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# What to expect in the FX market in 2021: Things can only get better, right?

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# What to expect in the FX market in 2021

2020 was an unprecedented year for financial markets.

Currency traders panicked in late-February as the COVID-19 virus began spreading aggressively outside of China. Trading activity and market volatility picked up sharply with investors selling risky assets and piling into the safe-havens, notably the US dollar. The US dollar index rose to its strongest position in more than three years in mid-March, with the key emerging market currency indices down between 7-15% year-to-date at one stage (Figure 1). Equity indices collapsed (the S&P 500 index tumbled by around one-third in the space of a month), with commodity prices also falling, led by a sharp decline in oil futures prices that even turned negative at one point for the first time ever.

Figure 1: MSCI vs. JPM Emerging Market Currency Indices (2020)



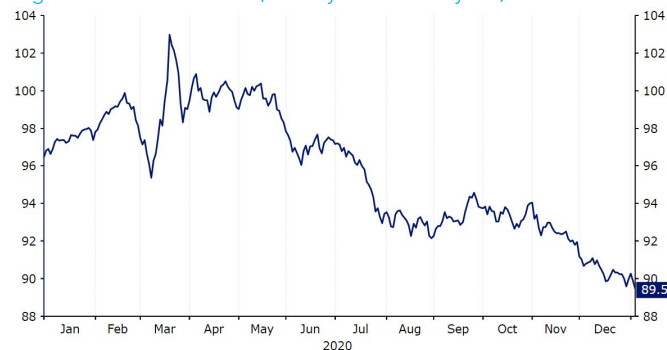
Source: Refinitiv Datastream Date: 06/01/2021

Since the peak of the sell-off on 19<sup>th</sup> March, risk appetite has gradually improved, with the last nine months of 2020 largely characterised by 'risk on' trading. Markets were calmed by the massive fiscal and monetary response from governments and central banks. Authorities around the world pledged huge stimulus intended to prop up businesses and individuals at the onset of the crisis, notably the various job retention and unemployment benefit schemes. Central banks also slashed interest rates to record lows, while amassing huge amounts of assets under their purchase programmes. Some, such as the Federal Reserve, restarted their asset purchase programmes from the financial crisis with others, such as the Reserve Bank of Australia, launching QE programmes of their own for the very first time.

Investors have continued to favour risk assets in the past few weeks, looking past the second wave of virus infection spreading through much of the developed world. Market participants first cheered Joe Biden's victory in November's US presidential election and then news of progress towards multiple COVID-19 vaccines. The three main vaccines, those from Pfizer, Moderna and AstraZeneca, all yielded high immune responses in the final stages of testing. The UK was the first country in the world to begin mass vaccinations using the Pfizer-BioNTech vaccine on 8<sup>th</sup> December, with rollout of the Oxford University-AstraZeneca jab also beginning in early-January. The US has followed suit, with the European Union also approving the use of the Pfizer vaccine just before Christmas, raising hopes of a return to economic near-normality by mid-2021. This optimism has seen currency traders dump the safe-havens - the US dollar saw all of its gains for the year reversed and is now trading near three-year lows (Figure 2).



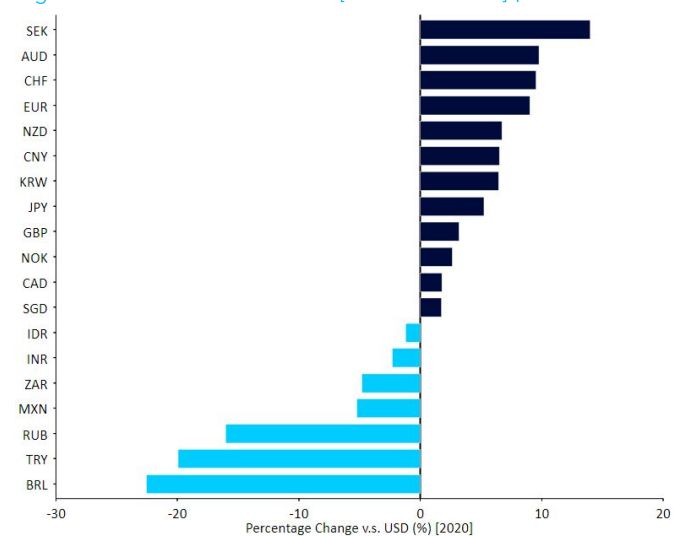
Figure 2: US Dollar Index (January '20 - January '21)



