

## The Dollar after US Presidential Elections

*The dollar was expected to weaken with a Republican Party victory as it was surmised that Donald Trump would turn protectionist which would not be good for the economy. However, the dollar has been strengthening relentlessly since then; and while domestic fundamentals have played their part at times for specific countries, in general currencies have been weakening against the dollar as the table below shows.*

To maintain comparability the periods chosen are 7 trading sessions before the Elections i.e. 8<sup>th</sup> of November and a similar number of sessions post- 8<sup>th</sup> November (ending 18<sup>th</sup> November). Some major countries have been selected and the changes in their currencies relative to the dollar have been tabulated for the two time periods. The numbers in red represent appreciation in the currency vis-à-vis the dollar. The changes are reckoned on a point on point basis for these 17 currencies.

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Drepreciation/appreciation (%)	28 <sup>th</sup> Oct to 8 <sup>th</sup> Nov	8 to 18 <sup>th</sup> Nov
Canada dollar	0.36	1.36
Euro	0.91	4.10
UK pound	1.77	0.37
Japan Yen	0.35	5.26
Brazil Real	0.05	6.60
China Renminbi	0.10	1.47
Hong Kong dollar	0.02	0.03
India Rupee	0.61	2.64
Indonesia Rupiah	0.62	2.37
Malaysia Ringgit	0.05	5.10
Mexico peso	1.50	10.82
Philippines peso	0.11	2.30
S Africa Rand	4.00	8.33
S Korea Won	1.37	4.10
Taiwan dollar	0.64	1.80
Thailand Baht	0.28	1.63
Turkey lira	1.79	6.68

Donald Trump's victory has led to a major re-pricing of assets, with investors rushing to buy U.S. stocks and the dollar, while exiting bonds and emerging market assets. As can be seen 11 of the 17 currencies had appreciated against the dollar till the 8th November indicating the strong sentiment in the market prior to the results being announced. Subsequently all of them have depreciated with the dollar strengthening quite sharply. The rupee has not performed too unsatisfactorily and is at the median change in this set of countries at 2.64%. The rupee has also been affected by other fundamental factors besides the stronger dollar.

The highest depreciation was witnessed in the 2 Latin American countries considered (Brazil and Mexico), Turkey, South Africa, Malaysia besides the Euro and Japan. The relatively better performing currencies were Hong Kong, UK, Canada and China. Mexico has been specifically hit due to the President's indication that there would be review of both immigration as well as trade treaties. China however has still been less affected even though the future policies of the USA could be targeting economic transactions from here. Hence, it would need to be seen if these trends persist for a longer period of time.

### **Why has the dollar strengthened?**

The markets do believe that the policies of Donald Trump will work in favour of the dollar and the main reasons being given are:

- Higher fiscal spending is expected based on what was promised at the time of elections. This will boost economic growth.
- Lower tax rates, especially for business will provide a further stimulus to the economy. In particular investment will receive a boost.
- Lesser regulation will work in favour of big business.
- All this combined will lead to potential inflationary forces which will cause Federal Reserve to increase interest rates which is good for dollar. In fact, the pace of increase may accelerate in case the inflation threat increases.
- Higher interest rates will tend to make the dollar stronger as investment flows back to the US. Conversely, such a turnaround in dollar flows will pressurize the external balances of the trading partners- especially emerging markets and depress their currencies further.

Therefore a combination of fiscal stimulus and monetary tightening could be the way forward.

### **Is this sustainable?**

Investors presently have no clear idea of the extent that Trump could actually implement his proposals, which include putting tariffs on goods from major trading partners such as China and Mexico, and going ahead with heavy tax cuts that would widen the U.S. fiscal deficit.

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Hence, one cannot be too sure about the future track of the dollar. It would depend largely on how the other policies shape up. If protectionism follows, then it will affect the growth of the economy as well as raise inflation (due to higher tariff) and interest rates on the domestic front which will weaken the dollar instead of strengthening it. Hence, a lot will depend on how these two forces work out in terms of medium term and impact the dollar. Also if the fiscal policy stance, which has pushed up the dollar, is pursued aggressively with higher deficits, it would also work against the strength of the dollar. Therefore, the same pointers leading to strengthening of the rupee could be interpreted otherwise in case at the secondary and tertiary stages it affects the growth prospects.

Hence, the follow-up action from the USA and possible reaction of other countries especially China could play a part in driving the direction of the dollar, as other countries too could impose tariffs on US goods affecting their exports. Further, the forthcoming OPEC meeting and the referendum in Italy could cause diversion from the dollar as other factors would come into play.

***On the whole the present trend of stronger dollar and rising Treasury yields would stabilize based on the actual course of action taken by the Donald Trump.***

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