

## FX: Protectionism to dominate

Year-end targets for EUR/USD and USD/JPY at 1.30 and 100 still make a lot of sense to us – with a slight preference for JPY out-performance



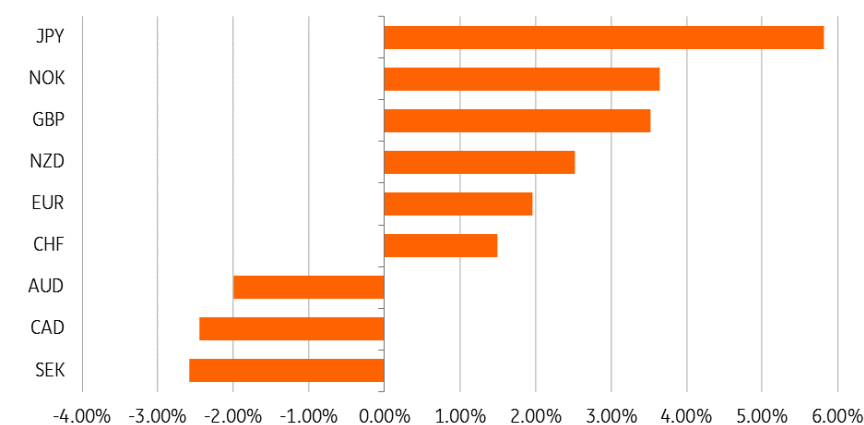
Source: Shutterstock

### We expect protectionism to dominate markets through 2Q18

On paper the loose fiscal and tight monetary policy mix in the US should be good for the dollar. And the recent widening in the USD Libor-OIS spread has only increased USD hedging costs still further – also a dollar positive. Yet the dollar has fallen against most G10 currencies as investors come to terms with Washington's trade policy. We expect protectionism to dominate markets through 2Q18 and the dollar to stay under pressure against the JPY and the EUR – currencies both backed by large trade surpluses.

None of this year's JPY out-performance is due to expectations of BoJ normalisation in our opinion. Instead it is down to the escalation in Washington's protectionism – from initially protecting narrow sectors to now targeting 1300 Chinese products to redress IPR theft. This seems to be part of a broader national security strategy adopted in late 2017.

## FX performance versus USD Year To Date (%)



Source: Bloomberg

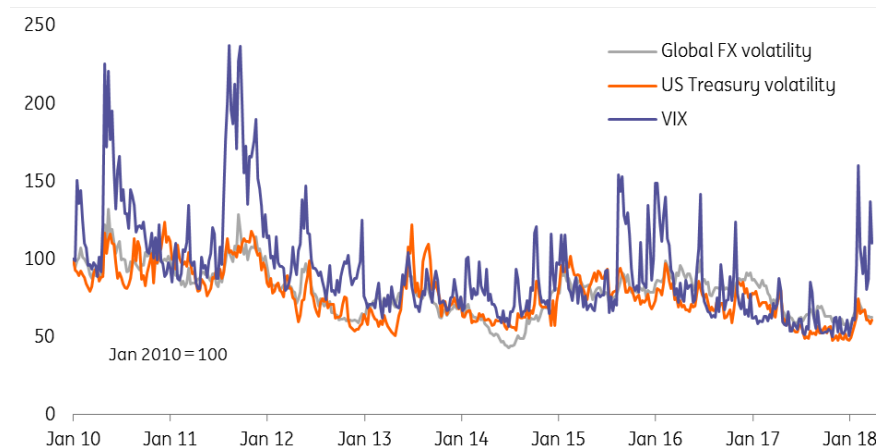
## Like Republican administrations before them, the current White House wants a weaker dollar

Central to this strategy is a view that US trade deficits are a function of unfair practises (included under-valued currencies) amongst trading partners. And like Republican administrations before them, the current White House wants a weaker dollar.

The role of FX in trade tension should come to the fore with the mid-April release of the US Treasury's semi-annual FX report. We've already seen the US Treasury discourage the Bank of Korea from KRW liquidity supplying operations over recent weeks – prompting USD/KRW to fall to a new low for the year. And we expect the tone of the report to be pretty critical of any-one running a large trade surplus with the US.

The Eurozone runs the second largest trade surplus with the US (US\$135bn in the 12 months to January) and the Eurozone's 3.5% current account surplus suggests a very competitive EUR. After the JPY, we do think the EUR can play a role as a safe-haven currency. Equally were protectionism to damage the US equity market and Trump to dial-down protectionism this summer ahead of November mid-term elections, we would also expect the return of monetary normalisation stories to help EUR/USD.

## We're yet to see broad-based contagion



Source: Bloomberg, ING

### Year-end targets for EUR/USD and USD/JPY at 1.30 and 100

Year-end targets for EUR/USD and USD/JPY at 1.30 and 100 still make a lot of sense to us – with a slight preference for JPY out-performance. This also suggests that the currencies of small, open economies with high export to GDP ratios should underperform – as has been the case with AUD, CAD and SEK so far this year.

We would also categorize protectionists fears currently as relatively low-level at present. Volatility in equity markets has not filtered through to generalised FX or bond market volatility. Investors believe Trump's bark is bigger than his bite. This looks complacent.

This article is taken from our Monthly Economic Update, which you can find [here](#).

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