

## FX: Timing the dollar decline

The dollar is around 10% off the highs seen in late September, and understandably the view is that the dollar bull cycle – which started summer 2021 – is well and truly over. Consensus expects the dollar to weaken further this year, and we agree



### Dollar bear trend could pick up speed in the second quarter

At the heart of the bearish dollar view is the call that the Fed will shift to a reflationary stance in the second half of 2023, US short-dated yields will fall and those yield differentials will move against the dollar. This story should be particularly acute for EUR/USD, where sticky core inflation in the eurozone means that the European Central Bank will not be considering rate cuts until late 2024.

At the same time, lower natural gas prices have seen the eurozone terms of trade improve markedly and justify fundamentally higher levels of the euro. Assuming that the China reopening story continues to evolve positively, we think this confluence of factors can drive EUR/USD steadily higher throughout 2023. Most of the gains, however, may come in the second quarter, when US inflation is seen falling quite sharply.

Sustained EUR/USD gains beyond 1.15 may be harder to achieve in the second half – especially if US debt ceiling negotiations are pushed to the limit. Some would argue that the US debt ceiling is a

bullish factor for the dollar – prompting a flight to quality. Yet the evidence from 2011 proves the contrary. Only were the US very close to an unthinkable sovereign debt default – i.e. extreme risk aversion – would the dollar derive any brief benefit.

USD/JPY should continue to fall throughout the year. Bank of Japan meetings will prove positive event risks for the yen as investors second-guess how quickly a new BoJ governing team will unwind the current very dovish settings. We target 120 here and the yen should outperform on the crosses whenever the benign investment conditions are challenged.

Sterling is trading on a slightly steadier footing as the UK government attempts to restore fiscal credibility. The marginally better global investment environment is also helping the risk-sensitive pound. Sterling may hold its gains through the first half of the year as the Bank of England stays hawkish. But clearer signs of easing labour market and price pressures in the second half of 2023 will see conviction build of a forthcoming BoE easing cycle. EUR/GBP may well be ending the year nearer 0.90/91.

## Author

### Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

[chris.turner@ing.com](mailto:chris.turner@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.