Source: Refinitiv Datastream Date: 06/01/2021

Meanwhile, high risk currencies, such as the Australian dollar (AUD) and Swedish krona (SEK) have outperformed since the peak of the crisis. Emerging market currencies have also rebounded strongly for the most part, with both the MSCI and JP Morgan EM currency indices now back trading at multi-month highs, though still below pre-pandemic levels in the case of the latter. The best performer emerging market currencies in 2020 tended to be those from Asia, where rates of COVID infection have been comparatively low, including the Chinese yuan (CNY), which trades increasingly like a major G10 currency. There have, however, been a few exceptions, notably the Turkish lira (TRY) and Brazilian real (BRL), which are still trading in excess of 20% lower on this time last year (Figure 3).

Figure 3: FX Performance Tracker [select currencies] (01/01/20 - 31/12/20)



Source: Refinitiv Datastream Date: 06/01/2021

The key question now is: what does 2021 have in store for the foreign exchange market? We outline overleaf our main expectations for currencies this year. Economically speaking, things can only get better, right?

## How could the COVID-19 pandemic impact markets in 2021?

The COVID-19 pandemic has, of course, had a massive impact on financial markets and the global economy in 2020. News that three of the main vaccines are in the process of either being approved by regulators or rolled out to the population in some of the developed nations has buoyed risk appetite and raised hopes of a return to normalcy by mid-2021.

Of the three vaccines, those from Pfizer and Moderna have been proven to be highly effective in triggering an immune response during trials, although both are relatively expensive at €20 and €33 per dose respectively. The Pfizer vaccine also requires ultra-cold storage of -70C, which presents somewhat of a transportation issue. Meanwhile, the Oxford vaccine is said to be slightly less effective, although it is both far cheaper and easier to store.

Company	How effective?	Storage	Cost per dose
Pfizer-BioNTech	95%	-70C	€20
Moderna	94%	-20C	€33
Oxford University - AstraZeneca	62-90%	+2-8C	€4

## Which currencies could benefit the most from the vaccine rollout?

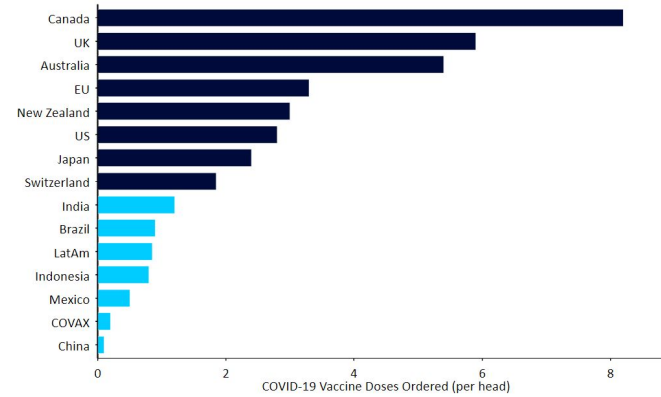
So far, the moves witnessed in the FX market following the recent vaccine news have been broad ones, for the most part, characterised by rallies in risk assets and sell-offs in the safe-havens. As we enter into 2021 we do, however, think that these moves could become increasingly idiosyncratic, with the currencies of those countries that are making more rapid progress towards mass vaccine rollouts likely to be favoured by investors. We think that the currencies that outperform on vaccine progress may well come from countries that have:

- Ordered the largest quantity of vaccine doses per person from multiple providers.
- Infrastructure and processes in place that allows swift mass distribution of vaccines.
- Suffered the largest economic blow due to the pandemic:
  - High rates of infection and virus deaths.
  - Strictest virus containment measures.

According to data from Bloomberg, Canada has so far ordered the largest quantity of vaccine doses of any country or economic area in the world relative to population size, more than 8 per person. The UK (5.9) and Australia (5.5) are second and third on the list respectively, with Britain also the first country in the world to begin mass vaccinations in early-December. Unsurprisingly, emerging market countries have ordered far fewer, less than one dose per head in most cases. This is partly why we think we have seen relatively subdued rallies in EM currencies on the recent vaccine news.



