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FX FOCUS

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US dollar

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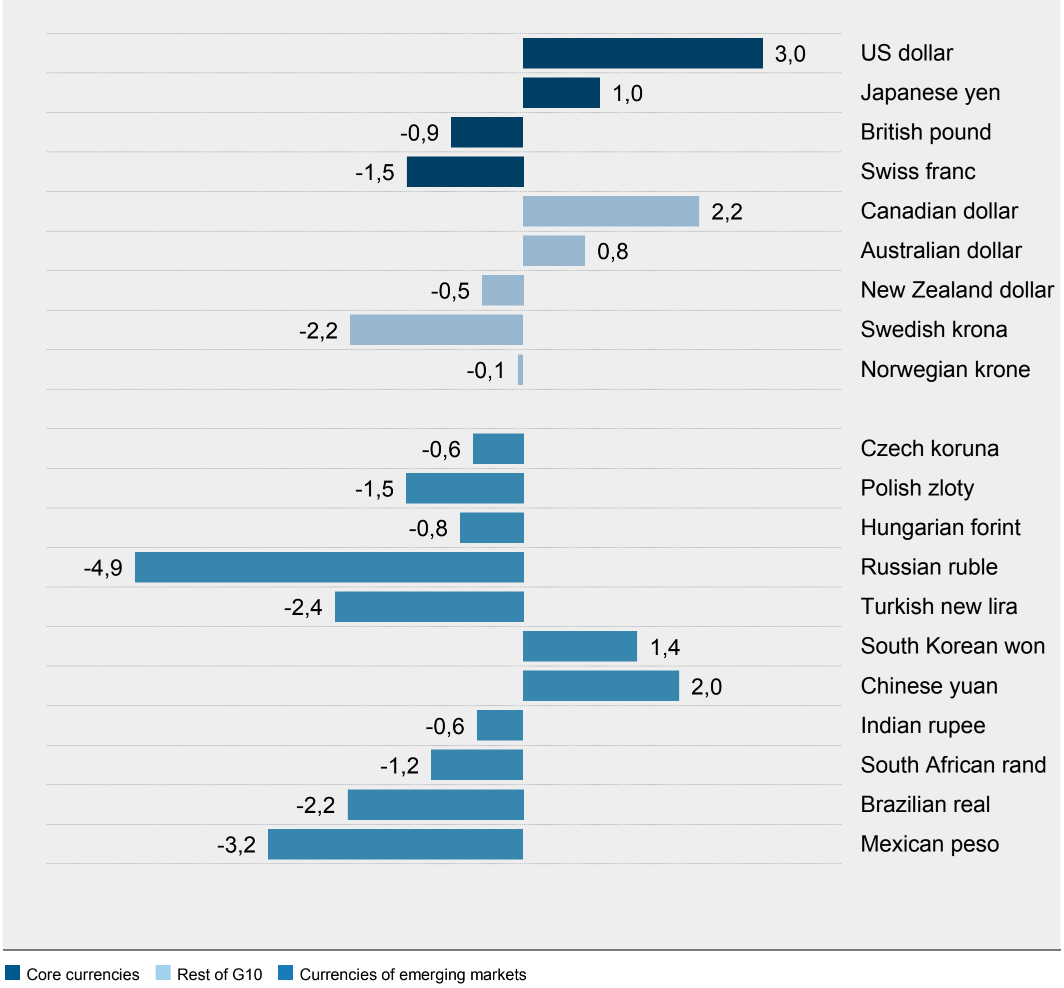
- The US dollar was most recently the big winner. The Swiss franc and the Swedish krona depreciated disproportionately. Emerging market currencies were broadly under pressure.
- The US dollar has overcome its phase of weakness for now and made up this year's losses. Although structural burdens like the growing budget deficit and the current account deficit remain in place, as does the US government's protectionist policy, these factors are overlaid this year by the cyclical tailwind for the US dollar. Further rate hikes and a high yield advantage continue to provide a boost to the Greenback. The euro-dollar exchange rate should fall down to 1.15.
- Helaba Currency Forecasts

Performance on a month-over-month basis

% vs. euro compared to the previous month (from 04/06 to 05/07/18)



