

## The USD Backdrop

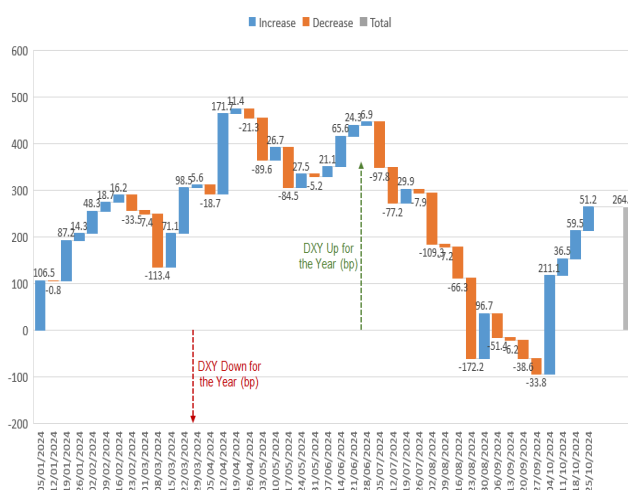
### 1. USD Set for a Soft Landing:

- As probabilities go, it is more likely that the **USD** (albeit not necessarily the US economy) **will eventually have a soft-landing** (into mid-/late-2025).
- Which is to say, the *Greenback will capitulate, but not crash*.
- Notably, as relative US exceptionalism underscoring Fed cuts matched by other Major central banks, suggests that the **USD is poised for more of a cushioned decline**.
- Specifically, on more complex “USD Smile” dynamics *rather than an uncontrolled downward spiral* (in coming months) tied to Fed rate cuts/expectations.
- Crucially, the **depth of decline is likely to be far more limited**, stopping well *short of a “full reversion” to pre-Fed normalization low-/sub-90 DXY index levels*.

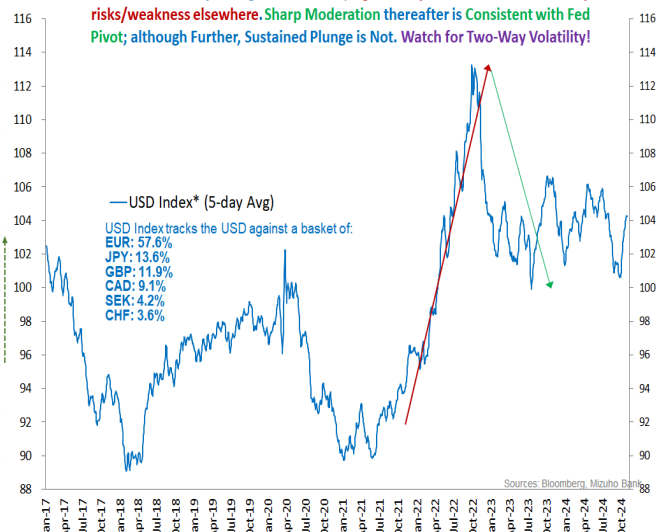
### 2. But on a Bumpy Path:

- And even then, the *path to a softer USD* may be *exceptionally bumpy with bullish detours likely into early-2025*.
- For one, it is **not a linear path to ubiquitously softer US data**. So, episodes of data out-run/upside surprise could easily invoke patches of USD rebound.
- Crucially, **US elections** and the **accompanying geo-political risks** may also be biased to a stronger USD.
- At least until the dust settles.
- Finally, initial, and sufficiently **acute US recessions risk could also ironically trigger USD strength via haven demand channels** (before USD soften on rate cuts and bottoming).

DXY Index (Weekly Chg from end-2023; bp): After a Sharp Downswing in Q3 (on Fed Pivot), USD Index has Rebounded in Oct, up\*265bp at 104 (from 101.33 at end-2023). USD is Presumably Reflecting Strength Associated with Relative US Exceptionalism & Election Risks.



USD Index hit 20-year highs in Oct 2022, Agitated by Fed Hawks and Incited by risks/weakness elsewhere. Sharp Moderation thereafter is Consistent with Fed Pivot; although Further, Sustained Plunge is Not. Watch for Two-Way Volatility!



### 3. Elections & Affections (of Strong USD):

- The **US elections** are **too close to call**. But the **uncertainty** itself may entail **heightened binary risks**.
- And the **tendency is for US election uncertainty to perversely underpin the USD**.
- To be sure, there is no clear directional correlation between US Presidential elections and the Greenback.
- But **global misgivings about the USD** will probably **compel the in-coming President** (regardless of Party and policies) **to (re-)assert commitment to a “strong USD” policy** on.
- And **Trump’s chest-thumping about a “strong USD”** in the event of his second Presidency **speaks to that**.
- And so, inclination for bouts of USD strength into (and around) the elections is arguably reinforced.

#### 4. “USD Smile” Decline:

- But talk (even from a President), however, is cheap. And **mere verbal support does not translate into enduring (USD) elevation**.
- Instead, the **Fed’s direction of policy travel** (down in rates) **corresponds to a gently softer USD tracing the path down the “USD Smile”**.
- Heading into mid-/late-2025. Specifically, with **diminished recession risks coinciding with lower rates**.
- And conditional on heightened geopolitical risks dissipating. In addition, better prospects of global demand recovery into 2025 could also help with a softer USD juxtaposed against “risk on”.

