

Rising recession risks: Implications for FX markets (USD, KRW, JPY & EUR)

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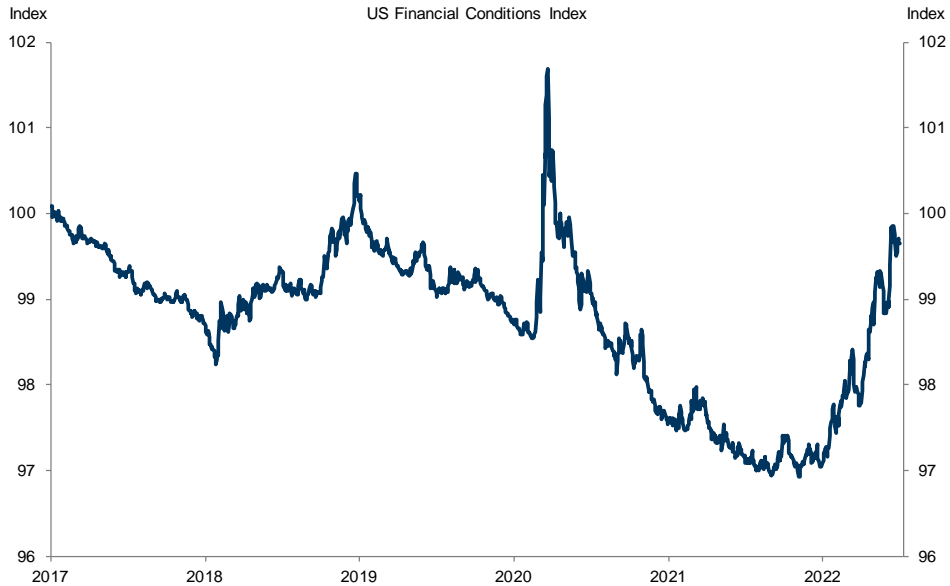
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Rising recession risks: Implications for FX markets (USD, KRW, JPY, EUR)

- **Recession risks have risen:** Tightening financial conditions reflect inflation, Fed tightening, slowing growth and concerns around China and Europe.
- **USD:** Tension between recession risk and Fed tightening (argues for *stronger* Dollar) vs. overvaluation (argues for *weaker* Dollar); for now, USD hard to beat as the Fed is the most unconstrained global central bank.
- **KRW:** Weakness can extend if global risk sentiment sours, Chinese growth stumbles, or USD/CNY weakens. Our 3-month (end-Oct) forecast for USD/KRW is 1320; our 6-month (end-Jan) forecast is 1280.
- **JPY:** With BoJ reiterating Yield Curve Control, USD/JPY will depend on US-Japan rate differential; JPY can appreciate from stretched levels if market prices a global recession. Our 3-month (end-Oct) and 6-month (end-Jan) forecasts for USD/JPY are 125.
- **EUR:** A trip back below parity in EUR/USD is possible if recession concerns continue in Europe. Our base case 3-month (end-Oct) forecast for EUR/USD is 1.05; our 6-month (end-Jan) forecast is 1.10.

Facing the Monetary Music

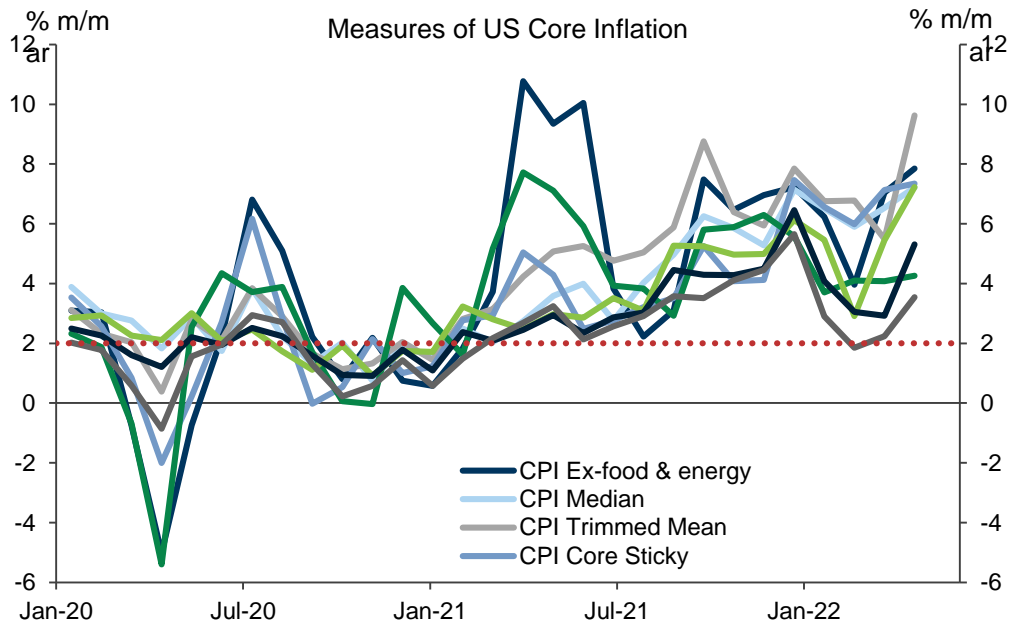
US financial conditions almost 300bp tighter year-to-date



Source: Bloomberg, Goldman Sachs Global Investment Research.

Macro: Facing the Monetary Music

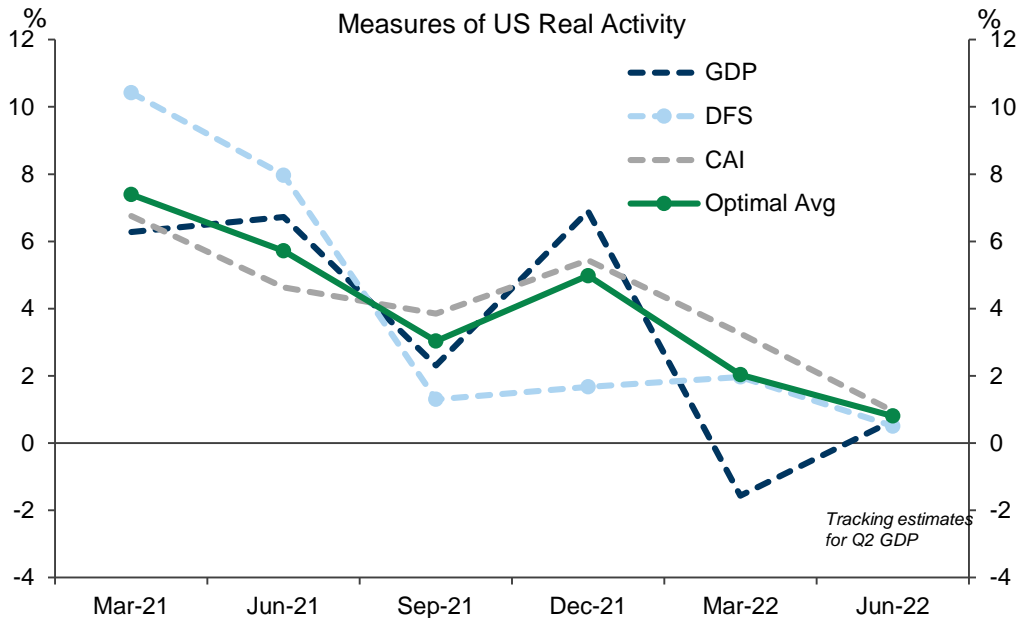
Realized inflation not yet slowing down



Source: Goldman Sachs Global Investment Research.

