FX Navigator H1 2021

Key insights and forecasts for the months ahead

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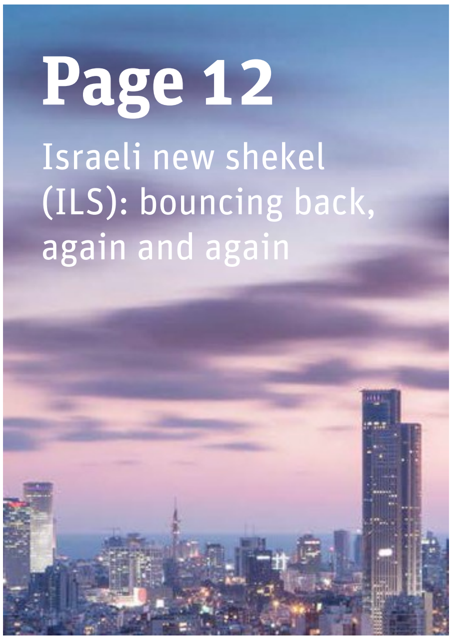


Events of a truly unprecedented year reshaping world economies

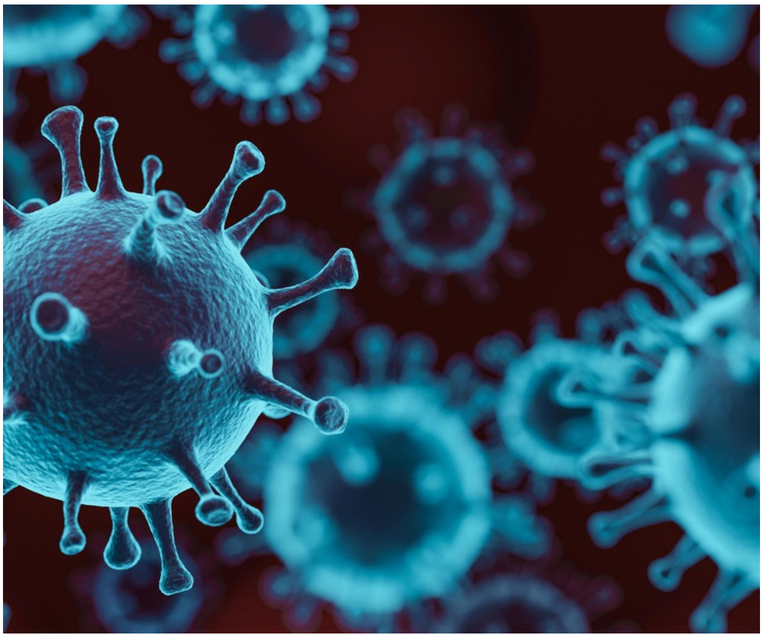
At the beginning of 2020, the world was contemplating how the outcome of trade negotiations between the UK and the EU would shape economies and markets on that side of the Atlantic. At the same time nations ruminated over the November US presidential election. Then, there was no line of sight as to the eventual impact of COVID-19.

COVID-19 eventually drove unprecedented monetary actions by central banks around the world, which supported global markets as interest rates were rapidly cut and massive amounts of liquidity were thrust into markets at an extraordinary pace.

In March, a flight-to-safety pulled the US dollar higher. It quickly peaked, reversed and began a downtrend that eventually saw it drop to levels not seen since 2018.

In the year ahead, we should see central banks and governments review their economic stimulus measures and reflect on what a recovery might look like.

2021 will offer increased certainty in some areas, such as in UK-EU post-Brexit trade, and in the new US administration. In Europe, the EU and the European Central Bank (ECB) will navigate a complicated recovery across member states.



As global vaccine deployments bring the world closer to drawing a line against further harm from the pandemic, governments will undertake measures to move countries forward on a solid path to recovery.

As vaccine approvals and deployments bring the world closer to drawing a line against the pandemic, governments will undertake measures to move countries forward on a solid path to recovery. Ballooning government deficits will likely be employed against populations eager for financial relief from the pandemic.

With the pandemic entering its second year, it is clear for many economies the road to recovery will be long. Without doubt, the pandemic has already reshaped, and will continue to shape economies for many years to come.