#### 5. Atypical Fed Cycle USD:

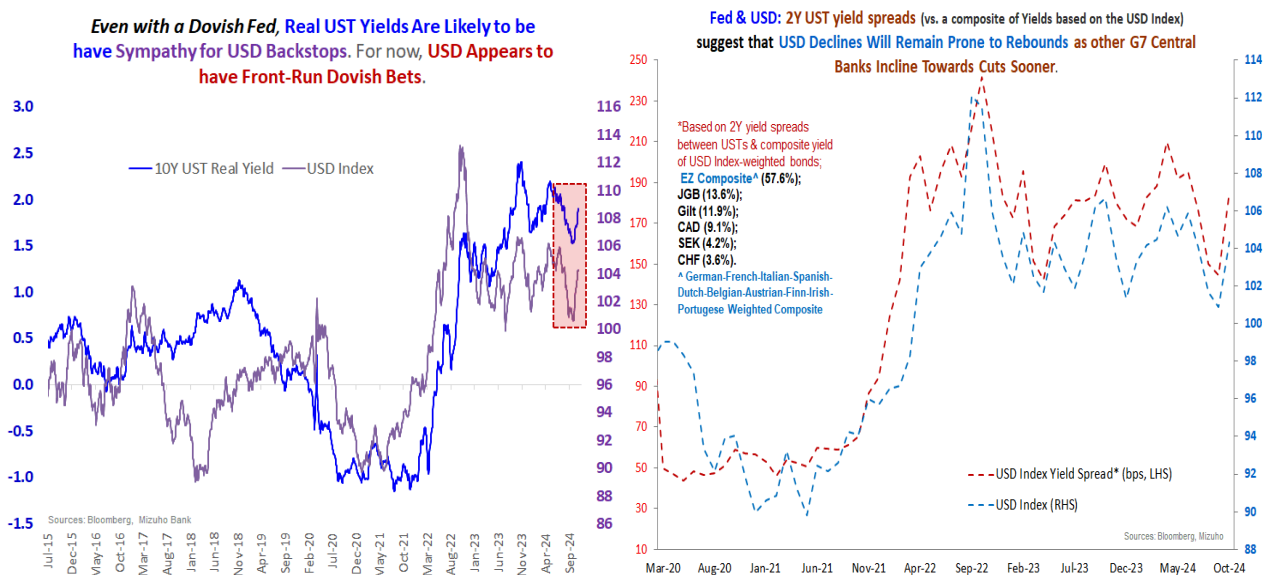
- But that said, the depth of USD decline ought to be tempered.
- For one, it is remarkable, as it is pertinent, that the **USD’s trajectory is atypical(ly resilient) for late-cycle Fed pivot**.
- This extraordinary resilience could in fact reveal a higher USD equilibrium into the rate cut cycle.

#### 6. Less Compelling Fiat Alternatives:

- Not the least because the **fiat alternatives to the Greenback are structurally less compelling compared to previous cycles**.
- This partly explains exceptional support in Gold (that has defied elevated real rates), cryptocurrencies and other real assets.
- The upshot though is that **in relative fiat terms, the Greenback could appear stronger** compared to past episodes of Fed cut cycles.
- More so, as geo-politics tilts the scale to the advantage of the Greenback.

7. No Real Divergence:

- What’s more, *in real rate terms, enduring and profound policy divergence, corresponding with a sharp and sustained USD drop*, is unlikely.
- Point being, the **US is unlikely to go it alone with large and fast rate cuts, checking nominal rate divergence.**
- And US dis-inflation is not particularly vulnerable to falling significantly short.
- Especially given superior domestic buffer to energy shocks (from geo-politics) in Europe and Japan.
- Again, this checks the extent of USD pullback.



8. Geopolitics & the “Heads I Win, Tails You Lose” Syndrome:

- Crucially, **interim risks of bullish USD outbursts could be triggered by geo-political flares.**
- These are tilted in favour of USD, and *across a spectrum of outcomes* at that.
- a. **Military conflict:**
  - Point being, an escalation of conflict could lift USD on haven demand and US war industry advantage on one hand.
  - But on the other, a de-escalation, on US terms that transfers remnant conflict risks to Europe, will also undermine EUR (by default underpinning USD).
- b. **Trade Antagonism:**
  - On the trade front too, direct assaults on Chinese exports carry significant risks of collateral damage to most other trading partners.
  - Notably to EUR (via supply chains/demand) and MXN (investments) over and above more direct hit on CNH and AXJ (via deep trade, investment and financial channels).

	Q3 2024	Q4 2024	Q1 2025	Q2 2025	Q3 2025	Q4 2025
DXY	100.8	103.8	103.6	101.2	98.8	98.5
	100.2-106.1	99.5-106.5	99.2-105.5	98.2-104.5	97.8-102.5	96.0-100.5

\* Note that this publication was part of the Global Assumptions for October’s FX & Rates Outlook.

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