



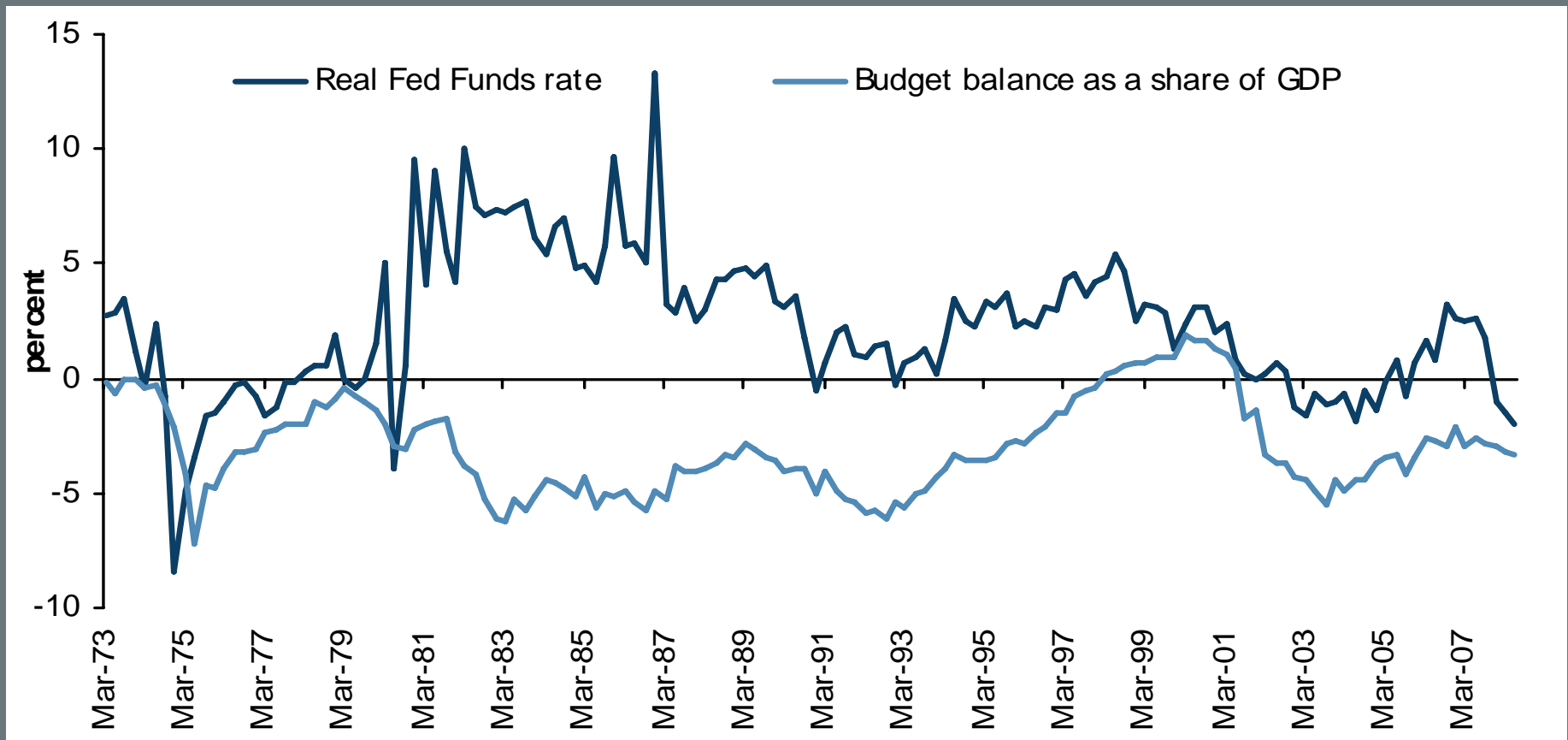
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USD: Vicious Circle

