US dollar struggling to make ground despite global risks

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The US dollar has struggled to make headway this month, repeatedly ranging 0.5ppts higher than its 10 July level, when our last Market Outlook was released, only to falter and eventually end the period 1.5ppts lower at 99.5 today. This is despite a deal between the US and Iran remaining elusive and with market participants optimistic on US growth but concerned over inflation, and consequently expecting the FOMC to hike into year end. As has been the case over the past year, the primary contributors to movements in the US dollar DXY index over the past 30 days were Euro and Sterling, both appreciating around 1.5 cents to USD1.16 and USD1.36 respectively. Compared to history, these are not challenging levels for either currency; and the balance of risks faced by each nation are becoming more favourable with respect to growth and inflation. To end-2027, we look for a continuation of this trend, leaving EUR/USD and GBP/USD at USD1.21 and USD1.39 respectively, after which each currency is likely to plateau. The more time passes, the greater the likelihood of the balance of risks shifting against the US and in favour of Europe and the UK. In part, this is because the US economy has experienced an extended period of outperformance that is coming across an increasingly narrow base, suggesting the run may not last. But it also pertains to the political status quo; the degree of common purpose over defence and economic development in Europe is a striking contrast with the US' partisan turbulence. Government debt is an issue for all three jurisdictions, but the structural imbalance in the US budget position, the ratcheting higher of US debt service, and the market's unease over dwindling forward guidance by the FOMC all point to a much greater financial headwind for the US dollar than Euro or Sterling. It is worth remembering that, while the 10-year average for DXY is around 1.0% below spot, the 20-year average is almost 9.0% lower. If risks crystallise against the US, there is a material chance of an outsized market move. As we write, the big story of the month is slowly fading into obscurity. After numerous failed attempts to turn the yen around, and with USD/JPY threatening to go through JPY165, Japanese authorities this month sought the aid of the US government. Buying of the yen by both counter-parties, aided by an active PR campaign, initially saw USD/JPY drop from a recent peak of JPY164 to a low of JPY155. However, despite warnings of additional actions, USD/JPY reversed course within days, trading back above JPY159. Without further intervention by both Japan and the US, the yen is likely to weaken further as participants search for authorities' limit. Still, a return to JPY165 seems unlikely absent a marked deterioration in Japan's economy; USD/JPY holding around JPY160 for the foreseeable future is much more probable. In our view, the yen is unlikely to begin a lasting uptrend until expectations for tighter US monetary policy recede, which we do not see occurring until late-2026. Thereafter, progress is likely to be slow, as participants continue to doubt the Bank of Japan's resolve and given Japan has less exposure to the global tech expansion than South Korea, Taiwan and China. We expect USD/JPY to only decline to JPY154 by end-2027, then to JPY146 come end-2028. At that level, USD/JPY will still be 32% above the 30-year average of 1990–2019 – a truly historic divergence. For the rest of Asia's currencies, the direction of travel is likely to be up, albeit proportional to each nation's exposure to technology and starting valuation.

Benefiting not only from exposure to high-end technology expansion but also pharmaceuticals, engineering, finance and tourism, at SGD1.28 Singapore's dollar is within a cent of its lowest level in a decade, and also within reach of the historic low of SGD1.22 seen in 2012. We expect the cross to settle between current spot and the 2012 low by end-2028, targeting SGD1.25 at that time. That said, a downside surprise for the US economy could see the 2012 low reached in the interim. The softer starting point for China's renminbi provides it with a little more room to rally over the forecast period. To end-2027 then end-2028, we see USD/CNY falling from CNY6.74 today to CNY6.40 and CNY6.30 respectively. A run towards CNY6.00 is certainly possible, although it would arguably require a marked change in domestic conditions as well as continued strength in trade and financial net inflows. India's rupee is an interesting comparison to the above Asian currencies. While India offers the world considerable capacity for technology and professional services as well as low-value-add manufacturing, it lacks the intellectual property of the US, China, Taiwan and South Korea. It also does not have the efficient process, depth of knowledge, financial capital and transport infrastructure that holds Singapore in such great stead. Concerted structural change is necessary if the rupee is going to materially reverse the declines of recent years. This is despite the nation's considerable advantage in terms of its population. To end-2028, we see USD/INR only falling from INR95 to INR87 against a 20-year average of INR64. To this view, there is clearly downside risk for the rupee, particularly if energy prices remain elevated. This analysis first appeared in Westpac Economics' August Market Outlook.

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