Macro: Facing the Monetary Music

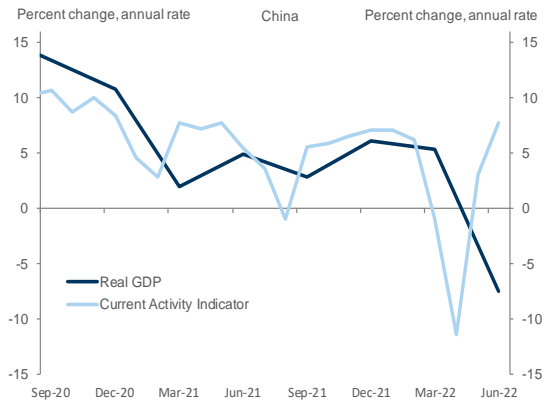
US growth momentum already modest as of Q1



Source: Haver Analytics, Bloomberg, Goldman Sachs Global Investment Research.

China growth is slowly recovering from Covid hit

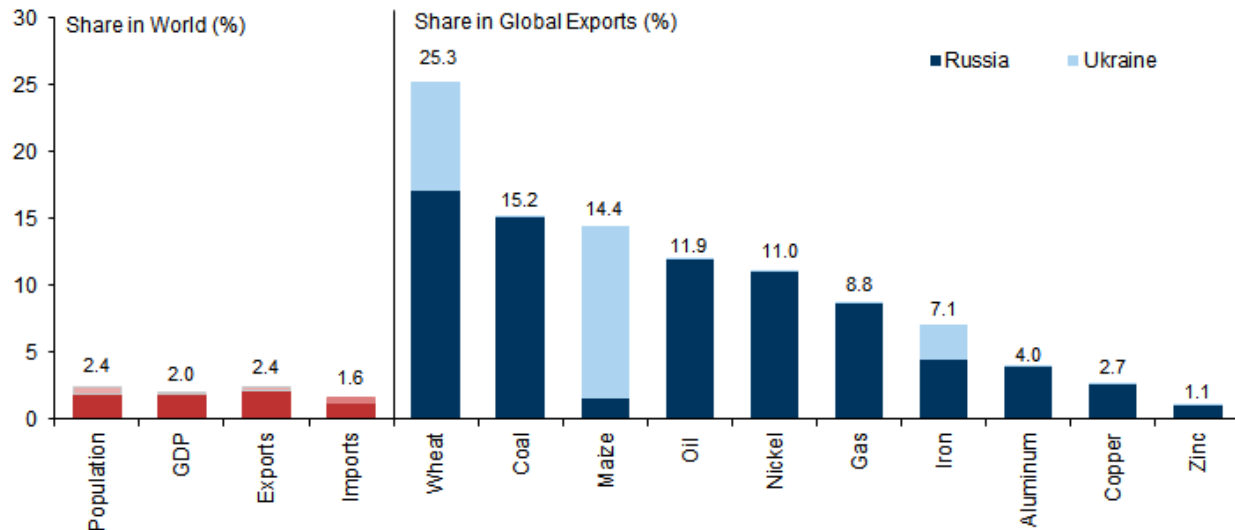
As the domestic macro policy is shifting unevenly to easing



Source: Bloomberg, CEIC, Haver Analytics, Goldman Sachs Global Investment Research

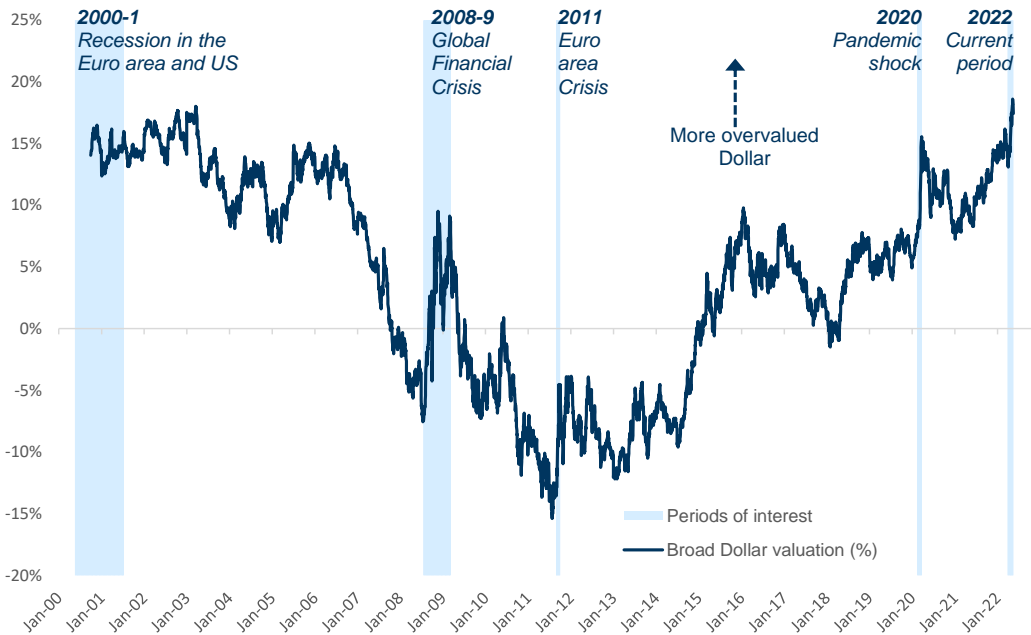
Economic exposures to Russia and Ukraine

A small share of global GDP, a large share of global commodities



Source: Goldman Sachs Global Investment Research, Haver Analytics, UN COMTRADE

USD: An overvalued currency, but a hard bar to beat with an unconstrained Fed and recession risks rising