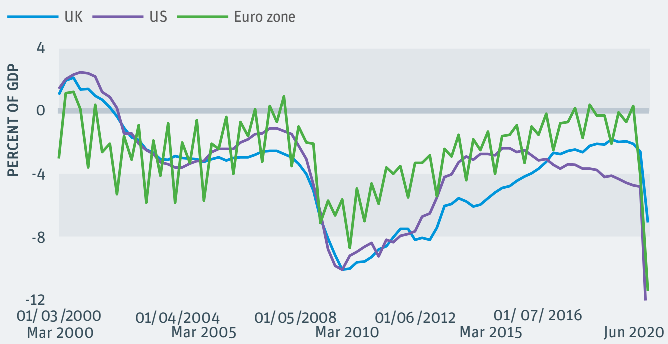
83.4m

COVID-19 cases worldwide*

*as at year-end 2020

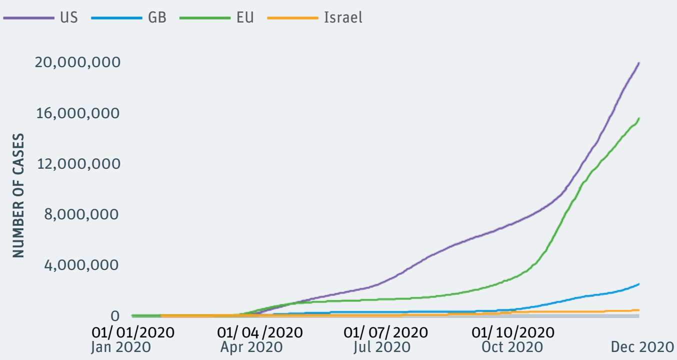
2021 will offer certainty in some areas, such as in UK-EU post-Brexit trade, and in the new US administration. In Europe, the EU and European Central Bank will be navigating a complicated recovery across member states.

Balancing the books – Current account deficits



Source: Bloomberg Financial, January 2021

COVID-19 cases



Source: Bloomberg Financial, January 2021

2020 numbers that Matter

1.1412
Lowest level in GBP/USD since 1985

17.5%
Range in Israeli shekel vs. US dollar

1653
Days from Brexit Referendum to UK departure from the EU

1568
point range in S&P 500

-0.50%
Lowest European Central Bank deposit rate on record

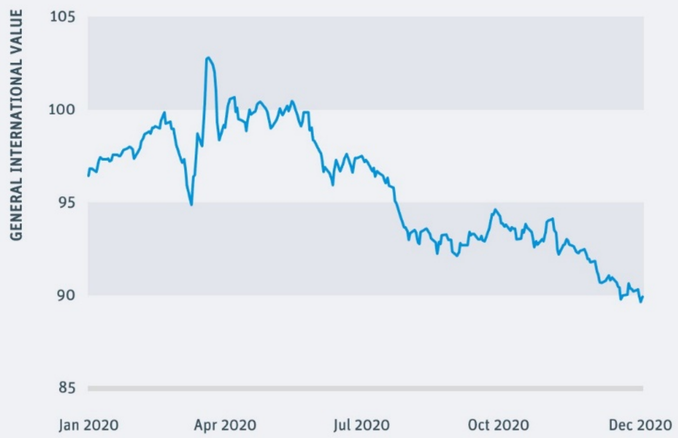
$29,292
Bitcoin's highest price, reached December 31, 2020

-$40.32
Intraday negative per barrel price in oil (WTI)

US dollar: Will the USD be greener on the other side of the pandemic?

The dollar had a volatile year, as the COVID-19 pandemic drove political and economic rhetoric throughout. Dramatic changes in the appetite for safe-haven assets played a large part in determining the direction of the greenback among G10 peers.

USD – index



Source: Bloomberg Financial, January 2021

Over the course of 2020, a state-by-state approach to the pandemic led to a struggle in arresting the coronavirus surge. By the end of the year, the US reached a staggering **19.9** million cases and over 345,000 deaths -- more than 20% of deaths globally. Cases soared in the second half of the year which further damaged an already struggling economy. The estimated percentage change in GDP resulting from the pandemic, was -2.4%.

The introduction of vaccines in December was welcomed by markets, with global stocks surging on the news. The S&P rallied nearly 10% and the Nasdaq 6% in December alone, both reaching record highs. Global investor optimism led to reduced demand for safe-haven assets, resulting in a drop in the US dollar to its lowest level since early 2018.

Emergency relief bill

The Federal Reserve provided monetary support in 2020, which benefited not only the United States, but the global economy as well. The Fed lowered interest rates, provided unparalleled quantitative easing (QE) and supplied foreign central banks with US dollar liquidity via swap funding lines. The Fed

1568

point range in S&P 500 in 2020

0-0.25%

Fed funds rate since March

The Fed's change to inflation targeting with a long-term goal of an *average* of 2% was a message to markets that rates will be "lower for longer."

funds rate has remained at 0- 0.25% since March, and its change to inflation targeting with a long-term goal of an *average* of 2% was a message to markets that rates will be “lower for longer.”

US Treasury assistance of more than $3 trillion USD in 2020 was only partially able to stem the economic decline resulting from lockdown restrictions, which forced many businesses to close and left 19 million US workers claiming jobless benefits by year end.