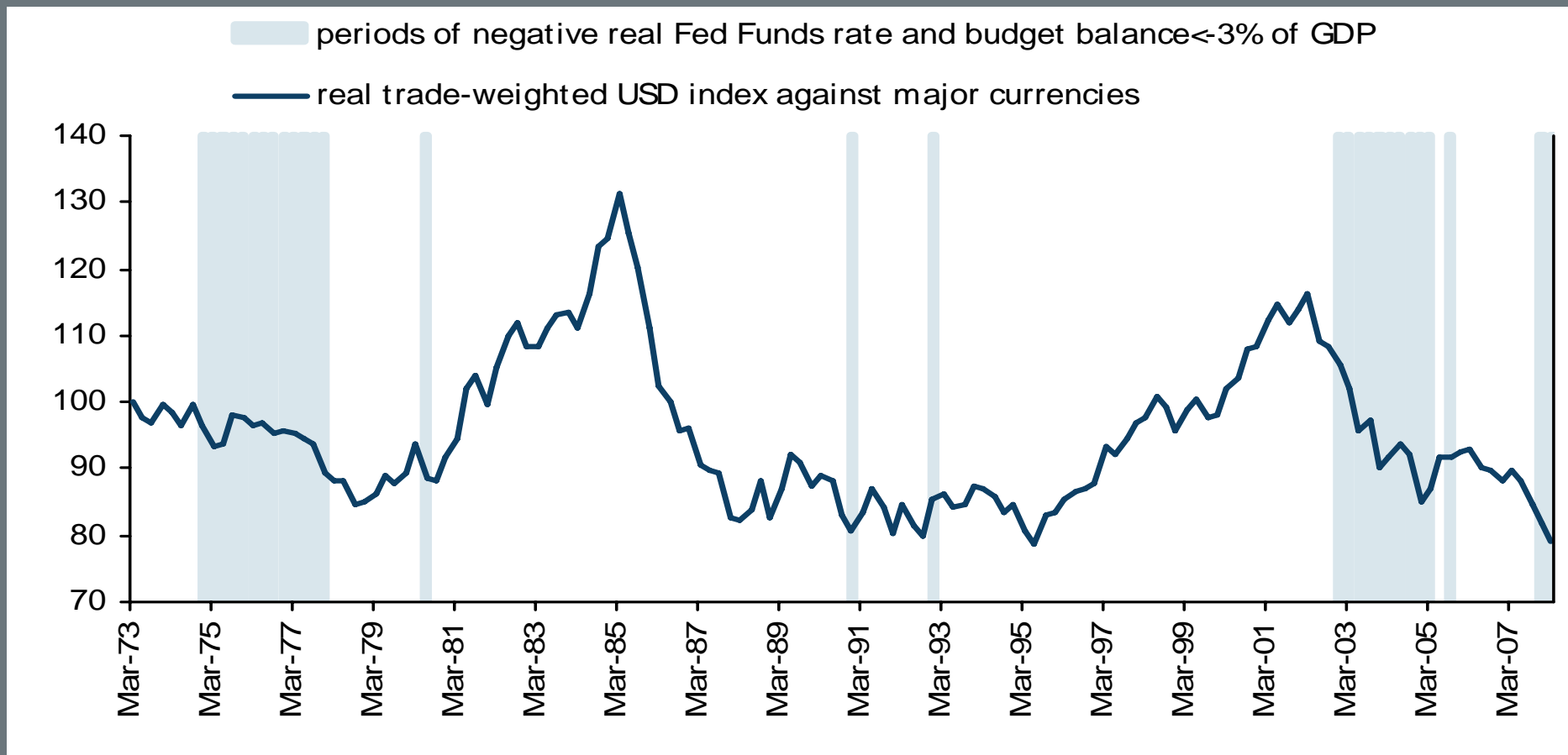
David Woo

Head of Global FX Strategy, Barclays Capital

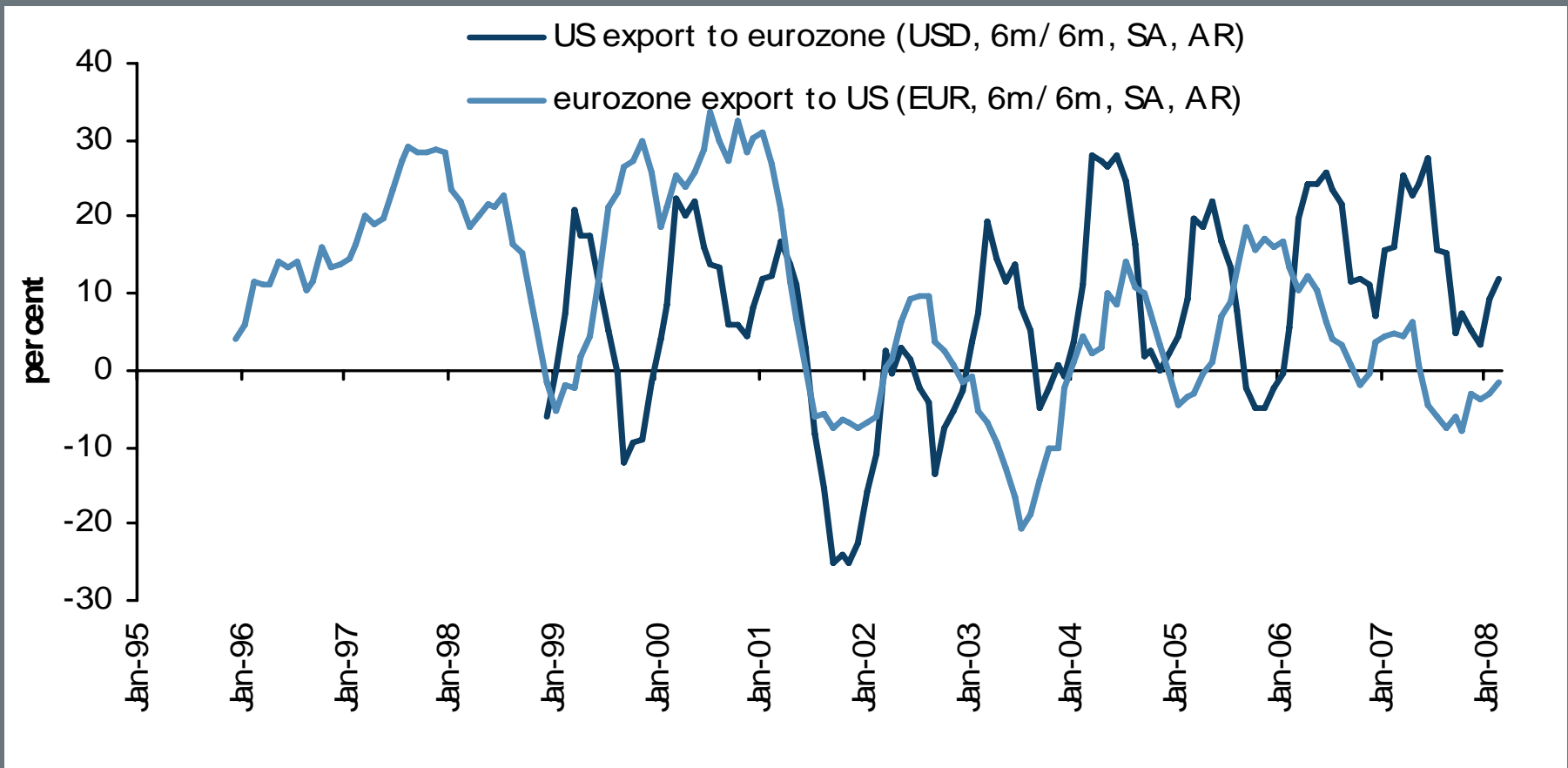
America is running both expansionary monetary and loose fiscal policies



