

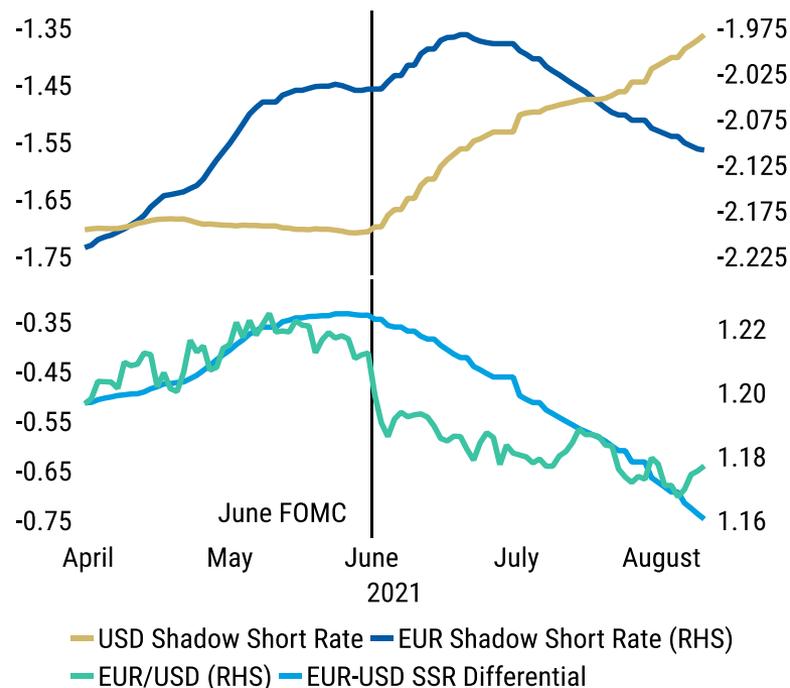
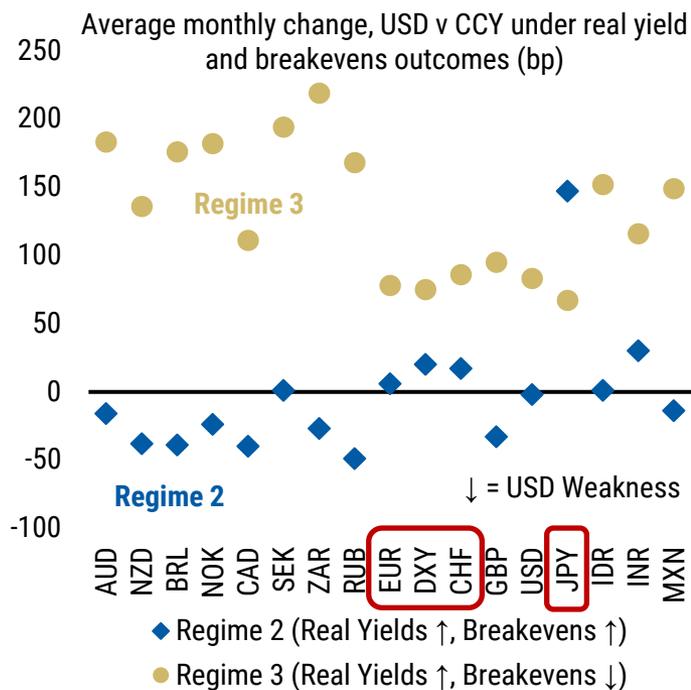
US Dollar (USD)

USD | A US Real Yield Bounce Supports USD

We expect US real yields to keep decoupling from still-falling European real yields, which should support USD versus low-yielding funders like EUR, JPY and CHF

USD tends to gain vs. EUR, CHF and JPY in both regimes where real yields are rising

