Macro | FX Research and Strategy

Global

FX Insight

DXY: Fade Away on Dovish Fed

Prolonged Fed Pause... Stale USD Longs to Unwind?

Dollar fell against most currencies after Fed was perceived to be more dovish than expected. Though the Fed target range of 2.25% - 2.50% was kept unchanged as widely expected, there were a few changes in terms of forward guidance.

In particular, Fed lowered the dots plot down to signal no more rate hike for 2019 (down from 2 previously) - this was more dovish than expected. We were cautioning for the chance of Fed lowering its dots guidance for 1 hike this year. Looking out, Fed is expecting just 1 hike for 2020. This is in line with our call that Fed nearing the end of tightening cycle implies there is limited room for Fed to tighten.

On balance sheet normalisation, Fed plans to slow the pace of normalisation in May and end normalisation in Sep. Financial conditions are expected to ease.

Fed Chair Powell added that rates could be on hold for "some time" as global risks weigh on the economic outlook and inflation remains muted.

We had shared that a prolonged Fed pause could further weigh on USD, especially when USD-long position is near 2019-high. Unwinding of stale USD longs could accelerate USD sell-off.

Analysts

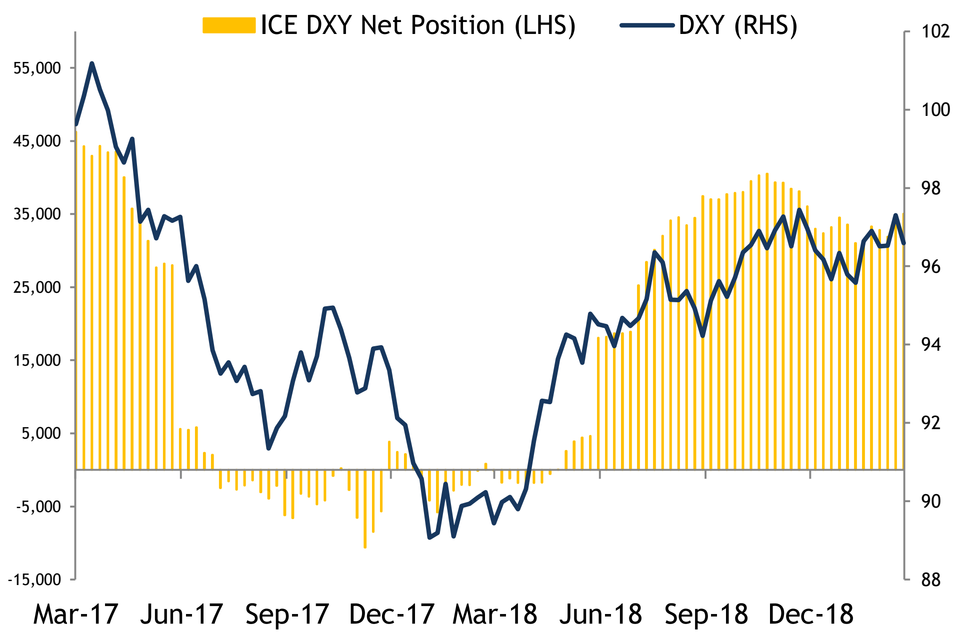
Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Leslie Tang
(65) 6320 1378
leslietang@maybank.com.sg

Unwinding of Stale USD Longs Could Accelerate USD Sell Off



Source: CFTC positioning as of 12 Mar for report released on 15 Mar, Bloomberg, Maybank FX Research & Strategy

Focus Shifts to US-China Trade Talks

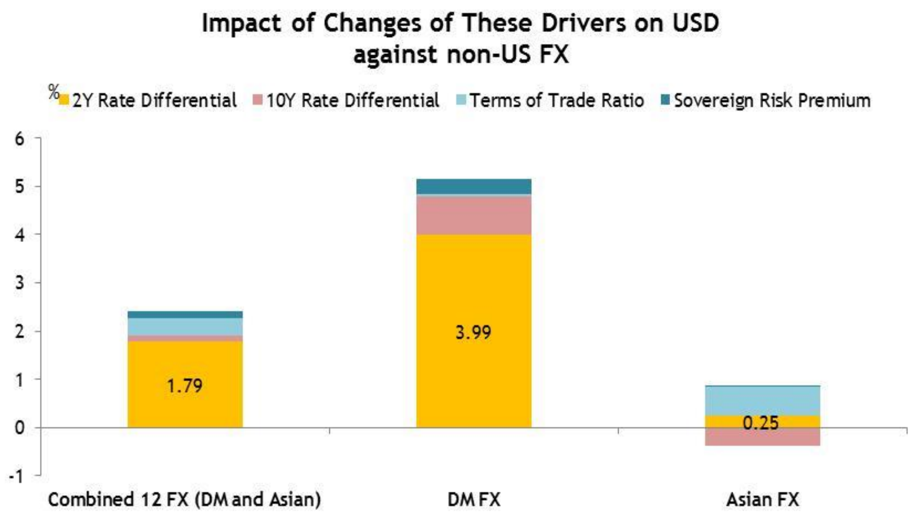
Elsewhere on US-China trade negotiation progress, Trump said that tariffs will stay until China complies with trade deal. This could marginally dial back markets' optimism of a US-China trade deal soon. Nonetheless it remains too soon to judge if trade talks are at risk of being derailed as USTR Lighthizer and Treasury Secretary Mnuchin will travel to Beijing for high level talks next week while Chinese Vice-Premier Liu He is expected to visit Washington later.