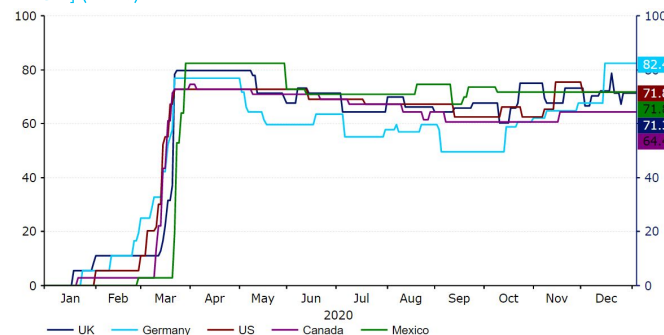
Figure 4: Approximate Orders of COVID-19 Vaccine Doses (per head)



Source: Bloomberg/The Economist Date: 06/01/2020

We also believe that those countries that have imposed the strictest virus containment measures should see their economies bounce back fastest once those measures have been unwound. The UK, US, Canada, Mexico and the Euro Area have all experienced among the tightest restrictions since the beginning of the crisis according to Oxford University's COVID-19 government response stringency indices (Figure 5).

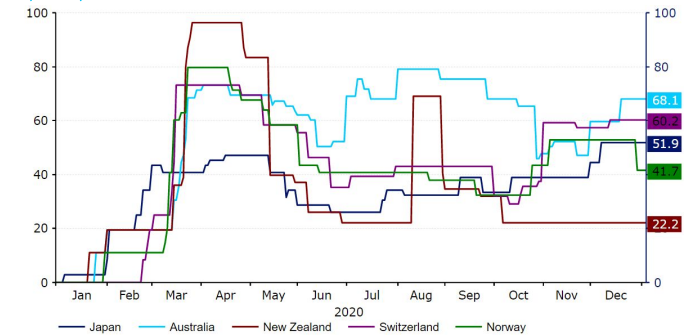
Figure 5: COVID-19 Government Response Stringency Index [select HIGH] (2020)



Source: Refinitiv Datastream Date: 05/01/2021

By contrast, nations such as Australia, New Zealand, Japan and Switzerland have been able to open up their economies to a much greater extent (Figure 6). We expect the currencies of these countries to receive less of a leg-up once the vaccine is rolled out to a larger percentage of the population.

Figure 6: COVID-19 Government Response Stringency Index [select LOW] (2020)



Source: Refinitiv Datastream Date: 06/01/2021

## How could the global economy perform in 2021?

2020 was not just an unprecedented year for financial markets, but also the global economy. Record contractions in the second quarter of the year were followed by all-time high expansions in Q3. While the re-imposition of restrictions looks likely to have weighed on the global economy again in the fourth quarter, we are upbeat regarding a robust rebound in activity in 2021, for a number of reasons:

- **Mass vaccinations to take place in H1 2021.** We are optimistic that once a high percentage of those most vulnerable have been vaccinated and built up immunity, we could begin to see a rapid unwinding in containment measures among developed nations by the spring. This, we think, could trigger a sizable boom in economic activity in Q2 2021.
- **Fiscal and monetary policy to remain highly accommodative.** Governments around the world have already pledged continued fiscal support throughout much or all of 2021. For their part, the major central banks have also committed to keeping rates at record lows for the foreseeable future, with many leaving the door open to additional increases in their bond-buying programmes this year.
- **Lots of pent-up demand among consumers thanks to resilient labour markets and constraints in spending during the pandemic.** This is one of the main reasons why we are more bullish than the market consensus for 2021, and think that many economies will bounce back stronger than central banks are currently pencilling in.

## What to expect from a Joe Biden presidency

As we thought that it would, the election victory for Joe Biden in November has buoyed risk assets and weighed on the US dollar. We think that a Biden victory not only increases the chances of larger US fiscal stimulus this year, but will also lead to less protectionism than under the Trump administration, both of which are supportive of risk sentiment.

