

**Markets Update: Exchanges at Goldman Sachs
What's Ahead for the U.S. Dollar?
Zach Pandl, Co-Head of Global Foreign Exchange Strategy,
Goldman Sachs Research
Host, Jake Siewert
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Jake Siewert: Welcome to our Exchanges at Goldman Sachs Markets Update for Friday, April 16th. Each week we check in with a leader across the firm to get a quick take on what they're watching in markets.

This week we're going to discuss the latest trends affecting the US dollar and other currencies. I'm Jake Siewert, Global Head of Corporate Communications here at the firm. And I'm delighted to be joined today by Zach Pandl, who is Co-Head of Global Foreign Exchange Strategy for Goldman Sachs Research.

Zach, welcome to the program.

Zach Pandl: Hi Jake.

Jake Siewert: So, Zach, you've had a pretty negative view on the dollar basically because of its high valuation, low interest rates in the US, and a recovering global economy. But you recently published a note removing your dollar short trade. Can you explain why?

Zach Pandl: Yes. We've had a negative structural view on the dollar. But the dollar appreciated in the first quarter as the market really repriced its expectation for where the Federal Reserve is headed over time. What we try to do with these trade recommendations is give investors the best expression to try to extract value from the bearish dollar thesis over time. We tried to short the dollar versus the commodity currencies in V10 in the first quarter like the Canadian dollar. Those were basically flat versus the green back. And so, we decided to take a step back.

Now, US rates have begun to stabilize recently, despite very strong data. Five year Treasury yields are actually a bit lower now than where they were one month ago despite booming growth and upside surprises to inflation. And lower rate volatility could open up room for new dollar shorts. We haven't issued new short recommendations just yet. But we are looking very closely at that opportunity.

Jake Siewert: Okay, given you're long term bearish on the US dollar, what currencies do you expect to appreciate against the dollar?

Zach Pandl: Well, over the next few months, I think the main option is really the euro, and closely relates currencies in that region. Investors have become pretty pessimistic on the European recovery. And we think that that pessimism is somewhat misplaced. Europe is seeing its COVID situation stabilize. Vaccinations are picking up and are likely to ramp up substantially over the next few months. And so, we're pretty confident on the growth story there.

We also have upgraded our forecast for European equity markets and see higher returns in that market relative to the US. The European Central Bank is probably going to be making some changes over the course of the summer to its bond purchases, which could result in interest rates moving up a bit. So, we're turning more confident on the euro in particular. We have a 12 month forecast of 128 for the euro/dollar cross. And at this point I'm pretty comfortable with that target.

Jake Siewert: Okay, so there's, from time to time, some people who proclaim that the dollar will lose its status as the world's reserve currency. But the dollar as a safe heaven asset, it's usually the currency of choice for cross border lending, global trade. Tends to make up an outsized percentage of global foreign currency reserves. But there were some new figures out from the IMF this month that showed that the dollar share of global reserves has fallen to its lowest level since 1995. So, do you think as global growth bounces back and there's big stimulus, will that help reverse that decline?

Zach Pandl: We think probably not. It's important to stress in this topic that the dollar is not going to lose its reserve currency status. But it is losing its reserve currency status to some degree. The dollar share of global foreign exchange reserves has been coming down. And we think that that probably continues over the medium term because the dollar faces new, genuine competition from both the euro and the Chinese yuan. We're seeing a common European bond market emerge as a kind of byproduct of the COVID crisis. Recovery fund issuance is going to be picking up and the middle of this year starting in July. And we think that those assets will be particularly attractive to our sovereign investors.

Meanwhile, China's financial opening has really moved into high gear. You've seen a regime change in how global fixed income investors are treating the Chinese market. And that reflects micro issues, the fact that China has now been added to many major bond indices. But also, macro issues. The high real interest rates in the Chinese market and the relatively low valuation of the Chinese yuan relative to the US dollar. So, really seeing tremendous portfolio flows into the Chinese market. That could also weigh on the dollar's reserve currency status over time.

So, we certainly don't want to be counting out the global role of the dollar. I think that's a very slow moving trend. But we do think that there will be downward pressure on the dollar's valuation as investors substitute, to some degree, to both the euro and the Chinese yuan over time.

Jake Siewert: Okay, so finally, the Biden administration recently put out its \$2 trillion infrastructure plan. And the funding for that, in part, would come from raising the corporate tax rate back to 28 percent from 21 percent where it sits today. How might higher tax rates in the US affect the dollar?

Zach Pandl: Equity portfolio flows across countries can be just as important as fixed income flows. And so, anything that negatively affects the US equity market relative to the other markets can have implications for the dollar. Our portfolio strategists estimate that as proposed, the Biden corporate tax plan would lower S & P 500 earnings per share for next year by about 9 percent. And that drag is one reason why we're forecasting lower returns in the US market compared to non-US markets over the next 12 months.

And so, we start to see that materialize. If US equity markets underperform, we may see some capital outflow from the US in search of higher returns overseas. And that can put some downward pressure on the dollar as well.

Jake Siewert: All right, well a lot to keep track of. Thanks for joining us today, Zach.

Zach Pandl: My pleasure.

Jake Siewert: That concludes this episode of Exchanges at Goldman Sachs. Thank you very much for listening. And if you enjoyed this show, we hope you subscribe on Apple Podcasts and leave a rating or a comment.

This podcast was recorded on Thursday, April 15th, in the year 2021. Thanks for listening.

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