As ‘America First’ Trade Focus Returns, The Dollar Is Still Too Strong

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The Trump administration is shifting its focus back to “America First” trade policies. That could put the spotlight back on the U.S. dollar, which economists say still is still too strong even after the currency notched its worst year in a decade.

Economists at the Institute of International Finance estimated on Monday that the greenback remains about 10% overvalued despite a year-long slide that has driven the currency down 7% against a basket of 16 currencies tracked by the Wall Street Journal.

As we noted in our Morning MoneyBeat newsletter Tuesday, the dollar’s value has been a subject of much debate since the election of President Donald Trump in 2016. The greenback began to strengthen broadly during the financial crisis, with gains accelerating in 2014 as the U.S. Federal Reserve began to pare back quantitative easing. The currency’s strength weighed on the economy by making U.S. exports more expensive to overseas buyers. Mr. Trump has repeatedly blamed the strength of the dollar--and foreign currencies’ weakness– for the yawning $500 billion annual U.S. trade deficit.

But the administration had largely failed to follow through on many of its trade-related threats, such as slapping tariffs on countries it believes are using unfair trade practices or labeling China a currency manipulator. That changed Monday, when the administration announced steep tariffs on imports of cheap solar panels and washing machines aimed at Asian manufacturers, the first step in what officials said would be a series of trade-enforcement actions in the coming months.The shift in focus towards Mr. Trump’s “America First” trade policy is likely to revive questions about the dollar’s value.

In order to fully close the U.S. trade gap, the IIF estimates the dollar would need to fall another 10% from its current levels. IIF economists say the dollar has furthest to fall against the currencies of Asian nations, such as China’s yuan, with which the U.S. runs its largest trade deficits.

“Given that the current account deficit is largely vis-à-vis Asia, a reasonable case can be made that this is where the bulk of dollar overvaluation exists,” IIF said.

Of course, changes to the value of the dollar are just one factor that impacts trade flows between the U.S. and the rest of the world. And so far, the dollar’s steady slide since January 2017 has done little to impact the trade deficit, which rose in November to its highest level since 2012. December data is due to be disclosed early February.

Still, the IIF’s forecast adds to the list of reasons for investors to stay bearish on the dollar. Many analysts have predicted that an escalation in trade tensions, or an all-out trade war, would drive the greenback down.

"A shift in trade rhetoric from the U.S. is emerging as the next major market theme, said analysts at TD Securities in a research note Tuesday. TD said the euro and yen are likely to benefit the most from "a pivot towards protectionism" from the U.S.

On Tuesday, the dollar slid 0.5% against the Japanese yen and 0.1% against the euro.

A weaker dollar isn't all bad news. The currency's decline has bolstered profits for U.S. multinationals' recently by making their products cheaper abroad, helping drive the S&P 500 and Dow Jones Industrial Average to new records. It has also helped support commodities such as oil–which are priced in dollars and become cheaper for foreign buyers when the U.S. currency weakens.

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