Where was the Seasonal Bid for the USD?

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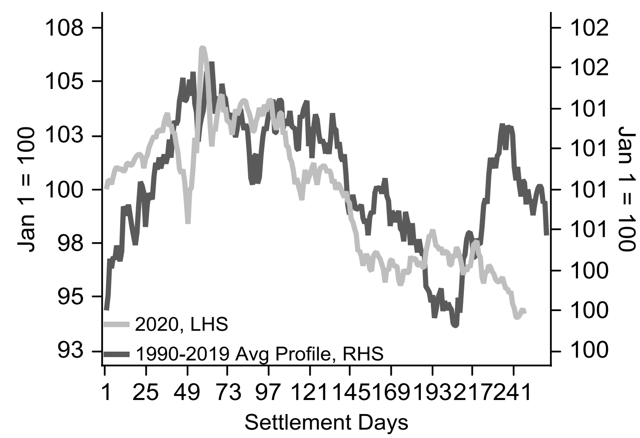
The USD typically—that is to say on average, looking at the past 30-odd years—experiences a squeeze higher in Q4 of the calendar year, usually through October and (especially) November, which more often than not seems to moderate and reverse in December. Since 1990, the DXY has strengthened 0.8% in November (one of the best months of the year for the DXY) and weakened 0.7% in December (one of the worst), on average. The DXY has gained nearly 70% of the time in November and weakened 62% of the time in December since 1990. Since 2015, the DXY has declined in four Decembers out of five, for an average loss (for all five years) of 0.9%. We caution that these trends are not hard rules.

DXY - Seasonal Profile



Source: Macrobond, Scotiabank FICC Strategy

Seasonality in commodities (energy, agricultural products) can be explained by changing supply and demand patterns over the course of the year. There is also a distinct seasonal trend in equity markets that is well documented in the literature (the so-called Hallowe'en Effect) that is persistent but less easy to rationalize. Seasonality in FX has an even less than obvious explanation but ultimately seems to reflect crowd behavior responding in the same way at same time of the year to issues such as fiscal or investment reporting deadlines (usually calendar-year based).

One factor that has helped support the Q4 push up in the USD in previous years is a "squeeze" in off-shore USD funding markets late in the calendar year as investors scramble to secure funding over the turn of the year. There has been some tightness in funding markets this year but we think that the Fed's efforts to ensure the provision of ample offshore liquidity following the market spasms around the early stages of the global pandemic has perhaps mitigated some—or more—of that seasonal demand which has spilled over into FX in previous years.

More generally, however, despite all the volatility and uncertainty that we have experienced this year, the broader pattern of USD—or DXY—trade has been remarkably consistent with the "average" annual profile of the last three decades. The early year bid for the USD emerged on cue but stumbled before peaking more or less on schedule in late March. There was a clear underperformance through Q2 and Q3 as well as the mid-year acceleration in USD losses. The only thing that has not emerged in line with the typical pattern of trade is the Oct/Nov USD rebound. But December's slide in the DXY is consistent (so far at –1.1%) with typical trends.

Assuming some sort of economic "normalization" emerges, we might see some moderation in the USD sell-off in the next few weeks (into early 2021) but we think broader trends continue to favour more USD weakness in the medium/longer term—which may help deliver the usual USD softness into the middle of the year.