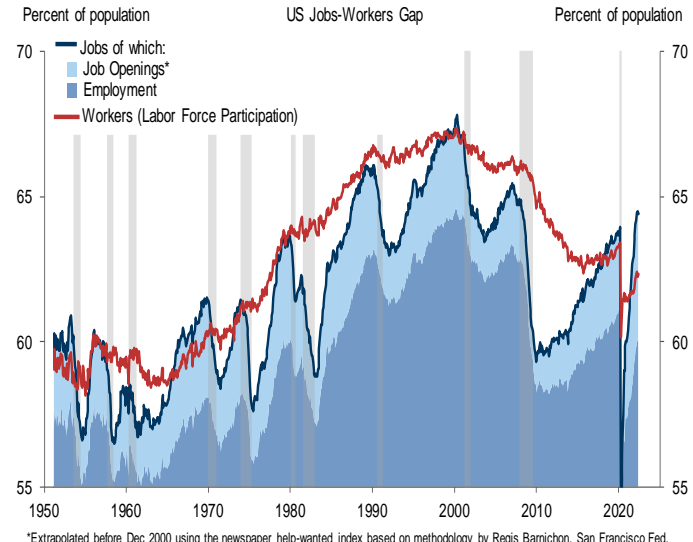
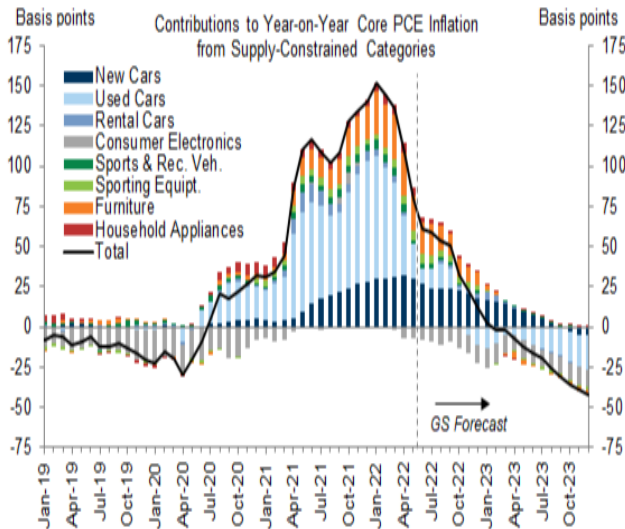


Average GSDEER/GSFEER valuation of the Dollar vs. a broad, equal-weighted basket of G9 and EM FX

Source: Goldman Sachs Global Investment Research

Past the peak in core PCE?

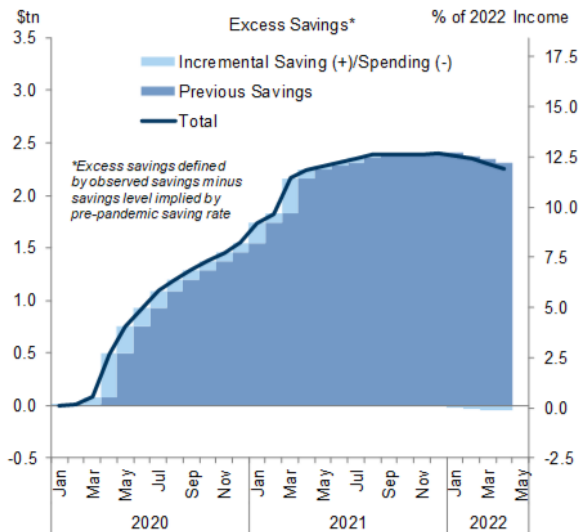
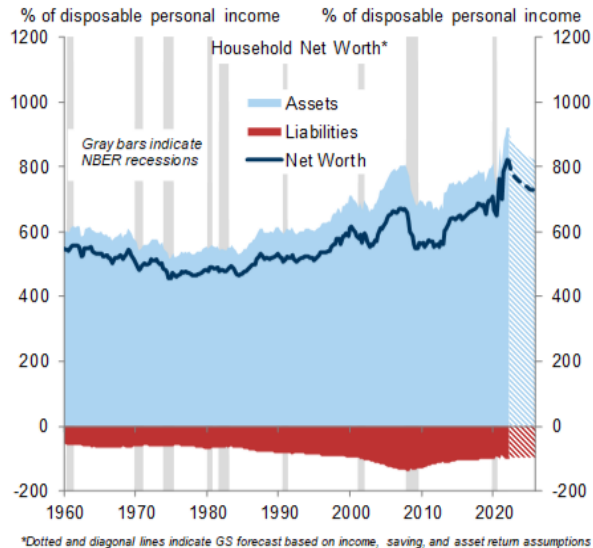
But the job-workers gap remains very large



Source: Department of Commerce, Department of Labor, Goldman Sachs Global Investment Research

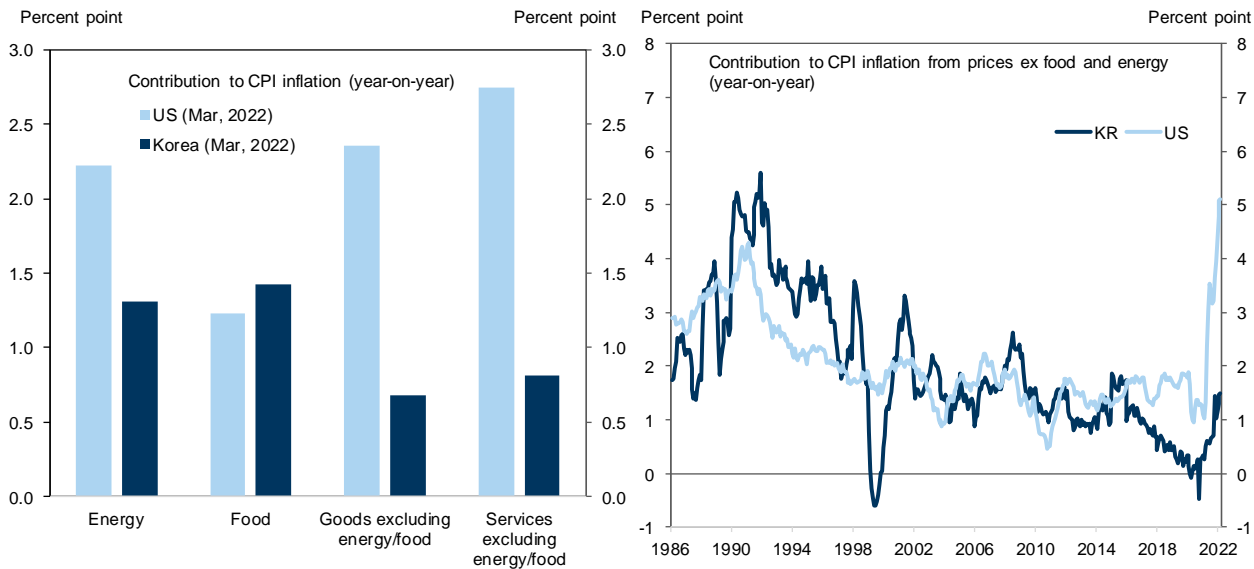
Healthy household balance sheets

Consumers can supplement their spending with savings accumulated during the pandemic