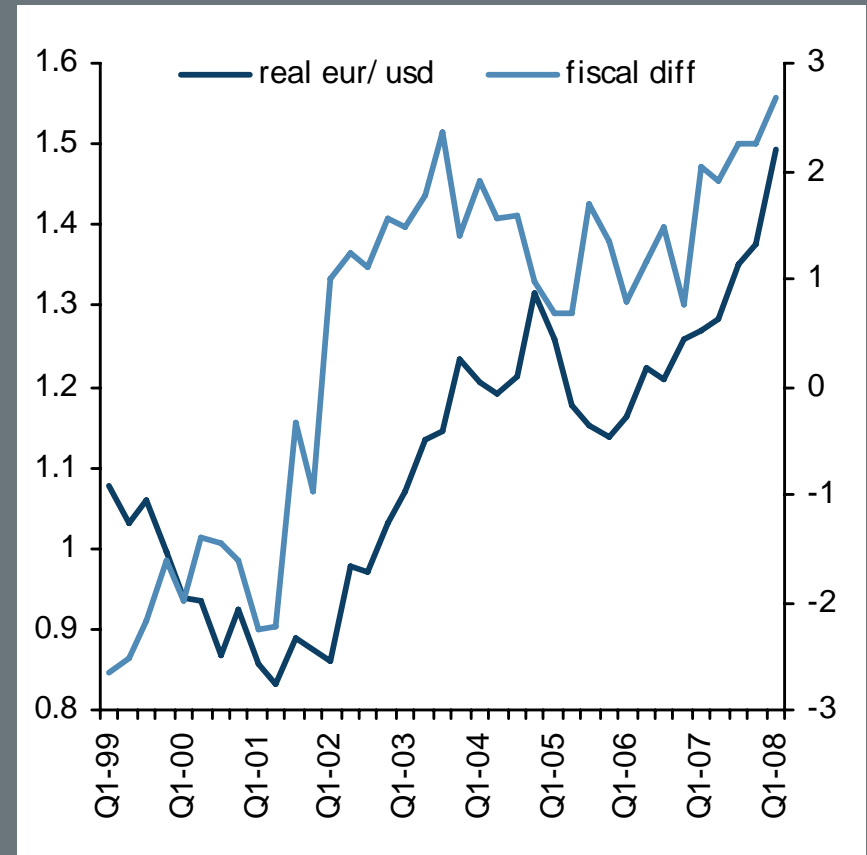
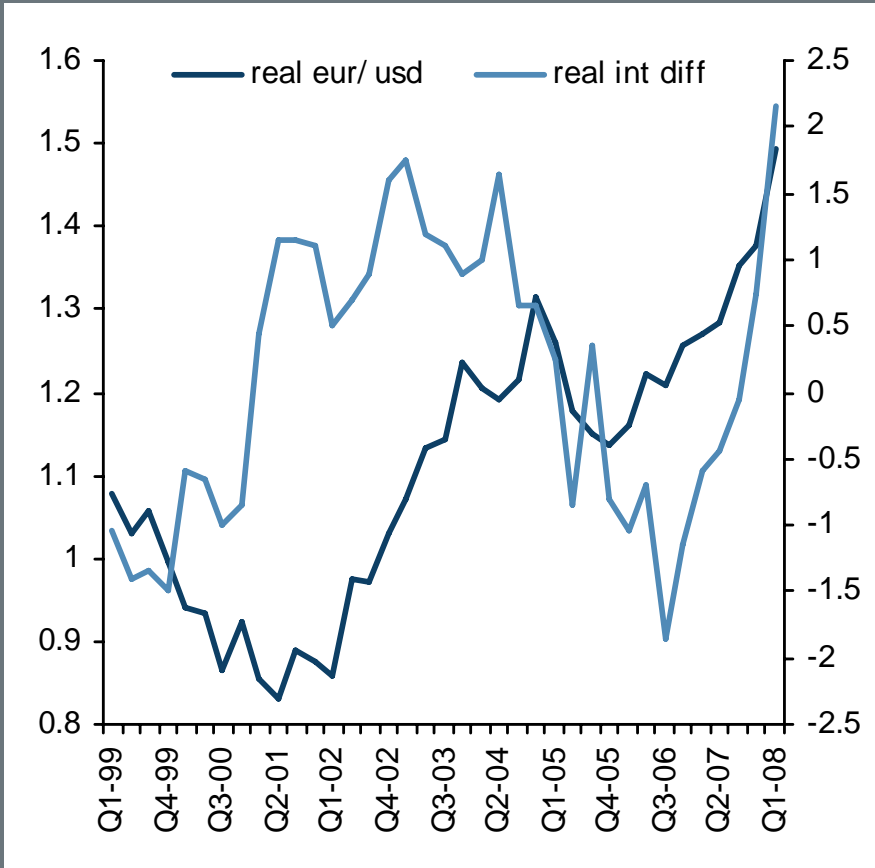
Periods of such policy stance were always characterized by a weak USD



