TOO CLO$E TO CALL

THE RACE FOR THE WHITE HOUSE IS FOCUSING THE WORLD'S ATTENTION ON US POLITICS. LEE McDARBY DISCUSSES HOW ELECTION FEVER COULD IMPACT THE DOLLAR

Much like the EU referendum on this side of the pond, the battle for the White House has taken centre stage over in the US this year and will continue to dominate news headlines in the run-up to polling day on 8 November. Whether the Democratic Party retains the presidency – presumably with Hillary Clinton at the helm – or are pipped to the post by the somewhat divisive Donald Trump, the appointment of America's 45th president could significantly impact the US dollar's performance later this year.

Before we contemplate the dollar's post-election future through analysing the precedent set by previous presidential battles in recent history, we should analyse how it has been performing so far in 2016, and consider how the official campaign period might influence its fortunes in the coming months.

With the election still just a dot on the horizon, other more immediate factors held sway over dollar sentiment in Q1 2016. Having strengthened on the whole against sterling – due largely to uncertainty surrounding the UK's referendum vote on its EU membership – the dollar was checked by further downbeat data emanating from China, confirming the fact that the world's second-largest economy remains sluggish. Not to mention, the proverbial icing on the cake of negative sentiment, a renewed slide in commodity prices. This prompted the US Federal Reserve (the Fed) to adopt a more cautious stance in relation to its appetite for further interest-rate increases, after hiking them back in December for the first time since 2006. Such dovish tones from the central bank triggered quarterly losses of around 4% against a basket of currencies.

Since then, however, not only have expectations of fresh US rate hikes gained traction thanks to improved domestic economic conditions after a Q1 lull, developments in the presidential election have begun to focus market attention.

With Donald Trump already confirmed as the Republican presumptive nominee – inching ever closer to clinching the party's official nomination for president after his remaining rivals dropped out of the race – and Hillary Clinton on track to reach the required number of delegates from the primaries to win the Democratic nomination, the ensuing political and economic instability bring uncertainty that could weigh on the dollar in the coming weeks and months. According to several major financial institutions, the dollar could become vulnerable to political rhetoric as both heavyweight nominees trade punches in what could be an open-ended presidential campaign; just as the British pound trended downwards after the UK announced it would be holding its EU referendum.

Historical evidence demonstrates how politics and economics make for intimate bedfellows. The effects of the former on the latter are significant, particularly when the prize is the Oval Office. Prior to the last US presidential election in 2012, the dollar weakened from $1.53 against the pound in mid-January

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to $1.63 in September, with opinion polls predicting the vote as too close to call. At the time, these would have been extremely beneficial conditions if your UK-based business was importing goods or services from the US during this period. For example, at the less favourable January rate, $300,000 worth of stock from your US supplier would have cost £196,000, whereas at the September rate the price would have dropped to £184,000. That constitutes a saving of £12,000 between the high and low points, simply due to fluctuating exchange rates.

Impact post-election

While we don't yet know who will be sworn in as the next US president on 20 January, it goes without saying that whomever comes out on top – Republican or Democrat – the result may well have a significant impact on the US dollar and the financial markets.

The Fed may control the nation's monetary policy, but decisions made and policies implemented by the new president will exert considerable influence over the dollar. If Clinton clinches the election, the impact could be less volatile to the climate of political policy than if Trump seizes power, given that the country has been under the control of a Democratic government since 2009.

If, as headlines suggest, a Trump win engenders a radical shift in policies – including a foreign-policy direction that could potentially isolate the US from its trading partners and have an effect on exports, the resulting market uncertainty regarding its potential impact on the US economy could precipitate exaggerated short-term dollar weakness.

Whether Trump comes up trumps in November or not, it is reasonable to expect that the dollar will experience an initial drop in value to some extent. However, recent history suggests it will recover shortly after some semblance of political and economic stability is restored. For example, when George W Bush was elected into his first term as president, the greenback strengthened against sterling from an average of 1.5150 in 2000 to 1.4500 in 2001. Even more notably, when Barack Obama was first elected, the dollar strengthened from an average of 1.8120 in 2008 to 1.5625 in 2009 versus the sterling.

Managing market volatility

The fluid nature of the FX market and its sensitivity to various political and economic events will be demonstrated by the upcoming US presidential election. This is largely because investors are likely to take flight from the dollar during the campaign period and in the immediate aftermath of the vote, in favour of more stable countries with a relatively strong economic performance in which to invest their capital.

As 8 November draws closer, the prospect of increased dollar volatility will pose different challenges for treasurers of companies that trade internationally, depending on the nature of their international payment requirements. For UK businesses that export to the US, this period of anticipated dollar vulnerability could have an adverse effect on their cash flows, as the cost of their FX exposure escalates.

As a value-added service for SMEs and corporations alike in terms of the management and execution of FX and international payments, an FX expert would help businesses mitigate the risks posed by market movements through the development and implementation of effective FX hedging strategies in line with trading activities. Having taken the time to understand a business's requirements, an FX expert will monitor the currency markets on their behalf, providing specialist guidance around the driving forces influencing their state – facilitating informed decisions around the optimum timing of transfers. By using a specialist in the field of FX and international payments, businesses will gain access to a personal, tailored and proactive service that may not always be offered elsewhere.

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