

Deconstructing Trump's Dollar Talk

President Donald Trump said Wednesday that the US dollar "is getting too strong" and he would prefer the Fed to keep interest rates low. While we've seen attempts from the President to talk down the dollar before, the reference to interest rates puts a potentially credible action point on the latest jawboning efforts.



Trump Dollar Jawboning 2.0: Why it may be different this time?

While we've seen attempts from the President to talk down the dollar before, the reference to interest rates puts a potentially credible action point on the latest jawboning efforts. Indeed, previous talk has often left investors asking how the Trump team could alleviate the positive dollar impact stemming from potential tax and infrastructure spending policies.

Changing the rules of the game for the Fed is one obvious way. Any assumptions around the interaction between Trump's pro-growth fiscal agenda and the Fed's reaction function have so far been hinged on US inflation remaining anchored around the 2% target; the typical view is that the Fed might be forced to tighten quicker if any fiscal stimulus was delivered. But it's clear that this chain of logic is becoming distorted and with the Trump administration set to appoint 2 new Fed Governors this year – and potentially a new Chair and Vice-Chair next year – the standard assumptions cannot be taken for granted.

Will the Fed comply with Trump's low interest rate wishes?

To clarify, it is the FOMC – not Congress – that sets the 2% inflation target in their statement of longer-run goals (see here). While a formal shift in the inflation target remains a tail risk for now (given the negative credibility effects), it's not inconceivable to see the Fed allowing for a sustained period of above-target inflation – without the need for much additional tightening.

The President's latest comments suggest that this is what the administration may be hoping for – and the risk of dovish Governors being appointed has increased. But if the Fed were to ever pursue an “inflation overshoot” approach, then they would certainly need to communicate this clearly in order to avoid market confusion and limit any unnecessary mispricing of policy risks. It's worth noting that some Fed officials might already be moving in this direction; the March FOMC minutes made several implicit references to allowing for a short-term deviation above the 2% target, while the statement itself noted the target was “symmetric”.

What if the Fed targets 2.5% inflation...

We use a simple Taylor Rule model to demonstrate what would happen to policy rates if the Fed were to aim for a higher inflation target – or an “inflation overshoot” – in the short-term (see LHS chart below). Based on current core PCE inflation data and output gap estimates this would suggest that we may be closer to a 2% – and not a 3% – terminal Fed funds rate world at present. Arguably, markets are already here and are pricing in a significantly lower end-point for the current Fed tightening cycle (see RHS chart below).

US reflation + gradual Fed hikes = Bearish steepening of US yield curve

The obvious question stemming from all of this is whether underlying US inflation ever does get meaningfully above 2% inflation. While core US CPI inflation is expected to come in at 2.3% YoY tomorrow, the PCE equivalent measure – which the Fed may be watching more closely – remains at 1.8% YoY. Still, our base case is that the Trump administration will deliver some demand-side fiscal stimulus this year in the form of tax reforms – which even if watered down, is likely to generate some inflationary pressures given that the US economy is close to full capacity. Assuming the Fed retains a gradual normalisation path – and hence limited scope for any repricing of current policy expectations – we would expect the net effect of any Trump fiscal package to be a modest steepening of the US yield curve.

G10 FX implications of a steeper US yield curve

In an environment where risk sentiment remains buoyant, the FX implications would be simple: JPY will be a clear underperformer (see RHS chart below). We think USD/JPY upside looks attractive at current levels – with a move back up to 115 in 2Q17 not out of the question under our baseline scenario of Trump reflation. Other USD crosses are likely to see more limited gains in the absence of any hawkish shift in Fed policy expectations, with high-beta activity currencies in fact taking their cue from the broader global risk outlook.

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com