FX: A false ceasefire in trade wars?

Any risk relief rally in FX is likely to be curbed

The topic of trade wars remains front-and-centre for global markets this week. We're now in the realms of a protectionist world, especially after recent US trade policy announcements, the latest being a $50-$60bn tariff package on Chinese imported goods.The implications for global markets now rest on how major trading partners choose to retaliate; Beijing's response thus far has been the announcement of a $3bn tariff on imports from the US – though we note this is a response to US steel and aluminium import tariffs (and not the latest US tariff package on China). While weekend reports suggest that trade wars may be following a more diplomatic path – with the WSJ noting that US and Chinese officials are quietly negotiating behind the scenes on ensuring 'fairer' trade – we still see good reason for investors to stay wary over the potential for an escalation in the current trade war dynamics. We look for the relief rally in global risk sentiment to be short-lived – with trade war headline risks elevated.

EUR: Mildly bullish bias in tact but EZ data and political risks need to stay low

The Eurozone data calendar is fairly light in the run-up to Easter – with single-country Mar CPI data releases in the latter part of the week the standout feature ahead of the EZ-wide inflation print next week (note Germany CPI on Thu). We retain a neutral to modestly higher bias for EUR/USD in the near-term amid a politically weak dollar backdrop – although given the potential dent to investor confidence ensuing from the threat of a global trade war, we note that there is heightened emphasis on EZ macro data staying resilient and EZ political risks remaining low to ensure that the EUR's procyclical rally does not lose any steam. On the latter, weekend reports hint that some progress has been made towards forming a government in Italy. Note also ECB hawk Weidmann speaks today (1130 CET).

GBP: Potential to be a relative outperformer in a 'Cold trade war' environment

Short GBP positions have been the recurring pain trade in FX markets – and we believe this will continue to be the case, not least after recent developments on the state of Brexit negotiations and the outlook for UK monetary policy. On the latter, comments by BoE policymaker Vlieghe that we may see one or two rate hikes a year in this tightening cycle – the first real indication by a BoE official on the annual pace of policy normalisation – gave implicit support to the currently steeper UK rate curve and should help GBP stay at these elevated levels under the status quo. Limited trade war escalation this week and a stabilisation in the equity market sell-off may see GBP/USD push higher towards the 1.4250-1.4300 post-Brexit highs. Indeed, we see GBP as a relative G10 outperformer in the near term amid a positive re-appraisal of short-term UK economic and political risks.

JPY: Sell $/JPY on rallies theme to persist as markets to stay trade war wary

With global trade wars in focus – and the yen the antithesis of US protectionist policies – we expect the downward bias for USD/JPY to remain firmly in place over the coming months. But look for USD/JPY to stay anchored around the 105 level this week in the absence of an escalation in the trade war narrative or any further leg lower in global equities. Equally, Japanese fiscal year-end and a negative USD bias from White House policy uncertainty should limit the scope for any significant upside in the pair (with the sell-on-rallies theme persisting).

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