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US Dollar: At the Crossroads

The US dollar appears to be at the crossroads. During the past four months, the US dollar index was able to recover nearly half of its 15% decline that occurred from December 2016 to February 2018. Stronger US economic data, rising US yields and emerging geopolitical risks in Europe has propelled the US dollar index by as much as 7% from the low of 88.59 recorded in February 15.

However, the 95 level is proving to be a strong resistance for the US dollar index. Hints by the ECB that it may end its QE program soon sparked a rally in the euro and caused the US dollar index to pull back recently.

Fed likely to raise rates this week

The sharp dollar rally from February to May 2018 was driven mainly by rising US rates. Following the strong jobs report in May, the Fed is expected to raise its benchmark rates when the FOMC meets this week. The Fed is on track to raise rates for the second time this year following the last hike in March.

Safe haven to Europe's risks

Political uncertainty in Italy and Spain, together with disappointing growth in the Eurozone, has turned the dollar into a safe haven in recent months. Worries over the outcome of Brexit negotiations between UK and its European neighbors have provided additional support to the dollar.

Dollar pulls back ahead of the G7 meeting

The US dollar index has corrected in 7 out of the last 9 trading days. ECB officials have signaled the past week that they may end their QE program as early as September. Concerns over an all-out trade war between the US and its key trading partners following the G7 meeting have also weighed the dollar down.

US dollar makes an intermediate low on February 15

February 15, 2018 marked the intermediate low in the US dollar index. Despite the recent pullback, the dollar is still up significantly against global currencies. Below is a table showing the performance of the US dollar against other currencies since the Feb. 15 intermediate low and on a year-to-date basis.

Major currencies	Since 15 Feb 2018	Year-to-date
Swiss Franc	-6.5%	-0.9%
Euro	-6.3%	-2.0%
British Pound	-5.2%	-0.9%
Australian Dollar	-4.6%	-3.0%
Canadian Dollar	-4.0%	-3.6%
Japanese Yen	-2.7%	-2.8%
Average	***-4.9%***	***-2.2%***

Other EM currencies	Since 15 Feb 2018	Year-to-date
Argentine Peso	-29.2%	-35.4%
Turkish Lira	-19.3%	-18.5%
Brazilian Real	-19.2%	-16.0%
South African Rand	-12.3%	-6.0%
Mexican Peso	-10.7%	-3.8%
Russian Ruble	-10.3%	-8.0%
Average	***-16.8%***	***-14.6%***

Asian currencies	Since 15 Feb 2018	Year-to-date
Indian Rupee	-5.6%	-5.7%
Pakistani Rupee	-4.7%	-4.7%
Taiwanese Dollar	-3.1%	-0.7%
Indonesian Rupiah	-3.0%	-2.9%
Thai Baht	-2.7%	2.8%
Malaysian Ringgit	-2.4%	1.5%
Singaporean Dollar	-1.9%	0.0%
Philippine Peso	-1.1%	-5.7%
Chinese Yuan	-1.0%	1.5%
Korean Won	-0.9%	-0.8%
Vietnamese Dong	-0.6%	-0.5%
Hong Kong Dollar	-0.3%	-0.4%
Average	***-2.3%***	***-1.3%***

US dollar vs. major currencies

Since the US dollar bottomed-out on February 15, major currencies are down 4.9% on average. The Swiss franc and the euro are the worst performers, falling 6.5% and 6.3% vs. the US dollar, respectively.

US dollar vs. Asian EM currencies

While Asian EM currencies have also weakened against the US dollar, these currencies fared relatively better compared to the majors. Asian currencies declined an average of only 2.3% since the time the dollar index bottomed in February. The Indian rupee weakened the most, declining by 5.6%. This is followed by the Pakistani rupee which depreciated 4.7% over the same period.

Other EM currencies suffer sharp declines

Other EM currencies did not fare well and suffered sharp declines. Soaring inflation, insufficient currency reserves and political uncertainty have plagued the Argentine peso, Brazilian real and the Turkish lira which plunged to record lows against the US dollar. To stem the slide, Argentina's central bank struck a record $50 billion credit line from the IMF last week. Turkey's central bank hiked its benchmark rate 125bp to 17.75%.

Philippine peso hits 12-year low

The Philippine peso did not escape the sell-off suffered by EM currencies against the greenback. It closed at a 12-year low of 52.70 last Friday. In the context of rising US rates and continued risk aversion in emerging markets, we expect the Philippine peso to continue moving in parallel with the movements of most currencies in Asia.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.