

What to expect from the US Treasury FX report?

Our base case remains that we do not expect any country to meet manipulation standards, meaning any protectionist risks should be contained.



3 things to watch out for in the US Treasury FX report

This will be subject to interpretation, but we provide three areas that may offer up some clues:

1. **Lowering or easing of thresholds:** In the initial April-16 report, the Treasury defined the thresholds for the three broad criteria stipulated in the 2015 Trade Act. In theory, the Treasury are able to change the thresholds – lowering the bar to label any country a currency ‘manipulator’ if this were the Trump administration’s goal. We see this as highly unlikely; the thresholds have only been in place for 2 reports (one year) and any change would question the credibility of the whole process.
2. **Justification for keeping China on the ‘monitoring list’:** For two reports now, China will have only met one of the three criteria (assuming no change in the thresholds), which means that it could fall off the ‘monitoring list’. Again, we wouldn’t bet on this – but we are

intrigued to see the rationale used by the Treasury to keep China on the list. Perhaps the large bilateral trade surplus loosely suffices as a reason.

3. **References to the Trump administration's policy agenda:** The report will make reference to the administration's trade policy and this will be important to watch. Still, we expect this to be broadly consistent with current White House rhetoric. Negative tail risk would be greater noise over the penalties for future currency manipulators (beyond the scope of the 2015 Trade Act).

How will FX markets react?

China won't be labelled a currency manipulator

One of the key outcomes of the Treasury's report could be confirmation of the administration's greater focus on tackling bilateral trade – not direct currency – manipulation. Investors need to delineate between the two here, as a more pragmatic trade approach by the Trump team would also be conducive to the broader global risk environment. Markets placing greater weight on US reflation - and not Trump protectionist risks - would also be consistent with our view for a modest steepening of the US yield curve over the coming months.