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Investment Strategy Bulletin

The dollar and 2020 US presidential elections

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The dollar and 2020 US presidential elections: protectionism and trade policies at the forefront

- The US presidential elections are scheduled for November 2020
- Though too early to speculate on the outcome, we discuss potential dollar implications under different presidencies
- We view the risks as tilted towards USD downside in case of a Trump or Warren presidency – something which could, however, be completely turned on its head under a scenario of a significant step up in protectionism and re-escalation in trade wars
- Biden and Bloomberg are more likely to provide a return to mainstream policies, allowing the dollar to trade more in line with relative economic developments.

It is still too early to speculate on the outcome of the 2020 US election and opinion polls are scarce. In addition, the path of US/China trade negotiations and the state of the US economy over the first six months of next year will surely factor in voters' decisions. Instead, in this note we consider how the dollar is likely to respond under different presidencies. We do so through a set of assumptions. First, the most likely current contenders are Donald Trump (the current president), Elizabeth Warren, Joe Biden and Michael Bloomberg (who announced his candidacy only recently to join a "pretty crowded field"). Second, that during the first half of 2020, the dollar will correct some of its overvaluation and so, fundamental misalignments are unlikely to be the primary driver from the autumn of next year onwards.

Taking the global growth outlook (a big influence on the USD) as given, the outcome of the 2020 presidential election may affect the dollar's trajectory in three ways:

1. dollar policy,
2. trade policies and
3. the interaction between fiscal and monetary policy.

We will look at each in turn.

1 USD policy or "shouting at the dollar"

On this front – and keeping all else constant - we think a Trump or Warren presidency would be likely to negatively impact the USD. A Biden (or Bloomberg) presidency would be neutral.

Since the beginning of his presidency in 2017, President Trump has made no secret of his preference for a weaker exchange rate. This was ineffective – at least since mid-2018. However, the reason has been the interplay between trade tensions (and a flight to safety) along with the late cycle US fiscal stimulus (US exceptionalism). With fiscal impulses now fading, limited room for additional meaningful fiscal expansion (since the deficit is expected to remain stubbornly above 5% of GDP for the foreseeable future) and some stabilisation in global trade/growth, "shouting at the dollar" may now be less ineffective than before.

A Warren presidency would very likely create some harsh FX rhetoric. Warren has called for the need to "actively manage the currency's value to promote exports and domestic manufacturing". She has also said that "...we should consider a number of tools and work with other countries harmed by currency misalignment to produce a currency value that's better for our workers and our industries". This strong language illustrates her views on the use of the currency as an instrument for growth. Here too, our expectation is that verbal currency interventions would this time meet less resistance in the market compared to the 2018/19 period.

Finally, we view a Biden or Bloomberg presidency as a return to "conventional policy". While Democrats have warned for years about globalisation's downsides for US workers, it is unlikely that either Biden or Bloomberg will resort to verbal FX intervention. Mr Biden has so far expressed rather mainstream views on trade policies and in some cases he has diverged from fellow Democrats: he voted, for example, for the NAFTA agreement in 1993. His political statements are clearly pro-international trade – with some 'standard' remarks about protecting US workers, safeguarding the environment, labour standards, wages and fostering innovation. He has shied away from commenting on the exchange rate and we think he would largely stick to this script if elected. Michael Bloomberg has been a proponent of free trade/immigration and opposes protectionism. It seems very unlikely that he would resort to verbal FX intervention of any kind.

2 Trade policies

Trade policy will depend largely on where US/China relations stand at the time of the election. Trump has been a proponent of tariffs but the lack of additional fiscal stimulus may restrain his enthusiasm for import taxes. There is certainly much unpredictability on the relationship between a Trump presidency and trade policies, but we only see a major impact on the dollar were there a severe re-escalation in trade tensions (either with China or Europe). In such a scenario, an outright global recession would present a significant risk, which would clearly support the dollar.

Interestingly, Elizabeth Warren's views on trade policy are not that far from Trump's. In fact, in many ways she looks more protectionist than the current president. On one hand, Warren has been wary of globalisation and very critical of poor Chinese standards and regulations on human rights, freedom of religion, labour rights etc. To the extent that she demands strict compliance from China on these (and other) fronts in exchange for free US market access, US-China relations could come under renewed strain. In addition, she has said that she does not think free-trade deals that benefit corporations at the expense of American workers "…are good simply because they open up markets". On the other hand, she has claimed that tariffs are not a long-term solution and she favours a more transparent decision-making policy. Nonetheless, we cannot rule out another wave of protectionism under a Warren presidency. On balance, we believe that compared with the current administration she will engage more in multilateral and bilateral discussions and so we see the risk of a significant re-escalation in trade tensions as somewhat lower than that of a Trump presidency.

Finally, we would consider a Biden or a Bloomberg presidency to result in normalising US-China relations, since both candidates have expressed pro-international trade views. In such a scenario, global trade would likely improve further. The dollar would then trade largely on the back of relative macro-economic fundamentals. To the extent, that further normalisation in trade relations improves global/EM growth we would expect the USD to come under pressure.