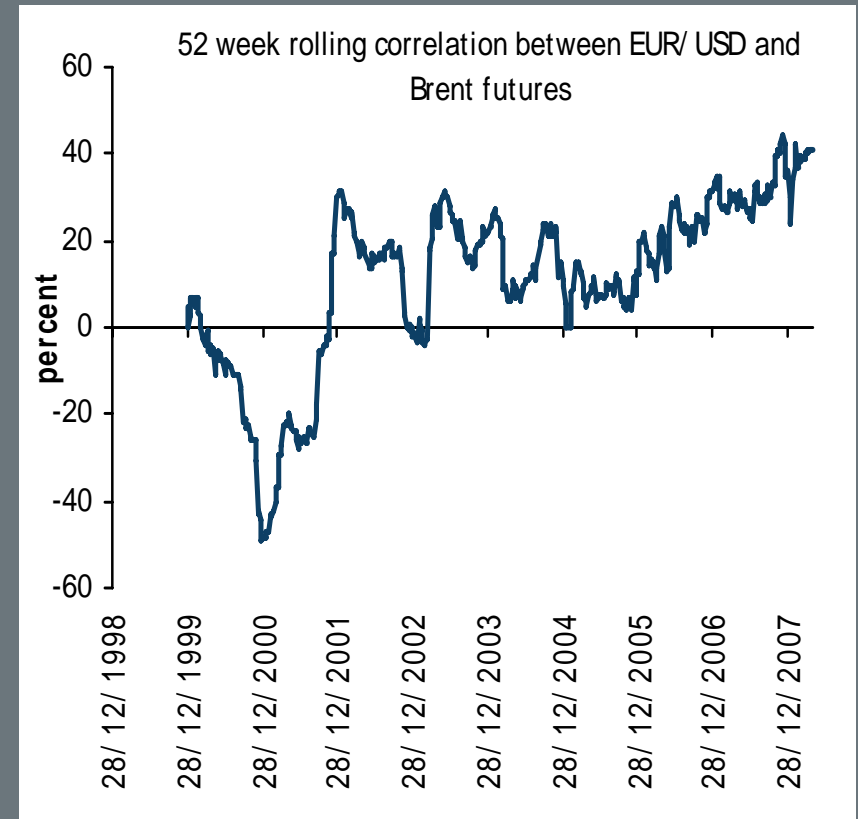
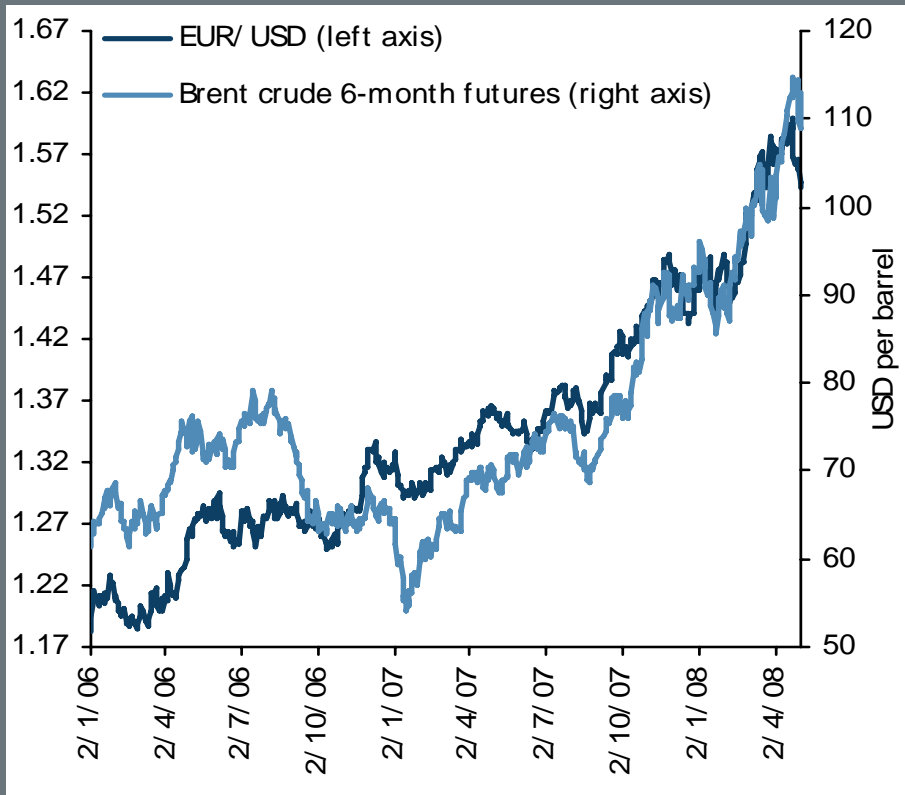
Eurozone exporters may be suffering from the strengthening euro.....



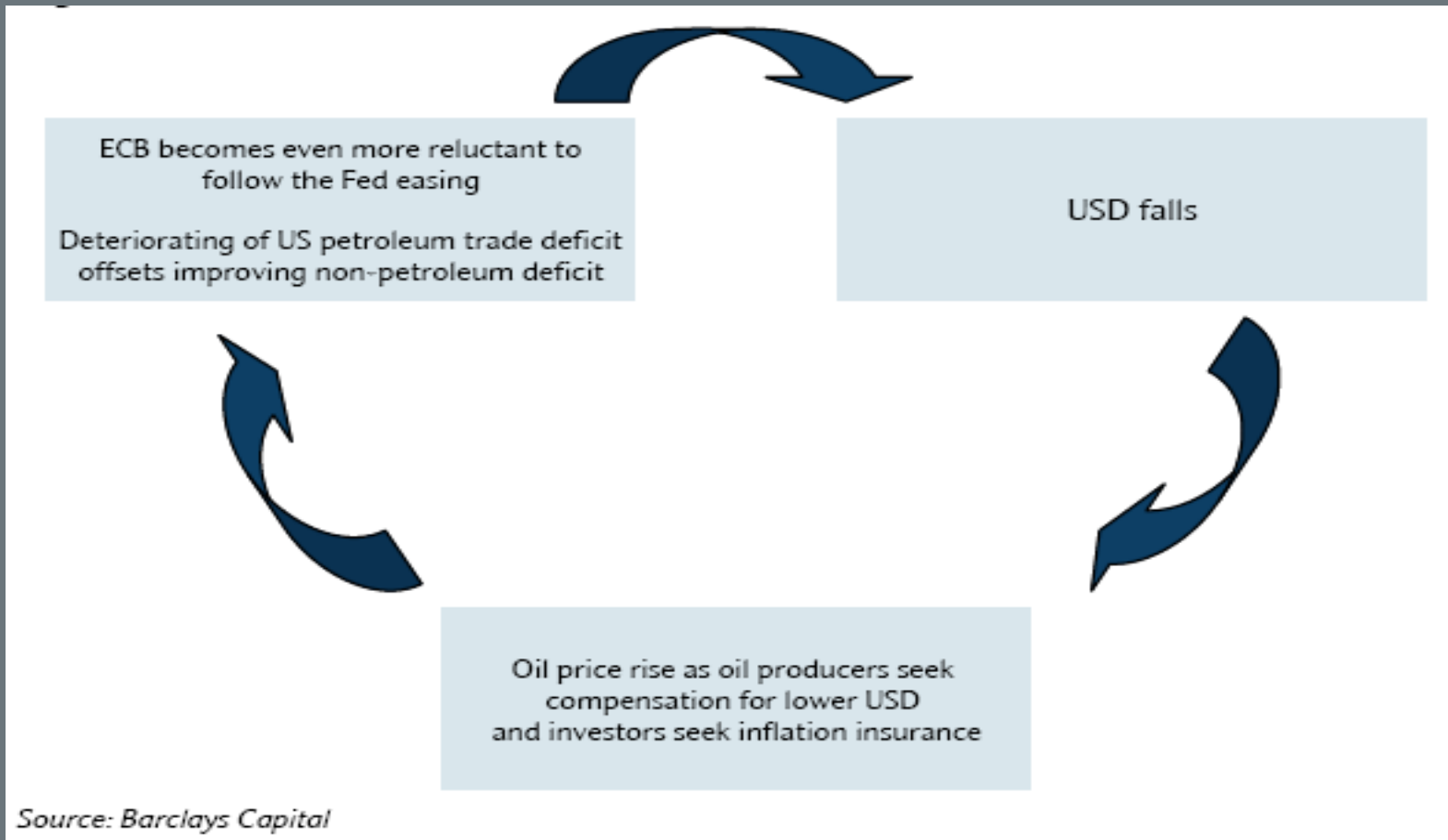
...but euro's rise against the USD has been supported by evolving relative fundamentals



