MULTIPLY GROUP

US DOLLAR

OUTLOOK AND INVESTING IMPLICATIONS

Currency outlook is a crucial piece of information in making cross border investing decisions. The US dollar, and with-it the UAE dirham, appreciated significantly last year, as interest rates rose in the US and investors sought the safety of the greenback amid the prevailing uncertainty. Understanding the direction of the USD in 2023 is important to internalize it in investment decisions and risk analysis.

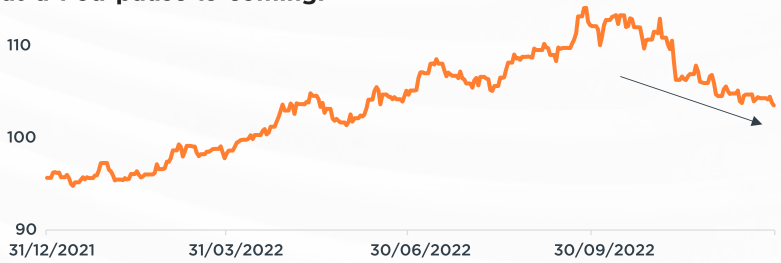
JANUARY 2023

WHY HAS THE DOLLAR STRENGTHENED

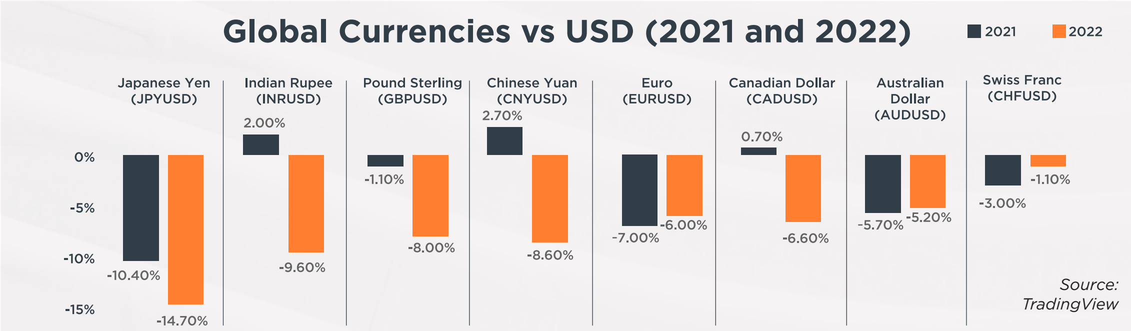
In 2022, the US dollar gained strength against the currencies of other major economies, appreciating 12% and reaching its highest level in 20 years. This strengthening reflects the market views on the global economy and policies. Many investors see the dollar as the safest asset to hold when stock and bond markets turn volatile as they did last year. Compounding this was the US economy looking relatively healthier than other major markets such as China, Europe and the UK.

The Federal Reserve took initiative to squash inflation and began raising rates higher and faster than other central banks. The higher yields attract investment capital from investors abroad seeking higher returns on bonds and interest-rate products. In response, central banks and governments around the world conducted rate hikes and foreign exchange interventions to increase the value of their own currencies, **with the dollar also under pressure as the market becomes more confident that a Fed pause is coming.**

US Dollar Index (DXY)



Source: Yahoo Finance



WHERE IS IT HEADING

It is likely the dollar has peaked and moderating expectations for US interest rates is expected to lead to a continued yet restrained softening of the dollar as the Fed approaches its terminal rate.

However, a Fed pause alone may not be enough to drive the dollar significantly lower. Improving economic conditions in the rest of the world combined with significant US disinflation, that would allow the Fed to reassess its hawkish stance, will be required to see noticeable dollar weakening. Furthermore, a rapidly falling dollar could provide an unwelcome measure of support for US inflation, making the Fed more inclined to keep policy tight.

