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DXY: Can USD's Pole Position be Challenged?

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Mid-cycle Adjustment Can Make Up of More than One Rate Cut

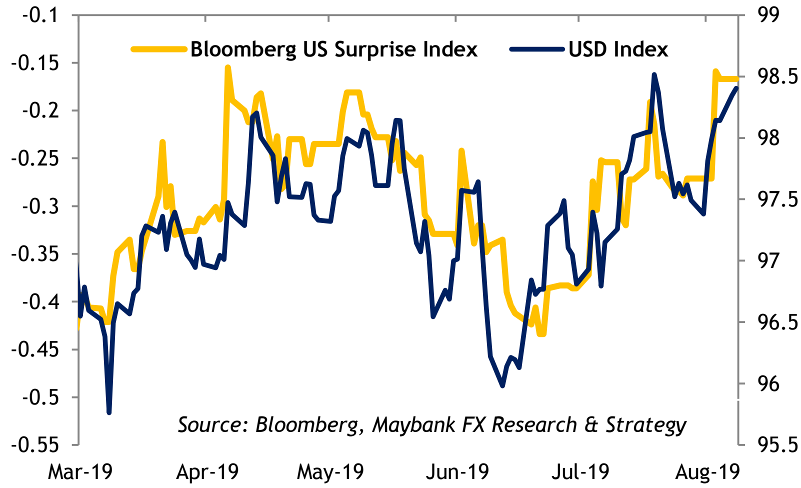
The key event (or perhaps even a non-event) risk this week is the annual Economic Symposium hosted by Federal Reserve Bank of Kansas City at Jackson Hole, Wyoming on 22 – 24 Aug). Main focus is on Fed Chair Powell's keynote speech on the Challenges for Monetary Policy, scheduled at 10pm SG/KL time on 23/Aug (Fri). **Markets are expected to look out for hint for any shifts or continuity from its last known stance at the FoMC meeting on 31 Jul.**

Recall at the last FoMC, the Fed cut 25bps to bring Fed fund target range lower to 2% - 2.25%. The Committee also ended the balance sheet reduction in Aug, two months earlier than planned. In particular **Powell said that this is a "mid-cycle adjustment to policy"** and **"should not be seen as the start of a lengthy easing cycle"**. But he did clarify that **he didn't say it's just one cut or anything like that** (giving him the wiggle room to cut again).

While markets are already expecting the Fed to cut again by 25bps at the next FoMC (18 – 19 Sep), question remains if the cut (if materialises) represents just another mid-cycle adjustment (policy stance continuity) or has a new easing cycle (a dovish shift) just begun?

Indeed at this point, it may be **hard to argue that the data-dependent Fed will signal a shift in its stance**. US data since the last FoMC has not drastically shown any weakening in economic conditions that justify for Fed to make a significant shift in policy stance. Though ISM manufacturing and non-manufacturing softened in Jul, they remain in expansionary territories. On data negatives, industrial production and Uni. of Michigan sentiment index came in weaker. But on the other hand, other activity and price indicators such as US ISM new orders, empire manufacturing, Philadelphia Fed business outlook, retail sales, CPI and average hourly earnings came in better than expected.

