

## FX: Dollar to defy seasonal trends

November and December are normally soft months for the dollar. This year, however, the tailwind from strong US growth and hawkish Fed policy should keep the dollar bid through to year-end



US macro outperformance has been the driving factor behind the recent strength in the dollar, lending additional credibility to the Federal Reserve's hawkish position

### Fed-driven dollar weakness will be a story for 2024

The dollar opens November close to the highs of the year. Normally, November and December are soft months for the dollar. This year, however, it is hard to see the dollar giving back its gains before year-end.

Driving that dollar strength continues to be US macro outperformance, which lends credibility to the Federal Reserve's hawkish position. The recent rise in US rates has largely come at the long end of the curve and has so far made little difference to the dollar. The view is that tighter US financial conditions are hardly good news for pro-cyclical currencies in Europe or Asia.

Equally, it seems too early for investors to view the sell-off in Treasuries as a dollar negative. There have been brief occasions in the past where the dollar has had a negative correlation with US yields – but these occasions have been few and far between. Instead, a disorderly rise in US yields is largely viewed as a risk-negative, dollar-positive event.

In fact, the most likely path to a weaker dollar will probably have to come from softer US macro data. The route to a weaker dollar through a re-rating of Chinese or European growth prospects

looks unlikely. And even if high US rates prompted something to 'break' somewhere in the financial sector, the first move in the dollar would be higher as dollar funding conditions would invariably tighten – albeit temporarily.

Given our house view that a US slowdown is more likely in the next quarter rather than this one, we therefore expect EUR/USD to end the year around this 1.05/1.06 area and USD/JPY to end the year not far from 150. Into 2024, however, we expect the short end of the US curve to start moving lower ahead of Fed easing next summer and the dollar to turn lower.

We are also cognisant of the risk that Fed easing does not always deliver a higher EUR/USD. For example, the Fed cut rates nearly 500bp in 2001 and EUR/USD went nowhere. Our forecast for a eurozone recession, a difficult return of the Stability and Growth Pact, and the ongoing threat of a geopolitical spike in oil prices present downside risks to our view of a Fed-driven rise in EUR/USD to 1.10 next summer and 1.15 by year-end 2024.

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