

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.

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