# FX: Trade Wars: The Presidential Menace

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## USD: Trump's protectionist talk ramps up the odds of a global trade war

Developments on US trade policy will be the primary focus for global markets this week, with President Trump's administration set to formally announce tariffs on US imports of steel and aluminium. The initial reaction from international investors will depend on (a) the details of the tariff policies – and whether some countries will be exempt and (b) the propensity for major trading partners to impose retaliatory protectionist measures on the US. Judging by the noise coming out of the White House this weekend – any country exemptions are not on the table 'at this point in time' (quoting Trump's trade adviser Peter Navarro). Add to this the President's tweeted comment last Friday that "trade wars are good and easy to win" – and the already strong countervailing threats made by the likes of the EU and Canada (less so China) – and the risks of some sort of 'global trade war' taking place have certainly increased. Global financial markets seem relatively underprepared for this scenario – not least as asset prices have largely been pricing in the narrative of synchronised global growth over the past couple of months. Any shift towards a global trade war would see our central assumption over the state of the global economy moving away from a positive reflationary story to a negative stagflationary – rising cost-push inflation and lower growth – story. For currency markets, 'America First' policies in our view equate to 'Dollar Last' – with the USD pricing in a greater US trade policy and political uncertainty premium in the run-up to the November midterms. Risks are that we see another 5-10% decline in the trade-weighted USD in 2018.

## EUR: Expect limited fallout in the euro given no major Eurozone political surprises

In theory, the euro should be breathing a big sigh of relief after this weekend's 'Super Sunday' of political events, which looks set to draw no major surprises (note while a German government is set to be formed over the coming weeks, the final result of the Italian election – which exit polls, albeit unreliable, suggest will yield a hung parliament – has yet to be confirmed at the time of writing). Still, in the absence of any last-minute Italian election upsets, the focus for Eurozone markets will shift away from European politics and towards (1) US politics and trade policy and (2) the ECB meeting later in the week (Thu). We expect the former will likely dominate the latter in terms of the EUR's general direction of travel this week – although any dissension within the Governing Council from the more vocal and noisy hawks could force the ECB's forward guidance to shift to a slightly less dovish tone (which would be mildly EUR supportive). Look for EUR/USD to trade within the 1.2200-1.2450 range this week – with Trump's protectionist talk adding to a mildly bullish bias for the pair.

## JPY: Global risk aversion + optimistic BoJ = Big USD/JPY downside risks this week

Talk of a global protectionist shift is likely to weigh on risk sentiment this week, which makes USD/JPY particularly vulnerable to a downside breakout. Add to this nascent signs of the BoJ shifting away from an 'ultra-loose' monetary bias to a 'slightly less ultra-loose' stance at this week's policy meeting (Fri) – and there is every chance USD/JPY could breach the 105 level. In the worst case, we could see a slide down to 102.50 (the post US election low is 101.20). There may be little the Ministry of Finance can do in any market that takes USD/JPY down to these levels.

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