Hopes of US-China finding a common ground on trade, slowing momentum in US data and Fed pause/dovish rhetoric in the environment of benign inflation and growth "not hot not cold" should see broad USD softness in the weeks to come.

USD Could Lose its Allure as "High-Yielder" DM FX

Drawing reference to our earlier report, What makes FX Skip a Heart Beat (sent on 8th Mar 2019), we shared that rate differentials matter the most amongst the list of selected financial variables in our model. **Our study shows a 100bps increase in 2Y rate differential in favor of US appreciates the USD by 1.8% vs. non-USD FX on average** (the reverse is also true). **In particular DM FX is more sensitive than Asian FX to changes in rate differential.**

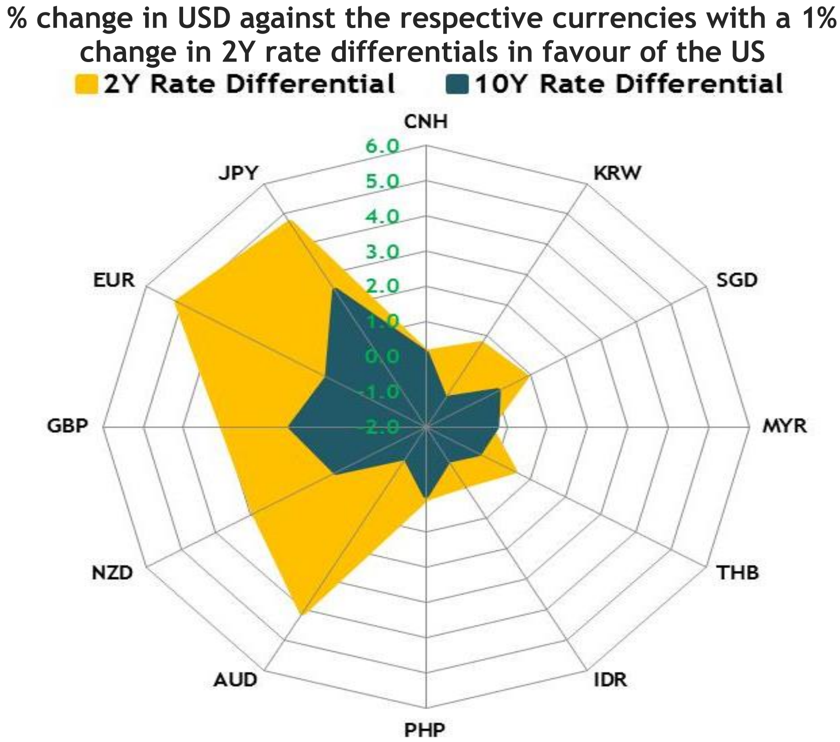
DM FX Are Highly Sensitive to Changes in Rate Differentials



Note (1): A 1% increase in 2Y rate differential in favour of US sees 1.79% appreciation of the USD over the non-US FX (DM, Asian), 3.99% appreciation against DM FX and 0.25% appreciation against Asian FX. (2): We estimated this model using daily data between Jan 2009 to Feb 2019 of bilateral USD exchange rate vs. selected DM FX using EUR, GBP, JPY, AUD and NZD and selected Asian FX including FX including CNH, KRW, SGD, MYR, IDR, THB, PHP via a panel data regression using the Pooled Mean Group Estimation (fixed effects).
Source: Maybank FX Research & Strategy Estimates, Bloomberg, CEIC, EViews

A 100bps increase in rate differential appreciates USD by 4% vs DM FX as compared to 0.3% vs Asian FX. This could be attributed to monetary policy divergence in the DM space in favor of the US as USD became a higher yielder in the DM space.

Within the DM FX space, our study shows EUR, JPY and AUD are most sensitive to movements in 2Y rate differentials. A 100bps increase in 2Y rate differentials in favour of the US appreciates the USD by 5%, 4.7% and 4.1% vs. EUR, JPY and AUD, respectively (the reverse is also true).

