

Trade Wars, Episode 5: The Donald Strikes Back

A weaker dollar is an interim equilibrium for Trump's protectionist rampage



The White House mindset

The risk of an all-out US-China trade war has risen substantially following a statement by President Trump that he has ordered the US Trade Representative to find an additional US\$100bn worth of tariffs on Chinese imports. While this may not be official policy just yet, it is the clearest insight so far into the mindset of a White House that is seemingly adamant to secure a flagship trade policy win.

Equally, we do not see this US administration easing up on their protectionist rampage until one of three things occur:

1. An instantaneous narrowing of the US trade deficit (in particular the bilateral trade deficit with China); or
2. China taking the imposition of additional US tariffs on the chin or making large enough trade concessions to ease Washington's concerns (or at least give President Trump the feeling of a win); or
3. Signs that the GOP are heading for a solid win at the November US Congressional elections

(we note that Trump's trade rampage is partly a political show).

The second seems highly unlikely given the economic and political costs attached – and one should expect Beijing's *'it's only polite to reciprocate'* stance to be applied again should the US escalate the current trade conflict. Moreover, the first is near-on impossible in the absence of any physical trade restrictions (quotas or import restrictions); as we've argued before, the US trade deficit is a structural by-product of the savings-investment imbalances in the US economy (with the Trump tax bill merely fuelling these imbalances).

Therefore we remain of the view that a weaker US dollar (and firmer Asia FX – see below) is a necessary interim equilibrium to counterbalance the risks of President Trump's mercantilist *'America First'* policy agenda. In the immediate future, while global stocks look set to fall sharply again today – the spillover effects to currency and bond markets from rising trade war hype has once again been limited. We suspect investors here will be looking to trade the facts, while a busy US calendar also lies ahead – with the US jobs report and a speech by Fed Chair Powell (1830 GMT) on the agenda. The best hope for global risk sentiment is a 'Goldilocks' jobs report – that is limited signs of wage inflation and resilient jobs activity – and a fairly neutral Powell. Both would provide a backstop to any trade war-led decline in risky assets (and EM FX).

📈 EUR & JPY: Caught between diminishing risk appetite and a short \$ squeeze

The US dollar's short squeeze higher against the EUR and JPY will be tested by the US jobs data today. In the absence of a positive wage inflation surprise, we think there will be little appetite for any Fed-related move higher in the USD. Look for EUR/USD to stay supported above 1.22, with USD/JPY topside limited to 107.90.

📈 Asia FX: Bias to the upside as policymakers seek to defuse US trade tensions

While Asia FX will continue to be pinned down by the uncertainty of Trumpian trade policy, the week ahead also sees two key central bank meetings in the region in Singapore and South Korea, which our economists [preview here](#). One of the themes we may see emerge over the coming month is Asian central banks allowing the required tightening of monetary conditions to come through via the channel of a stronger FX – as opposed to higher policy rates.