Additional government support was sought in the form of a fiscal stimulus package, but a divided congress forced a stalemate. At the 11th hour, however, with the prospect of an imminent government lockdown, a compromise was struck for a $900bn emergency relief bill.

3 trillion
USD in US Treasury assistance

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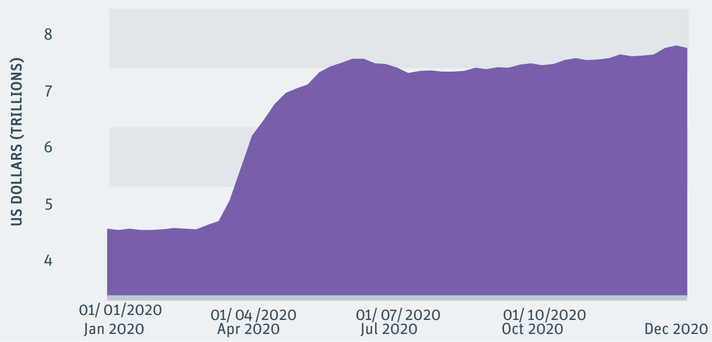
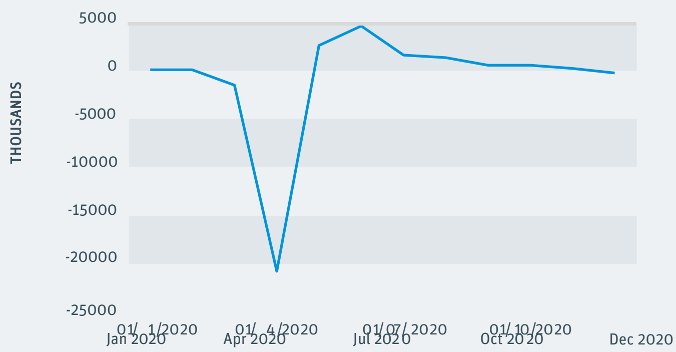
Federal Reserve balance sheet



Source: Bloomberg Financial, January 2021

Nonfarm payroll volatility



Source: Bloomberg Financial, January 2021

Presidential power

The presidential election became a political flashpoint in November as Democratic candidate Joe Biden won the election following a late surge to the finish line, winning 306 electoral college votes to Donald Trump’s 232. The Bloomberg dollar spot index lost 2.3% in value during the week of the election while the vote was being tallied and remained too close to call.

The outcome has been broadly perceived by the market as dovish for the dollar and bullish for equities. The positive impact of additional potentially massive fiscal stimuli implemented by the new administration may be outweighed by the likelihood of a hike in US corporate tax rates and unwinding of business-friendly regulations set in place by the prior administration. Biden’s ability to pass significant legislation will likely be supported by the Democratic “blue wave” in Congress. Foreign policy under Biden is expected to return to a more amicable tone with a focus on rebuilding alliances. While rhetoric around issues related to China may soften, the desire for China to change its ways may continue in earnest. Resetting relations with European allies will be a priority, with hope of fostering a shared international stance while deescalating trade tensions created under the previous administration.

Playing the long game

The end of 2020 saw the dollar continue its downward trend, losing 5% in the final quarter against a basket of currencies--its lowest level in over two years as risk appetite returned and long-dollar positions were unwound. While the road ahead is likely to remain turbulent, the greenback looks set to face the consequences of a market that has been structurally long dollars for the last decade. With the Fed keeping interest rates close to zero for the foreseeable future, global investors will increasingly seek greater returns elsewhere.

5%
Decline in US dollar index in Q4 2020

Euro (EUR): trending upwards

The shared currency was not free from the volatility observed across the board in 2020, as the EU found itself among the first to suffer from the COVID-19 outbreak. The first wave of the pandemic triggered a selloff in the euro, pushing it to 1.0636 EUR/USD--its lowest level against the dollar since early 2017.

1.0636

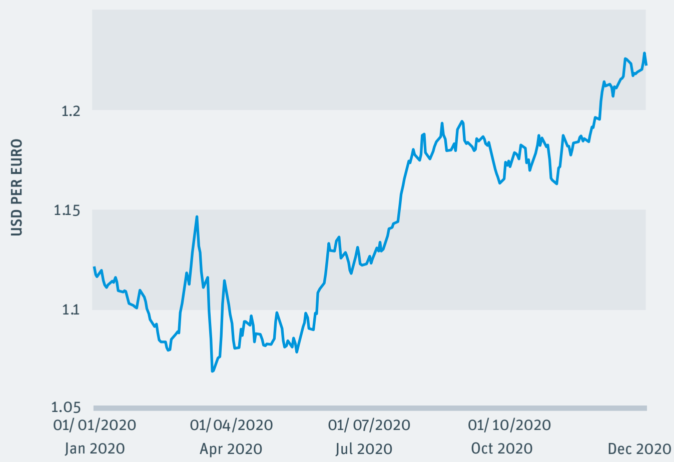
Lowest level in EUR/USD since 2017

The swift spread of Covid-19 prompted a unified response from EU member nations, with respective leaders agreeing to issue collective debt for the first time ever. In the background, difficult post-Brexit negotiations between the EU and UK continued, fueling excessive volatility in the EUR/GBP currency pair.

