FX: Mercantilist Trump is back

President Trump is reportedly set to announce a 25% tariff on US steel imports today (and also possibly a 10% tariff on aluminium imports). Will this test some of the assumptions underpinning global asset prices?

Source: Shutterstock

USD: The M&M Dollar Policy – 'Mercantilist and Mercurial' back to weigh on the dollar

President Trump is reportedly set to announce a 25% tariff on US steel imports today (and also possibly a 10% tariff on aluminium imports) – which arguably would be the most globally controversial protectionist measure the President has put in place since taking office. While the effects may initially be contained within commodity markets, the key for broader global markets is how the rest of the world – namely China – reacts to the US administration's 'America First' protectionist policies. Indeed, we have felt that investors in recent weeks may have been viewing the risks around US trade policy with rose-tinted glasses – and today's expected announcement by the President could test some of the more recent assumptions that have been embedded into global asset prices. One of those assumptions is the strength of the global economy – and certainly, the prospect of a 'global trade war' and heightened geopolitical tensions could temper some of the optimism and see greater two-way risks to global growth.

As for the dollar, history shows that a more protectionist US trade policy stance does not bode well for the currency – especially given the Trump administration's new 'Mercantilist and Mercurial' dollar policy. With heightened US protectionist noise, the risks are a return of a 'Sell America' theme being expressed in global markets – akin to what we saw in the early '90s under a Clinton administration (see our note Weak dollar policy: Careful what you wish for...).

For now, the implications of US trade policy on global markets remains a 'watch this space'. But for a structurally weak dollar, US politics far outweigh factors like subtle Fed policy changes over the long-run. Our view for USD/JPY to 100 – and EUR/USD to 1.30 – remains very much intact and could come sooner than we expect should any dollar decline prove disorderly.

EUR: Near-term support as markets paying little homage to Eurozone politics

The Eurozone calendar is fairly light today – with the near-term data focus elsewhere (namely US core PCE inflation and ISM manufacturing later in the day). With a cautious global risk backdrop, EUR/USD could find support above the 1.22 level – with markets paying little homage to the weekend's political risk events.

GBP: Risk-reward favours not chasing Brexit sentiment driven moves lower

The EU's draft 'Withdrawal Agreement' knocked the pound sharply lower – as investors reassessed the probability of a near-term Brexit transition deal being agreed. Yet, we believe GBP's decline this week is more Brexit sentiment driven – rather than a reassessment of UK economic fundamentals – and point to the two-three year part of the UK rate curve staying fairly resilient. History suggests that under such episodes, GBP has the propensity to correct more sharply if we get any good news. We'll need a catalyst, but risk-reward favours not chasing the move lower. Look for consolidation in GBP ahead of PM May's speech (Friday).

BRL: 4Q GDP data to show economic hope but election risks will far outweigh

A broad range of indicators suggests that economic activity is rebounding quite strongly in Brazil – and that should be reflected in today's 4Q GDP release. But, as shown by the recent credit rating downgrade by Fitch, Brazil's macro stance is still fundamentally weak due to the unanchored fiscal dynamics. Economic data will, therefore, be a secondary catalyst for the Brazilian real (politics mattering more).

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