

The Dollar Is Back: How China Rebalancing, The Great Rotation To US and Abenomics Will Change The World

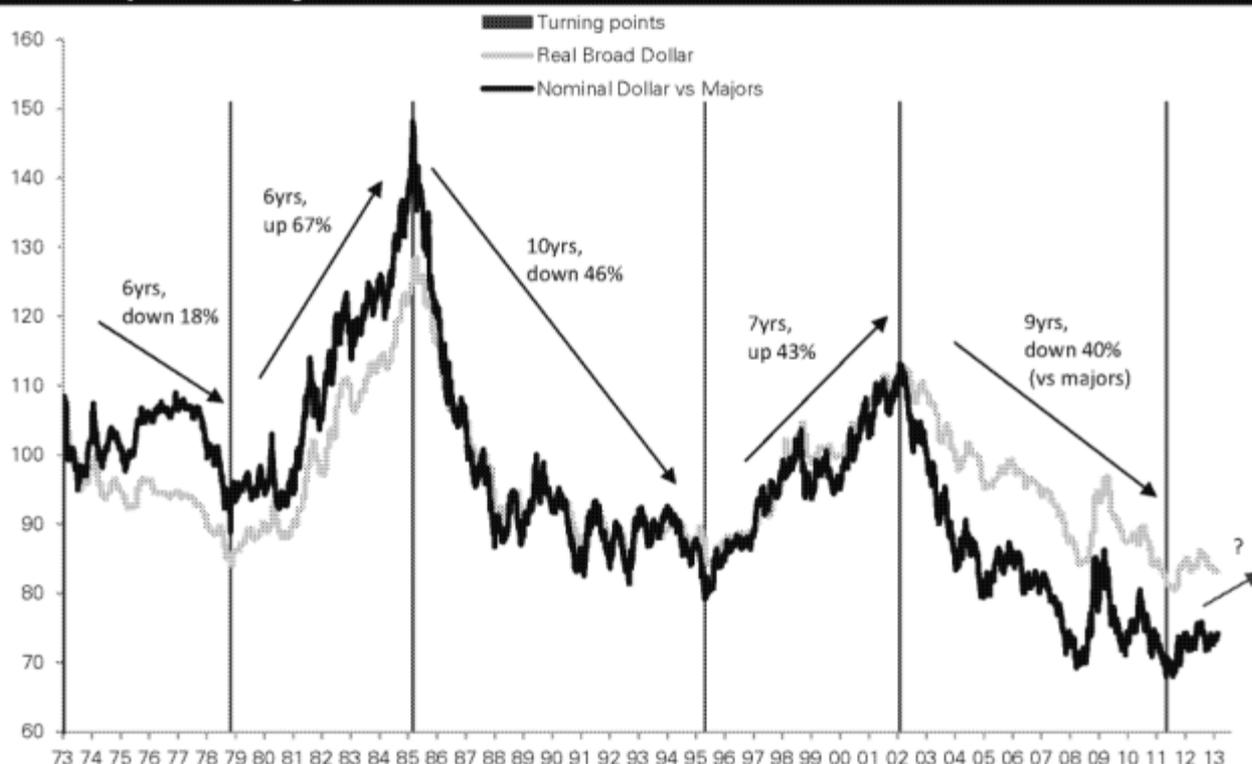
Bottom Line

Almost all currencies appeared to have peaked against the dollar, and the more recent rise in USD/JPY suggest the broad dollar is embarking on a multi-year uptrend. Superior US growth should support the rotation from bonds to equities that will help the dollar. Abenomics shows the scope central banks outside of the US have to weaken their currencies against the dollar. China rebalancing away from investment provides a downside risk to the China-linked currencies that have done so well since 2008. All these trends are intertwined and together point to sustained dollar strength. In terms of forecasts, by 2015, we expect EUR/USD to reach 1.10, USD/JPY 115 and AUD/USD 0.85. Most EM FX will weaken against the dollar. If anything, we risk underestimating the extent of dollar strength in coming years.

Dating The Dollar

The dollar tends to follow long-term cycles lasting between 6 to 10 years. A combination of valuations extremes, current account imbalances, and turns in rate cycles and capital flows tend to presage the switch from one multi-year trend to another. The latest clearly identifiable trend for the dollar has been a downtrend that began in 2002 and likely ended in 2011 thus lasting 9 years (see Figure 1). This is one year short of the longest trend in the post-Bretton

Figure 1: USD Uptrend Starting?



Source: Deutsche Bank, EcoWin, BIS.