Widening US-Europe shadow short rate differentials have weighed on EUR/USD

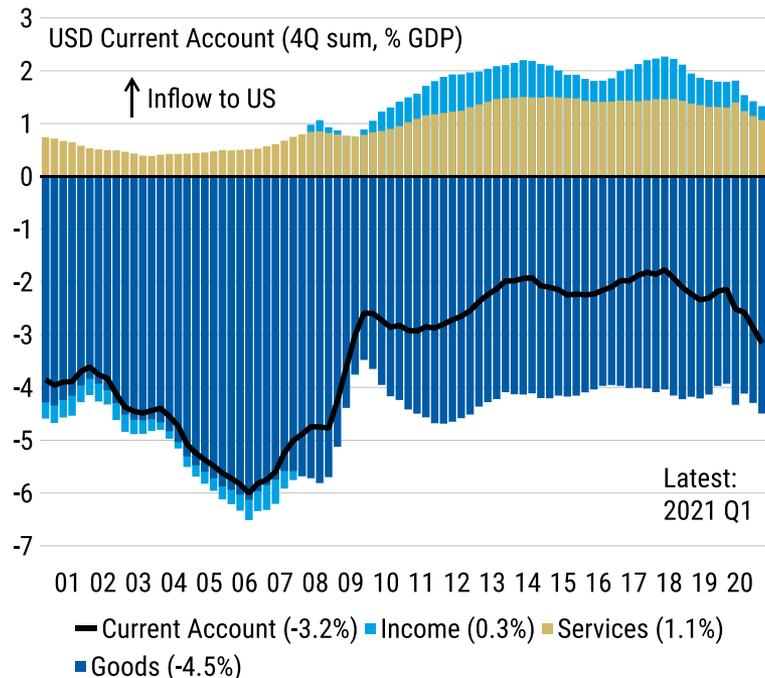


Source: Bloomberg, Macrobond, Morgan Stanley Research

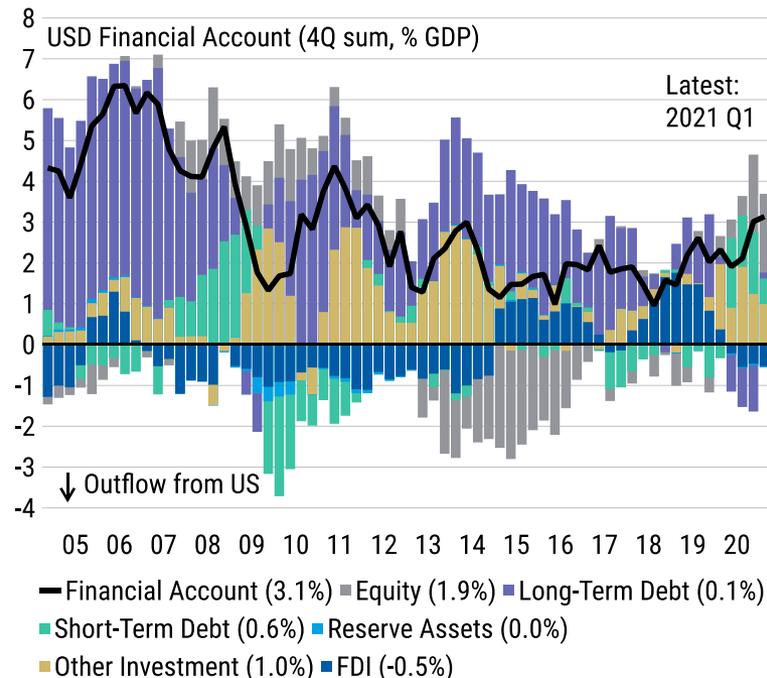
USD | Current and Financial Accounts

The US current account deficit is widening and likely to widen further to 4% of GDP by 2022 amid elevated US consumption and government spending

