

22 August 2018
Article

What the Cohen and Manafort news means for the dollar

A guilty plea by President Trump's ex-lawyer and guilty verdict for his former campaign chairman have injected a big dose of political uncertainty into the dollar. What now?

Content

- USD: US politics and Trump jawboning may see longs rush to the exit doors
- GBP: Lots of bad news priced in but too early to signal all-clear on politics
- BRL: Expect more voter volatility ahead of Brazil's presidential election

USD: US politics and Trump jawboning may see longs rush to the exit doors

Where do we begin? Just like that, the US dollar goes from looking like the King of the FX world to another politically infested currency (and there's no shortage of those about). News that President Trump's ex-lawyer Michael Cohen has pleaded guilty to charges related to campaign violations – at almost the same time as former campaign chairman Paul Manafort was being convicted – injected a big dose of political uncertainty into the dollar. While some [experts say that this will have limited legal consequences for the President](#), Trump impeachment noise may just be another reason for speculative investors that are extremely long the US dollar to rush to the exit doors (it's interesting to see that markets deem a Trump impeachment as a negative for global risk sentiment).

This fresh wave of negative USD news comes at a time when the President has ramped up his verbal jawboning of the currency and US interest rates – while US leading indicators are showing signs of coming off the boil (potentially as overseas tariffs begin to bite). All of this makes the USD vulnerable to a sharp positioning adjustment – prior long USD positioning clearouts have been worth around a 5-7% decline in the trade-weighted USD (BBDXY) index. In our [latest piece 'Dethroning the King'](#), we discuss five (out of the box) ways in which President Trump could weaken the dollar. While playing with dollar policy is like playing with fire – with history showing how markets can and will punish you for reckless dollar policy, we feel that all bets are off with this administration.

GBP: Lots of bad news priced in but too early to signal all-clear on politics

It's clear that a lot of bad news is priced into a pound plagued by twin sources of risk premia ([see our note for more context](#)). But when it comes to Brexit and the currency, talks between the UK and the EU are not necessarily the primary short-term risk. In fact, some investors may have found comfort from the Raab-Barnier presser yesterday – especially as it was clear that the EU isn't actively looking to push the UK off any Brexit cliff edge (which makes sense given that a no-deal Brexit would be somewhat damaging to both economies). The inherent willingness of both sides to find a Withdrawal Deal solution should serve as a bit of a backstop to the degree of no-deal Brexit risks priced into the currency. But when it comes to GBP and political risks, it is far too early to signal the all clear; the biggest test for the pound will be the return of a divided UK

parliament from their summer recess and the upcoming Party Conference Season. A murky UK political backdrop may continue to put a dampener on GBP in the near-term – [but as we noted last week](#), risk-reward may no longer favour chasing the pound much lower from these levels. We think GBP/USD at 1.27 (and EUR/GBP at 0.91) reflects a good chunk of Brexit negativity and look for a stable, yet volatile, pound.

BRL: Expect more voter volatility ahead of Brazil's presidential election

The Brazilian real is significantly underperforming the Latam FX universe – a sign that the upcoming contentious presidential elections (7 October) are starting to take over as the key driver for the currency. As [ING's Gustavo Rangel](#) points out, polls are likely to be the main domestic driver for local assets going forward. The lack of clarity over whether an investor-friendly candidate will win the elections could intensify demand for FX hedging that risks triggering a BRL selloff towards 4.00-4.20.