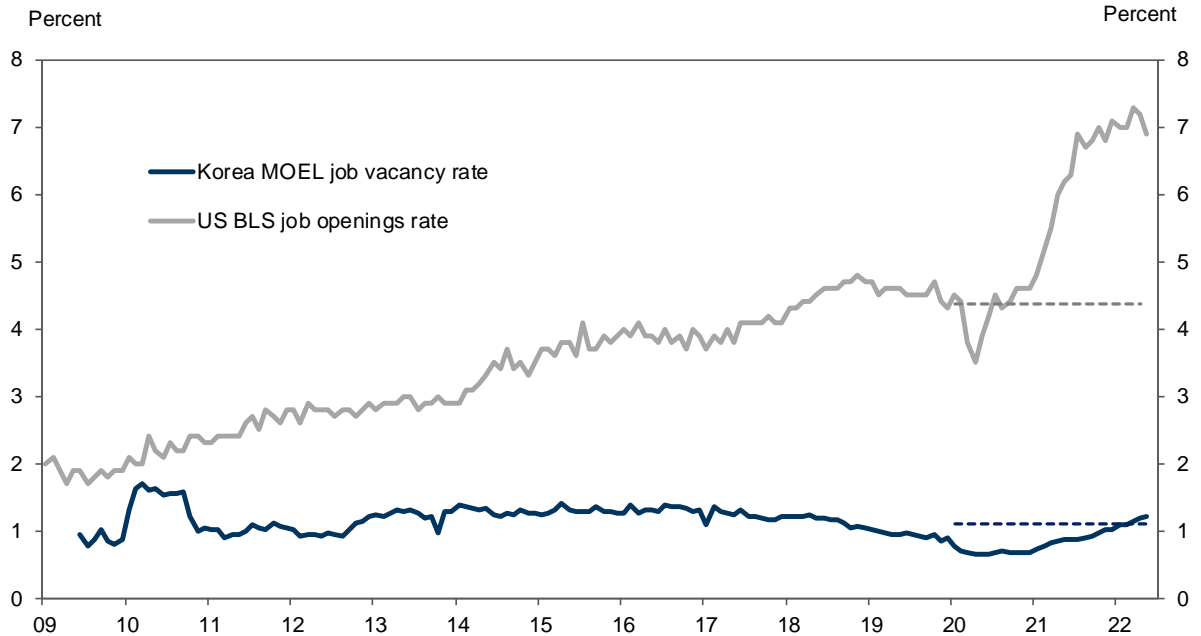
Source: Federal Reserve, Department of Commerce, Goldman Sachs Global Investment Research

Higher US core inflation accounts for most of the headline inflation differential



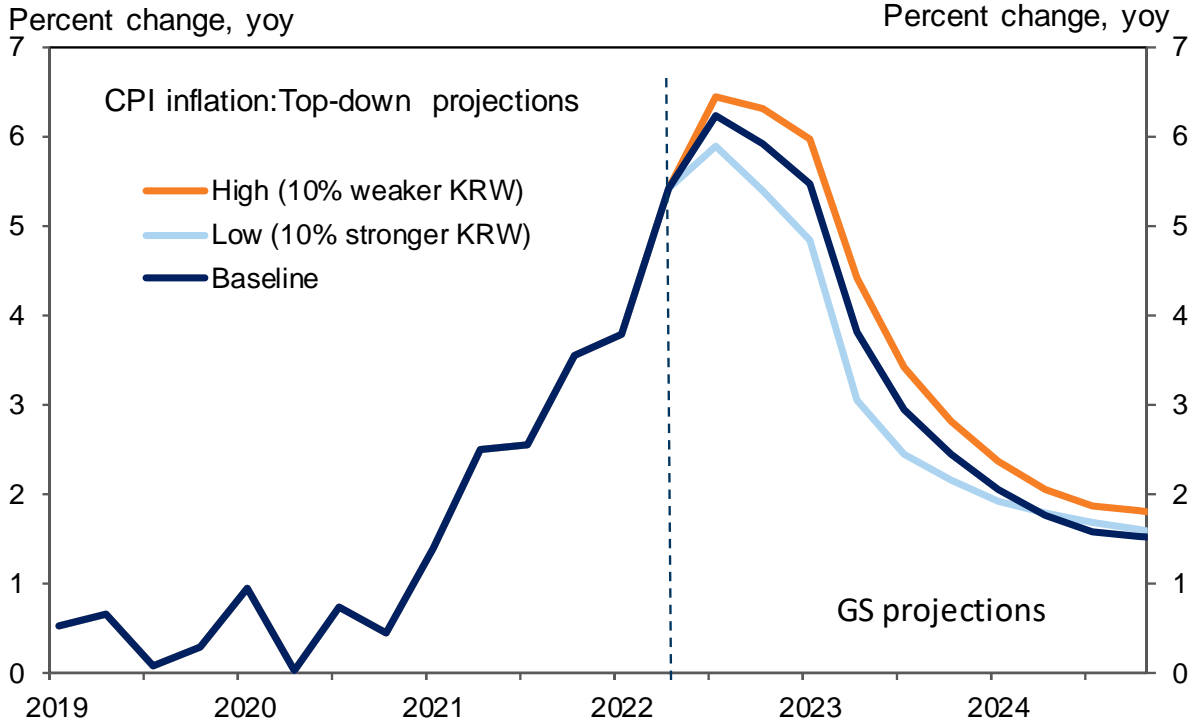
Source: Haver Analytics, Goldman Sachs Global Investment Research

Labor supply shortages have not been a major challenge in Korea



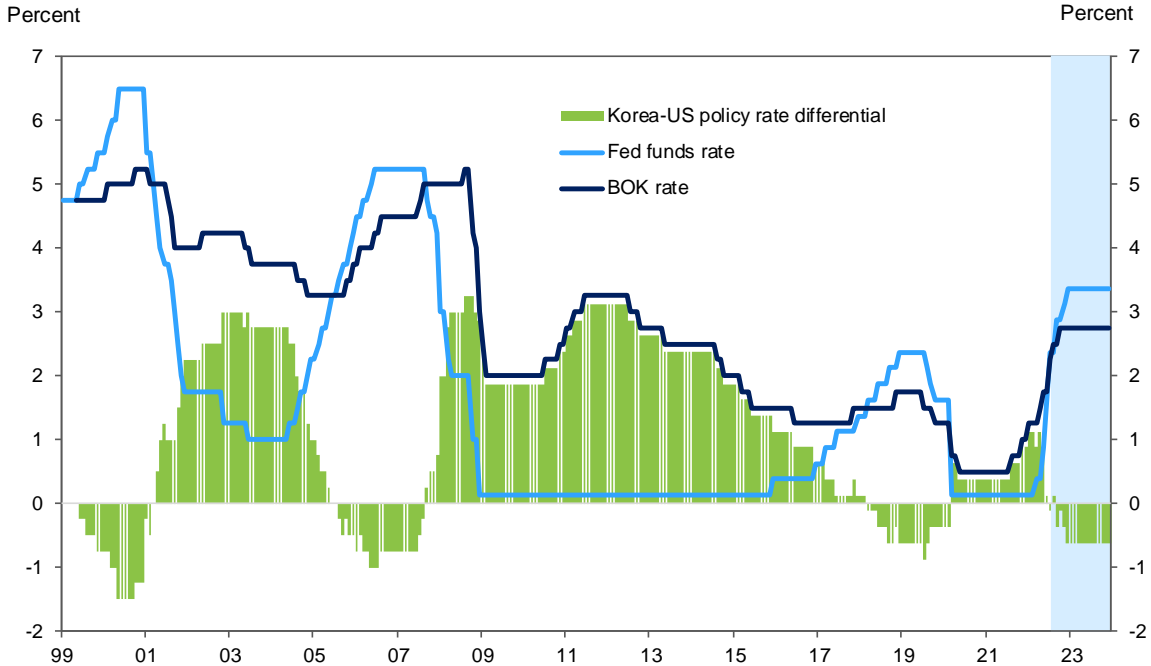
Note: Dotted lines refer to respective pre-pandemic averages (2015-2019)