Current account breakdown



Financial account breakdown

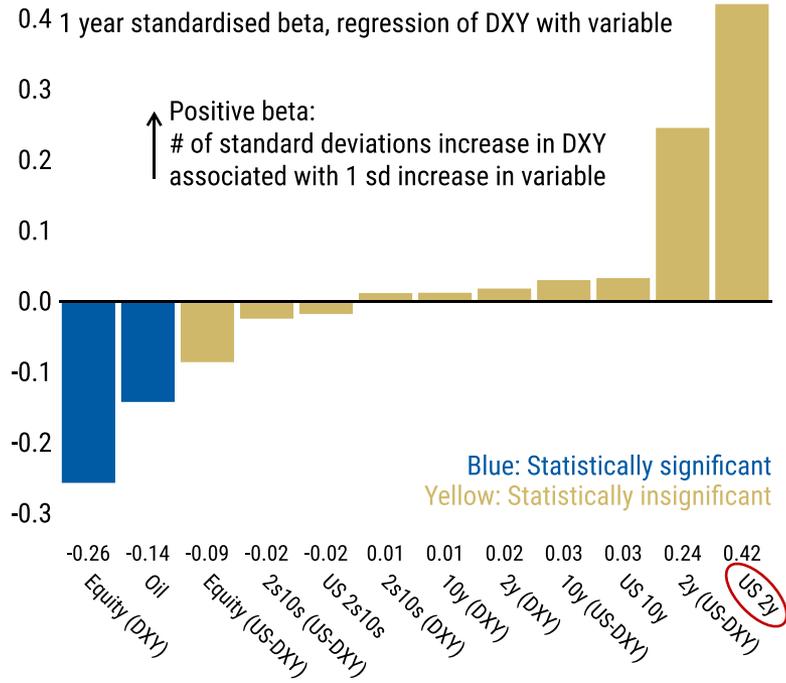


Source: Macrobond, Morgan Stanley Research

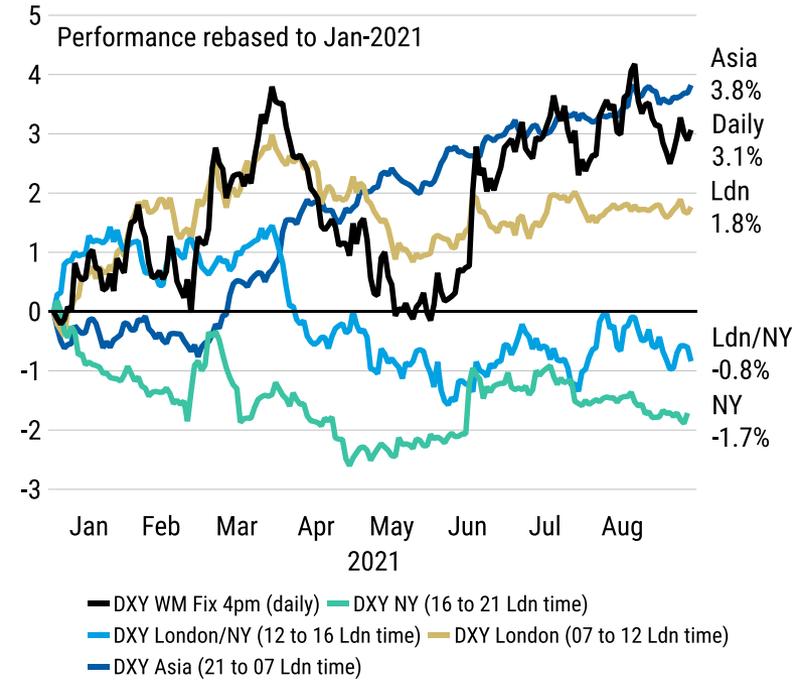
USD | Betas and Time Zone Performance

USD remains highly sensitive to Fed rate hike expectations. USD gains year-to-date have been chiefly concentrated in the Asia and London time zones

