The USD surprises the consensus at the beginning of 2021. Analysis and Perspective.

There is nothing more dangerous in markets than a safe bet (T. Holland told me yesterday). The dollar was supposed to collapse in 2021 (there was a solid consensus on this), but so far in 2021, the DXY (Dollar Index) has risen from 89.2 to 90.3, and in the case of the €/$ cross rate, the dollar's improvement has been even more pronounced (from 1.23 to 1.21). This is causing many analysts to rethink the arguments that led them to project a fall in the USD. Arguments ranging from possible over-valuation of the USD, mass vaccinations and the end of demand for safe assets, Democrat control in the USA and public accounts out of control, an ultra-dovish Fed, the persistence of twin deficits in the USA, etc.). Let me walk through some of these arguments, and see what we can conclude.

Over-valuation? After the fall of the USD in Q420, the over-valuation of the greenback may have been eliminated, and with this many could already take the argument of over-valuation out of the equation. The argument of excessive relative value was very strong in March 2020 (with the DXY at 102 and the €/$ at 1.06), but I am now inclined to think that the relative valuation of the USD is a neutral factor today.

Vaccines and pandemic control.
Will demand for the USD as a safe haven asset fall? I am positive about developments in pandemic control, which may eventually lead to this potential easing in demand for the USD as a safe haven asset. But with the US vaccinating at a much higher rate than other countries, a favourable scenario for the USD could emerge, and only as other countries achieve the vaccination rates seen in the USA, we would see a shift in demand from the USD to other currencies. This will be positive for the USD in the short term and negative in the long term.

Democrat control and greater stimulus.
Will they harm the USD? Indeed, we have already seen how Biden has proposed a new stimulus of US$2 trillion (with direct cheques to every taxpayer, materialising the "*helicopter money*").
Some think (wrongly) that stimulus should help the USD, because it will ultimately fuel growth and thus demand for USD assets. However, they forget that this stimulus will flow mostly to consumers (not producers), which in turn will be used to finance the purchase of products produced from abroad (as can be seen from the country's balance of payments). In other words, Biden's stimulus may end up on the balance sheets of Chinese or European companies, and this is an unfavourable factor for the USD. In parallel, any investor who thinks long term will know that Democrat control will, sooner or later, mean more regulation and higher taxes, something that is likely to end up negatively impacting the USD. Therefore, the argument for Democrat control remains, in our view, unfavourable to the USD in the long run. But there is a powerful countervailing effect in the Democrats' victory that could help the US$ in the short term. Just as Trump meant instability and lack of predictability, Biden's victory means a return to business as usual and, with it, a return to stability. The so-called "political risk premium", so pronounced with Trump, disappears with Biden.
And if the Democratic Party's centrists (those superdelegates who have already twice blocked Sanders' path to the Democratic leadership) continue to exercise their effective veto power over radical economic ideas, then the US$ may find unexpected support.

Ultra-dovish stance of the Fed: Will it continue to put pressure on the USD? The increase in price expectations is clearly higher in the USA than in the rest of the developed economies and this could lead us to believe that the Fed would have to abandon its ultra-dovish stance and thus favour the USD. Proof of this is the +60 bp spike in the IRR of the UST10Y (a move that suggests that the Fed would have stopped acting on the long end of the curve, allowing this movement).
Many of us believe that if the Fed abandons monetary activism (and continues to be more passive, allowing rates to normalise) then the USD will be supported. However, I believe that the Fed will not allow the bond IRR to rise substantially, hindering this potential support for the USD due to differential IRRs. Why is this so? Because of the seriousness of the 8 trillion of USD in Treasury bonds due for renewal in 2021, and the 2 trillion USD of new bonds to be issued (to finance the budget). I am convinced that the Fed, like me, has an unsettling shudder at the thought of having to issue 10 trillion USD in 2021 at substantially higher rates. The Fed can be either passive (letting IRRs rise) or active (controlling the rise in IRRs), and, based on what was observed in December, when the Fed expanded its balance sheet by USD140 billion in a month (the fastest monthly pace in a long time), I am inclined to think that the Fed will be active, controlling the movement in IRRs so that they don't break loose. Therefore, the Fed factor will continue to be unfavourable to the USD, not against the Euro, but against currencies of those countries whose central banks have not engaged in monetary activism. Specifically, Asian currencies, of which I have a better opinion over time.

Taper tantrum: Will it restore the USD's credibility? I have long thought (wrongly) that monetary normalisation, expressed in the form of an end to QE (or taper tantrum) should help the USD. In 2013, the taper helped boost the USD, but the joy was short-lived and the currency retreated again, just as the Fed made it clear that it would keep short-term rates at 0% while reducing its balance sheet. Interestingly, the USD (as measured by the DXY) only started to rise consistently in 2014, when the Fed signalled a Fed Fund Rate hike cycle (and which effectively took place in 2015). In other words, what matters to the market is what happens to official short-term rates.
They need to know then that the Fed's commitment to keep rates on hold seems firmer today than it did in 2013. Thus, from this side, the USD will not find support, and any rise in the greenback may be temporary.
To sum up, the USD is not overvalued, and vaccinations in the USA, as well as new political stability, could boost the USD in the short term. But as history is clear that printing money to finance debt never leads to a strong currency, I think that in the long run, both the USD and the Euro will experience a structural decline against those better-managed currencies and central banks of which have not engaged in such wild monetary activism. Don't be surprised if later this year we start recommending some Asian market bonds denominated in local currency. As for the €/$, the idea that the USD could regain some lost ground in the short term also applies here. I am not worried about the potential collapse of the USD that the consensus predicted for 2021. Perhaps, for 2021, a good idea would be to act in the 1.17-1.23 range. Cover the USD near the first level, uncover it near the second level. In the longer term, it remains to be seen what will happen with this European experiment, or how euro members might react if countries like Spain have to be bailed out again (for the third time).