Quarterly FX Forecast

UK, Eurozone, USA, Canada, Australia & New Zealand

July - September 2020

HAWK FX

Clarity Through Perspective

Introduction

The second quarter of 2020 will go down in infamy as the deepest recession of our lifetimes. Even though the full picture will not be clear for a couple of months, the granular data that appeared in May and June leaves investors in no doubt that the lockdown brought economic activity almost to a stop in April, leaving no part of the world unaffected.

In June the International Monetary Fund made another downgrade to its World Economic Outlook. The IMF believes the global economy will contract by 4.9% this year before recovering by 5.4% in 2021. Those projections are 1.9% and 0.4% below the estimates three months ago. The hardest hit are expected to be to Italy and Spain, which were badly affected by the pandemic. In both cases, gross domestic product is expected to shrink by 12.8% in 2020 and to rebound by 6.3% next year.

The progress of Covid-19 played an important part in deciding currency direction, but it was by no means the only factor. Investors also paid close attention to the efforts of central banks and governments in their provision of monetary and fiscal stimulus. Even though most mainstream interest rates had fallen as far as they were going to by the end of March, there was still plenty going on in the arena of quantitative easing and government handouts.

UNITED KINGDOM GBP

Economy

Britain's gross domestic product shrank by 2.2% in the first quarter of 2020. When the figure for Q2 comes in that will look good. Having closed down the hospitality, entertainment and tourist sectors and made it all but impossible for airlines to operate, it came as no surprise to see private sector business activity collapsing.

By the beginning of May, the Confederation of British Industry was reporting a historic slide in retail sales with 39% of shops closed. British Airways and Virgin Atlantic announced the closure of some of their operations, a move that had been mirrored by most airlines by the end of June.

People working from home and furloughed adopted new spending habits. Alcohol sales boomed because all the pubs were shut, and spending on travel, petrol and discretionary purchases evaporated because there was nowhere to go. In March, April and May together households repaid around £15 billion of debt, either because they could not spend it or in order to build a financial buffer against the coming recession.

Politics

Scarcely a month went by without the government cobbling together a new package of fiscal support. The chancellor did his best to finesse support measures such that as few as possible people fell through the financial safety net. He created "bounce back" microloans of up to £50k for small businesses, with minimal paperwork. He extended the furlough job preservation scheme to September.

While the chancellor mostly impressed investors, Downing Street flailed. The prime minister's enduring nightmare was his early reluctance to order lockdown, which set the stage for the third worst national death toll. Recurring issues with protective equipment compounded his problems, as did a bizarre incident when an advisor went on a road trip to test his eyesight. The end of lockdown was somewhat chaotic and remains incomplete at the time of writing. It was supposed to be carried out according to a "roadmap with maximum conditionality" but ended up as a big party on Bournemouth beach and piles of litter in Liverpool.

The spectre of Brexit loomed again when the government made clear that there would be no extension of the transition period beyond the end of the year. Negotiations about a future trade deal were hobbled by the pandemic, prompting Downing Street to warn that a no-deal Brexit was still possible. Investors still expect a deal of some sort, so are not panicking yet.

Monetary Policy

Having lowered Bank Rate to 0.1% in March the Bank of England could do little else with it. Some investors thought otherwise, with the bank not ruling out, and now actively considering negative interest rates.

In June the Bank added another £100 billion to its asset purchase programme, taking the total to £745 billion. With the economy faring less badly than forecast, the Bank did slow down the pace of it's purchases.

GBP / EUR

Since the sharp Covid-induced drop close to 1.05, sterling has regained some composure. The trading range has been between 1.15 and 1.10 with much of the time spent around 1.12. Over the next three months, the economic impact of coronavirus is likely to become clearer, as will any second wave, both on the UK and on the European countries. Most expect a relatively range-bound currency pair over the short term unless we see a breakthrough or breakdown around Brexit.

Key Economic & Political Events

Aug 6 BoE Interest Rate Decision & Inflation Report

JUL AUG SEP OCT

Sep 17 Interest Rate Decision

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Economy

The Eurozone economic data were predictably dire. Although it is doubtless impolite to point the finger at any one country in the midst of a global recession, it really cannot go unremarked that German factory orders fell 25.8% in April and Italian industrial orders were down by 32.2%. This was the stuff of plunge and plummet. The only consolation was that, from such abyssal levels, things could only get better.

