

FFTW Weekly Commentary

FOR PROFESSIONAL INVESTORS

With Trump's promised policies, the USD is already becoming "Great Again"

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Key takeaways

- Since Trump's election on November 8, 2016, the U.S. dollar has outperformed all major currencies except for the Canadian dollar, the British pound and the Russian ruble.
- Under Trump's policies, real growth should be boosted to a range of 2.5% to 3% in the medium term, through a large fiscal stimulus.
- Until global growth and inflation pick up more solidly, and this divergence in monetary and fiscal policies subsides, the U.S. dollar can continue to appreciate in 2017.

Full commentary

Since Trump's election on November 8, 2016, the U.S. dollar has outperformed all major currencies except for the Canadian dollar (renegotiating the North American Free Trade Agreement may be a positive for Canada), the British pound (Brexit is aligned with Trump's philosophy, and the pound had taken a large beating since June), and the Russian ruble (Putin is viewed favorably by Trump). These three currencies were up about 1% to 3% since the election, while the Broad Dollar Index (TWEXB) and the euro each moved by approximately 4% in favor of the U.S. dollar. The worst performers were the Japanese yen (U.S. long term rates shot higher while the Japanese 10-year government bond yields remain pegged at zero under the new Bank of Japan policy), the Turkish lira (the lira is highly sensitive to U.S. rates), and the Mexican peso (Mexico is a direct Trump target on trade). These under-performers each moved from 9% to 10% lower vs. the U.S. dollar.

What has changed? In a few words: expectations of Trump's policies should fuel higher growth and inflation in the U.S. in the next year. Whether these expectations will ultimately be realized, matters little in the current "honeymoon" period with Trump. Animal spirits are stirring in markets and the Federal Reserve (Fed) is about to finally deliver a hike in 2016, within the next week, after predicting they would do earlier this year.

U.S. real growth has averaged about 2% per annum since the post-Lehman recovery started in 2009 (see Graph 1). Under Trump's policies, real growth should be boosted to a range of 2.5% to 3% in the medium term through a large fiscal stimulus (mostly unfunded personal and corporate tax cuts, and a substantial infrastructure spending program). With oil prices having stabilized, inflation should soon move solidly over 2%, encouraging the Fed to normalize rates. In our base-case scenario, risks of a recession and disinflation in the next few years have diminished drastically, while longer term risks have likely increased due to threats of protectionism, and/or an overheating of the U.S. economy that triggers inflation, faster Fed tightening, and substantially higher interest rates - a classic boom/bust cycle. In this base-case scenario, the U.S. dollar is likely to rise broadly in 2017, as U.S. growth, inflation and rates rise. In the meantime, other major economies are likely to remain mired in a low-growth/low inflation mode beset by political issues and elections in Europe (Brexit, migration, and elections in Italy, France and Germany), continued struggles with the politics of Abenomics and disinflation in Japan, and subdued growth in China and emerging markets generally. This base-case scenario is subject to uncertainty in 2017, as Trump's agenda may not be fully implemented, protectionist pressures may arise much sooner than expected, and/or financial markets (stocks, bonds, credit spreads) may react negatively and disrupt growth prospects before the actual fiscal stimulus has a chance to come into play.

The U.S. Dollar Index (DXY) has broken out of a relatively narrow range of 8% that has been in place since March 2015 (see Graph 2). Against the majors in the Group of Ten (G-10), the U.S. is likely to experience a period of continued monetary policy divergence, now compounded by fiscal policy divergence, with Trump policies outdoing any fiscal stimulus feasible or likely in other major countries. Until global growth and inflation pick up more solidly, and this divergence in monetary and fiscal policies subsides, the U.S. dollar can continue to appreciate in 2017.



This week's market developments

Monday, December 5

- Markit UK Services PMI increased to 55.2 for November
- Markit Eurozone Service PMI (final estimate) decreased to 53.8 for November
- US ISM Non-Manufacturing Composite increased to 57.2 for November

Tuesday, December 6

- Eurozone 3rd Quarter GDP growth (final estimate) remained at 0.3% q.o.q. (s.a.)
- Germany Factory Orders growth increased to 4.9% m.o.m. (s.a.) for October
- US Factory Orders growth increased to 2.7% m.o.m. (s.a.) for October
- US Durable Goods Orders growth (final estimate) decreased to 4.6% m.o.m. (s.a.) for October

Wednesday, December 7

- Germany Industrial Production growth decreased to 0.3% m.o.m. (s.a.) for October
- UK Industrial Production growth decreased to -1.3% m.o.m. (s.a.) for October
- UK Manufacturing Production growth decreased to -0.9% m.o.m. (s.a.) for October
- Japan 3rd Quarter GDP growth (final estimate) decreased to 0.3% q.o.q. (s.a.)

Thursday, December 8

- US Initial Jobless Claims are expected to decrease to 258,000 for the week of December 3rd

Friday, December 9

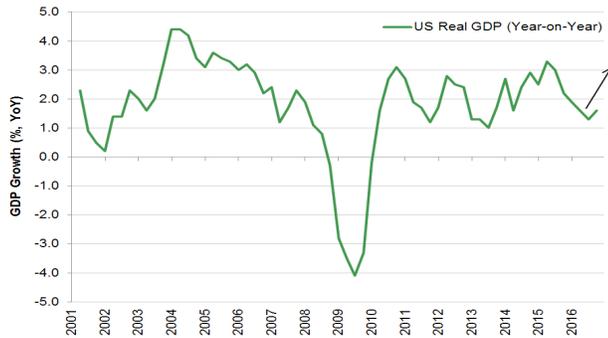
- University of Michigan Consumer Sentiment Index (prelim estimate) increased to 98.0 for December

Source: Bloomberg, as of end December 12, 2016



Charts of the Week

U.S. Real GDP (Year-on-Year) 2002 - Present



Source: Bloomberg, as of end December 12, 2016

U.S. Dollar Index 2002 - Present



Source: Bloomberg, as of end December 12, 2016



Next week's market developments

Monday, December 12

- Japan Machine Tool Orders growth is expected to increase to -5.6% y.o.y. for November

Tuesday, December 13

- Germany CPI growth (final estimate) is expected to remain at 0.1% m.o.m. for November
- UK CPI growth is expected to increase to 0.2% m.o.m. for November
- UK PPI Output is expected to decrease to 0.2% m.o.m. for November

Wednesday, December 14

- Eurozone Industrial Production ex. Construction growth is expected to increase to 0.1% m.o.m. (s.a.) for October
- US Retail Sales Advance growth is expected to decrease to 0.3% m.o.m. for November
- US PPI Final Demand growth is expected to increase to 0.1% m.o.m. (s.a.) for November
- US Industrial Production growth is expected to decrease to -0.3% m.o.m. (s.a.) for November

Thursday, December 15

- US CPI growth is expected to decrease to 0.2% m.o.m. (s.a.) for November

Friday, December 16

- Eurozone CPI growth is expected to decrease to -0.1% m.o.m. (s.a.) for November
- US Housing Starts are expected to decrease to 1,230,000 for November

Source: Bloomberg, as of end December 12, 2016



Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3m rate on March 2017 Interest Rates Futures Contract	Next meeting
Fed	+25 basis points	December 16, 2015	0.25 % - 0.50 %	0.69 %	December 14, 2016
ECB	-5 basis points	March 10, 2016	0.00%	-0.18 %	January 19, 2016
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.06 %	December 20, 2016
BoE	-25 basis points	August 4, 2016	0.25 %	0.40 %	December 15, 2016

Source: Bloomberg, as of end December 12, 2016

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