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FX Week

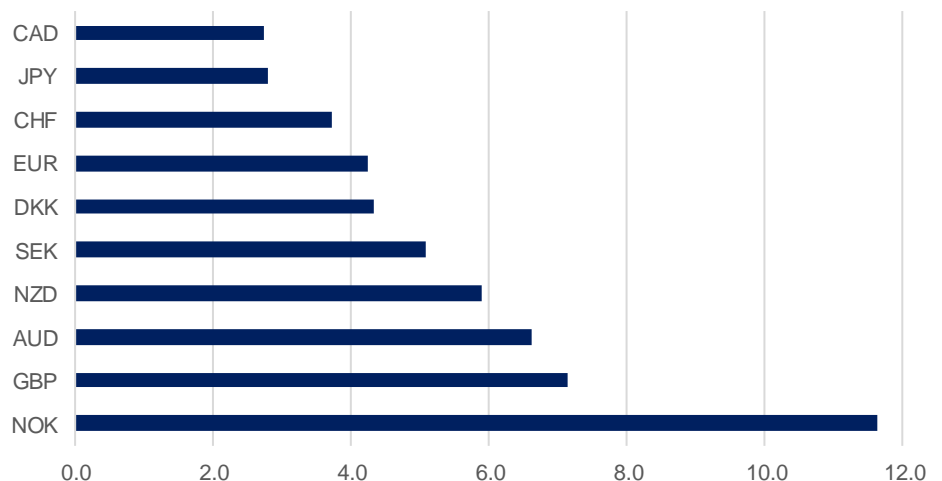
Last week saw markets recover ground lost over the previous ones, even as they caught the first real glimpse of the negative impact of the coronavirus on economic activity. In the FX markets this meant that currencies appreciated at the expense of the US dollar, with GBP and the NOK being the best performing (+7% and 11% respectively) after being the worst performing in the week before. Equities also bounced from the middle of the week after suffering their worst decline since the early 1930s in the previous one. The Treasury market also recovered into the weekend with the 10-year rate falling 17 bps to close at 0.675% and the 2-year yield also ending 5 bps lower at 0.24%.

The devastating economic effects of the shutdowns aimed at containing the impact of coronavirus became evident over the last few days. Market reactions showed that these were largely discounted, however, but they were still striking and raise questions about how long the markets will be able to absorb such weak data without responding more negatively. The most graphic deterioration was seen perhaps in the weekly US initial unemployment claims data which soared to 3.3 million. March PMI surveys also revealed sharp deteriorations. The UK's preliminary March composite PMI hit a series record low (since January 1998) of 37.1, collapsing from 53.0 in February. Eurozone preliminary March PMIs also signaled a deep recession is likely already underway. The composite index fell to 31.4, down from 51.6 in the previous month, with the services showing the sharpest drop to 28.4 from 52.6 in February. In the US the impact was only partially visible. The March services PMI dropped to 39.1 from 49.4, but the manufacturing index held up better at 49.2 down only slightly from 50.7. However, the later arrival of coronavirus in the US probably explains this and there will likely be a catch-up in April, particularly given the current intensity of covid-19 in the US. As a result of the data revealed last week forecasts for growth are being downgraded around the world, with y/y contractions starting to be projected, not just in Q2 which looks likely to be a wipe out.

That financial markets were able to recover last week probably owes to the policy responses which have been widely considered to have been 'all in'. The G20 has taken unprecedented steps in the last few weeks including unlimited QE from the Fed and ECB, while massive fiscal support is also on its way, including a USD 2.2 trillion relief package from the U.S.

The critical question now is how long this economic blow out will last, and the longer it lasts will financial markets continue to be able to withstand it? President Trump's optimism that restrictions will be able to be lifted in time for Easter on April 12th already look way off the mark, with most estimates about the peak of the outbreak in Europe not being seen until late April to late May. Even after that there is tremendous uncertainty about what will follow and about how quickly restrictions can be relaxed. That being the case, market euphoria last week might be seen as premature. Following the Fed's unlimited supply of dollars through FX swap lines with other G7 central banks further currency appreciation might be possible. But if risk aversion begins to return which seems likely at some point, then these gains will quickly reverse.

Weekly currency movement vs USD (%)



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