Korea's inflation peaks in Q3 and falls to low-2% level by late 2023 in our baseline scenario



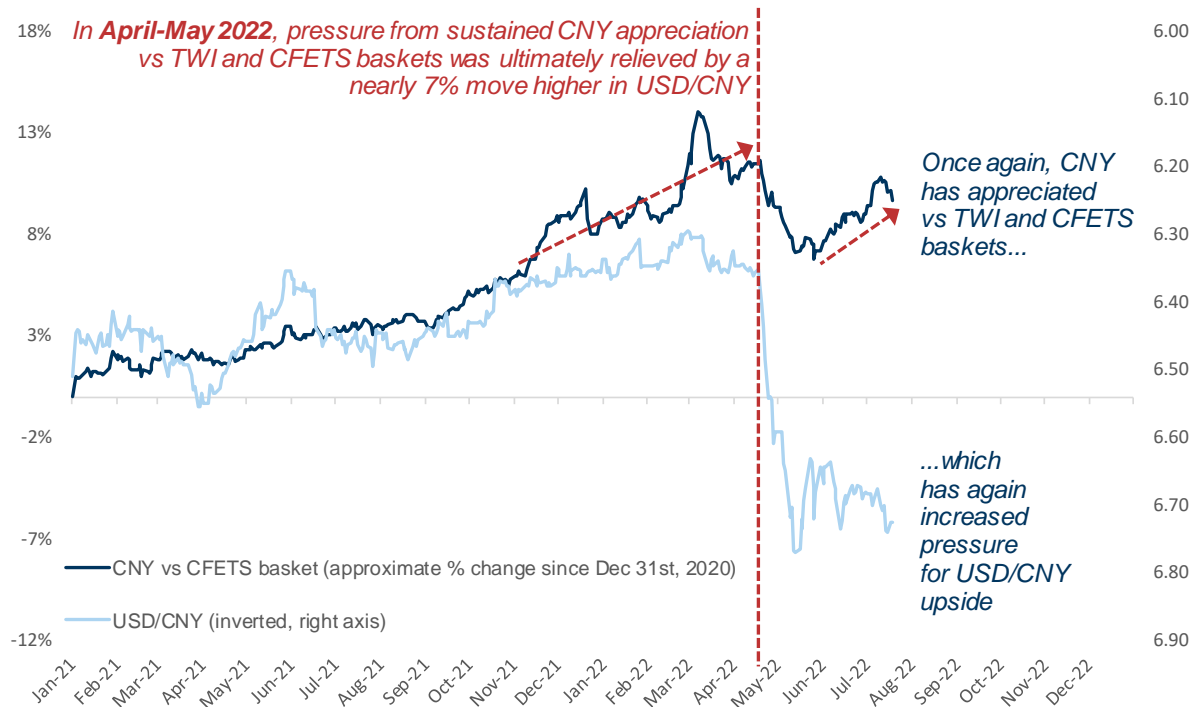
Source: Haver Analytics, Goldman Sachs Global Investment Research

The interest rate gap between BOK and Fed expected to be similar to previous Fed rate hike cycles



Note: Shaded area indicates GS forecasts

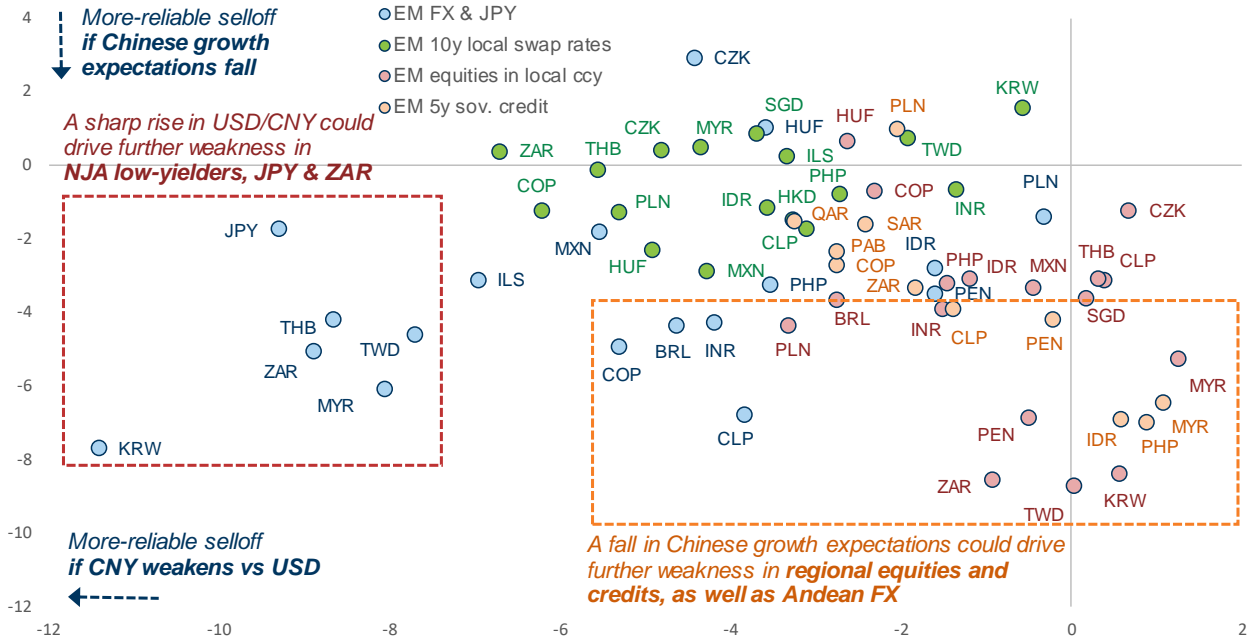
Upside risks to USD/CNY: Have we seen this before?



