drive the dollar higher or lower. This may be an unsustainable equilibrium in the long run, but we expect it to continue for now. Factors potentially pushing the dollar higher include euro weakness driven by sluggish Eurozone manufacturing and expectations of renewed European Central Bank rate cuts.

Further, the dollar is supported by continual flows into U.S. assets, motivated by both "perceived safe-haven" demand at times of volatility and a global hunt for yield where the vast bulk of positive-yielding bonds are dollar denominated. On the other hand, investor concerns have held the dollar back from rapidly appreciating. Most currency valuation models see the dollar as overvalued in terms of purchasing power parity or the real effective exchange rate. And investors' perceptions of overvaluation are compounded by expectations that the Federal Reserve may continue to cut rates and fears of a change in U.S. currency policy towards favoring a weaker dollar.

## Investment implications

As for other major developed market currencies, the British pound may remain under pressure until uncertainties surrounding Brexit are resolved. The possibility of a damaging "no-deal" Brexit might send the pound sharply lower and would also hurt the euro. Market volatility driven by trade escalation, Brexit, or multiple other factors should continue to support safe-haven currencies of major global creditor nations, such as the Japanese yen and the Swiss franc.

We also expect the dollar to remain relatively stable but firm against major emerging market (EM) currencies. We do not foresee a repeat of last year's large falls in EM foreign exchange rates, but it seems unlikely that EM currency indices can rally significantly in the current environment of slowing global growth and rising geopolitical risks. The latest escalation in the U.S.-China trade dispute and the possibility of further managed depreciation of the Chinese yuan increases the downside risks to EM currencies in this respect.

A stable to firmer dollar will mean that returns to developed market equities will likely not be enhanced by currency gains. The risk of volatility in EM currencies may be one factor restraining EM equity indices. For bonds, deeply negative yields in euro and yen make the U.S. interest-rate advantage all the more attractive; plus, the perception of safe-haven appeal of the U.S. dollar's global reserve status, leading to inflows into U.S. fixed income, may keep yields lower and investment-grade spreads tighter than they otherwise would be. Gold is often considered an alternative currency. And while a strong U.S. dollar can often be a drag on gold prices, it hasn't been in 2019. In fact, the growing volume of negative yielding debt that is helping to strengthen the dollar has also pushed gold to 6-year highs, and we encourage investors to look at cheaper alternatives, such as platinum or silver.

**Economic Calendar**

| Date | Country | Report | Estimate | Previous |
|---|---|---|---|---|
| 9/10/2019 | FRANCE | Industrial Production YoY | -- | 0.00% |
| 9/10/2019 | AUSTRALIA | Westpac Consumer Conf SA MoM | -- | 3.60% |
| 9/11/2019 | US | PPI Final Demand MoM | -- | 0.20% |
| 9/11/2019 | US | PPI Final Demand YoY | -- | 1.70% |
| 9/11/2019 | US | PPI Ex Food and Energy YoY | -- | 2.10% |
| 9/11/2019 | US | PPI Ex Food, Energy, Trade YoY | -- | 1.70% |
| 9/11/2019 | MEXICO | Industrial Production NSA YoY | -- | -2.90% |
| 9/12/2019 | US | Initial Jobless Claims | -- | -- |
| 9/12/2019 | US | Monthly Budget Statement | -- | -$119.7b |
| 9/12/2019 | US | CPI YoY | -- | 1.80% |
| 9/12/2019 | US | Continuing Claims | -- | -- |
| 9/12/2019 | US | CPI Ex Food and Energy YoY | -- | 2.20% |
| 9/12/2019 | US | CPI Core Index SA | -- | 263.569 |
| 9/12/2019 | US | Real Avg Hourly Earning YoY | -- | 1.30% |
| 9/12/2019 | JAPAN | Tertiary Industry Index MoM | -0.30% | -0.10% |
| 9/12/2019 | EUROZONE | ECB Main Refinancing Rate | 0.00% | 0.00% |
| 9/13/2019 | US | U. of Mich. Sentiment | -- | -- |
| 9/13/2019 | US | Import Price Index MoM | -- | 0.20% |
| 9/13/2019 | US | Retail Sales Ex Auto and Gas | -- | 0.90% |
| 9/13/2019 | US | Business Inventories | -- | 0.00% |
| 9/13/2019 | US | Import Price Index YoY | -- | -1.80% |
| 9/13/2019 | US | Export Price Index YoY | -- | -0.90% |
| 9/13/2019 | JAPAN | Industrial Production YoY | -- | 0.70% |
| 9/13/2019 | EUROZONE | Trade Balance SA | -- | 17.9b |
| 9/13/2019 | US | U. of Mich. Expectations | -- | -- |
| 9/15/2019 | CHINA | Industrial Production YoY | -- | 4.80% |
| 9/16/2019 | US | Empire Manufacturing | -- | 4.8 |
| 9/16/2019 | ITALY | CPI EU Harmonized YoY | -- | -- |

Source: Bloomberg as of September 10, 2019.

## Risk Considerations

Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. Investing in **gold**, silver or other precious metals involves special risk considerations such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry.

Currency risk is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline.

Definitions

An index is unmanaged and not available for direct investment.

**U.S. Dollar Index** (DXY) measures the value of the U.S. dollar relative to majority of its most significant trading partners. This index is similar to other trade-weighted indexes, which also use the exchange rates from the same major currencies.

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