Sources: Bloomberg, Helaba Research

USD: cyclical tailwind

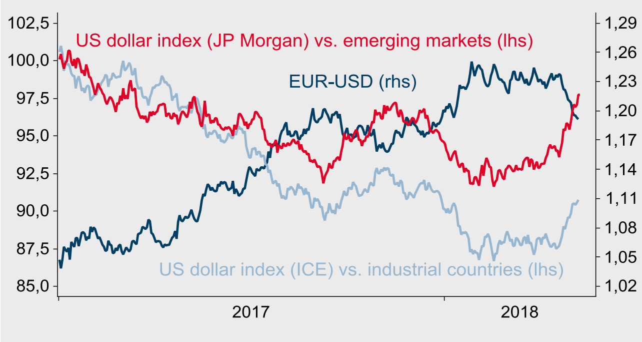
The US dollar seems able to turn the corner, after all. Every couple of years, the US currency faces the threat of its demise. This time, rising budget and trade deficits in the US, as well as the protectionist policy of the Trump administration, were supposed to inflict massive damage on the Greenback. And the US dollar did in fact suffer substantial losses in 2017 and at the beginning of 2018. However, after months of settling between 1.22 and 1.25, the euro-dollar exchange rate dropped most recently even below 1.20. The Greenback has lately also recorded a plus against the Japanese yen and many other currencies – especially those from emerging markets. Were the concerns about the US dollar once again greatly exaggerated?

US debt mountain growing

As a result of the tax cuts and higher government spending, the federal budget deficit in the US will grow. At around 5 % of GDP, the deficit will be at a high level relative to the country's own history and especially compared to the euro zone. Over the next ten years, the US debt mountain – the federal debt alone, not counting the individual states and local governments – will approach the 100 % mark as measured against the GDP. However, rising debt does not automatically lead to a depreciation of the currency. According to the textbooks, a higher deficit and the rise in interest rates that comes with it even lead to an appreciation.

US dollar starting to catch up

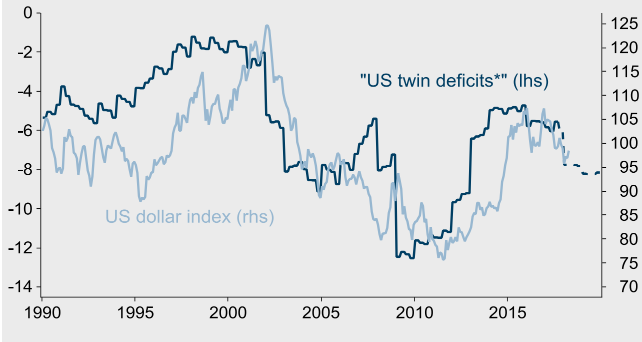
Index, indexed 01.01.2017 = 100 USD



Sources: Macrobond, Helaba Research

"Twin deficits" a blemish on the dollar... long-term

% points of GDP Index



* Sum from US current account balance and budget balance (federal government); Sources: Macrobond, Helaba Research

The current discussion is about the "twin deficits" in the US, that is, the sum of the budget and the current account deficits. The latter is influenced above all by the development in foreign trade. Here, at least, theory posits a clear connection between a larger deficit and a weaker currency. The accumulation of current account deficits is causing the level of foreign debt to rise. And the US needs to generate the income to service that debt. Over the long term, that could become increasingly difficult.

US current account deficit not at critical level

In the past there was a connection – rather loose, to be sure – between higher twin deficits and a weaker US dollar. 2017 the US deficit in the current account deficits stands at around 2.5 % of GDP, which is just below the average of the last thirty years. The governmental demand impulses will not invariably lead to markedly higher deficits. As a result, the negative effects for the US dollar should be reasonably contained overall.

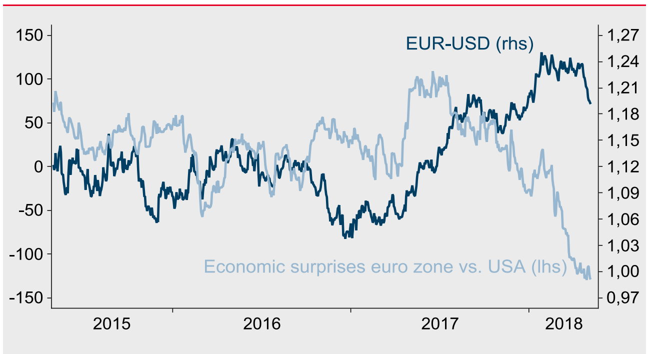
The US government's protectionist stance can weaken the currency indirectly. By themselves, punitive tariffs did not argue for a currency depreciation. Strictly speaking, tariffs and depreciations are even substitutes. Accordingly, the trade restrictions should in fact result in an appreciation. However, the wish for a weaker US dollar could become important, especially if, on account of that, the monetary policy remains fairly loose. Although the US central bank is not free from political influences, its official independence notwithstanding, at the moment it does not look like the Federal Reserve will respond to those influences. On the contrary: the US central bank is gradually raising its key rates.