Source: Goldman Sachs Global Investment Research; Goldman Sachs

KRW is exposed to both CNY weakness and a fall in Chinese growth expectations

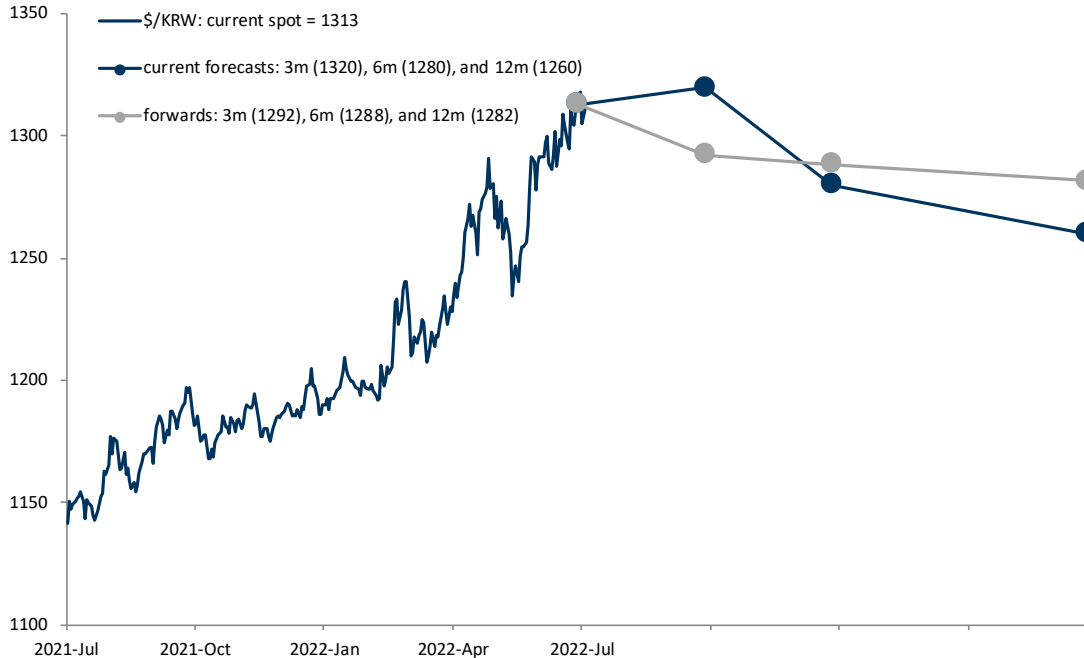
t-statistics from regressions of high-frequency returns in the displayed assets on either a rise in the USD/CNY exchange rate (x-axis), or a fall in our market based measure of Chinese growth expectations (y-axis). Results control for a wide range of market factors.



Source: Goldman Sachs Global Investment Research, Goldman Sachs, Thomson Reuters

We expect USD/KRW to rise in next 3 months, then fall as pressures for Dollar strength ease

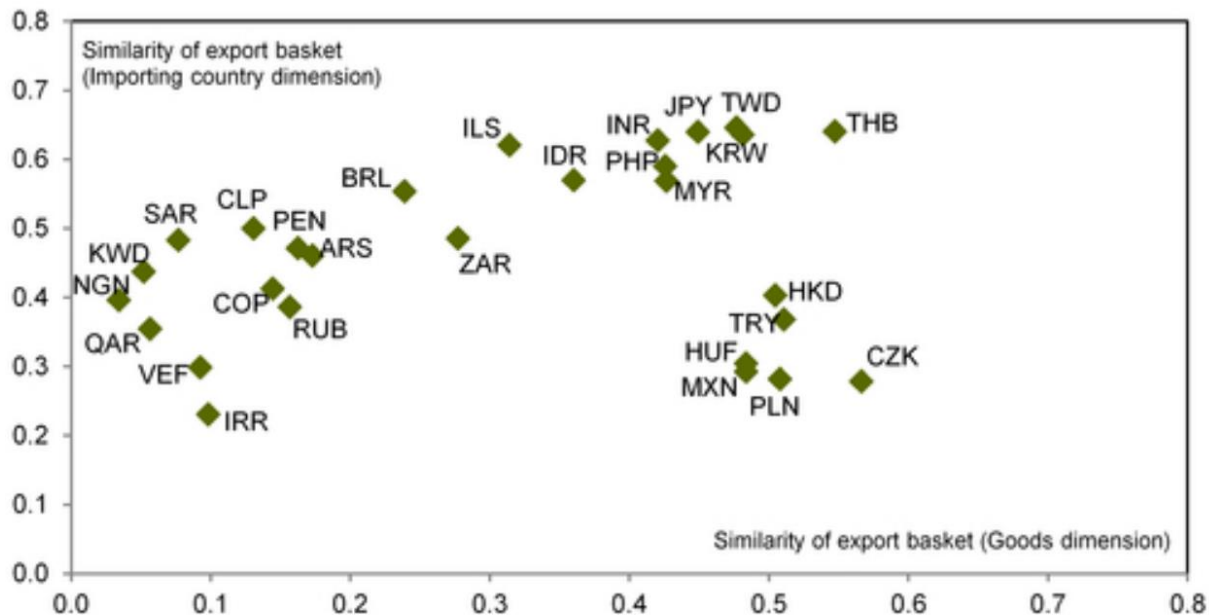
Goldman Sachs forecasts and forward pricing as of July 21, 2022



