FX: Trade Wars – Episode II: Attack of the Cohns

Gary Cohn's resignation shows a lack of US economic policy cohesion. That's fuelling a loss of confidence in the long-run trajectory of the US economy

Source: The White House

USD: Cohn's resignation provides confirmation a weak dollar trend is here to stay

The resignation of White House chief economic adviser Gary Cohn may be all the confirmation global markets need that the US administration's protectionist policy agenda is more than just a political show. While the reasons for Cohn's departure remain speculative – one can imagine that at this stage it is as much to do with a difference of economic ideology than anything else. Indeed, since the passing of the GOP tax bill, there has been a clear power shift amongst the President's closest advisers – with the typically touted nationalists (Wilbur Ross, Peter Navarro) seeing greater 'airtime' relative to the globalists (like Gary Cohn).

One only needs to look at the White House's muddled economic policy agenda to understand why such ideological divisions have arisen. On the one hand, the administration has just passed a $1.5trn deficit-financed tax cut – which based on simple economic identities (and the assumption that private sector savings remain unchanged), would see a widening of the US current account deficit. But with the policy focus now shifting towards tackling what would partly be a self-inflicted trade deficit – by use of anti-growth tariff measures – it is no wonder that global investors are having difficulty in squaring the economic goals of the Trump administration. As our 'Trump Trilemma' framework shows, it is this lack of US economic policy cohesion that is fuelling a loss of confidence in the long-run trajectory of the US economy – which is what a weakening US dollar is moving in lock-step with. Former US Treasury Secretary Larry Summers makes a similar point (see here). Even more telling is that when global markets have previously expressed a similar loss of confidence in US policy institutions – it has taken a big policy regime shift (and a big character) to restore such confidence (eg, Paul Volcker's extreme Fed policy in the 1980s, Robert Rubin's 'strong dollar' policy in the 1990s). As we noted on Monday – we're still in watch this space mode, but this history lesson should serve as a warning sign for global markets (and those looking to fight the weak US dollar story).

As for today, it is worth keeping an eye on the ADP employment data ahead of Friday's US jobs report. But in the context of the current market narrative, we suspect confirmation that the US trade deficit widened in January may be of greater significance (both data releases due 1330 GMT).

Bottom line: Look for the US dollar to continue trading on the back foot, with Cohn's resignation merely providing confirmation that the currency should be trading with a risk premium due to greater US policy and political uncertainty.

EUR: All quiet on the EZ front ahead of the ECB; look for a dovish NBP today

The final reading of 4Q17 Eurozone GDP data should confirm that the economy grew at its fastest pace in a decade last year (2.7% YoY). Yet, we suspect that it is future Eurozone growth that will be of greater concern for the ECB – not least given the likely headwinds that would manifest from any US-led global protectionist shift. We may hear more from President Mario Draghi on this at tomorrow's meeting. Elsewhere, we have a Polish central bank meeting today – with our economists looking for a more dovish MPC stance to send EUR/PLN up towards 4.22-4.25.

CAD: Post-BoC sell-off risks limited given the 1.0-1.5% 'US tariff' risk premium

The Bank of Canada is currently caught between a rock and a hard place – with signs of a resilient domestic economy and higher inflationary dynamics offset by heightened US trade policy risks. USD/CAD has shifted its emphasis onto the latter this week; our model estimates suggest the rally up to 1.29-1.30 has been an overshoot of short-term fair value (1.2750-1.2850) and thus speculative due to the prospect of US tariffs on steel and aluminium imports (Canada's US$12bn exposure is the largest in nominal terms). While such developments have seen investors scale back on their expectations for a May BoC rate hike (currently at a 35% probability), we note that the overall policy tightening expected in 2018 remains around 50bps (ie: two hikes). Given that CAD is trading with a 1.0-1.5% 'US tariff' risk premium, we think only a scenario where the BoC explicitly cites dovish risks to their policy outlook would justify $/CAD moving beyond 1.30.