The euro recovered throughout the year, trading at 1.231 against the dollar and 0.8937 against the pound by year-end, with favorable momentum and expectations for 2021.

COVID-19 caused Eurozone GDP to contract by 1.3% QoQ and 5.0% YoY in the fourth quarter. 2021 should benefit from the recently approved €1.8 trillion EU seven-year budget and €750 billion recovery fund. Disbursements are scheduled to begin mid-year. Southern member countries are in more urgent need than those in the north.

EUR/USD



Source: Bloomberg Financial, January 2021

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Europe's leaders make their mark

European Central Bank President Christine Lagarde assumed office in November 2019. A mere five months later she faced the fiercest crisis the bloc had seen since the 2008-2009 global financial crisis. Fortunately, her previous experience as head of the International Monetary Fund allowed her to hit the ground running. To help governments and firms survive the biggest recession in recorded history, the ECB is fully committed to propping up the eurozone by keeping borrowing costs close to or below zero for years to come.

German Chancellor Angela Merkel, who has held office since 2005, is due to step down in September 2021. At year-end 2020, she concluded Germany's six-month EU Council presidency by helping complete post-Brexit trade negotiations, established the first European collective debt program and agreed on an historic investment deal with China. Her departure will leave a significant leadership void at the heart of European politics in the years ahead.

€750b

Size of the ECB's emergency bond-buying program

As the pandemic winds down, new uncertainties await as collective debt, underwritten by all EU members, is set to be deployed, launching a significant stimulus package to help kick-start the EU economy. While consensus was ultimately reached on the pan-European rescue package, any further fiscal support may see push-back from the so-called 'Frugal Four,' nations comprised of Austria, Denmark, Sweden and the Netherlands.

Christine Lagarde welcomed the news on a collective EU debt program, having repeatedly insisted that fiscal support was needed alongside the central bank's expansionary monetary policy.

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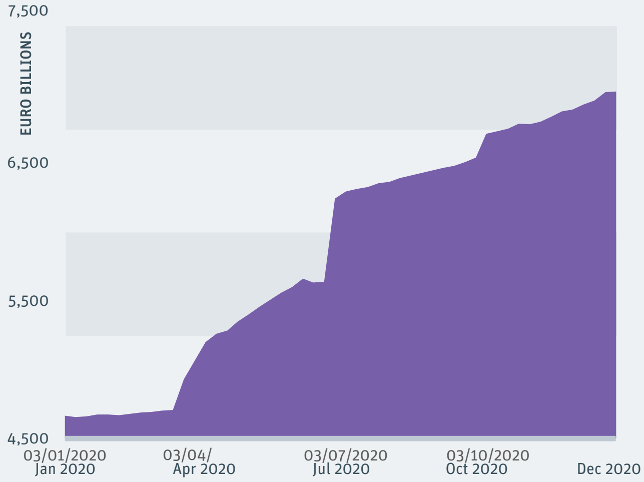
ECB balance sheet total assets



Source: Bloomberg Financial, January 2021

The next chapters

With Merkel stepping down this coming September, her party will look to nominate a replacement to head the CSU/CDU, who will then likely succeed as Germany's Chancellor.

France's President Macron will begin to position himself for a tough general election in 2022, when domestic considerations will no doubt weigh materially on the outcome.

The political agenda and narrative of EU stalwarts over the medium term remain unclear. Another key player in Europe, President of the European Commission, Ursula von der Leyen, played a leading role in negotiating the UK's departure from the bloc and will likely provide important support for political and economic continuity in 2021 amid the various transitions and distractions in the EU's leading economies.

British Pound (GBP): a tale of extremes

As anticipated, Brexit negotiations were a focus in 2020. The pandemic however, and its impact on the population and economy, crowded its limelight. In March, as investors rushed to the safety of the US dollar, sterling plummeted to levels not seen since 1985. For the year, the GBP experienced especially high volatility compared to most other currencies, reaching a high of 1.3200 only to sink to a low of 1.1412 in March, followed by a new high of 1.3686 in December.

