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By Wilson Sy

The US dollar is "too strong" – Trump

The US dollar is "too strong" according to newly installed President Trump. In an interview with Wall Street Journal, President Trump said that China is holding down the yuan. "Our companies can't compete with them now because our currency is too strong. And it's killing us."

Trump's statements sent the US dollar index (symbol DXY) tumbling to a 7-week low of 100.69 last week. Investors took Trump's statements to mean that the US may be backing off its long-standing mantra of a "strong dollar" policy. The DXY is a leading benchmark for the international value of the US dollar. It measures the value of the US dollar against a basket of top foreign currencies.

Rhetoric vs. actual policies

Donald Trump's comments are pretty much at odds with his own policy statements. On one hand, Trump says that the dollar is already "too strong" implying that he wants the dollar lower. But on the other hand, his economic policies of fiscal stimulus, infrastructure spending, corporate dollar repatriation and other reflationary measures are structurally bullish for the dollar. Trump has also been saying that he wants the Fed to let interest rates rise, saying that the Fed had kept rates artificially low for such a long time. This is also dollar bullish.

Long-term dollar strength vs. short-term

Treasury Secretary nominee Steven Mnuchin, however, was quick to clarify that President Trump's comments were not meant as a long-term policy. Mnuchin, when asked at his confirmation hearing before the Senate Finance committee last week, said that "the dollar's long-term strength – over long periods of time – is important."

He said that when Trump made a comment on the US dollar, "it wasn't meant to be a long-term comment." "It was meant to be that perhaps in the short term, the strength in the currency, as a result of free markets and people wanting to invest here, may have had some negative impacts on our ability to trade."

Markets are quick to react and discount

Trump's reflationary policies were seen as structurally bullish for the US dollar (see *Dollar strength re-accelerates after Trump win*, Dec. 5, 2016). But the market may have priced in this information already. Hence, the pullback in the US dollar prior to Trump's inauguration may in fact be case of a "sell on news" event. Note that the market and politics operate in different timetables. While the market has quickly discounted the news, it may take a much longer time before politicians actually enact the policies that the Trump administration has laid out.

Major currencies making short-term headway against the dollar

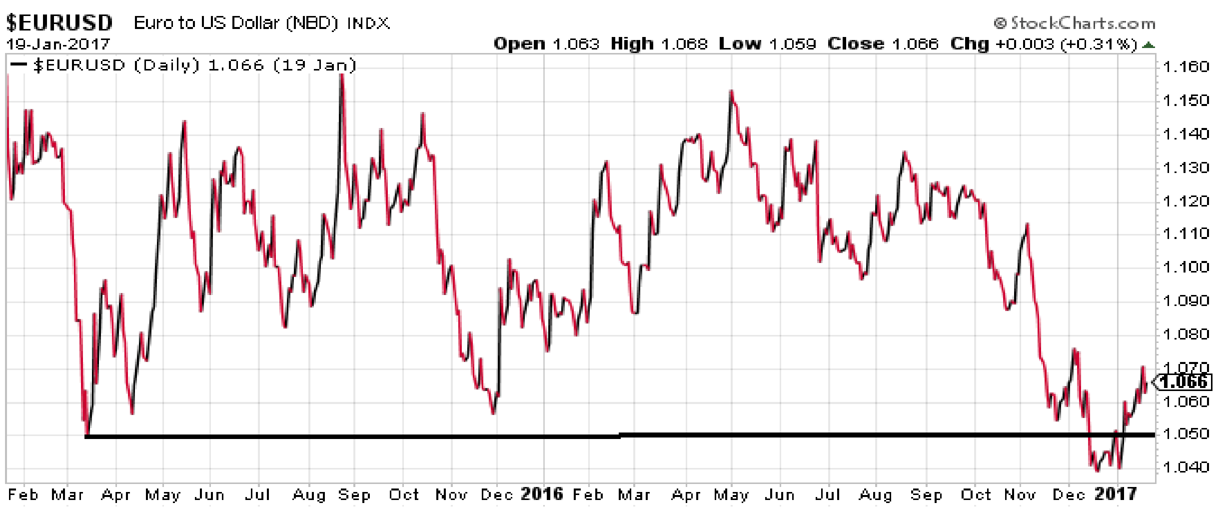
Markets rarely move in straight lines. Certainly, after an 11% run since May of 2016 the DXY (shown below) is bound to give back some of the gains. It has retraced 3 percent since reaching a 14-year high of 103.82 last month. The 100 level for the DXY - previously a major resistance but now turned into major support - is crucial. A breakdown below this level would mean a much longer consolidation for the DXY. However, if it continues to hold above 100 and rallies back up, the chart formation remains bullish.

Source: Stockcharts.com

While the DXY remains in bullish territory, a number of major currencies have recently made headways in the near-term against the US dollar. Below we show the technical picture of the US dollar against these other currencies.

Euro

The euro chart appears to have made a false breakdown and formed a double-bottom against the US dollar. The loss of downside momentum is apparent after the EURUSD recovered above 1.05. Note that while many analysts were calling for par at the start of 2017, the chart formation now shows that a retracement towards 1.08, and possibly 1.10, is more likely.



Source: Stockcharts.com

Japanese Yen

After the decline in 4Q16, the USDJPY was way overextended and has hit the resistance level at 118. The yen has since strengthened by 3.5 percent this month and a larger retracement in USDJPY seems likely from here.

Source: Stockcharts.com

Singapore dollar

Another important currency pair in Asia is USDSGD whose recent move above last year's high of 1.44 was sharply repelled. Although it reached 1.45 and traded there for about two weeks, USDSGD is now down to 1.425. From a technical standpoint, the break below the short-term trendline suggests further retracement lower.

Source: Stockcharts.com

Chinese Yuan

Meanwhile, Chinese policy makers have been tightening capital controls which has reduced capital outflows significantly. Based on the data from China's State Administration of Foreign Exchange, only a net $900 million worth of yuan left China in December vs. an aggregate outflow of $309.4 billion for the full year of 2016.

The PBOC also raised short-term funding rates at the start of the year to protect the currency. If the PBOC is successful in mitigating capital flows this year and the yuan further stabilizes, there will be less pressure on Asian currencies, including the peso, to depreciate against the US dollar.

Reversal or just a respite?

While the dollar index has lost some ground and the developed market currencies have made some headway against the greenback, it is too early to say if the dollar has indeed reversed or is just pulling back. It may also take some time to figure out the actual economic and foreign exchange policies of President Trump.

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