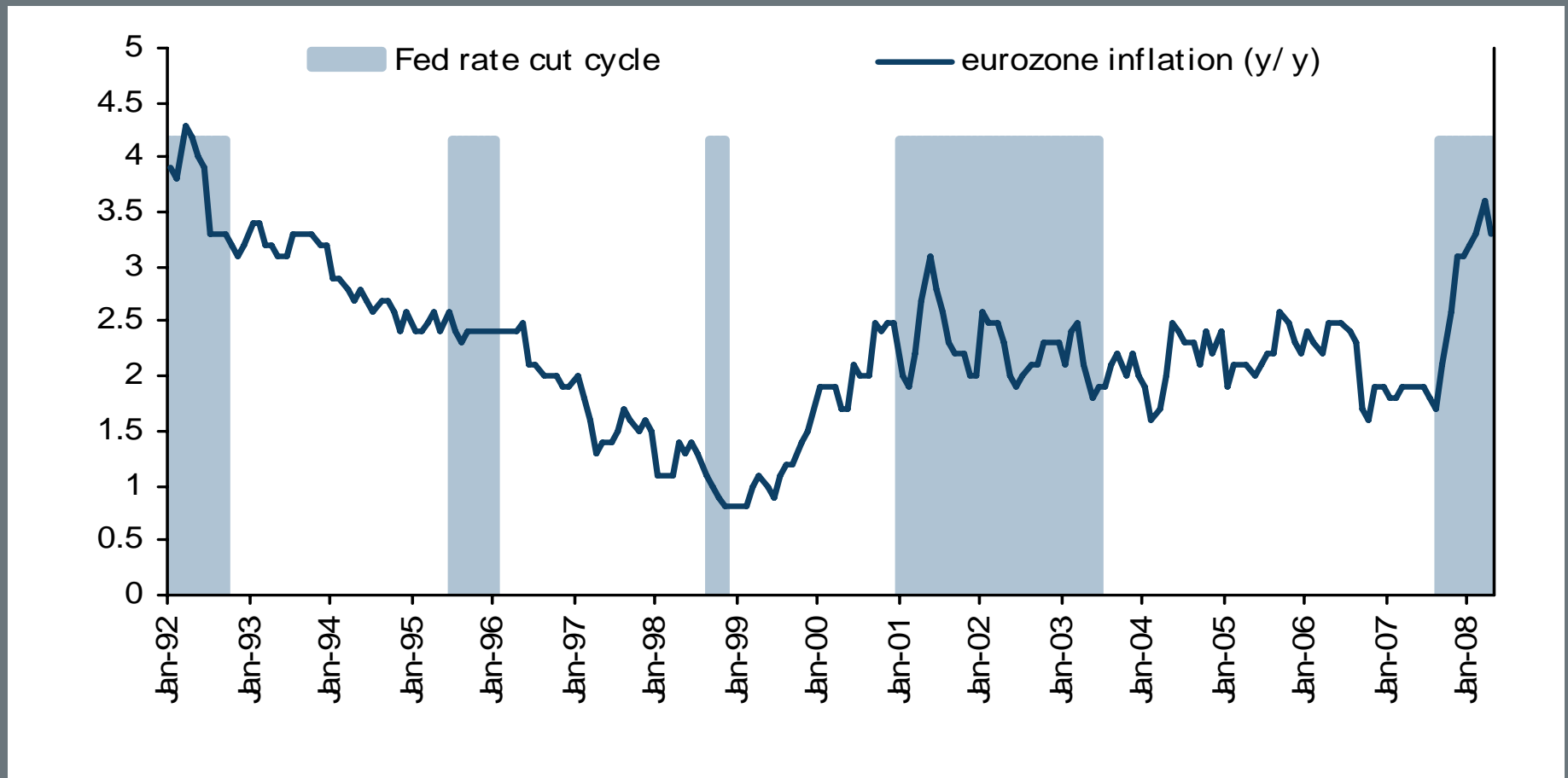
EUR/USD uptrend and oil uptrend are becoming mutually reinforcing