Downside Surprise to US Data Could Drag DXY Lower

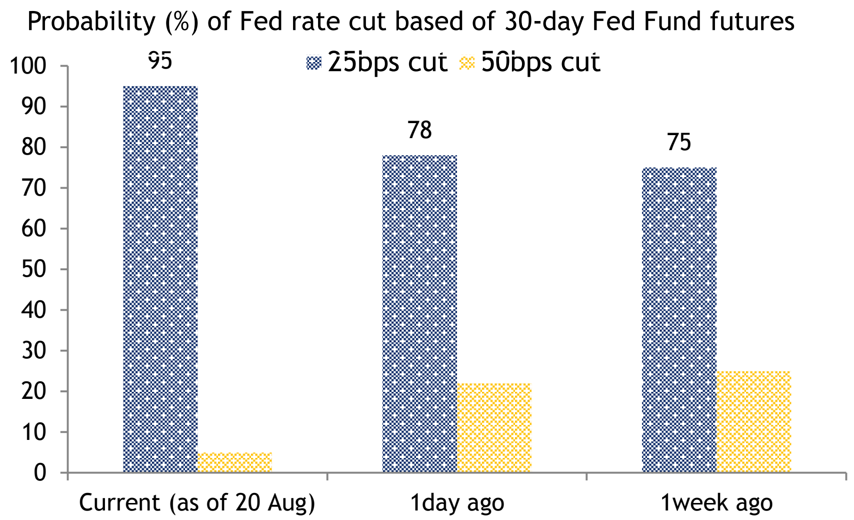


Source: Bloomberg, Maybank FX Research & Strategy

Can Dollar's Pole Position be challenged?

This resonates with Boston Fed Rosengren's (one of the two dissenters in the last FoMC) recent comments during an interview on Bloomberg TV earlier (20 Aug). He expects US growth to be closer to 2% for 2H 2019 and acknowledged that global conditions are weaker. And while global economies are weak, the cure is for foreign countries to stimulate their own economies rather than just the US doing the easing. He also said "we have to be careful not to ease too much when we don't have significant problems" (as lower interest rate reduces the cost of borrowing and could encourage businesses and households to increase their leverage and this could amplify the pains of any recession). He basically **wants evidence of slowdown to justify rate cut** and would only **make up his mind about monetary policy just before the Sep FoMC**. He however did say that he **could change his mind and support a rate cut if there are signs that consumer spending is slowing down**.

Markets Expectations for 50bps Cut Scaled Back



Source: CME Group Fedwatch Tool, Maybank FX Research & Strategy

In essence, hopes for a larger than 25bps cut were dampened. CME Fed watch tool now shows only 5% chance (vs. 22% chance yesterday) of 50bps cut. Indeed the **USD may well remain broadly supported** in the environment of (1) Fed less likely to cut as much as markets and Trump have hoped; (2) most economies including China, Germany, Singapore etc. suffering growth slowdown amid damage inflicted by US-China trade war and (3) political uncertainties in UK (Brexit), Italy (snap elections).

That said it **does not mean that USD's pole position cannot be challenged in the near term.** With markets scaling down expectations for 50bps cut (95% now look for 25bps rate cut) to just 25bps cut and the USD back up near 2019-high, we believe the room for further DXY upside may be limited. We argue that **risk-reward perspective may favor short term play to lean against DXY strength**. Downside could have more runway only if Powell surprises with more dovish rhetoric. Elsewhere softer US data may also help to limit USD strength – watch US prelim PMIs on Thu. Given that Trump's repeated calls for Fed to cut rates by at least 100bps (20 Aug) continued to fall on deaf ears (can't blame the Fed as Fed asserts for central bank independence), there could be some risk of US Treasury potentially intervening to sell USD or change in USD policy (though we see this as a relatively low risk at this point).

Dollar Index (DXY) Supported but Overbought

Month-to-date, DXY has managed to claw back nearly most of its decline (~1.5%) in early-Aug and was last seen near-2019 highs again ahead of Jackson Hole Symposium. DXY was last seen at 98.37 levels. Directional bias remains skewed to the upside but stochastics is approaching overbought conditions on the daily chart. A mini rising wedge appears to be in the making – this is typically associated with a bearish reversal. Resistance at 98.50/70 levels before 98.93 (2019 high). Bias to sell rallies. Support at 97.92 (21 DMA), 97.40/50 (50, 100 DMAs) and 97 levels (200 DMA). A decisive break below 200DMA is needed for more downside to come into play.

DXY (Daily Chart): Tactical Bias to Sell Rallies

Source: Bloomberg (as of 20 Aug), Maybank FX Research & Strategy

Nonetheless we still caution that upside risks to DXY remain: (1) if Powell surprises with a hawkish assessment of economic and policy outlook; (2) external risks such as Germany unable to pass through fiscal spending plans to address economic softness, Italy snap elections, Brexit fall-out with EU, etc.

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