

2021 Year Ahead Outlook

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Where does the USD go from here & what are some of the key drivers?

There are two key drivers of the U.S. dollar going forward. One short term and one longer term. The most important short-term driver for the dollar in the coming months will be the outlook for risk and risk appetite. There is no question the dollar remains a safe haven currency. All throughout 2020, when the stock market went up, the dollar went down. When the stock market went down, the dollar went up. And we think the dollar is going to continue to trade that way in the foreseeable future, to the extent that equity analysts believe that the stock market may be due for a correction on valuation concerns. There's no question that the dollar would be the biggest beneficiary of such a correction when it does come. So from that point of view, short term, we definitely see the dollar as being highly dependent on the outlook for risk and risk appetite.

Longer term, the biggest driver for the U.S. dollar is going to be the outlook for U.S. fiscal policy. Many investors are concerned that the explosive debt dynamics in the U.S. unleashed by COVID could potentially compromise the dollar's reserve currency status and debase the U.S. dollar. The concern stems from the fact that [a] bigger budget deficit means bigger QE and for longer. Also, [a] bigger budget deficit means that the ability of the U.S. government to service its debt is going to be called into question. Therefore, [the] U.S. government has a strong incentive to keep interest rates lower for longer, even when the economy no longer needs it. There is no question that the fiscal outlook for the U.S. under the new administration represent[s] the biggest risk to the U.S. dollar on a medium-term basis, in our view.

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