That cannot be said of gross domestic product. GDP for the Eurozone as a whole contracted by 3.6% in Q1, and the figure for Q2 will inevitably be even more negative. That said, there is every hope that April will mark the bottom of the cycle. In the IMF's opinion, GDP for the euro area as a whole will contract by 10.2% this year, the same as in Britain, while its 6.0% rebound in 2021 will lag the UK's 6.3% partial recovery.

The situation is improving, but Euroland is still not out of the woods. Purchasing managers' index readings for the manufacturing sector on 1 July indicated growth in France and Ireland (and Britain), but for the rest of the bloc, the numbers remained stubbornly below the line at 50 which separates growth from stagnation.

Politics

Certain members of the Eurozone would love to put together a financial care package for those of their colleagues most hurt by the coronavirus pandemic. In May, France's Emmanuel Macron and Germany's Angela Merkel surprised the EU with a joint request for a €500 billion recovery fund. Little more than a week later the European Council caused even more jaws to drop when it proposed a €750 billion recovery fund.

Yet nothing has happened in that direction yet: to go ahead, the plan needs the unanimous support of all member states. With Germany and France in the driving seat, it at least has a chance, but unanimous support for any plan is never straightforward in Europe.

On trade and travel, the European Union and the United States are somewhat at odds. A US ban on entry from the EU in March has given way to an EU ban on American visitors, on account of the uncontrolled spread of Covid-19 in the States. At the same time, the US administration is openly contemplating new tariffs on European goods.

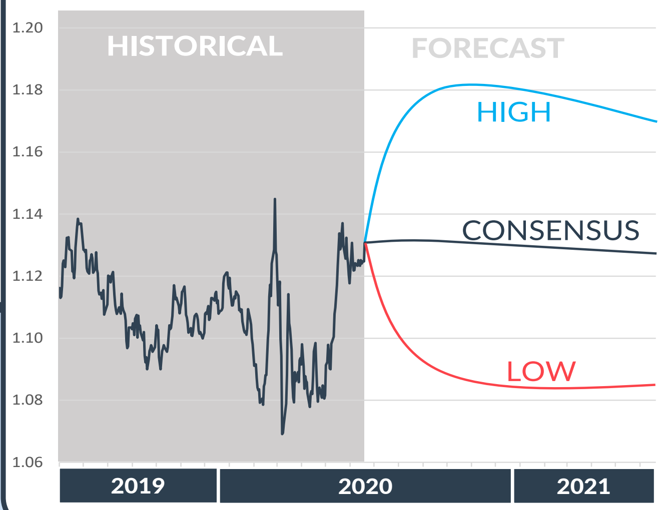
Monetary policy

The European Central Bank has been a hive of activity, not all of it voluntary. A long-running battle between the ECB and Germany's Constitutional Court re-erupted in early May when the German court contradicted a ruling by the European Court of Justice that the ECB's quantitative easing measures are legitimate. The subsequent spat has left the ECB in the position of having to justify the "proportionality" of its actions. It is likely to prevail, but the litigants are not yet ready to back down. There were also other steps taken by the European Central Bank. It has made provision for buying "junk" bonds in its asset purchase scheme, as long as they have only been downgraded as a result of the pandemic. It is helping commercial banks whose business has been hurt by the ECB's negative interest rates. It has set up swap facilities for other central banks in need of EUR liquidity.

On top of that, the ECB also announced in early June that it would bump up its Pandemic Emergency Purchase Programme, a subset of quantitative easing, by another €600 billion.

EUR / USD

After a volatile end to the first quarter, with wild, Coronavirus induced swings, the second quarter could be split into two. The first half was spend bouncing around 1.09, with lockdowns across Europe, but as the situation improves in Europe and worsens in the US, we have seen a move back up to the 1.13 area. Forecasting in the current situation is a challenge, and for the coming year, the forecasters are split with more volatility expected, but no clear consensus on direction.