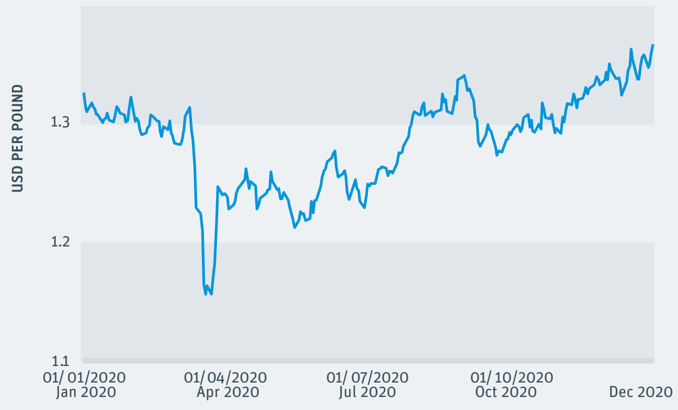
Last March, the Bank of England (BoE) initially reacted to the economic downturn by dropping interest rates from 0.75% to 0.25%, followed just a week later with a drop to an all-time low of 0.10%. The nation also ramped up its quantitative easing (QE) program in a bid to prevent the country from entering a recession. Late in 2020, as the Covid-19 third wave began, the BoE stated it would not cut rates any lower but injected a further £150 billion to support the economy.

Vaccines herald hope but hurdles remain

The UK government has been under scrutiny for its handling of the pandemic. Britain entered a nationwide lockdown later than its European peers and quickly overtook Spain and Italy in the number of cases and deaths. By year-end 2020, more than 2.4 million confirmed cases of coronavirus and 72,000 deaths left the UK only slightly behind Italy, the country in Europe with the most deaths attributed to the pandemic.

A brief sigh of relief came with the UK being the first Western country to approve a COVID-19 vaccine, and large-scale vaccination roll-out. The FTSE 100 recorded its best month since 1989, rising 12.4% following upbeat vaccine news in November. As we enter 2021, there does not seem to be any respite from the virus with new variants increasing the rate of transmission and further complicating the crisis.

GBP/USD



Source: Bloomberg Financial, January 2021

With the USD expected to weaken under the new administration and a Brexit deal at the finish line, market participants expect the greenback to weaken and the pound to gain some ground as 2021 progresses.

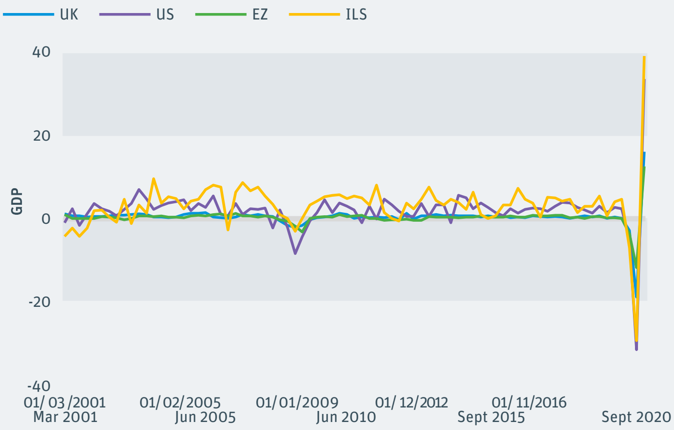
New year, new rules

Four and a half years after the Brexit referendum vote and following nine months of intense negotiations, the UK and the EU finally reached an agreement on an economic partnership that will govern bilateral trade worth more than £650 billion. The main sticking points of fishing rights, state aid, and a level playing field concept were regular features in the news. Sterling became increasingly reactive to Brexit headlines, often moving 1-2% on news of negotiation progress.

The Brexit deal arrived as an early Christmas present for markets on December 24. It covers aspects of trade in sectors including pharmaceuticals, professional services, chemicals, and autos, and outlines new terms for trading goods across the border. In relation to the level playing field concept, the UK is now free to set out its own standards in certain areas such as labor and environmental law. However, UK businesses will need to meet both sets of standards and regulations and will risk losing access if they deviate too far from EU rules. UK nationals will also have restrictions on their ability to work, study, start a business or live in the EU. Although services make up close to 80% of UK GDP and 40% of the UK's trade with Europe, the agreement will leave UK services effectively unprotected going forward.

Sterling became increasingly reactive to Brexit headlines, often moving 1-2% on news of negotiation progress.

Regional GDP growth



Source: Bloomberg Financial, January 2021

A bounce back for Britain?

The UK became the first western nation to approve a vaccine for COVID-19. Its vaccination program began last December, and many predict the country will be regain its economic footing in the latter part of2021.

0.10%

All-time low UK interest rate

The US dollar is expected to weaken under the new administration. Coupled with a new post-Brexit UK, investors expect the pound to gain ground against the greenback as the year progresses.