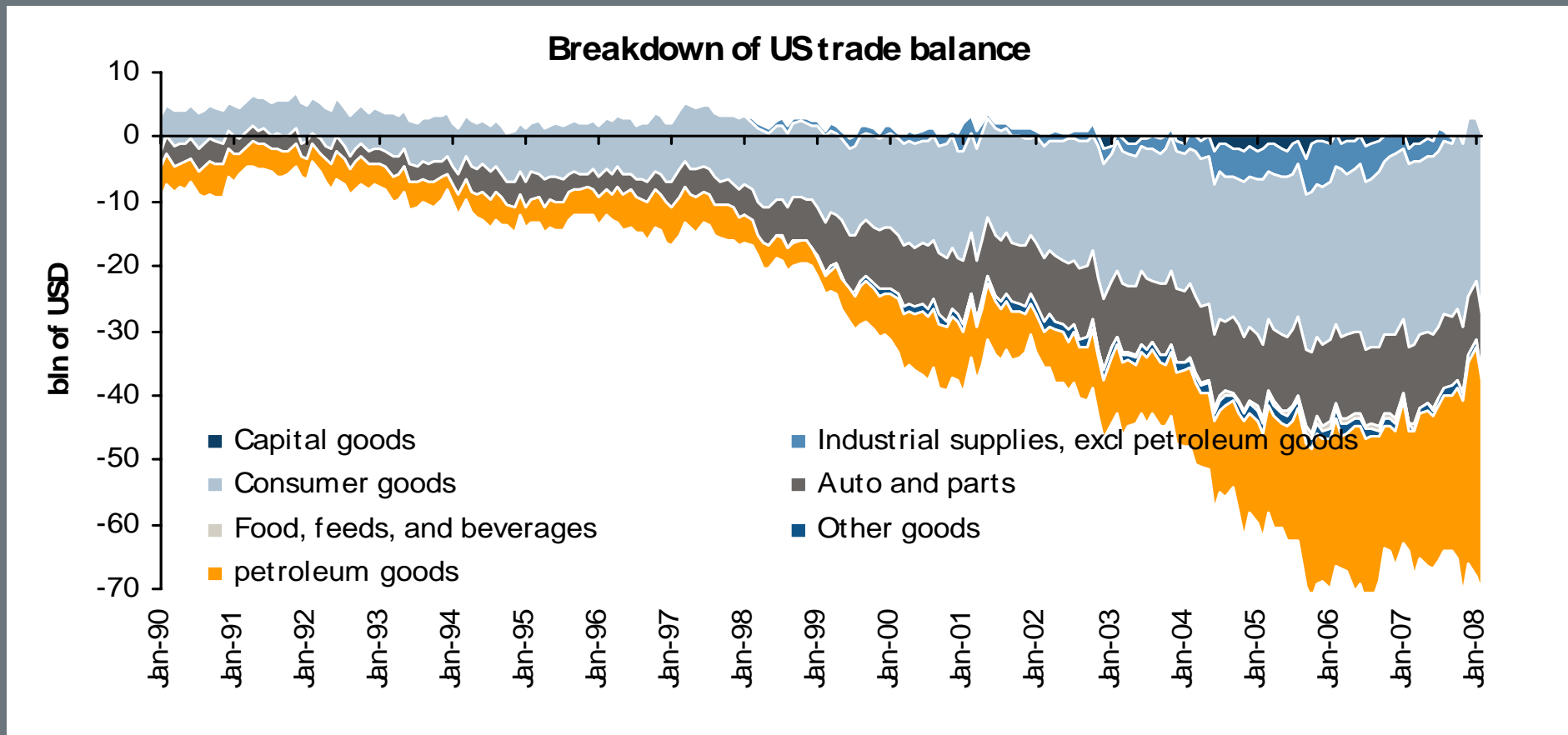
USD's vicious circle



This is the first time in twenty years that Eurozone inflation is rising while the Fed is cutting rates



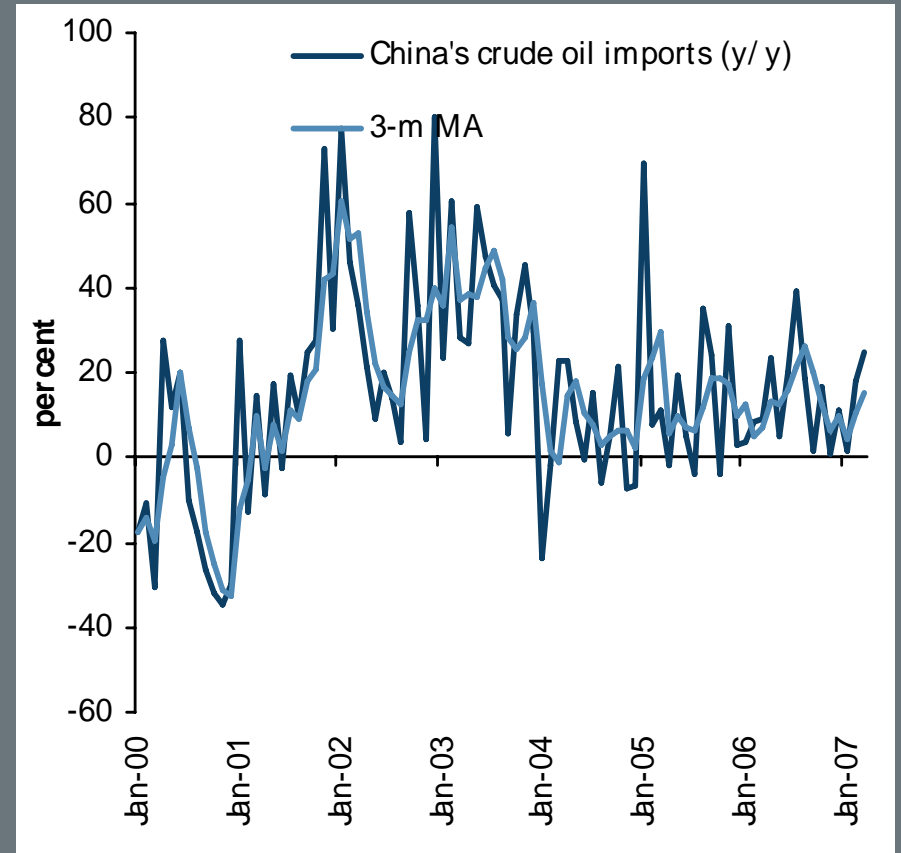
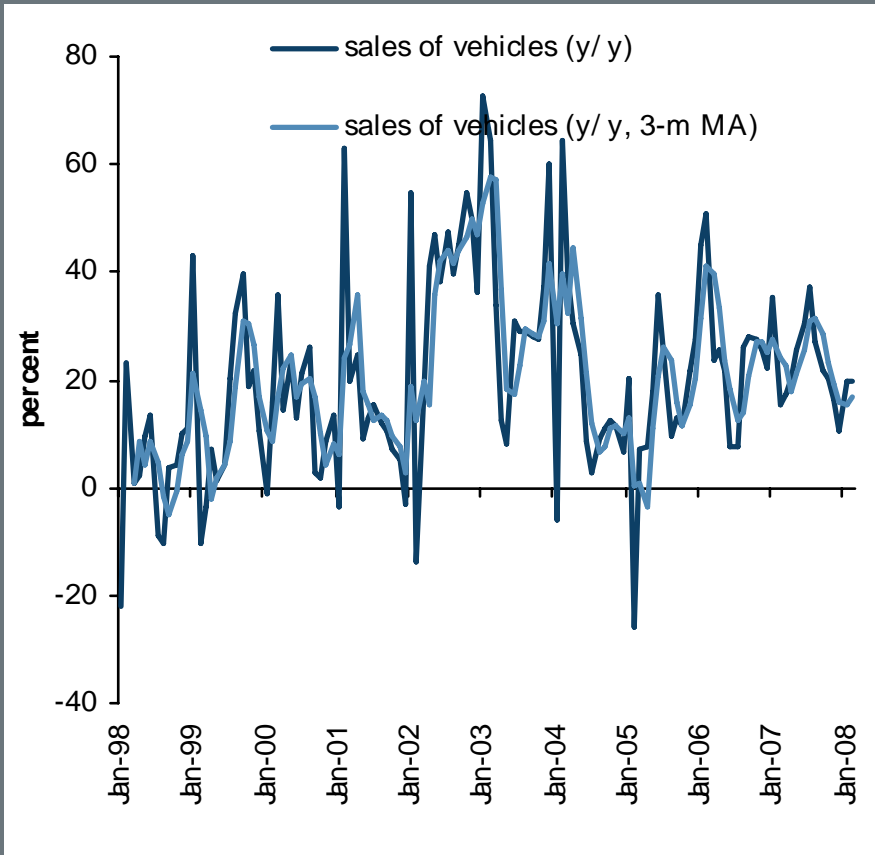
Increase in oil prices has prevented an improvement of US trade deficit, despite US slowdown and USD weakness