3 The interplay between fiscal and monetary policies

As discussed previously, the room for additional fiscal policy easing looks limited. We believe that if Donald Trump were re-elected, he would feel the need to compensate the lack of fiscal stimulus with easier monetary policy. Of course, this is not his call, but he will surely be tempted to appoint dovish Fed members (Jerome Powell's term as Chair of the Board of Governors expires in early 2022). That would be bearish for the dollar.

On the other hand, Warren appears more respectful of the separation between fiscal and monetary policies and Fed independence. However, her strong views on the use of the exchange rate to protect jobs suggests that she too will have an incentive to offer a dovish spin to the FOMC. Purely on the fiscal front, the situation is more complicated. Warren has advocated higher taxes on large corporations, increased wealth taxes, "Medicare for all" and strengthened banking supervision. It is difficult to see how all these policies could be enacted, especially under the most likely scenario of a split Congress coupled with an already large budget deficit. But if implemented, such a programme would provide an entirely different type of fiscal policy to the Trump administration's. Markets may see it as disrupting corporate profitability, slowing flows to the US. The immediate impact on the USD would be negative, perhaps lessened somewhat by higher interest rates (due to a higher US risk premium) and some flight to safety.

A Biden presidency would represent a return to basics, likely aimed at the middle class. Biden's fiscal plans appear less "left-leaning" compared with Warren (or Sanders) and lacking any revolutionary wealth or financial transaction tax proposal. He opposes "Medicare for all" although he has said he would expand it. While Biden has not made his view clear on the size and sustainability of the US budget deficit, his policies could induce some deficit increases over the next few years – if approved by Congress. On balance, we do not consider them "make or break" for the USD. We hold similar views on a Bloomberg presidency. Michael Bloomberg is largely seen as a centrist and fiscal conservative (he turned New York City's USD 6bn deficit into a USD 3bn surplus) and has been a staunch opponent of the Trump administration's fiscal stimulus. While we lack precise details about his fiscal policy plans, we believe that like Biden, he would represent a return to normalcy. In fact, with a successful track record as an entrepreneur and NY mayor, Bloomberg could be seen by markets as an efficient, growth-friendly and dollar-supportive choice.

In sum, we see the risks as tilted towards USD downside in the case of a Trump or Warren presidency. However, that would be completely turned on its head if there were a significant rise in protectionism and re-escalation in trade wars. Biden and Bloomberg are more likely to represent a return to more mainstream policies, allowing the dollar to trade more in line with economic developments.

Vasileios Gkionakis, Global Head of FX Strategy

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SWITZERLAND

GENEVA
Bank Lombard Odier & Co Ltd[1]
Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com
Lombard Odier Asset Management (Switzerland) SA
Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG
Banque Lombard Odier & Cie SA · Bureau de Fribourg[1]
Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE
Bank Lombard Odier & Co Ltd[1]
Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY
Banque Lombard Odier & Cie SA · Agence de Vevey[1]
Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH
Bank Lombard Odier & Co Ltd[1]
Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS
Lombard Odier (Europe) S.A. Luxembourg · Belgium branch[2]
Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com
Credit institution supervised in Belgium by the Banque nationale de Belgique (BNB) and the Financial Services and Markets Authority (FSMA).

LONDON
Lombard Odier (Europe) S.A.· UK Branch[2]
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
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LUXEMBOURG
Lombard Odier (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com
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Lombard Odier Funds (Europe) S.A.
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Lombard Odier (Europe) S.A. · Sucursal en España[2]
Paseo de la Castellana 66 · 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
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Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.
Paseo de la Castellana 66, 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
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MILAN
Lombard Odier (Europe) S.A. · Succursale in Italia[2]
Via Santa Margherita 6 · 20121 Milano · Italia
milano-cp@lombardodier.com
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MOSCOW
Bank Lombard Odier & Co Ltd · Representative Office Moscow
Letnikovskaya st.2, bld.1 · 115114 Moscow · Russian Federation · moscow@lombardodier.com
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PARIS
Lombard Odier (Europe) S.A. · Succursale en France[2]
8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com
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Bank Lombard Odier & Co Ltd · Representative Office Dubai
Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE ·
dubai@lombardodier.com
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Israel Representative Office · Bank Lombard Odier & Co Ltd
Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv 6688312 · Israel · telaviv@lombardodier.com
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JOHANNESBURG
South Africa Representative Office · Bank Lombard Odier & Co Ltd
140 West Street · Sandton · Johannesburg 2196 · South Africa
johannesburg@lombardodier.com
Authorised financial services provider Registration number 48505.

MONTEVIDEO
Lombard Odier (Uruguay) SA
Luis Alberto de Herrera · Torre 2 · Oficina 2305
11300 Montevideo · Uruguay
montevideo@lombardodier.com
Supervised by Banco Central del Uruguay.

NASSAU
Lombard Odier & Cie (Bahamas) Limited
Goodman's Bay Corporate Centre · West Bay Street · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.

PANAMA
Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
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Lombard Odier (Panama) Inc.
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ASIA - PACIFIC

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Lombard Odier (Hong Kong) Limited
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Lombard Odier (Singapore) Ltd.
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TOKYO
Lombard Odier Trust (Japan) Limited
Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com
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