

Trade wars, fragmenting politics and higher US rates

Is the White House trying to talk down the dollar? Trump's economic advisor Larry Kudlow says the Fed should go slowly in raising rates



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USD: A safe haven, for now

As we discuss in [our G10 FX Week Ahead](#), the landscape for FX markets will remain clouded this summer. At present, the Trump administration is showing no signs of backing down in its trade dispute with the rest of the world, with the threat of auto tariffs firmly on the table. Trump's trade stance has weighed heavily on emerging markets and prompted speculation that the People's Bank of China may be deliberately weakening the renminbi in retaliation – the CNY having fallen 3.5% against a basket of currencies over the last two weeks. Our team has recently revised down its CNY forecasts, which if correct means a fragile undercurrent for the EM class as a whole. This all comes at a time when the 2-10 year US curve is the flattest since summer 2007 and an inversion this summer would no doubt spark some serious headlines of a US/world slow-down into 2019. High dollar rates are supporting the US dollar as a safe haven in the current environment, but we've seen comments over the weekend from Trump's economic advisor Larry Kudlow that the Fed should go slow on raising rates. This break with protocol (politicians leaving the Fed alone) should come as no surprise, but may also warn that the White House is trying to talk down the

dollar, too. DXY to stay in 94.20-95.50 range.

EUR: Time for scenario analysis

In a very uncertain environment it's good to look at a scenario analysis of possible outcomes and what they mean for the EUR/USD trajectory. We've published [just such an analysis](#) on Friday. Most scenarios seem skewed to a weaker outcome for the euro. For today, let's see whether the CDU-CSU coalition in Germany can hold together. Look for a 1.15-1.17 broad range trade in EUR/USD.

GBP: All eyes on Friday showdown with the Brexiteers

Friday will see Prime Minister Theresa May take on the Brexiteers. This may ultimately prove positive for the pound, but in the short term, EUR/GBP looks poised to challenge 0.89 again.

MXN: Lopez Obrador elected President

As expected by the market, left-wing candidate Lopez Obrador has won the Mexican Presidential election and will take office in December. The focus going forward will be the results from the Congressional elections (Senate and Chamber of Deputies) where a big win for Obrador's Morena party and perhaps even a super majority will determine what room he has for manoeuvre. The selection of his cabinet will also be in focus where the choice of respected former Banxico Governor Guillermo Ortiz would be welcomed by the markets. Obrador will take charge at a difficult time for emerging markets, where tighter Fed policy and Trump's trade war provides little room for policy error. For the short term, we'd imagine the Mexican peso could see demand if USD/MXN were to correct to the 20.25 area – but keep a close watch on the congressional votes and appointments.

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