Sensitivity of USD (DXY) Index to different market variables



DXY performance across time zones



Source: Macrobond, Bloomberg, Morgan Stanley Research

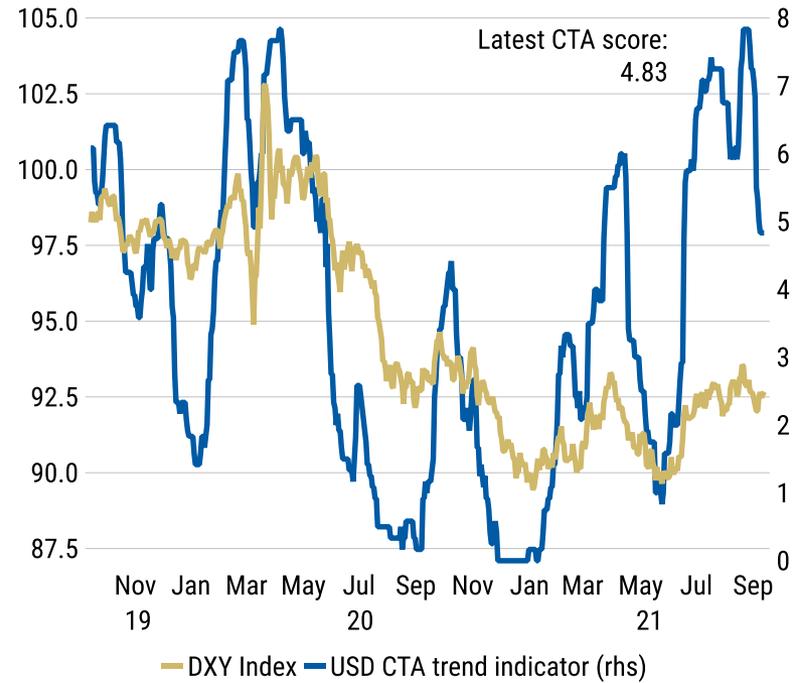
USD | Market Positioning and Sentiment

Short-term options positioning is neutral on USD after peaking on August 20, while the CTA indicator has continued turning less USD-bullish as well

Options positioning



CTA trend indicator



Source: DTCC, Macrobond, Bloomberg, Morgan Stanley Research

USD | Rates Market Backdrop

We think US real yields have bottomed, given nominal yields are likely to keep rising and longer-term breakevens are at fair value based on the Fed's average 2% goal

Real yields



Breakeven inflation rates

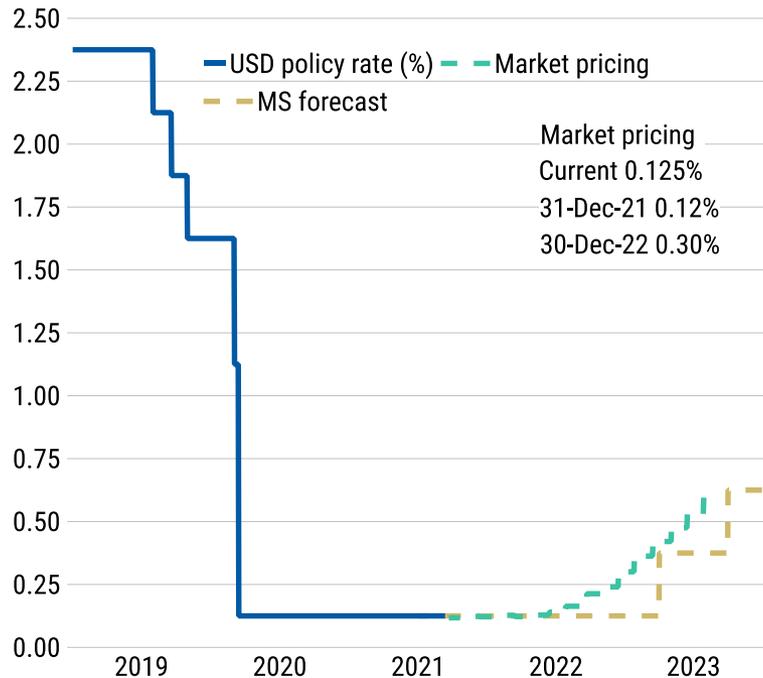


Source: Macrobond, Bloomberg, Morgan Stanley Research

USD | Monetary Policy

Markets are pricing in Fed liftoff in March 2023, modestly earlier than our economists' call for 2Q23

