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Dollar trending lower as politics, trade, and rates dominate

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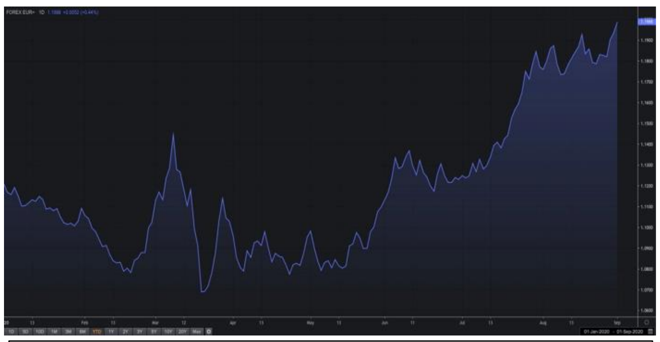
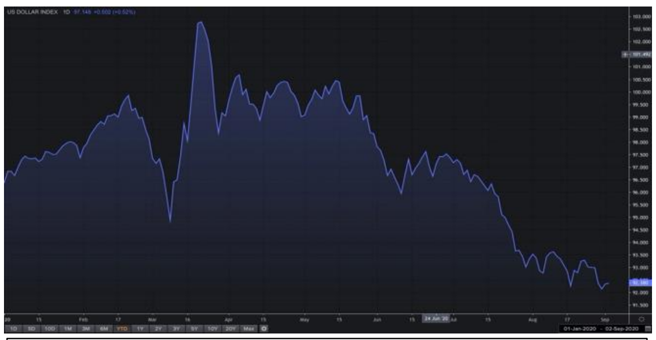
For quite some time it seems that Forex has been on the backburners with focus on Equities, Commodities and Treasuries being driven by the growing global economic devastation caused by the pandemic and the ensuing lockdown.

The dollar has been taking quite a hit though this year against major currencies such as the EUR and against Gold. Both have broken major levels against the dollar with the Euro breaking 1.2000 and Gold breaking 2000. Below is a chart showing the EURUSD moves year-to-date, and the dollar index which has lost over 10% since March. This clearly shows a strong trend against the declining dollar.



EURUSD YTD 2020 - Reuters



Dollar Index YTD 2020 – Reuters

Speculators are betting on this continuing, as evidenced by CFTC net speculative currency short positions being at their largest since 2011. So, what is driving this and what does it mean for international trade, economic growth and what do countries want to see their currencies do?

One of the key drivers of Forex is Interest rate differential, and the dollar has been falling because the Fed's current policy is suggesting that US rates will stay lower for longer than other countries. This is being aided by the Fed's Bond buying keeping longer term rates subdued, and stimulus will continue through to the next Presidential Term and until 2022, as indicated by the Fed. Another key driver is economic performance, but with the pandemic continuing to affect the economy, concerns over future economic performance, particularly in the US, remain subdued.

Another driver for the lower dollar is the political landscape and outlook in America. The country has become very divided, issues over civil unrest and most importantly uncertainty of who will win the election are affecting the dollar and confidence. Also increasing thoughts that whoever wins will face a supreme challenge to get the economy back on track and mend civil issues whilst trying to solve the severe fiscal challenges created over the last few years of incredible deficit growth.

In Europe the EURUSD move is providing a new challenge for the ECB, as already fading economic recovery and slumping inflation is further being impacted by the strong Euro. The ECB has already said its on their minds, so it would be unsurprising to see the ECB take action as a result of the currency strength. Europe is particularly exposed because of the importance of exports to the USA. A strong currency weakens its trade competitiveness and dampens inflation, highlighted by inflation turning negative for the first time in Europe for 4 years this week. They will probably start by using verbal tactics, as it's hard to say what they can really do since the bigger problem herein lies in the fact that global demand is low.

The optimists out there see the dollar's decline as a sign of global confidence returning and currency flows out of the 'safe haven' USD. Historically a lower dollar has been a catalyst for increased global trade, but with so many economies facing challenges exacerbated by the pandemic, it is unlikely a rebound in global trade can be predicted in this instance. This time, it is all about US domestic concerns, and a weaker dollar will likely continue for some time into the future.

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