Key Economic & Political Events

Jul 16 ECB Rate Decision

Sep 10 ECB Rate Decision

Oct 29 ECB Rate Decision

JUL AUG SEP OCT

UNITED STATES USD

Economy

Perhaps because it is the largest in the world, the US economy is expected by the IMF to perform roughly in line with global GDP this year and next. GDP growth for 2020 is put at -8.0%, and the 2021 rebound is pencilled in at +4.5%. The most recent US data showed GDP contracting by 1.3% in the first quarter, and the shrinkage is likely to be much greater in Q2.

As with most of the developed world, the monthly economic data were bad in March, worse in April and less awful in May, matching the intensity of the pandemic lockdown. The numbers for June are likely to be better again, despite the resurgence of Covid-19 in some states and cities. Because the US job-retention scheme operates differently from Britain's, there was no camouflaging the loss of jobs brought about by the economic shutdown. It was stratospheric, with between 1.6 million and 5.8 million more people registering every week as unemployed. (Pre-Covid the weekly average was around 215,000.) The monthly data suggest that trend is reversing: after a thumping 20.2 million monthly fall in nonfarm payrolls at the beginning of May, the numbers have been positive, but they have a long way to go.

Politics

Inevitably, the president involved himself in the efforts to contain the coronavirus, not always to good effect. His most startling suggestion was that American's should inject themselves with bleach, a notion which was quickly pounced upon by health officials. Trump could not resist referring to Covid-19 as the "Chinese virus", and he conflated the pandemic with other beefs about trade and security issues.

Nor did the administration cover itself with glory following the police killing of George Floyd and the subsequent Black Lives Matter protests. At one point he threatened to mobilise the US army again the population. Again his advisors saved him from himself: the defence secretary objected to the idea and his predecessor publicly roasted the president. As the time approached to consider an end to the lockdown, the president tried to enlist the support of state governors. To an extent, he was successful, with the result that some of them jumped the gun, allowing the virus to flare up. New York, New Jersey and Connecticut required travellers from certain virus-hit southern states to quarantine on arrival.

Monetary policy

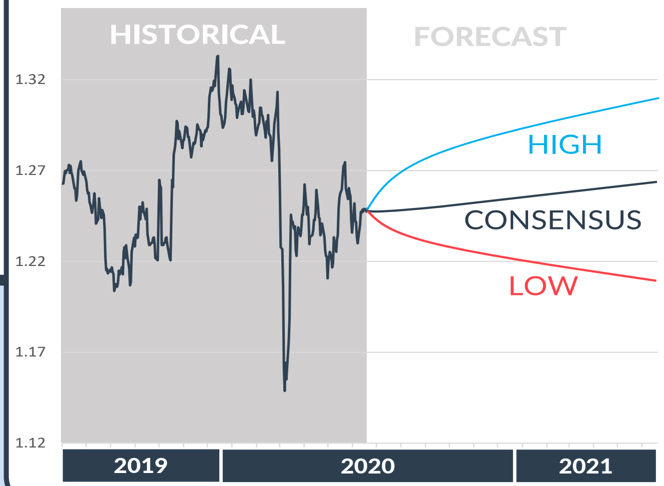
The consistent message from the Federal Reserve chairman was one of caution. He downplayed the idea of a rapid recovery and endlessly repeated the mantra that the Fed could wheel out more monetary stimulus if necessary. As for interest rates, Jerome Powell memorably told journalists that he was "not even thinking about, thinking about taking them higher.

As for negative interest rates, he described them as "an unsettled area" but "for now, it is not something we are considering". Investors are fairly confident that US rates will not go negative unless something extraordinary happens. Equally, they expect the Funds rate to remain near zero through the end of 2021 and beyond.

What has not yet been put to bed is the idea of yield curve management: setting not just the overnight rate for money but also targeting the yield on, for example, three-year bonds. It would not be a novel idea and the minutes of the June FOMC meeting acknowledged that it might be worth considering.

GBP / USD

The sharp fall at the end of last quarter to around 1.14 has been at least partially erased. Sterling has spent the last quarter bouncing about in the low 1.20's. With further stimulus from the Bank of England, but at a slower pace, the economy seems to be picking up faster than forecast. Brexit clouds still hang with the uncertainty that brings. Markets expect a relatively range-bound short term, with the potential for sharper moves if we see a Brexit deal - overall the expected outcome with sterling strength likely as a result.