Policy rate



Months to first rate hike

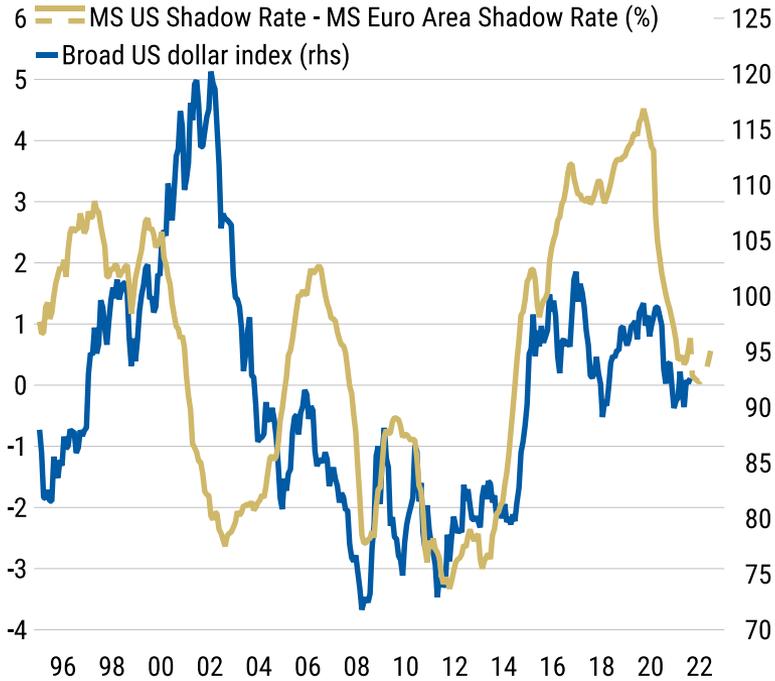


Source: MS STIRT Desk, Macrobond, Bloomberg, Morgan Stanley Research forecasts

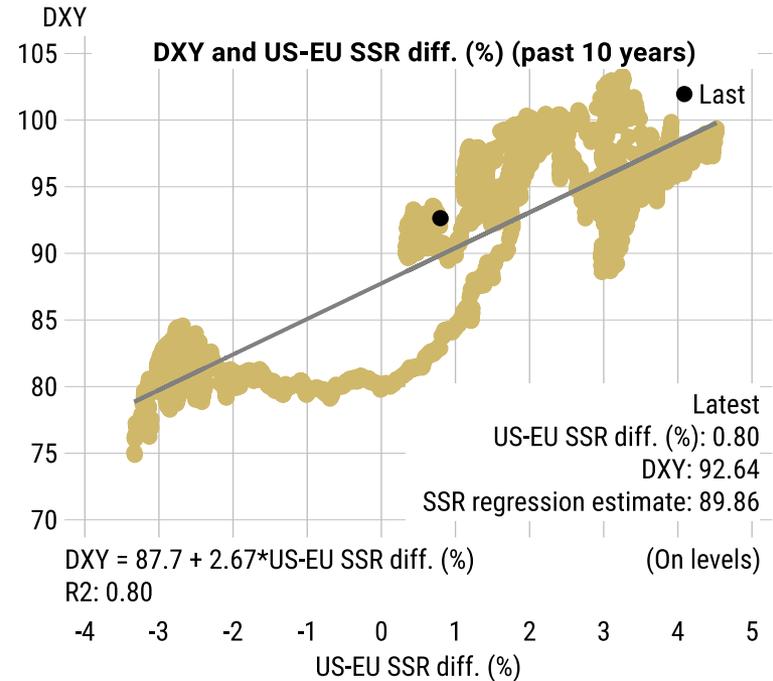
USD | Shadow Short Rate

Shadow short rate differentials imply that USD is likely overvalued by about 3% for the DXY Index

SSR differential vs. spot history



SSR differential vs. spot regression



Source: Macrobond, Bloomberg, Morgan Stanley Research Forecasts