

## 10 REASONS FOR A WEAK DOLLAR IN 2018



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*“The US dollar will continue its weakening trend during 2018, and we target 1.30 against the EUR.”*

### SUMMARY

The US dollar, traditionally a safe haven currency during volatile times, has been trading near multi-year lows. We believe that there is further downside during this year and we explain the main points below.

We expect the dollar to weaken in the second half of the year, with a target of 1.30 against the EUR at the end of 2018. Here are the reasons that support that view:

The Federal reserve’s (Fed) path to tighter financial conditions is now largely priced-in by the markets, while on the contrary, normalization of policy from the European Central Bank (ECB), Bank of England (BoE) and Bank of Japan (BoJ) has not or has hardly begun (the ECB and the BoJ are still keeping up with the Quantitative Easing!).

The transition to a cycle of gradual interest rate increases from other major central banks will be key for the foreign exchange market which will, in relative terms, make the greenback less attractive.

In a context where the European and Japanese economies are also less advanced in their expansion cycle than the US economy, and where the Euro Zone and Japan have current account surpluses of around 3% of their GDP, economic fundamentals point to a phase of strengthening of the Euro and, after, of the Yen, against the dollar and the American “twin deficits” (external and budgetary).

### Euro and Yen advance against the dollar



Source: Bloomberg, SYZ Asset Management  
Data as at: 15 March 2018

Assuming a continuation of synchronized global growth and the gradual normalization of monetary policies in Europe and Japan, the financial flows that have supported the Dollar in recent years should reverse. With negative 10-year Bund or 10Y Japanese Government Bond (JGB) rates, European and Japanese bond investors had been pushed towards US Treasury bonds in order to generate returns. Now, the cost of hedging FX EUR/USD and JPY/USD makes this diversification much less interesting, especially with positive Bund (and, possibly one day, JGB) rates.

Valuations of the European and Japanese equity markets are less strained than those of the US market and their growth potential appears to be greater given the stages of their economic cycle.

Donald Trump’s announcement of the introduction of import taxes on steel and aluminum only adds an additional factor to this trend as this action seems to be implicitly aimed at weakening the Dollar, and in fact accelerating this dynamic. In addition, the US “tax reform” indicates an increase of fiscal deficits, which tend to lead to a weaker dollar

China is not allowing the value of the renminbi to fall, as Beijing worries about being accused of currency manipulation. At the same time the People’s Bank of China is not buying as many US Treasuries as it usually does.

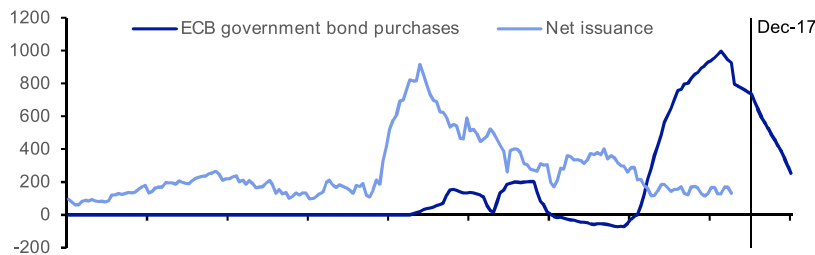
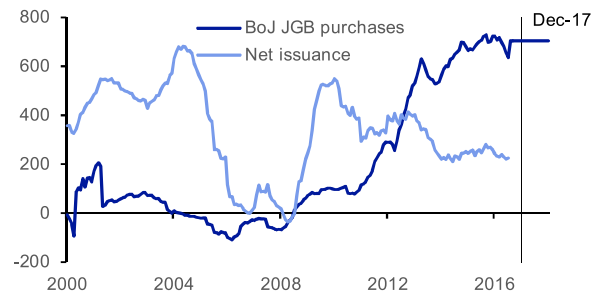
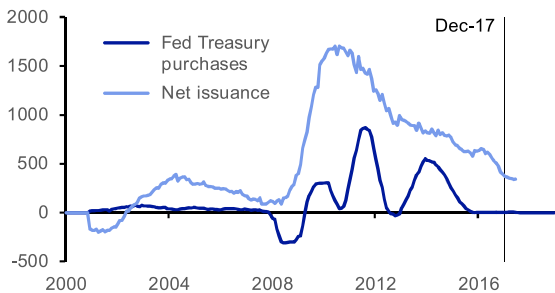
The ECB, and BOJ government bond purchases were above net issuance, contrary to the Fed treasury purchases that never exceeded net issuance. This situation forced domestic buyers of government bonds such as insurances and pension funds to increase their exposure to foreign bonds, essentially US treasuries. As a result, normalization from the ECB could apply upward pressure on European rates and strengthen the currency.

**The Renminbi is strengthening against the dollar**



Source: Bloomberg, SYZ Asset Management  
Data as at: 5 April 2018

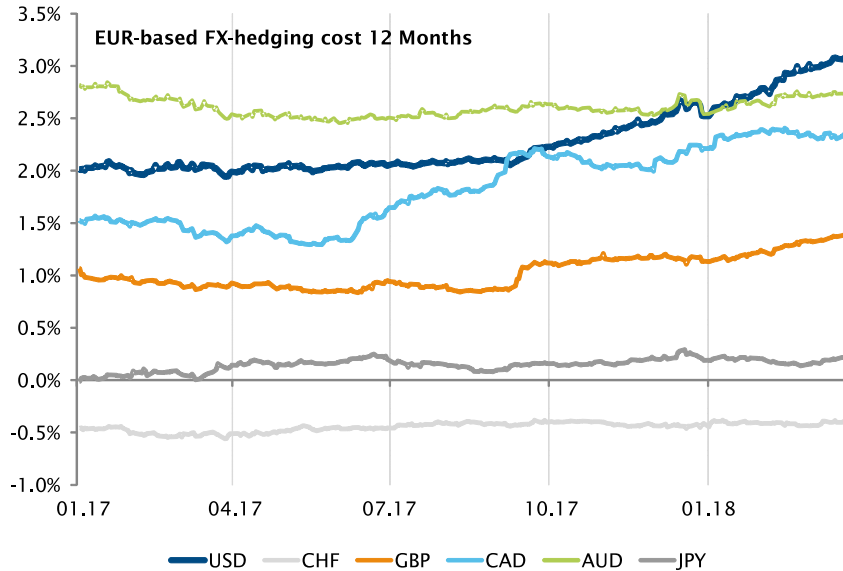
**UST Issuance was always above QE but they moved in tandem. ECB QE has dwarfed issuance but the gap will narrow massively in 2018...**



Source: Deutsche Bank, Haver, Global Financial Data, Bloomberg, SYZ Asset Management  
Data as at: 31 December 2017

Finally, the cost of hedging USD risk has increased meaningfully since the last quarter of 2017, which makes investments in US treasuries from European or Japanese investors costly.

**Hedging cost is increasing**



Source: Bloomberg, SYZ Asset Management  
Data as at: 12 March 2018

It should be noted that this kind of trend rarely develops “in a straight line” and that correction phases, after rapid movements and/or depending on the economic/political/central banks schedules can come to feed sometimes considerable rebounds. The elements mentioned above though, underpin our belief of a continued Dollar weakening trend.