Wall Street¡¯s Failed Dollar Call Redoubled on Fed: Currencies

2013-12-23 17:53:54.753 GMT

(For a Currencies column daily alert: SALT FXCOL.)

By John Detrixhe

Dec. 23 (Bloomberg) -- After wrongly calling for the dollar to strengthen against the euro this year, Wall Street strategists are making the recommendation again for 2014.

Barclays Plc, Deutsche Bank AG, HSBC Holdings Plc and UBS AG, four of the five biggest currency dealers, are among banks forecasting the U.S. tender will rally 6.4 percent versus the euro in 2014, according to the median estimate in a Bloomberg survey of 84 participants. A year ago, a survey predicted a 3.7 percent gain for the greenback in 2013. Instead, the 17-nation euro has appreciated 3.9 percent this year versus the U.S. currency, beating its major counterparts.

Strategists expect the U.S. economy to outperform its developed-market peers, enabling the Federal Reserve to print fewer dollars as it unwinds unprecedented monetary stimulus while Europe¡¯s central bank is seen easing further. The euro rallied the most this year against the dollar since 2007 after the region emerged from recession and the Fed maintained its $85 billion in monthly bond purchases longer than economists anticipated.

The diverging growth prospects ¡°justify the differentials in monetary policy,¡± Geoffrey Yu, a senior currency strategist at UBS in London, said Dec. 20 in a phone interview.

U.S. Growth

Economists surveyed by Bloomberg forecast American gross domestic product will expand 2.6 percent next year, while the euro area¡¯s will grow 1 percent. The U.S. grew at a revised 4.1 percent annualized pace in the third quarter, the strongest since the final three months of 2011 and up from a previous estimate of 3.6 percent, the Commerce Department said Dec. 20.

The dollar was at $1.3701 per euro as of 12:50 p.m. in New York, on pace for the second yearly drop and its biggest annual decline since it depreciated 9.5 percent in 2007. The common currency will weaken to $1.28 by the end of 2014, according to the median forecast in a Bloomberg survey.

¡°One thing we¡¯re looking for probably is flow allocations to continue heading into the U.S.,¡± Yu said. ¡°U.S. asset markets will outperform.¡±

The Stoxx Europe 600 Index has rallied 16 percent this year and the Standard & Poor¡¯s 500 Index of stocks has gained 28 percent. Bank of America Merrill Lynch¡¯s Pan-Europe Broad Market Index of fixed-income securities has risen 1.4 percent as of Dec. 20, while the U.S. Corporate & Government Index has fallen 2.3 percent.

Barclays, Citigroup Inc., Deutsche Bank and UBS are the four biggest currency dealers, according to a Euromoney

Institutional Investor Plc poll. Deutsche Bank was No. 1 with a 15.2 percent share, followed by Citigroup with 14.9 percent, Barclays with 10.2 percent and UBS with 10.1 percent.

¡®Crucial Element¡¯

Frankfurt-based Deutsche Bank estimates the greenback will strengthen to $1.25 against Europe¡¯s currency by the end of 2014. Last year, the firm forecast that the dollar would rally to $1.20 versus the euro in the following 12 months.

¡°The crucial element to the strength in core European currencies has been the normalization of the euro-area crisis,¡± Bilal Hafeez, the London-based global head of foreign exchange at Deutsche Bank, wrote in a Dec. 18 report. ¡°The long-term dollar cycle, a turn in the Fed cycle and U.S. capital flows and corrections in overvalued currencies should all support the dollar in 2014.¡±

Dollar Index

The Dollar Index, which InterContinentalExchange Inc. uses to track the currency against six of its major trading partners, has risen 0.8 percent this year, and reached a level of 80.6 today. The gauge is weighted 57.6 percent to movements in the euro, 13.6 percent to the yen and 11.9 percent to the pound.

The benchmark will climb to 86.5 by the end of 2014, according to the median forecast in a survey by Bloomberg. A year ago, analysts estimated the gauge would be about unchanged at 79.7 by the end of 2013.

Goldman Sachs Group Inc. analysts, who correctly predicted the dollar¡¯s slide against the euro this year, are betting against the consensus that the greenback will be among the best currencies to own in 2014.

The dollar will weaken to $1.40 per euro for the first time since October 2011 because reduced Fed stimulus is already reflected in the U.S. currency¡¯s price, Thomas Stolper, Goldman¡¯s London-based chief currency strategist, said in an e-mailed response to questions two weeks ago.

Citigroup¡¯s Bet

Citigroup also sees the European currency gaining to $1.40 in 2014, after wagering a year ago that it would fall to $1.20 by December 2013, Bloomberg data show.

While the ECB¡¯s shrinking balance sheet has buoyed the euro this year, traders are betting the common currency will lose that advantage now that the Fed has started reducing its monetary stimulus program.

The ECB¡¯s holdings have fallen to 2.3 trillion euros ($3.2 billion) from a peak of 3.1 trillion euros in June 2012. The Fed is still adding assets, which climbed to about $4 trillion from less than $1 trillion in September 2008.

ECB President Mario Draghi surprised investors in November by cutting the euro region¡¯s main interest rate to a record 0.25

percent. Draghi said Dec. 5 that policy makers briefly debated pushing the deposit rate into negative territory and the terms for fresh long-term loans to banks, hinting that more easing is possible next year.

The U.S. central bank said on Dec. 18 it will trim its monthly bond purchases to $75 billion from $85 billion, taking the first step toward unwinding the stimulus. Policy makers coupled their decision to taper with a stronger commitment to maintaining an accommodative, or looser, monetary policy.

HSBC sees the dollar gaining versus the euro in the next 12 months to $1.28, after betting last year that it would depreciate about 2 percent to $1.35, Bloomberg data show.

¡°Key for the Fed and markets will be the extent to which this new dovish forward guidance remains credible in the face of ongoing tapering and the presumed continuation of better U.S. economic data,¡± Robert Lynch, a currency strategist at HSBC in New York, wrote in a Dec. 18 report.

For Related News and Information:

Fed Seen Tapering QE in $10 Billion Steps Through October

NSN MY43HZ6JIJVB <GO>

Banks Said to Snitch on FX Competitors in Race to Avoid EU Fines

NSN MY2FX56K50ZK <GO>

Canadian Dollar Most at Risk as Fed Turns to Taper: Currencies

NSN MY0O5N6TTDS5 <GO>

Top currencies news: TOP FRX <GO>

Currency reversal calls: NI MARKETREV <GO>

--Editors: Dave Liedtka, Kenneth Pringle

To contact the reporter on this story:

John Detrixhe in New York at +1-212-617-3409 or

jdetrixhe1@bloomberg.net

To contact the editor responsible for this story:

Dave Liedtka at +1-212-617-8988 or

dliedtka@bloomberg.net