Gains in the pound and UK assets in general will likely be limited however, as UK-EU trade may be initially sluggish while thousands of firms adapt to the new rules and additional bureaucracy. The coronavirus and the government's handling of vaccine deployment will remain key currency value drivers over the foreseeable future.

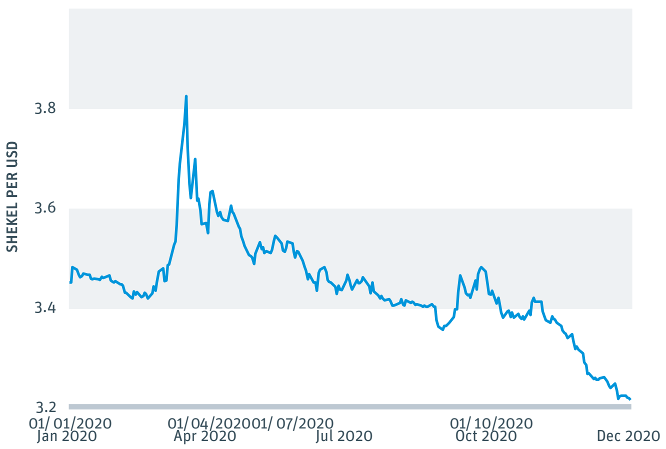
Israeli new shekel (ILS) bounces back, again and again

Extraordinary demand for both the USD and the ILS fluctuated throughout the year. In just twelve months, the shekel recorded its weakest level against the dollar in three years and its strongest level in 20 years.

Last February, after trending lower for 15 months, the USD/ILS experienced a sharp reversal: economic devastation from the pandemic led to flight-to-safety demand for the dollar, with the currency pair moving from 3.42 to 3.84 at its March peak. The shekel was in fact one of the first currencies to fall victim to panic-selling as concerns regarding the impact of COVID-19 to Israel's economy rattled investors. However, thanks to the country's early reaction to the pandemic, introducing strict quarantine and lockdown measures, confidence soon returned. Then in September, a second wave and subsequent lockdown saw the USD/ILS bounce back briefly (to near 3.50) before calm --and the shekel's strengthening path--resumed.

In October and November, the USD/ILS traded sideways between 3.35-3.40, but then broke lower with renewed vigor-- the shekel strengthening against the dollar in a nearly parabolic pattern. In the last few trading days of the year, the currency pair tested the 3.20 level, its lowest level in over 20 years, and considered by many traders as the new line drawn in the sand by the Israel central bank.

USD/ILS



Source: Bloomberg Financial, January 2021

In the last few trading days of the year, the [USD/ILS] currency pair tested the 3.20 level, its lowest level in over 20 years, and considered by many traders as the new line drawn in the sand by Israel's central bank.

17.5%

2020 range in USD/ILS

Despite political uncertainty, its effect on the shekel remains muted--perhaps an indication that confidence in the economy remains, regardless of who holds office.

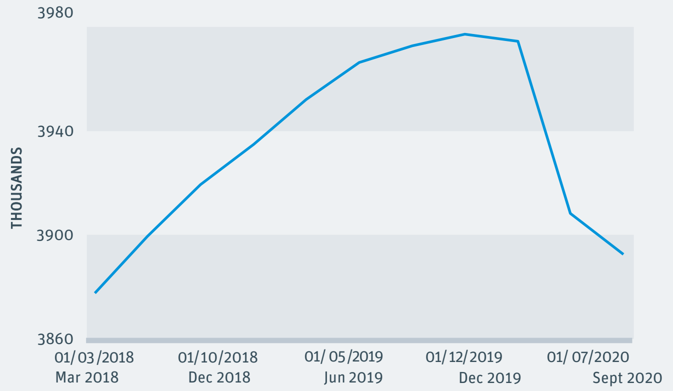
Confidence in the currency

Politics remained a theme in Israel throughout 2020, with an unprecedented three elections held in the year in an effort to regain government stability. After the "corona coalition" collapsed in December, the country now looks set to head back to the polls in March for a fourth vote. Despite political uncertainty, the multiple election effect on the shekel remains muted--perhaps an indication that confidence in the economy remains, regardless of who holds office.

The Bank of Israel (BoI) remained active throughout the year, intervening in the FX market to attempt to contain gains in the shekel and accumulate currency reserves, which peaked at $167 billion in November. However, the effectiveness of the intervention diminished as shekel demand remained persistent and as companies repatriated expanding offshore profits back into ILS. Still, the central bank appears to have ample tools available in its monetary policy toolbox to support the economy.

