

Trade war chess

President Trump's threat to hit China with a second round of tariffs if it retaliates against the first round is not good for risk assets



USD: Another step towards a full blown trade war

Risk assets are back under pressure, as the US threatened to hit China with a second round of tariffs if it retaliates against the first round. President Trump is threatening to slap an additional \$200 billion of tariffs on Chinese imports (vs \$50bn previously). While it's likely to take time before the second round of tariffs is imposed (as was the case with the first round, the proposal must go through the public consultation process), the pure signalling effect is negative for risk appetite. In such an environment, it's the risk assets linked to China that are likely to underperform (as per the decline in the Australian dollar overnight) though higher beta FX and in emerging markets, in general, should remain under a pressure. We also note that with the risk of a trade war looming, currencies of open economies are likely to suffer (such as the Swedish krona – see below).

EUR: EUR/USD to continue stabilising

A tentative agreement between German political parties- who have clashed over immigration ([see Germany: Merkel sunset postponed](#))- should keep the pressure off the euro. Although we see the euro as vulnerable to the escalation of trade wars (mainly if the US imposes auto tariffs), for now EUR/USD should remain supported as the focus is on US-China trade relations, while EUR/USD seems to have undershot meaningfully last week. With the spectre of trade wars weighing on

emerging markets FX, central and eastern European currencies should continue weakening against the euro.

SEK: At risk to global trade wars

Scope for the Swedish krona (SEK) to appreciate further from here is fairly limited, even if we see a decline in the Swedish May unemployment rate today. With the dovish ECB June meeting further decreasing the odds of a shift in the Riksbank's monetary stance, the reaction of SEK to any positive data surprises should be more muted. This is particularly the case when the short-term risk premium has been completely priced out of SEK, as our financial fair value model suggests. We continue to see upside risk to EUR/SEK in coming months as the escalating trade wars are a negative for a low liquidity currency of an open economy such as Sweden. The Swedish Democrats desire for an EU referendum is also SEK negative. Today, EUR/SEK may test the 10.3400 resistance level.

HUF: No policy response = weaker HUF

Despite pressure on the Hungarian forint (HUF) and local bonds, the central bank is likely to adopt a 'wait-and-see' approach today as current levels of HUF don't endanger the inflation target just yet (we estimate EUR/HUF above the 330 level as the pain threshold for the NBH). This should have negative implications for HUF as the market appears to be in need of a policy response for the currency to stabilise. EUR/HUF likely to test the 326.00 level today and EUR/HUF implied volatility to rise further. HUF to remain the CEE underperformer.