Key Economic & Political Events

Jul 29 FOMC Policy Announcement

Sep 16 FOMC Policy Announcement

JUL AUG SEP OCT

AUSTRALIA AUD

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Economy

Having been among the first countries to suffer the economic effects of the pandemic – China is its biggest customer – Australia was also among the first to begin pulling itself out of the hole. It was therefore perhaps not entirely coincidental that the Australian dollar became the top performer among the major currencies in Q2.

That important trade link with China affected the Aussie more than once during the spring. In May there was a story that China was planning to reduce imports of Australian coal. The story was debunked, but the damage had been done to the AUD. Little more than a week later, the boot was on the other foot after an equally unsubstantiated report that China would be needing more iron ore from Australia.

In Australia as in Britain, retail sales experienced huge swings as panic buying gave way to lockdown hibernation. After building their stockpiles of toilet paper and Vegemite in March, pushing sales up by 8.5%, households sat back in April to work their way through their storerooms, sending sales tumbling 17.7%. Both were record monthly moves.

Politics

The focus of Australia's international politics has been very much on China. The two countries have been at loggerheads for more than a year and in May China imposed an 80% tariff on barley imports from Australia. The relationship was not improved by prime minister Scott Morrison's call for an inquiry into the origin of Covid-19 and Chinese investment in Australia has fallen to its lowest level since 2010.

Another point of contention is "malicious" cyberattacks that have been mounted against crucial infrastructure and public services by "a sophisticated state-based actor". The prime minister has held back from naming China as the perpetrator but "there aren't too many state-based actors who have those capabilities". A similar attack on Parliament House in February 2019 was attributed to China.

Most recently, Mr Morrison has stepped into the international debate about Beijing's crackdown on Hong Kong. Like Britain's Johnson, he proposes to offer a home to refugees from Hong Kong, telling a reporter "We are considering it very actively". It remains to be seen how the Chinese authorities will react to what they typically describe as "foreign interference".

Monetary policy

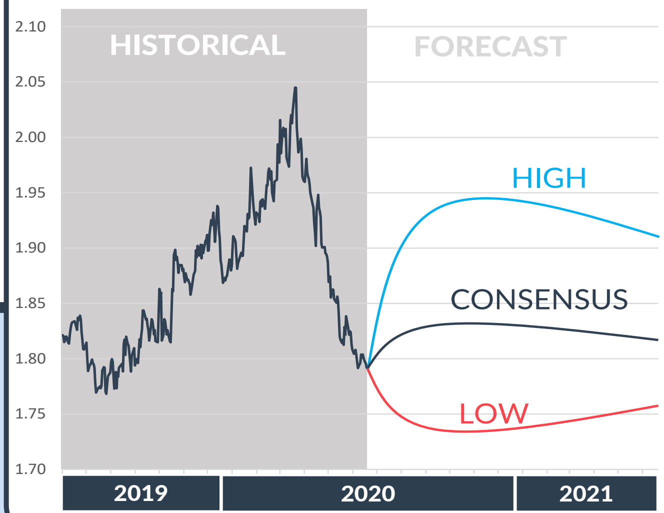
Two rate cuts by the Reserve Bank of Australia in March let the Cash Rate at a record low of 0.25%, and it has shown no sign of going anywhere else since then.

At the board meeting in early June, the RBA kept policy unchanged, as expected. There was, however, concern that plentiful and cheap money risks creating bubbles for house prices and other assets. "Members discussed the sharp recovery in the prices of risky assets since their lows earlier in the year and whether this was warranted given the large decline in global economic activity and the highly uncertain outlook".

Later the same month RBA governor Philip Lowe wondered publicly about changing the bank's aim for monetary policy, maybe altering the inflation target or replacing it with some entirely different objective. He sounded in no hurry to make the change.

GBP / AUD

With the first quarter seeing a continuation of Aussie dollar weakness with concerns around Covid, the second quarter was a very different story. The Chinese and Australian economies were relatively quick to get back on their feet after early lockdowns. As a result, the Aussie dollar has been the top major currency over the last quarter. Further significant gains are not expected, with a return to a slightly weaker currency expected.



