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Article

FX: Reasons to be cautious

Global markets are waiting for President Trump's next move in a potentially escalating trade war

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USD: Waiting to hear USTR recommendations against China

Global asset markets continue to trade on a cautious footing – largely awaiting the next move in a potentially escalating trade war. The top of these risks may well be the US Trade Representative's recommendation on what to do about China's alleged theft of Intellectual Property Rights – an investigation into this was launched last August. USTR will make a recommendation to Trump over coming weeks and there's the possibility of a broad tariff response against China – which would certainly escalate the trade war. That should heap more pressure on USD/JPY and put a dent in activity currencies. Thus we continue to favour defensive FX plays for the time being. For today's session, we'll just see US industrial production and housing starts, but these look unlikely to move the dollar much. And today's quarterly equity indices re-balancing adds another layer of uncertainty to markets.

EUR: Whatever happened to... yield spreads?

Two-year US sovereign yields now trade a staggering 288bp over Germany. Three-month EUR/USD swap points are now pushing through the highs seen in 1999 and 2006, making USD hedging very expensive indeed. It is amazing EUR/USD is not trading lower. Yet the Trump risk premium and investors front-running expected portfolio shifts into 2019/20 (ECB's Benoît Cœuré addressed this in a [must-read speech last November](#)) should keep EUR/USD bid. We also think the Eurozone's 3.5% current account surplus positions the Euro as a safe haven currency.

JPY: Defensive properties

The Japanese yen remains the defensive play of choice. In the current environment, unilateral Bank of Japan intervention to support USD/JPY looks impossible this side of 100.

RUB: Russia goes to the polls this weekend

The people of Russia vote in Presidential elections this weekend. There is little doubt that President Putin's term will be extended until 2024. As [Dmitry Poleyov notes in his preview](#), turnout will be key, with a level of 63-67% seen to be legitimising the vote. The election comes at a time when the West is considering further sanctions against Russia in response to the use of a nerve agent in the UK. With the Trump Administration in a state of flux (national security adviser H.R. McMaster reported to be on his way out) and foreign policy potentially turning even more hawkish, it would not be a surprise for international investors to be assessing their Russian exposure. On some measures, foreigners own more than 50% of the Russian sovereign OFZ bond market, similar to

the extremes of foreign ownership seen in the Czech Republic. Even though Russia may show good demand for an 11-year Eurobond sale today, priced at 4.75%, we think the rouble looks vulnerable.

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