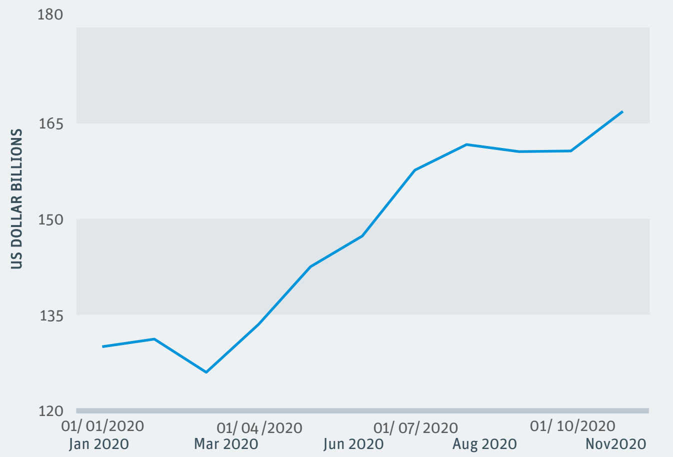
The argument for the Bank of Israel to ramp up its accommodative monetary (QE) policy continues to grow as local companies feel the pain of collecting revenue in a weakening USD. As we begin 2021 with USD/ILS printing its lowest level since 1996, the question remains as to how effective central bank interventions will be, and at what level the new floor will be for the USD/ILS.

Employment snapshot



Source: Bloomberg / Israel Central Bureau of Statistics

Bank of Israel foreign currency reserves



Source: Bloomberg Financial, January 2021

3.1948
Lowest level USD/ILS since 1996

$167b
BoI foreign currency reserves, November

The argument for the Bank of Israel to ramp up its accommodative monetary (QE) policy continues to grow as local companies feel the pain of collecting revenue in a weakening USD.

The macro lens

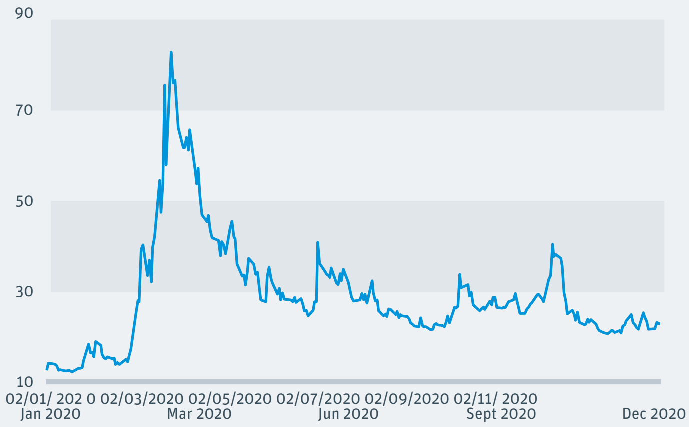
In 2020 unprecedented events called for unprecedented interventions from both central banks and governments. Central bank balance sheets ballooned and government debt-to-GDP ratios soared. Global stock markets panicked in March and many stock exchange circuit breakers were triggered. Safe haven assets were in demand and the “stay-at-home trade” for investors became popular.

Then, in April, oil had its own market capitulation, as negative oil prices were recorded for the first time in history – buyers of oil were effectively being paid to take physical delivery of the commodity.

-$40.32

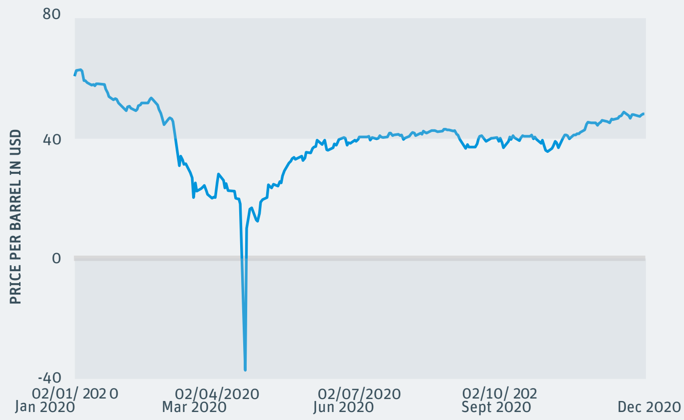
Negative cost per barrel reached for oil (West Texas Intermediate)

CBOE Volatility Index



Source: Bloomberg Financial, January 2021

Crude oil, WTI



Source: Bloomberg Financial, January 2021

Fear of missing out (FOMO)

In response to the pandemic-induced economic collapse, the Federal Reserve and other major central banks eased monetary policy by lowering interest rates and flooded the market with liquidity via aggressive quantitative easing (QE) programs. The term “Powell-put”, named for Fed Chairman Jerome Powell, gained popularity with investors.