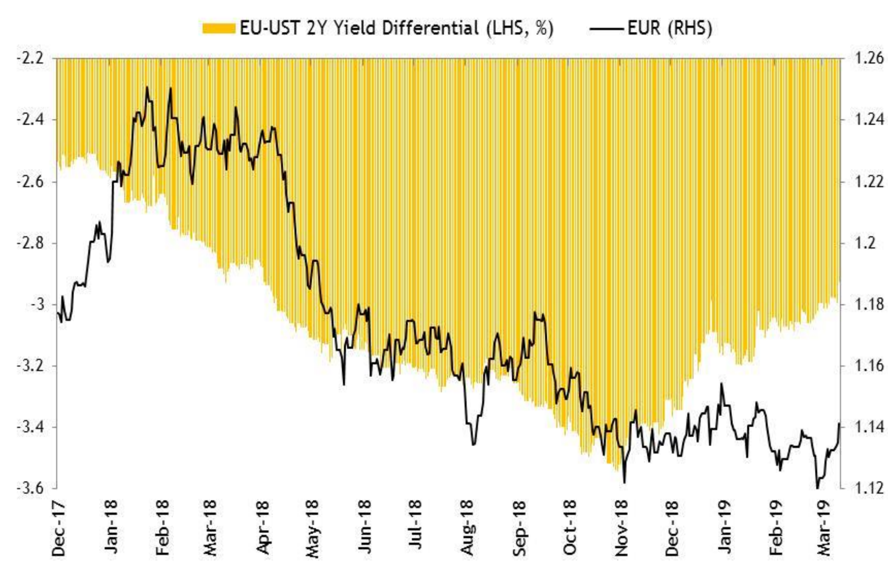


Source: Maybank FX Research & Strategy Estimates, Bloomberg, CEIC, Eviews

We shared in our report yesterday that a **prolonged Fed pause should see negative EU-UST spread narrow even further and this could provide the support for EUR recovery.**

We note that 2Y EU-UST yield differentials had already narrowed sharply from -354bps in Nov-2018 to -292bps overnight.

Narrowing of EU-UST Yield Differentials Supportive of EUR Recovery



Source: Bloomberg, Maybank FX Research & Strategy

DXY Outlook: Sell Rallies Preferred; Oversold on Daily Basis

DXY was last seen at 95.90 levels. Move lower was sharp overnight but decline failed to see follow-through beyond 200 DMA (at 95.90) this morning. Bearish momentum on daily chart remains intact but stochastics is falling into oversold conditions. **Bias for downside play but technical rebound risk not ruled out in the short term**. Bias remains to sell rallies. Immediate support at 95.9 (200 DMA), 95.5 (23.6% fibo retracement of 2018 low to triple top in 2018-19). We do not rule out a move towards 94.10 levels (38.2% fibo) if those above-mentioned support levels are broken. Resistance at 96.40 (21, 50, 100 DMAs), 97 levels.

DXY (Daily): Break Below 200 DMA Could See Decline Gather Pace

Source: Bloomberg, Maybank FX Research & Strategy

Maintain DXY Forecast and Trajectory

Our DXY forecast and trajectory continue to do well as we were already pricing in market expectations for dovish Fed amid benign inflation, fading momentum from fiscal support, hopes of US-China trade deal in coming weeks and a global growth neither ‘hot nor cold’. As such we keep our forecast and trajectory unchanged for the next 4 quarters.

This justifies our view for USD softness into 2Q - 3Q 2019 as speculative USD longs are at risk of unwinding and fatigue sets in for USD bulls as EM risk premiums look overstretched. Towards the end of 2019, our baseline builds in some expectations of heightened concerns about weaker global and US growth intensifying thus leading to some level of global risk off, supporting the USD somewhat.

Forecast	2Q 2019	3Q 2019	4Q 2019	1Q 2020
USD Index	95.88	94.64	94.86	94.62

Note: These forecasts are meant to be indicative of FX trends and not meant to be point forecasts or represent intra-quarter high or low.
Source: Maybank FX Research & Strategy

Upside Risks to USD View

We highlight 3 upside risks to our USD view: (1) **the risk of further gains in oil prices** (possibly due to supply-disruption or material progress on US-China trade deal) could translate into **inflation ticking higher in US** and this could reignite pressure for Fed to tighten and would be **supportive of the USD** (recall that oil prices and USD rose in tandem in 2018). (2) if growth and monetary policy divergence resumes in favor of US, then the USD could be poised for further upside risk. (3) if global equities enter into a deeper sell-off owing to deep economic slowdown globally or stagflation concerns, then the USD could also be poised to strengthen (flight to safety and quality).

DISCLAIMER

Published by:

Malayan Banking Berhad
(Incorporated in Malaysia)

Saktiandi Supaat
Head, FX Research
saktiandi@maybank.com.sg
(+65) 63201379

Christopher Wong
Senior FX Strategist
wongkl@maybank.com.sg
(+65) 63201347

Fiona Lim
Senior FX Strategist
Fionalim@maybank.com.sg
(+65) 63201374

Leslie Tang
Senior FX Strategist
leslietang@maybank.com.sg
(+65) 63201378