# FX: Cold war sinks the dollar

President Trump plans to enact cold war national security trade legislation to support the US steel and aluminium sectors. The question now is whether other nations retaliate


Source: Shutterstock

## USD: The reality of protectionism demands a much lower USD/JPY

News that President Trump will likely impose import tariffs on the steel and aluminium sector look a clear dollar negative, especially against the safe-haven Japanese yen. Here it looks as though Trump will enact recommendations from the Commerce Department – using cold war national security trade legislation (section 232) – to support the US steel and aluminium sectors. Those sectors just happen to be located in swing states of Pennsylvania and Ohio – suggesting mid-term elections are playing a role here. While the discussion has been on global tariffs (pouring attention on big steel exporters to the US like Brazil, Canada and Turkey) it seems pretty clear that these cold war tariffs will primarily be directed at the likes of China and Russia – a geopolitical play. Trump may well choose to give key allies waivers or apply quotas at 2016 or 2017 levels. Understandably, equity markets have sold off on this, with steel input costs set to rise and the prospect of trade retaliation in the agriculture and airline sectors. Will we also see China start to question its rationale in holding US Treasuries as well – just as Japan did during a similar trade dispute in the 1990s? USD/JPY has also been hit by the Bank of Japan's Haruhiko Kuroda mentioning a BoJ exit strategy in FY19. This will be a challenge, since USD/JPY will probably be trading at 80 by then. USD/JPY could easily have a big break below 105 short-term.

## EUR: Caution ahead of Sunday event risk

In our G10 FX Week Ahead, published a week ago we felt EUR/USD could this week fall as low as 1.2130 on the back of Jay Powell's testimony and concerns over European political risk. In reality, Powell has done most of the heavy-lifting on this move, with European political risk barely registering (BTPs performing well). Paolo Pizzoli previews the Italian elections in THINK and we find it fascinating that a hung parliament (Paolo's most likely scenario) may not be too bad for markets ultimately – given safeguards built into budgets. Perhaps a bigger short-term threat is 460,000 SPD voters being asked to back the grand-coalition. Carsten Brzeski's preview outlines that the risk of a 'No' vote is higher than the market expects, but would represent a missed opportunity as opposed to a major setback on the Eurozone recovery path. Investors will also recall how the EUR reacted after French political risk was overcome last April/May. Our preference is to look for any EUR weakness early next week as a multi-quarter EUR buying opportunity. Today, however, EUR/JPY to 128.85 looks the story.

## GBP: May speaks at 1430CET

PM Theresa May delivers a key Brexit speech today, entitled 'Our future partnership'. Reports suggest the speech has been neutered by the Brexiteers, suggesting little progress on key issues will be evident. EUR/GBP capped at 0.8920.

## RON: Romania sovereign ratings reports today

S&P and Moody's provide ratings updates on Romania today. No rating changes are expected, but we expect them to highlight the negatives – since no fiscal consolidation is in sight. The credit looks exposed to ratings action if the external environment were to turn more averse.

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