Key Economic & Political Events

JUL AUG SEP OCT

Jul 7 RBA Rate Decision

Aug 4 RBA Rate Decision

Sep 1 RBA Rate Decision

Oct 6 RBA Rate Decision

NEW ZEALAND NZD

Economy

Business NZ's Performance of Services Index delivered its weakest ever result in April, with the sector "grinding to a halt" as the measure slumped 11.4 points to 25.9. The equivalent figure for manufacturing was 26.1, another record low.

Visitor arrivals, a key indicator for the travel sector, were all but wiped out with a 99.4% annual fall in April. The number did not come as a surprise, given New Zealand's self-isolation.

Retail sales are reported quarterly, so the 0.7% decline in Q1 is a fairly useless indicator. However, the monthly count of electronic card retail sales serves as a substitute. They were, to say the least, volatile, falling 47.5% in April and rocketing 78.9% in May.

The official unemployment data are no more timely. In the first quarter 4.2% of the workforce was in need of a job.

Politics

New Zealand's 39-year-old prime minister Jacinda Ardern is two years into her term of office and will go to the country again in a little over three months' time (NZ parliaments typically last three years and elections take place in the spring). The next general election takes place on 19 September. Recent opinion polls suggest Ms Ardern's Labour party could win a comfortable overall majority.

Ms Ardern's undoubted popularity owes much to her successful management of the Covid-19 pandemic. An early decision to close New Zealand's borders resulted in extremely low levels of infection and very few fatalities. In early June the prime minister declared that the virus had been eliminated in NZ, an unfortunate call given that a couple of days later two visitors from Britain were tested positive.

Monetary policy

The Reserve Bank of New Zealand made no alteration to interest rates in the second quarter, but it did almost double its asset purchase programme, from $33 billion to $60 billion, in May and the governor frequently shared his thoughts with the media.

Adrian Orr's comments were not always to the benefit of the Kiwi. When he upped the asset purchase programme, he said "we would not rule out [interest rate] cuts into negative territory next year". His comment appeared partially to substantiate the opinion of Westpac analyst who see an Official Cash Rate of -0.5% by the end of the year.

In June the RBNZ once again held the OCR at 0.25% and reiterated that it would remain there "for at least the next 12 months". At the same time, it floated the possibility of adding to the asset purchase programme and said it would "continue to prepare for the use of additional monetary policy tools as needed". As in the rest of the developed world, NZ interest rates will not be going up any time soon.

GBP / NZD

The New Zealand dollar followed a similar path to the Aussie dollar weakness, with a similar trade link to China and similarly successful lockdown. With the country seeming to weather the storm particularly well, the Kiwi dollar has gained close to 10% over the quarter. Again there are few predicting significant further strength, but we live in uncertain times with Covid.

Key Economic & Political Events

Aug 12 RBNZ Rate Decision
Sep 23 RBNZ Rate Decision
Oct 9 Election Results

JUL AUG SEP OCT

CANADA CAD

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Economy

Canada shared the world's pain as the Covid-19 pandemic spread, both in terms of the human and economic cost. In the first quarter monthly and imports had been around $50 billion per month. By the end of Q2, both were a third lower. The same was true of manufacturing sales: they fell by 35.2% between February and April.

The Bank of Canada's quarterly Business Outlook Survey which came out at the beginning of April, which had been carried out "before concerns around Covid-19 had significantly intensified", showed that sentiment had already softened, especially in the energy sector. Those concerns turned out to be well-founded.

After OPEC agreed in April to reduce oil production by 9.7 million barrels per day, WTI crude fell from $25 to an 18-year low of $18. Worse was to come, as the global shutdown crushed demand. Before the end of the month, WTI crude had traded at the seemingly impossible price of minus $40 a barrel in the futures market because supply was beginning to exceed storage capacity. By early June the price had recovered to $40 a barrel, but demand remained slack.

Politics

On 1 July – Canada Day - the United States Mexico Canada Agreement, known colloquially as NAFTA 2.0, came into effect two years after it was signed by the three countries at the G20 summit in 2018. US officials celebrated the event and US secretary of state Mike Pompeo said "we are proud to see our partnership with Canada in action".