Cyclical divergences

The US economy overall continues to hum along. In spite of the somewhat lower rate for the first quarter (at an annualized 2.3 %), growth in 2018 should accelerate to 2.8 % in 2018 – even if dearly paid for with fiscal impulses. The unemployment rate actually dropped to an 18-year low. Things look different in the euro zone, which, surprisingly enough, was still able to outdo the US in GDP growth last year. The dynamism has probably passed its peak in the euro zone. Not only did the sentiment indicators are pointing down, but real growth also slowed noticeably in the first quarter. While inflation in the US is visibly picking up speed, in the euro zone it has so far barely accelerated. No wonder, that the ECB is moving very cautiously and is not holding out the prospect of interest rate hikes this year. By contrast, the US central bank is pushing its cycle of rate hikes. For the year as a whole, the Fed will presumably even carry out four rate hikes. The US yield advantage expanded accordingly – by now to a 29-year high for both ten-year and two-year maturities. This argues clearly in favour of the US currency, even if the currency market barely rewarded this factor in recent months.

Economic momentum supports the US dollar

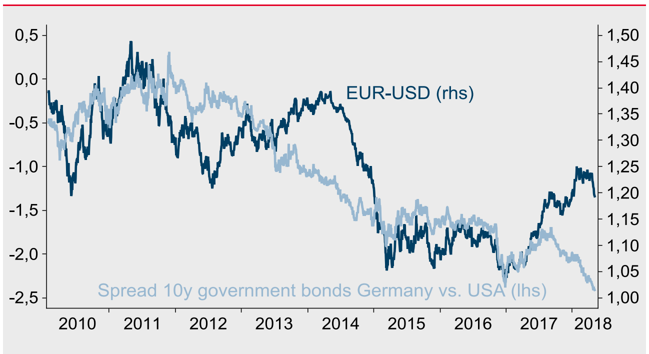
Difference of indexes USD



Sources: Macrobond, Helaba Research

US yield advantage now relevant, after all

% points USD



Sources: Macrobond, Helaba Research

1.15 in view

Yes, the US currency is suffering from a few structural problems, which will be set for resubmission in the future. However, these problems do not seem so serious that the Greenback has to suffer a massive lean period. These rather long-term factors are being overlaid for the time being by the cyclical tailwind for the US dollar. At the moment, the US dollar can make the most of is substantial yield advantage over the euro. As a result, the euro-dollar should decline noticeably. Since speculative investors are still betting one-sidedly on the euro, the unwinding of these positions can then lead to a pronounced correction in favour of the US dollar. The euro-dollar exchange rate will presumably drop to 1.15, and even lower levels cannot be ruled out temporarily.

Helaba Currency Forecasts

	Performance year to date	1 month	current*	Forecast horizon at end ... Q2/2018	Q3/2018	Q4/2018	Q1/2019
vs. Euro	(vs. Euro, %)						
US dollar	0,7	3,0	1,19	1,15	1,15	1,15	1,20
Japanese yen	4,0	1,0	130	125	125	123	125
British pound	1,0	-0,9	0,88	0,90	0,90	0,85	0,85
Swiss franc	-2,1	-1,5	1,20	1,15	1,17	1,15	1,15
Canadian dollar	-1,7	2,2	1,54	1,50	1,47	1,47	1,51
Australian dollar	-3,1	0,8	1,59	1,49	1,47	1,47	1,50
Swedish krona	-6,6	-2,2	10,53	10,10	9,90	9,70	9,50
Norwegian krone	2,3	-0,1	9,62	9,00	8,90	8,80	8,80
Chinese yuan	2,8	2,0	7,59	7,48	7,48	7,48	7,68
vs. US-Dollar	(vs. USD, %)						
Japanese yen	3,3	-2,0	109	109	109	107	104
Swiss franc	-2,8	-4,3	1,00	1,00	1,02	1,00	0,96
Canadian dollar	-2,4	-0,8	1,29	1,30	1,28	1,28	1,26
Swedish krona	-7,4	-5,0	8,84	8,78	8,61	8,43	7,92
Norwegian krone	1,7	-3,0	8,07	7,83	7,74	7,65	7,33
Chinese yuan	2,2	-1,0	6,37	6,50	6,50	6,50	6,40
US-Dollar vs. ...	(vs. USD, %)						
British pound	0,3	-3,8	1,36	1,28	1,28	1,35	1,41
Australian dollar	-3,7	-2,2	0,75	0,77	0,78	0,78	0,80

*07.05.2018

Sources: Bloomberg, Helaba Research ■