



## Theme #1: Green Back

The dollar is the top performing currency in G10 so far this year, and not far from the top if emerging market currencies are included. Therefore, dollar strength has not been confined to just the yen (see first chart), which suggests a broader dollar uptrend is unfolding. The fact that the consensus of analysts is only looking for moderate dollar strength against the majors and weakness against the rest of G10 and EM add to the case that we are only at the early stages of dollar strength.

### Equity Flows Still Not Supportive

Ironically, dollar strength has so far not been supported by foreign inflows into US equity markets, despite US outperformance. The US saw negligible equity inflows in Q1, with the Euro-area seeing by far the largest. Both Japan, and the rest of Asia also saw larger inflows (see second chart). Flows often lag performance, so one would not necessarily expect flows to immediately pick up into the US with stronger US markets, but the resilience of the dollar does augur well for a dollar uptrend.

### China Wildcard

Yet the equity flow picture has not been the most surprising flow story of 2013. Instead, the significant increase in Chinese FX reserves takes that prize. Reserve accumulation has been at the highest pace since 2011, and undoubtedly has provided much support to currencies such as the euro and Australian dollar through a rebalancing effect. The backdrop of weak growth and strong credit expansion has provided an unusual mix for such a pace of accumulation. It would appear that some inflows to China have occurred through over-invoicing of exports and onshore entities taking advantage of the carry offered by borrowing in dollars and lending in Chinese rates. However, over the past week, new measures have been introduced to clamp on these practices. This should slow the pace of reserve accumulation.

Moreover, the sharp decline in the USD/CNY fix over April has also likely added to inflows. USD/CNY continues to trade at the bottom of the band around the fix, which implies still significant CNY demand. However, this state-of-affairs is unlikely to continue not least because the much anticipated band widening may actually occur over the coming months, and bring to an end anticipatory inflows.

### Dollar Mispricing

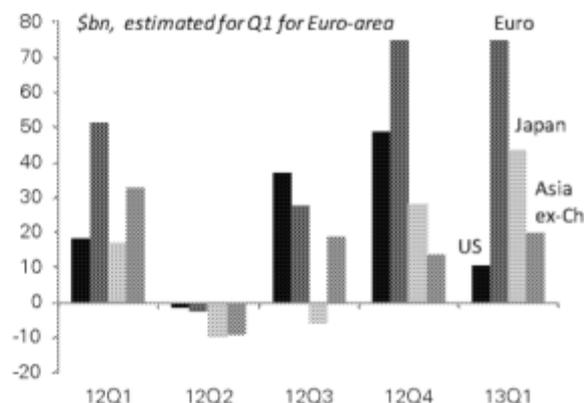
Stepping back, what is evident is that US equity markets have been outperforming since 2009, but the dollar has only started to gain traction since late 2011. The 1995 dollar turn also saw US equity

Figure 1: Dollar Trending Higher In 2013



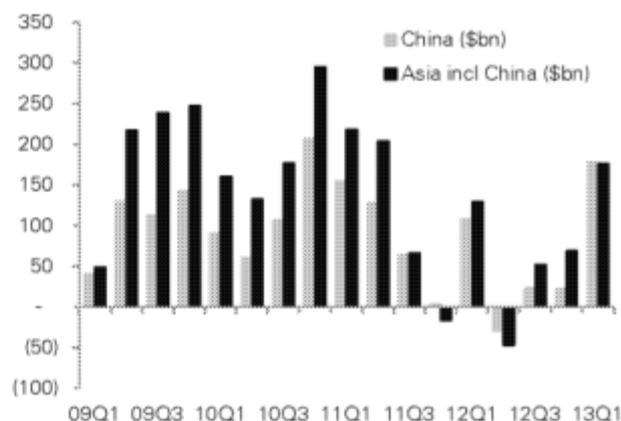
Source: Deutsche Bank

Figure 2: Equity Flows To Everywhere But US



Source: Deutsche Bank

Figure 3: China Reserves Have Surged In 2013



Source: Deutsche Bank