As other global economies begin to provide more competitive policies and post stronger economic data, we could see a continued shift of capital to other markets. **At the start of the year, we have seen progress on both fronts; a trend of lower US CPI data and global growth expectations in key markets (such as China) improve.** The energy situation across the EU has improved and China's opening is expected to propel growth across Asia and Europe. As a result, **we expect the dollar to fluctuate within a narrow band.**

2023 Year End Dollar Forecasts

	Morgan Stanley	BANK OF AMERICA	J.P.Morgan
EUR/USD	1.15	1.10	1.00
GBP/USD	1.20	1.21	1.08
USD/JPY	136	137	133

Current Rates: EUR/USD = 1.09 GBP/USD = 1.24 USD/JPY = 129

Source: Morgan Stanley, BofA, JPMorgan

THREATS TO DOLLAR DOMINANCE

At the 2023 World Economic Forum, **Saudi Arabia's finance minister suggested they are open to discussions about trade in currencies other than the US dollar. The statement was a reminder that dollar dominance could wind down in the future** as competitors develop stronger cases and developing nations look to trade in regional currencies.

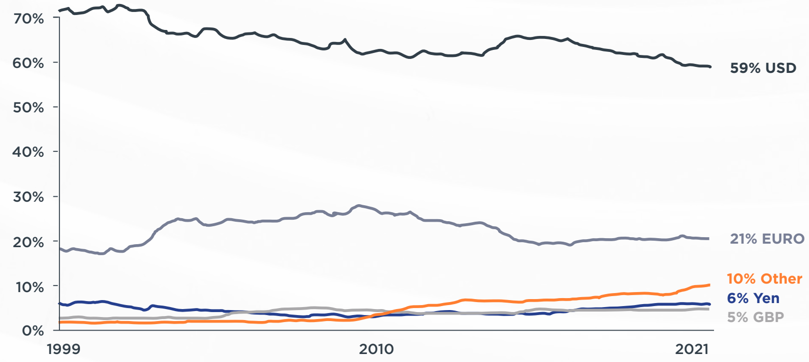
Dollar dominance in the past has been bolstered by the weaknesses of its rivals. The euro has been repeatedly undermined by financial crises, while the renminbi is heavily managed by an authoritarian regime. Nonetheless, alternatives are gaining ground. Over the last few years, the dollar based monetary system has been challenged by de-dollarization, whereby countries such as Russia, India and China have increased cross-border trade in their respective currencies and build reserves in gold. In addition, **the emergence of digital currencies, with more than half of the world's central banks exploring digital options, is also threatening the currency's global position.**

Beyond the Big Four currencies (USD, Euro, Japanese Yen and the British Pound) global use of other currencies has risen, including the Canadian and Australian dollar, the Swiss franc and the Chinese renminbi. They now account for 10 per cent of global reserves, up from 2 per cent in 2001.

From an investing viewpoint, this could lead to less emerging market currency volatility. In addition, several top currencies, and not just the dollar, will strengthen when there is a flight towards safety.

Currency composition of global foreign exchange reserves, %

Source: IMF



INVESTMENT IMPLICATIONS

A strong dollar causes companies that have a significant portion of their earnings coming from outside the US (or the UAE) to suffer most. It also makes international stocks a bargain for dollar denominated investors who want to diversify their portfolios. However, early investors have faced a significant exchange related decline in returns. For example, an investment in Europe last year would be down -17%, compared to -9% if investors kept their assets in euros and didn't convert their investment back into dollars.

Competitiveness of UAE based companies exporting goods or services abroad declines as these services become more expensive in local currency terms. This is more crucial now as demand is becoming more price sensitive amid rising inflation.

Investing in the UAE market may become less attractive as a strong dirham drives up asset price in local currency terms. More so, investors may find it more attractive to close their positions and repatriate their profits to gain from currency strength.

Perhaps most important when considering investment opportunities, is to understand how the changing foreign-currency translation may be impacting the fundamentals of the business itself.

KEY TAKEAWAY

Emerging economies are expected to be more stable and witness higher growth and accordingly the risk adjusted returns will be higher. The key is to build a robust currency risk screening mechanisms and hedging tools when investing in emerging economies. These includes economies that have a large current account deficit, declining foreign reserves, rising inflation and an openness to creating artificial exchange rates and capital controls.