Prime minister Pierre Trudeau made a brief appearance to mark the day at the Ottawa Food Bank's community farm. The visit went down better than Mr Trudeau's attendance at No Justice No Peace rally earlier in the month, where he "took a knee" in solidarity with anti-racism demonstrators. Critics accused him of virtue signalling, alleging that his government has not done all that it can to eradicate police violence against racial minorities.

Monetary policy

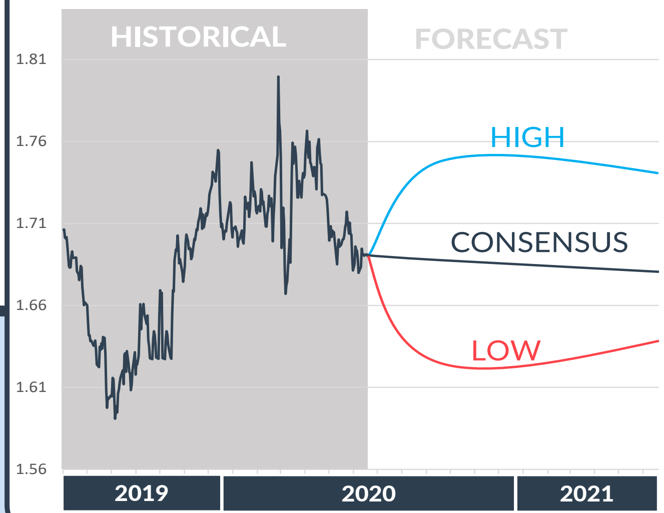
Having cut its interest rate target three times in March, eventually to 0.25%, there was little more the Bank of Canada could do in that direction during the second quarter. Canadian inflation is either 1.6% (core) or 0.9% (headline), lower than the BoC would like but not out of line with the G7 trend, nor contentious enough to require the central bank's attention.

The bank's next rate decision and monetary policy report are due in mid-July. No change to the benchmark rate is expected.

Bank of Canada Tiff Macklem, who succeeded Stephen Poloz at the beginning of June, has indicated that he intends to pick up where his predecessor left off rather than make any major changes to the monetary policy structure. He told the House of Commons finance committee that he is committed to providing "low, stable and predictable inflation". Mr Macklem confirmed that in a subsequent speech, noting that "The recovery will likely be prolonged and bumpy, with the potential for setbacks along the way".

GBP / CAD

The Canadian dollar has had a less volatile second quarter after following Oil's drop in the first. With a more stable price for Oil, and central bank cuts to stimulate the economy, the Canadian dollar has been relatively stable against the pound in and around 1.70. With ongoing impact on the economy awaited, markets do not see a particular directional bias over the next few months.



Key Economic & Political Events

- Jul 15 BoC Rate Decision
- Sep 9 BoC Rate Decision
- Oct 28 BoC Rate Decision

JUL AUG SEP OCT

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Clarity Through Perspective

Deepest Recession Of Our Lifetimes

For the global economy, the worst is over. Probably. Absent any wholesale resurgence of the Covid-19 pandemic it looks likely that April's near-universal lockdown will have marked the low point in this unexpected and alarming economic cycle.

That is not to say that recovery will take place as quickly as the slump. It almost certainly will not. Until somebody comes up with an effective and easily-produced vaccine, it is hard to imagine hospitality, tourism or international travel regaining their previous momentum.

For currencies that present a conundrum. A quick cure or an effective treatment ought to boost activity across the board, allowing the services sector – more than three-quarters of Britain's economy – to get back to work and encouraging people and businesses to open their wallets.

The continued lack of both treatment and cure would be likely to have the opposite effect, encouraging thrift and the building of rainy day funds. The former would benefit the Commonwealth dollars and, conceivably, sterling. The latter would work in the favour of the safe-haven Swiss franc, the Japanese yen and, probably, the US dollar.

Hawk FX has the resources, experience and expertise to help protect you or your organisation in these uncertain times. Contact us to find out how.

+44 (0)330 380 30 30

info@hawkfx.com

www.

www.hawkfx.com