Despite seemingly insurmountable headwinds, equity indices here and abroad recorded new all-time highs during 2020. The Dow, S&P 500 and Nasdaq each set fresh records on the final trading days of the year. At the same time, expectations of higher inflation led to an increase in interest rates, with US 10Yr Treasuries poised to breach 1.0% for the first time since early March.

Yet current GDP growth continues to lag pre-pandemic levels. Stock markets are, by valuation, forward looking, yet there are concerns that recent market euphoria is ignoring obvious headwinds and the huge cost of supporting economies which eventually will need to be repaid. Concerns of a stock market bubble are frequently versed across the newswires, yet underlying themes – “the trend is your friend,” “fear of missing out” (FOMO), and “there is no alternative” (TINA), continue to grip investors. Market consensus remains positive.

Despite seemingly insurmountable headwinds, equity indices here and abroad recorded new all-time highs during 2020. The Dow, S&P 500 and Nasdaq each set fresh records on the final trading days of the year.

A new safe haven (gold vs Bitcoin)

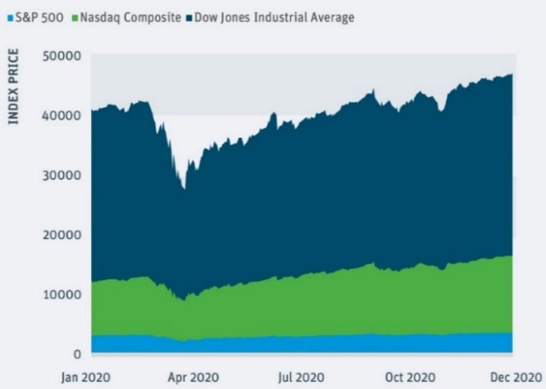
Source: Bloomberg Financial, January 2021

A new safe haven?

2020 saw gold close above $2,000 per ounce for the first time in history, and bitcoin returned to the headlines. The decentralized cryptocurrency gained traction in October peaking at $29,700, breaking the much anticipated $20,000 barrier. Could this modern alternative be gaining attraction as an inflation hedge?

Still to come: unprecedented events, market anomalies and an uncertain future. Governments race to roll out vaccination programs and adjust to dynamic political and economic conditions. The question is are soaring stock markets another case of irrational exuberance or are they justified given a new US administration, more certainty post-Brexit and new vaccines? Only time will tell.

Recovery rally or irrational exuberance?



Source: Bloomberg Financial, January 2021

$29,292

Bitcoin all-time high reached on December 31

FX innovation: e-commerce and currencies

COVID-19 has ignited a global e-commerce boom, driving a new wave of consumer transactions and behaviors online and in-app.

The ongoing global pandemic has caused a seismic shift in ways that the innovation economy interacts with customers and suppliers. The surge in e-commerce will have long-lasting benefits. One such benefit is enabling technology efficiencies to be aligned to currencies. International consumers want to view a website or an app in their native language and now, it's equally important to offer e-commerce transactions in native currencies as well.

Like-for-like settlement of transactional currencies provides e-commerce firms with greater control and granular visibility across multiple daily transactions.

While the task of managing multiple currencies has traditionally been a daunting one, treasury technology is helping corporates overcome these challenges. As Covid-19 restrictions and currencies fluctuate globally, efficient technology utilization is now even more important.

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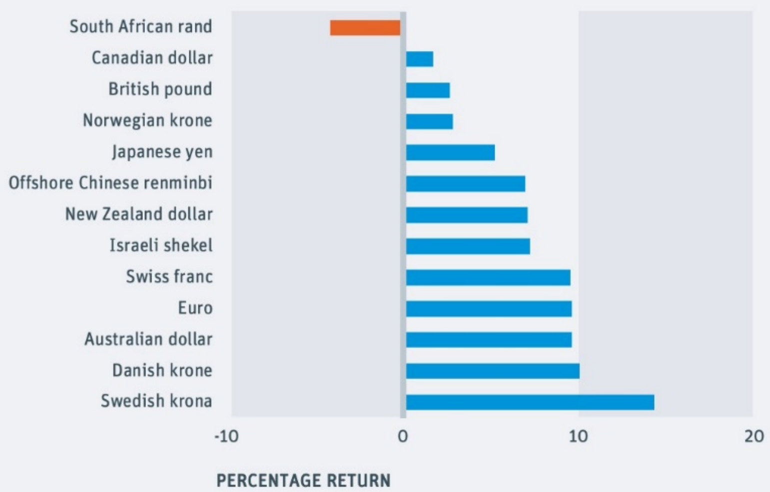
Currency returns versus USD in 2020

Currency returns against USD



Source: Bloomberg Financial, January 2021

Your SVB FX team is on hand to help you navigate your global payments and FX challenges.

Contact your FX Advisor or the FX Team at fxadvisors@svb.com