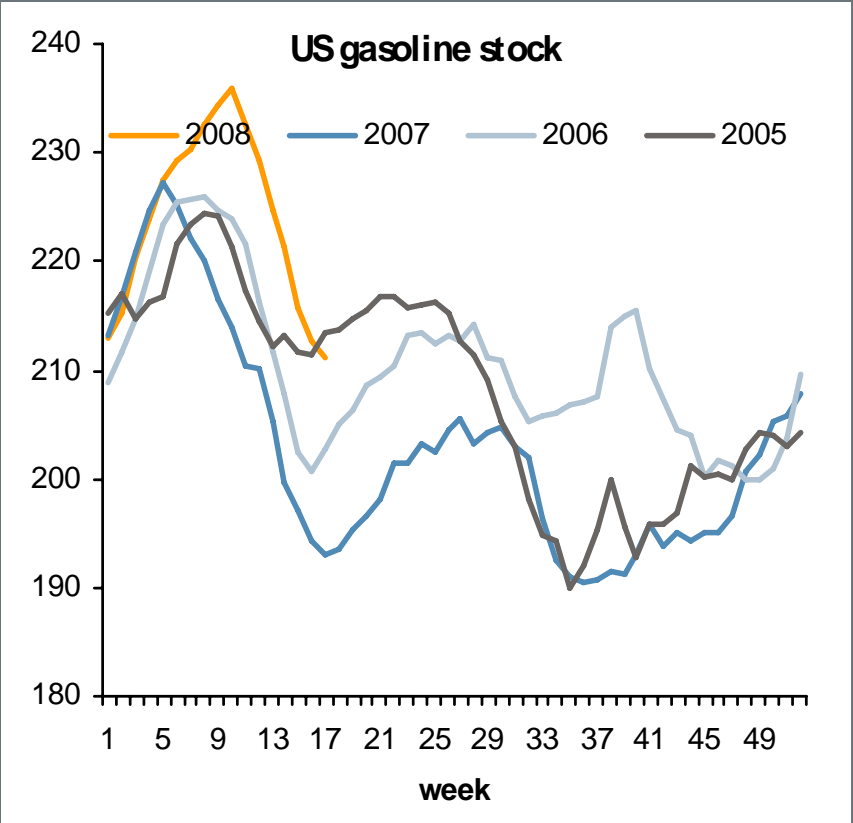
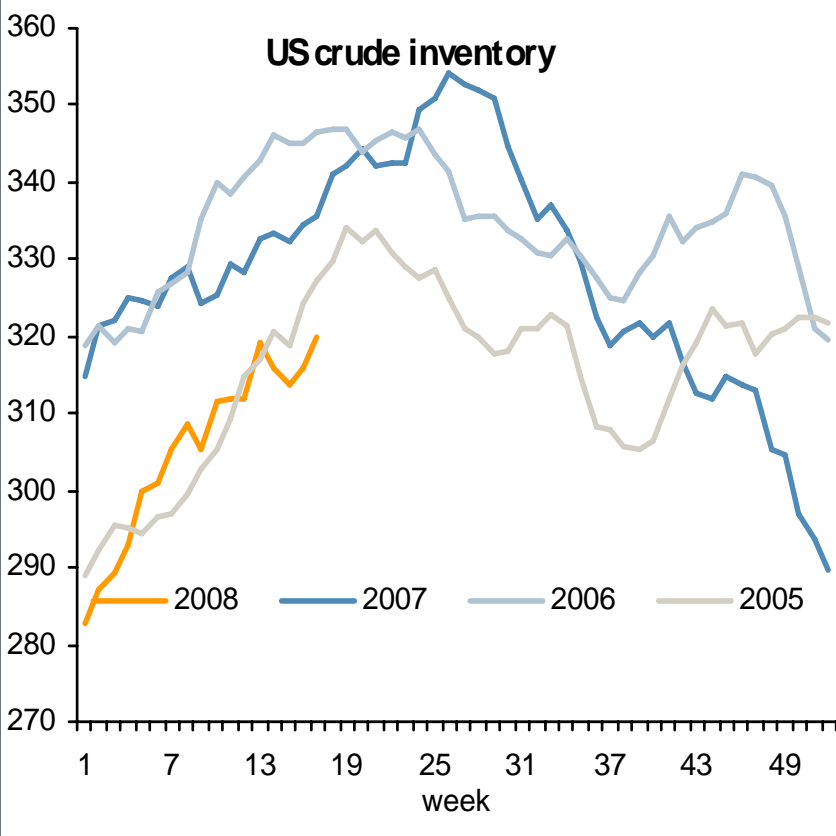
Preconditions for a sustainable USD recovery

- **Sharp slowdown in China:** such an event would dampen global marginal demand for oil, and, by triggering a correction of oil prices, break the vicious circle.
- **Big correction of the US equity market:** there are no signs of any decoupling of ROW from US financial markets. Synchronized equity sell-off would be followed by synchronized global economic slowdown
- **Visible negative knock-on effect of USD decline on US asset prices:** If further USD decline were to reduce appetite for US assets and drive down US asset prices, then US policy makers may be forced to change their ways

