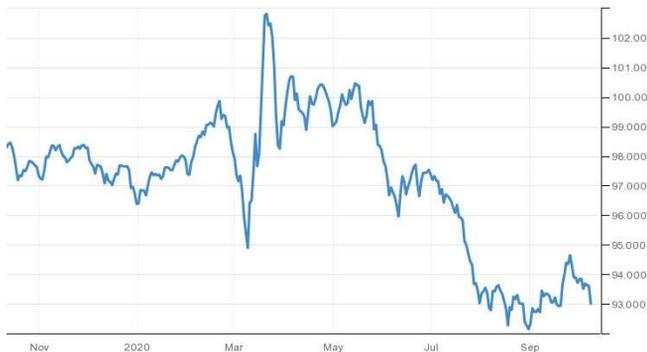


## USD: Long-term bearish trend

The currency market is at an inflection point. Major upcoming events and risks may reset the relative levels of currencies going forward: the US elections, the second wave of the pandemic, the US and China's on-going economic trade war and Brexit. In our currency valuation analysis we don't aim to predict currency as we know currencies follow a random path, yet we can witness their secular (long-term) trends and dynamics. Our goal is to explain currency drivers and their trends set by fundamental economic data which can, however, be disrupted by geopolitical events.

DOLLAR INDEX



SOURCE: TRADINGECONOMICS.COM

EURUSD Power Purchase Parity (PPP) = 1.27



Source: Macrobond, Thomson Reuters, UBS, as of April 2020

### USD: Long-term bearish trend

The US structural twin deficits, combined with fundamental and geopolitical factors, are negatively affecting the USD in end-2020 and 2021:

- **Budget deficit:** the Federal Reserve keeps on increasing the printing of new dollars needed for Trump's tax cuts as well as the massive stimulus to avoid recession. This will only get worse if Joe Biden wins the election as he vowed to improve the underfunded welfare system in the US.
- **Commercial balance deficit:** the US has a negative commercial balance with most countries, particularly its two biggest partners, China and Europe, which generates systematic flows of USD selling and RMB and EUR buying.
- **Negative real US rates** (nominal interest rates minus inflation): the Fed rate is set at 0.1% and inflation is at 1.3%, i.e. real rates are at -1.2%. Consequently, holding USD no longer has the advantage of generating income.
- **The USD Power Purchase Parity is low:** it is 10% below its market value (depending on the currency pairs), generating a negative drift for the "overvalued" USD.
- **De-dollarization:** on-going US sanctions on many countries and corporations around the world (Russia, China, the Middle East, European banks) have forced states and corporations to avoid transactions in USD and to diversify their commerce currency into Euro and RMB. As a result, one of the US' main creditors, China, has started to reduce its US treasury holdings at a time when the US needs it the most.

Nonetheless, USD remains a safe haven, as the US is still the only superpower. When negative events such as the Covid pandemic arise, the first reaction from investors is to buy USD and get rid of most of the other currencies (with the exception of CHF and JPY). Consequently, the USD haven status can temporarily trigger short-term trading rallies.



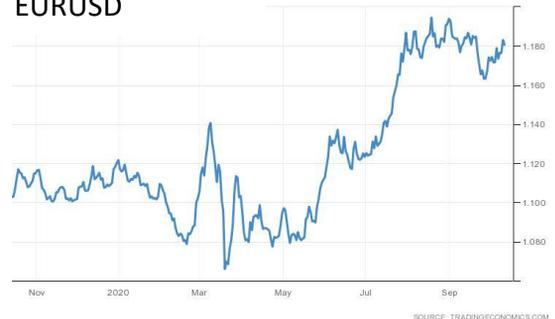
# USD: Long-term bearish trend

## Currencies versus USD

### EURUSD: bullish trend with a target at 1.25

The 1.16 resistance was broken in July, and EURUSD has remained above it since then. The Euro is benefitting from USD weakness. In addition, for the first time, the EU has issued Euro supranational bonds with the ECB as the major buyer, which reflects a strengthening of the Eurozone governance generating positive sentiment and has increased investor trust in the Euro. This has underpinned the Euro's bullish trend with a target at 1.25, close to its Power Purchase Parity of 1.27. EURUSD becomes vulnerable if the second Covid wave gets out of control in Europe.

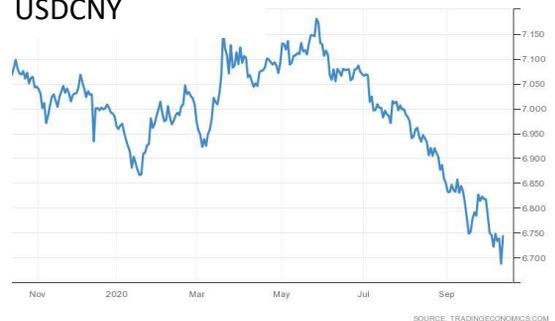
### EURUSD



### USDCNY bearish (CNY bullish), range [6.00 ; 6.80]

The trend for CNY is bullish given China's solid economic growth and positive balance-of-payment dynamics as well as the yuan's attractive interest rates yield curve above 2%. This year, investors substantially increased their positions in Chinese government bonds, which has supported the CNY. The CNY rallied as investors bought Chinese equity and debt amid signs of a faster and sustained economic recovery.

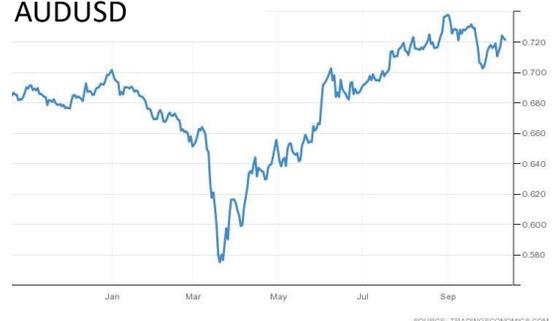
### USDCNY



### AUDUSD volatile, range [0.68 ; 0.74]

Australia's central bank is expected to keep interest rates close to zero while the government's fiscal program will be announced this week. The Reserve Bank of Australia will incrementally lower the cash rate and buy longer-dated government bonds as it continues to keep its monetary policy accommodative in the aftermath of the Covid-19. This will add downward pressure to the Australian dollar and limit the currency's upside in 2021.

### AUDUSD



### GBPUSD volatile, little visibility till Brexit negotiation is over, range [1.2675 ; 1.35]

We expect some type of Brexit deal before year end, which will be positive for the GBP. However, a hard Brexit will send GBPUSD below 1.2675. The GBPUSD PPP is 1.53 so at this point in time the pound is about 20% undervalued.

### GBPUSD