Source: Goldman Sachs Global Investment Research, Goldman Sachs, Thomson Reuters

KRW is linked to both the CNY and JPY Through export market competition

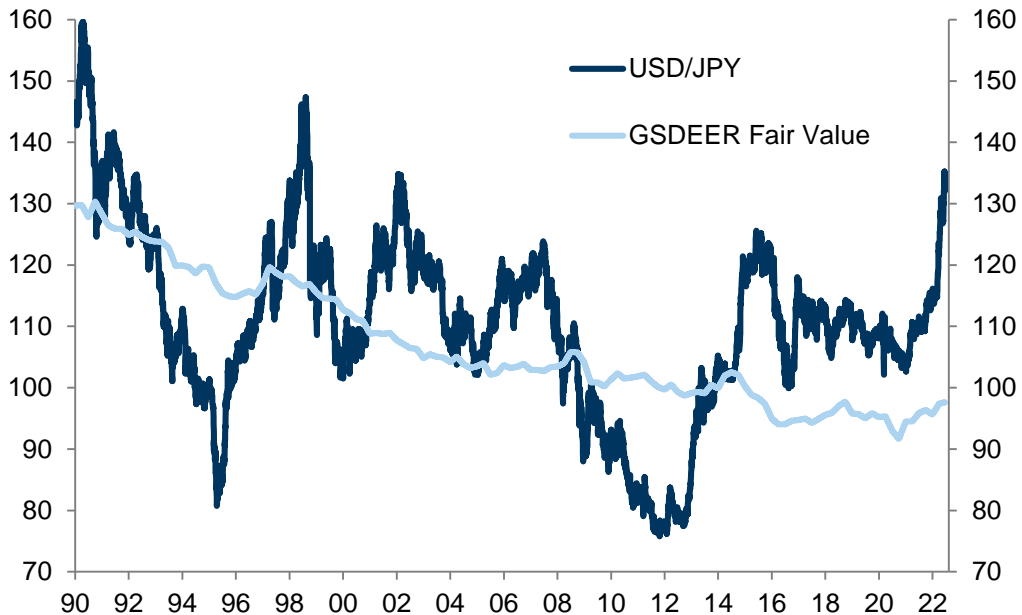
Indices of export similarity with China



Source: Goldman Sachs Global Investment Research, Goldman Sachs, UNCTAD

FX: Stocks Down, Dollar Up

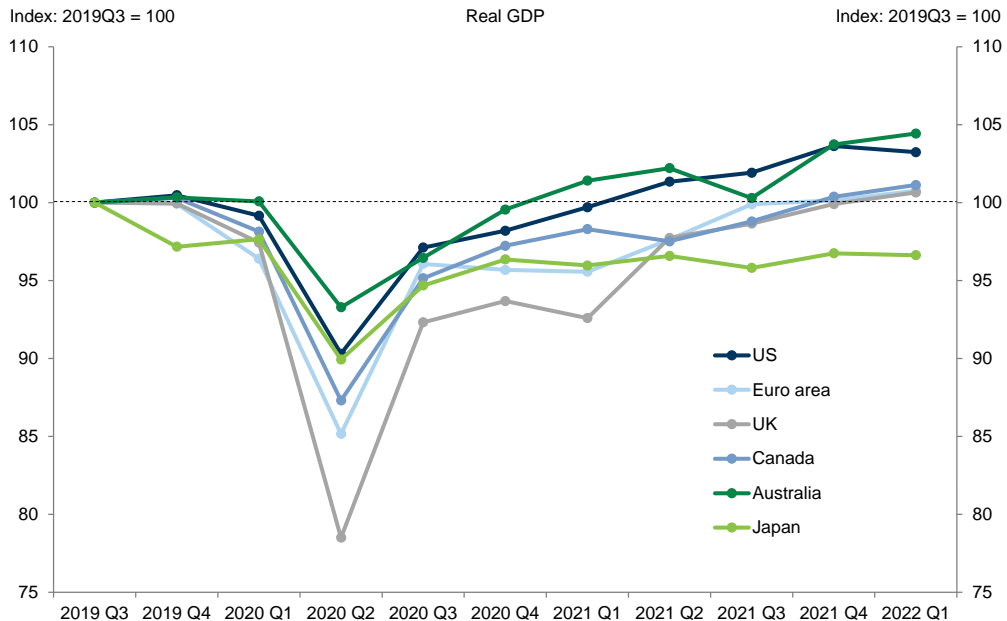
Yen an undervalued safe haven for uncertain times



Source: Goldman Sachs Global Investment Research.

FX: Stocks Down, Dollar Up

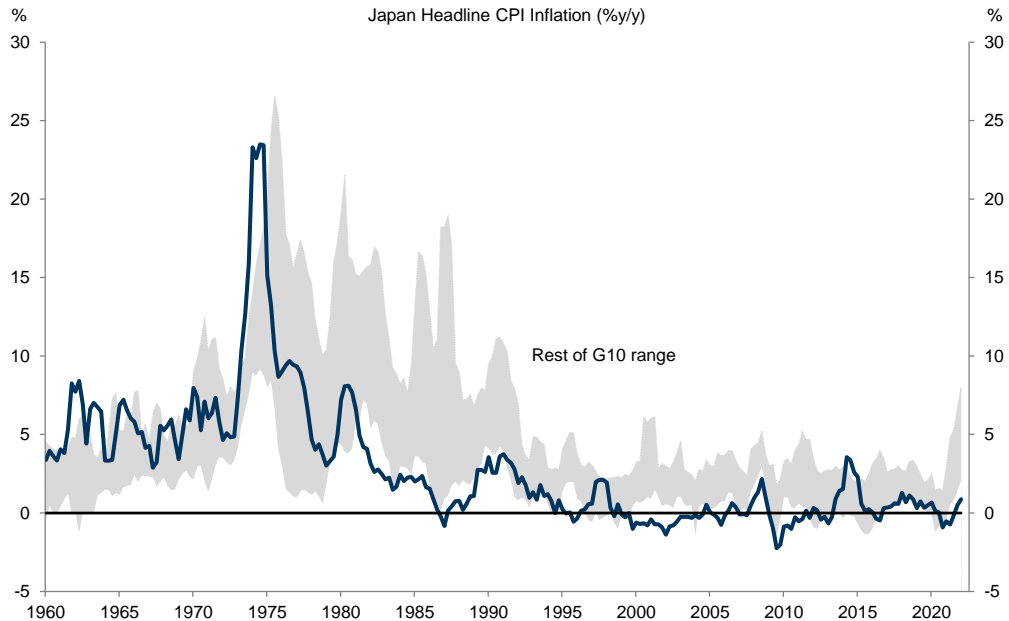
Japan's lagging recovery



Source: Goldman Sachs Global Investment Research.

FX: Stocks Down, Dollar Up

Nothing about Japan that implies permanently low inflation

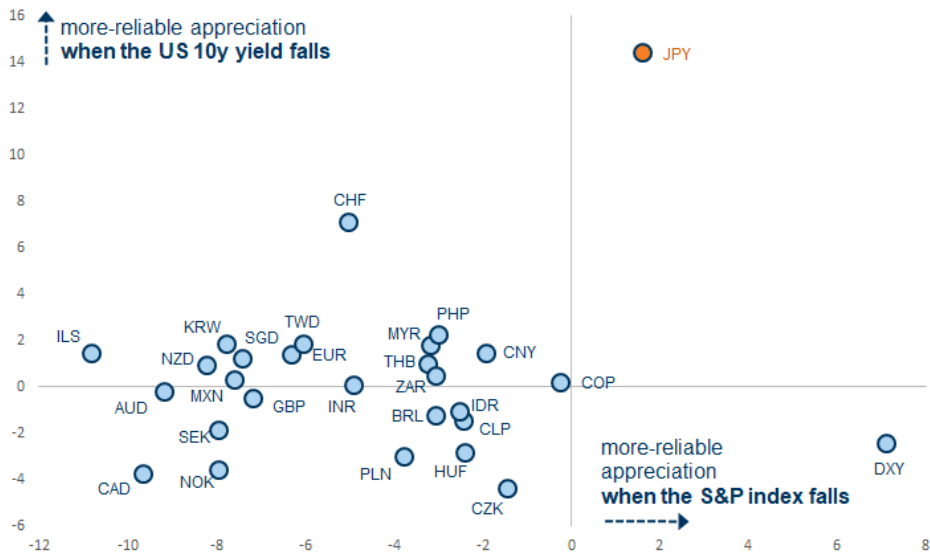


Source: Haver Analytics, Goldman Sachs Global Investment Research.

