

US dollar decoder: What a strong dollar means to you

What's happening with the US dollar?



The dollar is soaring*

- Year to date, the US dollar (USD) has climbed almost 8% against a basket of 6 major currencies (including the euro, Japanese yen and UK pound sterling).
- It has risen almost 13% over the past 12 months, approaching a 20-year high.

The USD's value has appreciated significantly this year, closing in on a 20-year high



Source: FactSet. Data as at 29 April 2022.

What's pushing the dollar higher?



Flight to quality

- Geopolitical tensions have risen notably in recent months, largely due to the invasion of Ukraine by Russian armed forces.
- When investors feel uncertain, they tend to flock to investments and currencies considered safer – particularly the USD and securities denominated in USD.



A hawkish Fed and relatively weaker responses from other central banks

- In the short run, the US dollar is driven largely by interest rate differentials.
- The US Federal Reserve (Fed) is pushing rates higher, while the European Central Bank (ECB) and other central banks are delaying inevitable monetary tightening.
- This combination attracts yield-seekers to dollar-denominated assets, since yields tend to rise as the Fed hikes rates.



A weaker growth environment

The dollar has historically strengthened in times of weaker global growth and higher economic and financial market uncertainty, as evidenced by its positive correlation with equity and bond volatility. The rising risk of a potential US and global recession in 2023-2024 remains a clear tailwind for the greenback.

* Source: FactSet, citing the ICE US Dollar Index (DXY). YTD period is 1/1/2022 through 29/4/2022.

What's Allianz Global Investors' outlook for the dollar?



Strong USD may continue

- We believe the strong US dollar trend is still intact, based in part on the drivers mentioned above.
- These include a flight to quality, interest rate differentials between central banks and the risk of economic recession.



Some headwinds for the USD

- The dollar appears overvalued based on longer-term valuation metrics.
- The US is also running a large current account and fiscal deficit, which is usually burdensome for a country's currency.
- In addition, the yuan is gaining acceptance in some circles as a solid medium of global trade.



Our bottom line

- In the near term, we believe the dollar will continue to appreciate, although at a slower rate.
- We may see a "topping out" or correction later in 2022.
- But if the global economy weakens or even enters a recession, the dollar should be well supported overall.

The upside (and downside) of a stronger dollar

The upside

- Owning dollars (and dollar-denominated assets) may be beneficial, since these assets may be worth more if the dollar continues to rise.
- Owning USD-denominated assets may help European investors in particular. The euro has recently depreciated noticeably against the dollar, and euro-area yields tend to be lower than their US counterparts.

The downside

- A stronger dollar makes it harder for non-US countries to curb inflation, since their policymakers must defend their currencies or risk "importing" inflation.
- US exports may slow as non-US customers have less purchasing power.
- Risks for the Fed could increase as it tries to navigate a tightrope between taming inflation and not stifling growth.



Timely investment ideas

US dollar-denominated securities

Lower risk, lower reward potential



Higher risk, higher reward potential

US government bonds

Fixed-income securities (such as US Treasuries) issued by the US government, which guarantees the timely repayment of interest and principal.

US investment-grade corporate bonds

Investment-grade securities issued by US corporations to pay down debt. Investment-grade ratings imply a relatively lower risk of default.

US short-duration high-yield bonds

Non-investment grade securities that offer higher current income with a lower level of interest-rate risk, in exchange for certain additional risks. Category can include high-quality credit and bank loans.

US high-yield bonds

Non-investment grade securities that feature a favourable risk/reward profile relative to other asset classes, seeking equity-like return with less volatility.

US convertible securities

Corporate bonds that can be exchanged for stock. They offer an attractive asymmetric return profile – meaning they have historically participated in more of the underlying stock's upside than its downside.

Short-duration versions of these securities may help reduce interest-rate sensitivity, which may be beneficial given rising US interest rates.

The ICE US Dollar Index is a geometrically averaged calculation of six currencies weighted against the US dollar. It contains six component currencies: the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc.

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