An issue for Biden at the time was that the Democrats were unable to win control of the Senate and achieve a so-called 'blue wave'. Two run-off Senate elections on 5<sup>th</sup> January have taken on an unusual amount of significance and have been closely watched by financial markets. The Democrats required a double-win in order to obtain full control of Congress, which would grant Biden a much better chance of passing legislative changes once he takes office later this month. By contrast, a split Congress would increase the chances of deadlock in the US government, making it much more difficult for Biden to pass a substantial fiscal recovery package in order to support the US economy during the remainder of the pandemic.

With almost all of the ballots counted at the time of writing, the Democrats look on course to have surprised expectations in winning both votes. So far, currencies have reacted as we anticipated that they would in such a scenario, with the dollar selling off across the board and risk assets rallying. We think that the dollar could come under a bit of additional selling pressure in the short-term, as investors continue to price in larger fiscal support and higher corporate taxes from the Biden administration.



## How could the FX market react in 2021?

We think that macroeconomic and monetary conditions will be conducive of further rallies in risk assets in 2021. We have an optimistic outlook on the global economy and think that the mass rollout of the multiple COVID-19 vaccines in the first half of the year should allow for a more rapid unwinding in restrictions than we think the market is currently pricing in. We think we could see many of the restrictions that are currently in place in the developed nations unwound by late-spring. This, we believe, may trigger a sharp increase in economic activity in the second quarter of the year and allow the global economy to grow at a faster pace in 2021 than the market is currently expecting. That being said, the detection of the more aggressive spreading strains of the virus does present a significant risk and may slightly delay the unwinding of these measures.

We are pencilling in a continued sell-off in the US dollar against most of its peers in 2021, and broad rallies in emerging market currencies. As has been the case since the beginning of the crisis, we think that the individual performances of these EM currencies in the short-term will be dependent on the ability of authorities to control the spread of the virus and the length and severity of the containment measures. Over the medium-term, we think that investors will likely re-focus on macroeconomic fundamentals and, of course, the successfulness of each country in rolling out the various COVID vaccines to their population.

Based on our above criteria, we have created scorecards that denote the countries (and therefore currencies) that we believe may benefit the most from the mass rollout of COVID-19 vaccines in 2021. For the G10 countries, our overall rank is based on both the quantity of vaccine doses ordered per capita and the stringency of the government response to the pandemic. For the select group of ten emerging market currencies that we have chosen, our overall rank is expanded to also include each individual nation's macroeconomic fundamentals and quality of infrastructure. The latter, we believe, provides a proxy for how effective each EM country will be in successfully rolling out the multiple vaccines en masse, particularly those that require ultra-cold storage.

### G10 COVID-19 Vaccine Scorecard

G10	COVID-19 Vaccine Orders Rank	Vaccine doses ordered per capita*	COVID-19 Restrictions Rank	Average COVID-19 Government Response Stringency index^	OVERALL RANK
UK	2	5.9	1	67.3	1
Canada	1	8.2	4	63.5	2
Euro Area	=4	3.3	3	64.5**	3
Australia	3	5.4	5	63.2	4
US	7	2.8	2	66.7	5
Sweden	=4	3.3	6	57.6	6
New Zealand	6	3	9	40.1	7
Switzerland	9	1.9	7	50.5	8
Japan	8	2.4	10	38.2	=9
Norway	10	1.4	8	48.2	=9

\*approximate figure according to Bloomberg as of 05/01/21

\*\*average of Germany, France, Spain & Italy

^since 1<sup>st</sup> March 2020

## Emerging Markets [select] COVID-19 Vaccine Scorecard

EM	COVID-19 Vaccine Orders Rank	Infrastructure Rank^^	COVID-19 Restrictions Rank	Macroeconomic Fundamentals Rank***	OVERALL RANK
India	3	=7	1	4	=1
China	8	3	2	2	=1
Russia	2	5	8	1	=3
South Korea	1	2	10	=3	=3
Brazil	4	10	4	=3	5
Singapore	N/A	1	9	6	6
Mexico	7	6	3	8	7
Turkey	6	4	6	9	8
Indonesia	5	9	7	7	9
South Africa	9	=7	5	10	10

^^based on the World Economic Forum Global Competitiveness Report (2019)

\*\*\*Ebury assigned based on FX reserves, external debt & current account balance



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