JPY: Undervalued Safe Haven

Yen a uniquely useful hedge for “risk down, rates down”

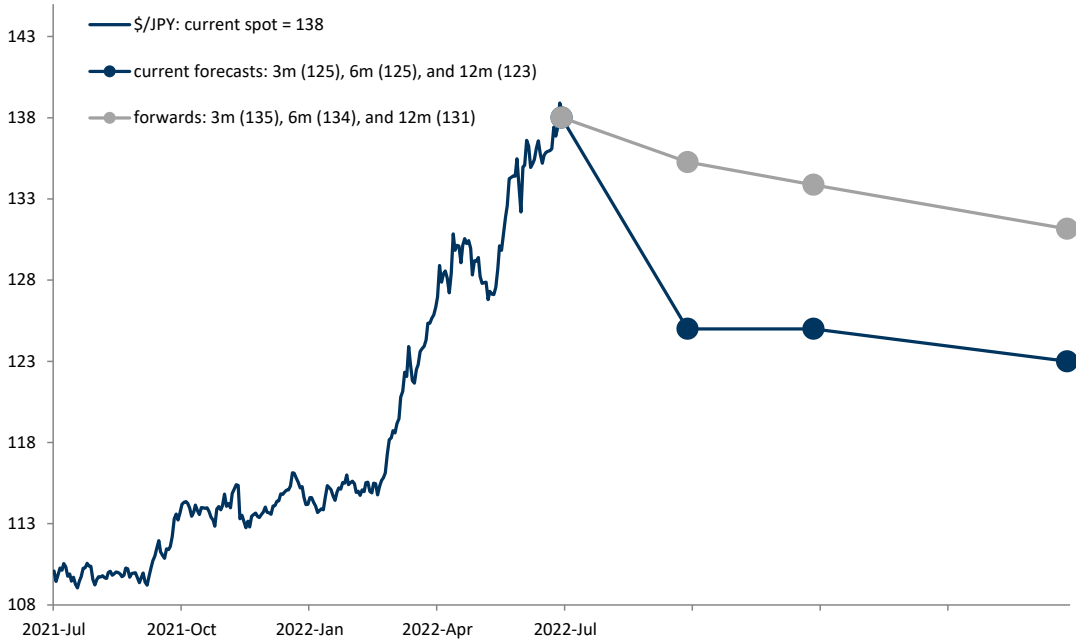
t-statistics from regressions of high-frequency currency appreciation over the past year on changes in the S&P index (x-axis) and the US 10-year yield (y-axis). FX appreciation is considered vs USD for all crosses except SEK, NOK & CEE (vs EUR) and for the DXY index



Source: Bloomberg, Haver Analytics, Goldman Sachs Global Investment Research.

If global recession risks rise, USD/JPY can fall

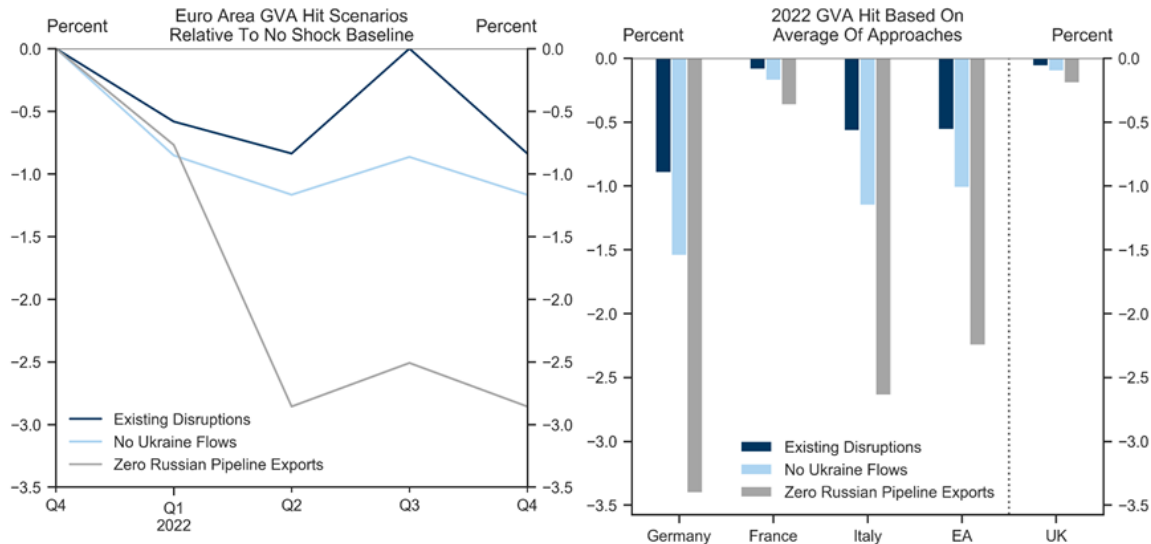
Goldman Sachs forecasts and forward pricing as of July 21, 2022



Source: Goldman Sachs Global Investment Research, Goldman Sachs, Thomson Reuters

FX: Stocks Down, Dollar Up

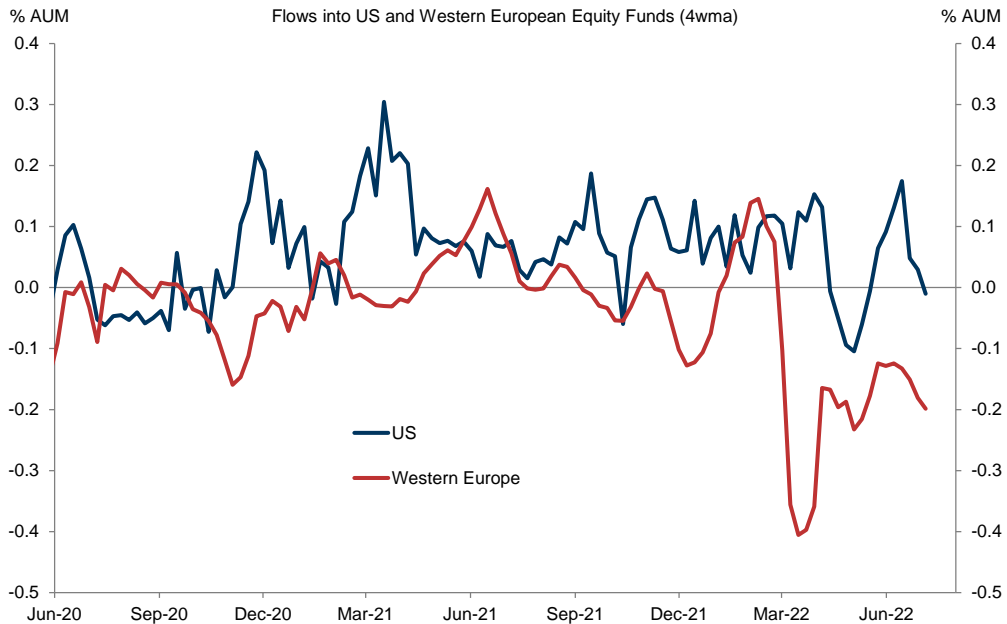
Downside risks to European growth from war in Ukraine



Source: Bloomberg, Goldman Sachs Global Investment Research.

FX: Stocks Down, Dollar Up

Downside risks to European growth from war in Ukraine



Source: Haver Analytics, Goldman Sachs Global Investment Research.

