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FX Focus

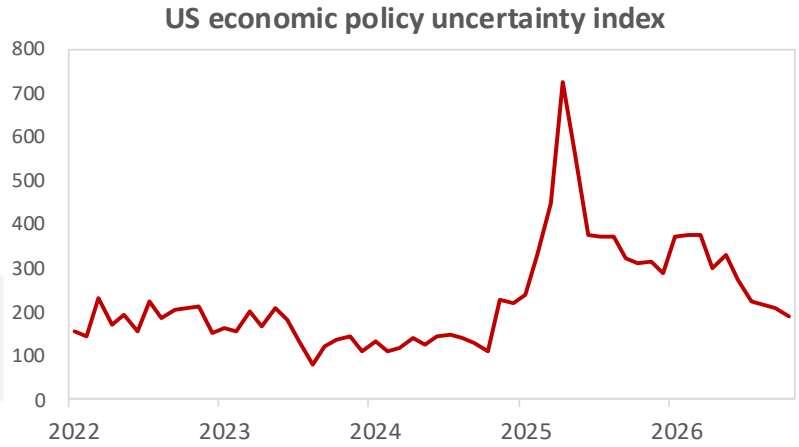
Peak Dollar? Not Yet

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- *The USD remains well supported by strong US growth, sticky inflation and a hawkish Federal Reserve risk, while Europe and China have yet to generate comparable economic momentum.*
- *AI investment and superior US earnings continue to attract global capital. A Democratic sweep could reduce policy volatility, although tighter AI oversight poses a longer-term risk.*
- *Near-term USD gains should be modest. EUR weakness may persist, but managed CNY appreciation and an improving JPY outlook should limit broader USD upside.*

The USD has remained resilient, trading within a narrower-than-usual range despite geopolitical shocks, policy uncertainty and periodic bouts of volatility. Although reserve diversification is continuing, there is still little evidence of outright de-dollarisation.

US economic policy uncertainty has already fallen significantly from its mid-2025 highs



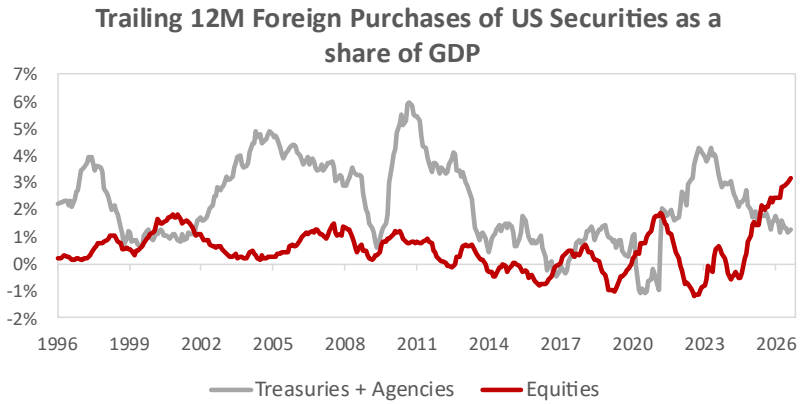
Source: Bloomberg, Baker et al, OCBC Group Research

The Democratic sweep in the US midterm elections could create a less volatile policy backdrop by constraining the administration's agenda. US economic policy uncertainty has already fallen significantly from its mid-2025 highs. This should allow economic fundamentals to play a larger role in driving the

USD. The US cyclical picture remains firm. Fiscal risks have faded from view, but they have not disappeared and could return in 2027.

Sustained USD weakness has historically required steady US growth alongside a much stronger recovery elsewhere. Those conditions are not yet in place. The US economy continues to outperform Europe, while China's domestic demand remains subdued despite resilient exports. The US advantage is even clearer in corporate earnings and margins, with the AI investment boom continuing to attract global capital into US assets. AI-related equity gains have been supported by earnings growth, strong infrastructure spending and continued fund inflows.

Foreign equity demand, likely supported by AI investment boom, increasingly compensated for weaker Treasury demand



Source: Bloomberg, TIC, OCBC Group Research

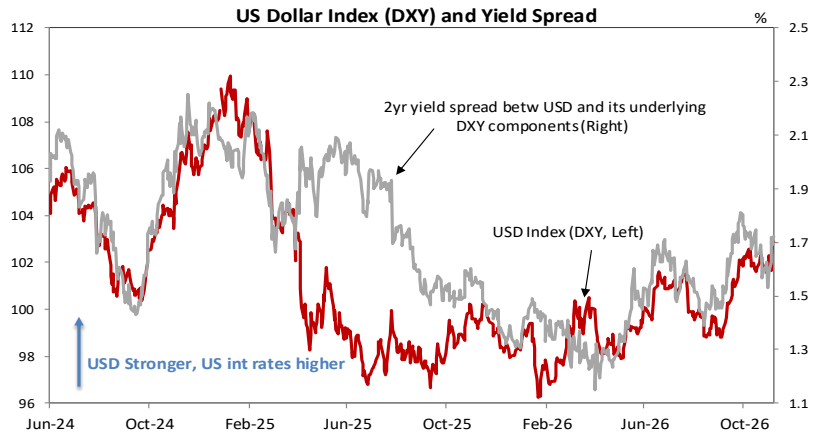
The Democratic sweep nevertheless creates some downside risks for the USD. Greater scrutiny of the AI industry could eventually slow investment, while lower oil prices would reduce the US terms-of-trade advantage. For now, however, it is too early to position for broad USD weakness. Our base case remains that AI investment will stay strong and oil prices will decline. A material slowdown in AI spending looks more like a medium-term risk than an immediate threat. Better prospects for de-escalation and more Gulf export capacity leads us to cut our end-2027 Brent forecast back to USD75/bbl from USD85/bbl.

Recent US inflation data also strengthen the case for a firm USD. Core inflation remains sticky while growth and employment remain resilient. This supports our call for another Federal

Reserve rate hike in December and raises the possibility of further tightening in 2027.

We see scope for further modest USD gains against the EUR as French fiscal tensions remain a focus into early 2027. Unlike in the US, there is also limited evidence that stronger European demand is generating persistent underlying inflation. The risk of greater Fed-ECB policy divergence may therefore be underpriced, leaving relative rate differentials supportive of the US dollar index (DXY).

Risk of greater Fed-ECB policy divergence may be underpriced, leaving relative rate differentials supportive of the DXY



Source: Bloomberg, OCBC Group Research

Broader USD upside should nevertheless be modest. Firmer currency management across Asia, including managed CNY appreciation, and an improving JPY outlook should provide resistance. More frequent bouts of US-centric AI volatility could also strengthen the JPY's appeal as a hedge.

Declining oil prices should support EM Asian carry trades but developed-market high yielders such as the AUD may have limited appreciation potential as the Reserve Bank of Australia hiking cycle matures. We expect the broader USD cycle to turn lower, but mainly from the second half of 2027, when slower US growth, lower energy prices and easing European political risk should provide a more durable catalyst for EURUSD upside.

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