OCTOBER 21, 2024

PHILEQUITY CORNER

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Dollar Makes a U-turn

Just when the market thought the US dollar would break down, it reversed. The critical catalyst was Iran's direct attack on Israel. The US dollar index (DXY) rebounded sharply from multi-month lows following Iran's unprecedented missile attack on Israel on October 1, 2024. This caught financial markets off guard, triggering a flight to safety. The dollar's strength was further bolstered by a strong US jobs numbers and recent presidential surveys showing Trump overtaking Harris.

Markets blindsided by Iran's bold move

Unlike Iran's missile and drone attack on Israel last April 14, 2024, which was largely telegraphed, this assault blindsided the markets. Previously, Iran fought an indirect war using its proxies – Hamas in Gaza, Hezbollah in Lebanon, and the Houthis in Yemen. The market's complacency was shattered as Iran took direct action on its long-standing adversary, forcing a rapid repricing of risk across global financial assets.

IRGC unleashes missile barrage

Iran's Islamic Revolutionary Guard Corps (IRGC) launched approximately 200 ballistic missiles at Israel, including the debut of the "Fattah-2" hypersonic medium-range ballistic missile. The attack was framed as retaliation for Israeli strikes in Gaza and Lebanon, as well as the assassinations of key figures in Hezbollah, Hamas and the IRGC.

Escalation fears mount

Concerns of a dangerous escalation in missile exchanges are growing as both nations threaten further action. Israel has promised a "lethal, precise, and fundamentally unexpected" response, while Iran warned of "stronger and more painful" consequences. The United States has reaffirmed its unwavering support for Israel, raising the stakes and the possibility of a wider regional conflict. Experts anticipate Israel will launch an attack after the US elections.

Dollar reigns supreme in uncertain times

When faced with the unknown, investors flee to the greenback. The US dollar's status as the world's reserve currency, backed by the world's largest economy and biggest military might, again proved its worth. The DXY surged 3.1% from recent lows as investors sought refuge from geopolitical upheaval. Asian EM currencies declined 2.5% on average, while major currencies slumped 3.5% from their lateSeptember highs. The Philippine peso took a hit of 3.3% over the same period. Despite these recent declines, both EM and major currencies are still holding onto gains from their July lows.

Asian EM currencies	Year-to-date 2024	rally from low July low	decline from Sept high
Malaysian Ringgit	6.7%	11.4%	-4.2%
Thai Baht	3.4%	12.3%	-2.2%
Singaporean Dollar	0.8%	4.2%	-2.2%
Chinese Yuan	0.0%	2.4%	-1.3%
Indonesian Rupiah	-0.5%	6.3%	-2.4%
Indian Rupee	-1.0%	0.0%	-0.6%
Vietnamese Dong	-3.6%	1.2%	-2.5%
Philippine Peso	-3.7%	2.4%	-3.3%
Taiwanese Dollar	-4.6%	2.6%	-1.4%
Korean Won	-5.7%	1.9%	-4.3%
Average	*-0.8%*	*4.5%*	*-2.5%*
Major currencies	**Year-to-date 2024**	**rally from low July low**	**decline from Sept high**
British Pound	2.5%	5.7%	-2.7%
Australian Dollar	-1.5%	4.8%	-3.0%
Euro	-1.6%	2.3%	-2.8%
Swiss Franc	-2.7%	6.3%	-2.8%
Canadian Dollar	-4.0%	0.5%	-2.7%
Japanese Yen	-5.7%	8.1%	-6.0%
Norwegian Krone	-6.9%	1.8%	-4.8%
Average	*-2.8%*	*4.2%*	*-3.5%*
Dollar Index	*2.1%*	*-2.3%*	*3.1%*

Source: Bloomberg, Wealth Securities Research

A Trump win would strengthen the US dollar

Recent surveys showing Trump leading Harris in the upcoming US elections are providing additional support to the US dollar. In a Bloomberg interview last Wednesday, billionaire investor Stanley Druckenmiller observed, “In the last 12 days, the market is very convinced that Trump is going to win. You can see it in bank stocks. You can see it in crypto.” A Trump victory would cause a lot of volatility in the markets and a potentially bigger trade war with China, boosting the dollar in the short-term.

Fed policy remains key long-term driver

The outcomes of the current US election and the Middle East war are crucial in setting the direction of the US dollar. In addition, the strong US jobs data in September defied expectations of a sharper US economic slowdown. This has raised concerns that the Fed may be less aggressive in cutting rates than previously expected.

However, the Federal Reserve’s interest rate policy remains a critical factor in the dollar’s trajectory. Recent Fed minutes suggest that rate cuts are still on track, offering a counterpoint to the dollar’s current strength. After a 50-basis-point cut in September, the Fed plans further easing in the coming quarters to reach a more neutral stance.

Geopolitics vs. Fed policy

Historically, the Fed tends to act more quickly and aggressively in both raising and lowering rates compared to other major central banks. With the Fed cutting rates through 2025, the dollar may face headwinds from diminishing yield differentials. Investors must balance short-term haven flows with the prospect of a weaker dollar as rate cuts materialize. However, a strong US economy or “no landing” scenario, coupled with fewer-than-expected interest rate cuts, could strengthen the dollar. Ongoing geopolitical tensions, an unconventional and potentially erratic US presidency, and fewer-than-expected Fed cuts could collectively keep the dollar higher for an extended period.