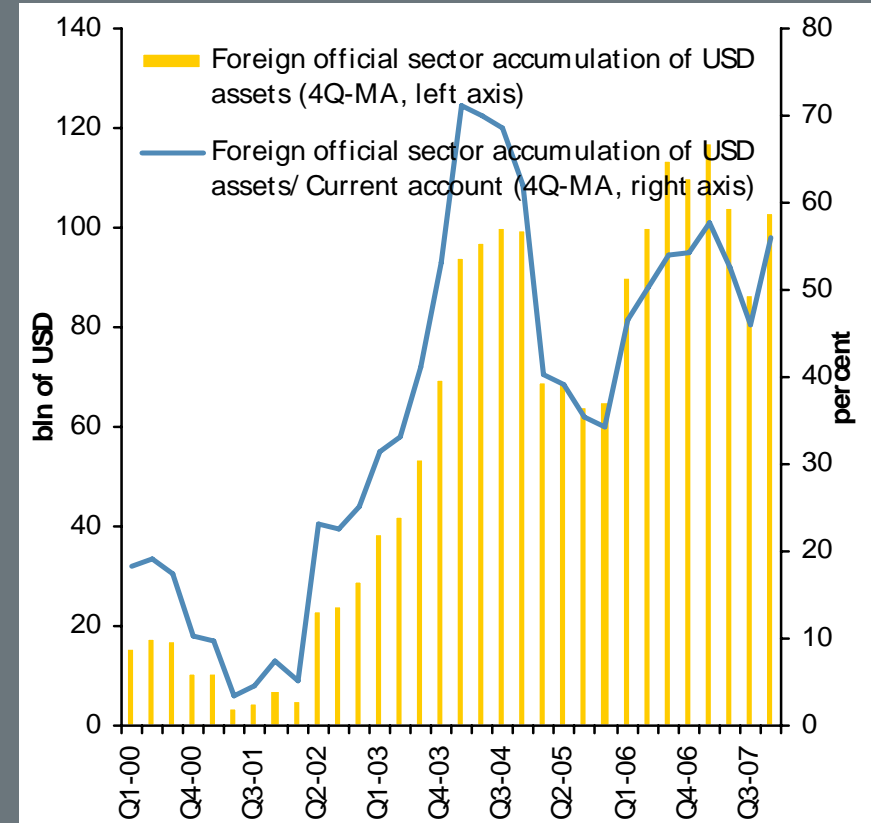
But if China is slowing at all, it is slowing very gradually



Meanwhile, global oil inventory remains tight



Bond vigilantes are suppressed by inelastic demand from reserve managers



Positioning and sentiment indicate scope for further USD rally in the short-term is limited

Figure 11: CFTC data on speculative short USD positions

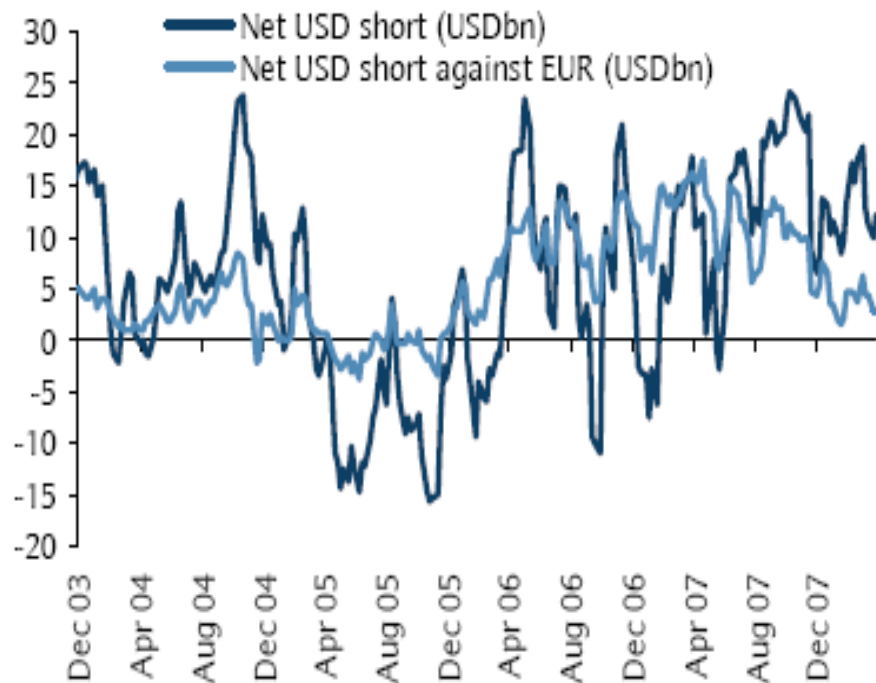
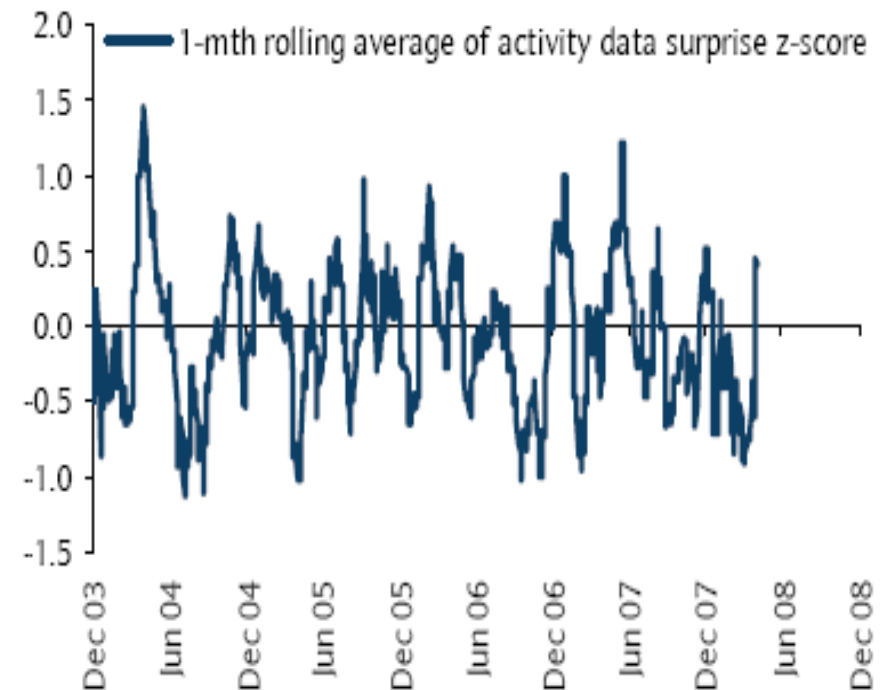


Figure 12: Barclays Capital US activity data surprise index



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