

Rude awakening

Back from two weeks of holiday - what's changed? Turkish Lira, EURUSD. Lower US Treasury yields

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Coming back from vacation is a bit like opening Christmas presents...not all desirable

Coming back from a two-week vacation, much of which was spent in wi-fi purdah, is a bit like opening Christmas presents - what am I going to find in bond market space? Oh, like the obligatory pair of socks - nothing too interesting here. 10Y Yields still below 3%, despite all the US inflation measures being over-target and the Fed still in tightening mode. 2Y US Treasury yields have dipped sharply (an unexpected but welcome jar of marmalade?).

But then open the FX wrapping paper, and whilst most of Asian FX seems to have stuck at levels reached some weeks ago (more socks?), the Turkish Lira continues to be under serious pressure, and some of this is now spilling into the EUR, due to the region's close trade linkages with Turkey (a tasteless sweater perhaps?). So much so, that this is even beginning to see EUR/GBP moving sharply in favour of the pound, despite Brexit seeming to have moved no further in a positive direction (some things never change).

OK - that's enough of this analogy, which was getting a bit stretched anyway (like the tasteless sweater - three sizes too small). But on the EUR/USD, relatively range-bound since June, one question is, should we really be treating US protectionism as a USD negative? Many big finance houses are doing so. But there are good reasons to think we should not.

Sure, past history has typically been unkind to the dollar during periods when it was being protectionist. But then how many occasions has this been? Is this really a statistically significant set of observations? Were economic conditions similar on those few occasions? The answers to these questions are, respectively, "Not many, no, and not really." At best, we should probably have approached this protectionism neutrally.

From a theoretical perspective, whenever the US administration slaps tariffs on other countries, it is improving its terms of trade (export prices relative to import prices) at the expense of other countries. If nothing else were changing, this ought to provide the USD with a boost. If it didn't, then protectionism would allow aggressor countries to have their cake and eat it too - they could improve their terms of trade with tariffs, and their currency would also move in a helpful direction.

In this respect, Turkey's currency is behaving as you might expect given that its terms of trade have been hurt by US tariffs, it is weakening to offset that damage. As we await a convincing response from the Central Bank and government, this will likely continue to be the case, and so too

will the spillovers we see today for example, in EUR/GBP. For now, this is not an Asian issue except in as much as the pressure for the USD to respond to its protectionism with some further appreciation remains. Ironically, this is probably exactly the opposite response President Trump would like to see, though he is being helped for the moment by the decline in yields in US bond markets. If this changes, then this ought to provide the USD with a further boost. Then, this might become an Asian problem.

Asia day ahead

We've already had a slightly disappointing start to the day with Singapore 2Q18 GDP revisions coming in a little lower than the 4.1% consensus view (3.9% actual versus 3.8 preliminary). But the 1Q18 figures were revised higher to 4.5% (4.3% previously) mitigating some of the disappointment. And at this stage, we don't expect to have to respond to this data with any change to our 3.0% full-year GDP forecast. More important will be Friday's non-oil domestic export figures, which will set the scene for the second-half of the year.

Other than that, it is a quiet day - we may get some Chinese money supply figures, though these may not be out until Wednesday - we expect these to be strong, whenever these are released. Other than that, we are in wait-and-see mode ahead of China's activity data releases for July, released tomorrow.

Author

Olivia Grace

Editor

olivia.grace@ing.com

Julian Geib

Junior Economist, Global Trade

julian.geib@ing.de

Zoltán Homolya

Economic research trainee

zoltan.homolya@ing.com

Amrita Naik Nimbalkar

Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@ing.com

Michiel Tukker

Senior UK & Eurozone Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Senior Economist, Healthcare & Technology
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@ing.com

Coco Zhang
ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Deputy Global Head of Editorial and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporate Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@ing.com

Rafal Benecki

Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Chief Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com

