2020 Currency Outlook

Welcome to WorldFirst's 2020 Currency Outlook where Currency Specialist Jack Cincotta provides the highlights for the year ahead in currency markets.

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2019 Snapshot

Last year was an eventful year for foreign exchange markets with the tendency for politics to dominate the headlines over economic data. The Australian Dollar was rattled by the US-China Trade Talks whilst the Brexit situation left the AUD not knowing where to go. The AUD depreciated against all major currencies in 2019 and time will tell if Australia is at the bottom of the cycle with room to grow.

The below table highlights the peaks and troughs of 2019 with the trend being the lows grouped towards the end of the year.

AUD Against	High	Month Achieved	Low	Month Achieved
USD	0.7295	January	0.6670	September
EUR	0.6376	April	0.5957	August
GBP	0.5694	July	0.5122	December
NZD	1.0865	November	1.0307	December

Top Events in 2020

Trade Wars: Yes, plural this time. US-China talks have steadied whilst it seems that US-Europe discussions have just started. The signing of the 'Phase One' agreement should provide some stability to the market and with the US seemingly holding off further tariffs on Europe. Let's hope growth won't be affected.

China's Economic Slowdown: With China still being Australia's largest trading partner, any change in its economy will inevitably impact Australia. The effects of 'Phase One' on China are yet to be seen but this is something that will be discovered in 2020. Currently, the market's perception of China is that the economy is beginning to slow and this can be seen in the YoY GDP figure falling from 6.4% to 6.0% in 2019.

Interest Rates: Most central banks are at the end of the falling interest rate cycle. 2020 will be interesting to see if the RBA and Fed have the requirement to cut rates further. Early pressure will be on the BoE to help turn around a struggling economy with interest rate cuts.

Geo-Political & Other Issues: If tensions continue to rise between the US and Iran, global markets could continue to shift further towards a risk-off sentiment. This would heavily impact the AUD with the appetite for risk diminishing. Early 2020 will also be dominated by the outbreak of the Coronavirus which has already had a negative impact on financial markets. It will be interesting to keep an eye on any global events that develop throughout 2020 as these regularly have the ability to impact the volatility of financial markets.

Brexit! Who would have thought we would still be here in 2020. Extensions, negotiations and elections have dragged out the uncertainty of Brexit for longer than anticipated. Extensions are no-more, the 31st of January has been and gone and the UK has left the European Union. The Pound has strengthened significantly on the back of this event, but with 11 months of trade negotiations ahead, the end is far from near. Below are the key dates to lock in your diary for 2020:

Key Brexit Dates

— **31/01/2020:** 'Brexit Day' Westminster completes its ratification of the deal.
— **01/03/2020:** Negotiations continue between the UK and the EU.
— **26/11/2020:** Trade deal presented to the European Parliament.
— **31/12/2020:** 'The Cliff Edge', if nothing's agreed to World Trade Organisation terms will be used for future trade between the UK and the EU. This is being likened to a no deal Brexit.
— **31/12/2020:** This is also the final date to which the transition period can be extended.

The developments of Brexit will continue to rage on during the early stages of 2020 but this isn't the only change that will take place in the UK in 2020. The Bank of England Governor Mark Carney will be stepping down on 15th March 2020 and be replaced by Andrew Bailey.

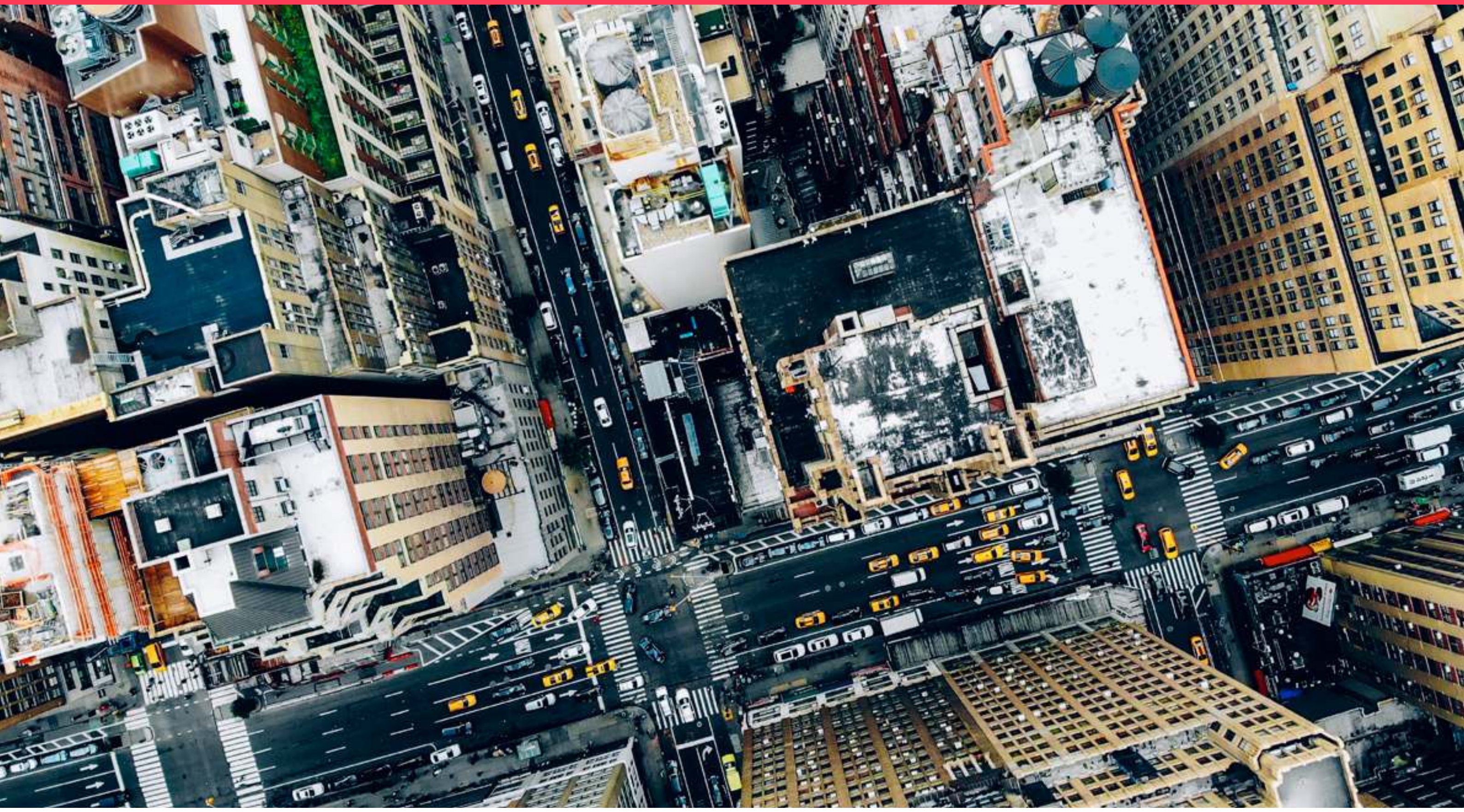
It won't be smooth sailing for Mr Bailey as the UK continues to come under increasing pressure amid ongoing poor economic data releases. In the month of January no interest rate cut was decided but expectations are still high that a cut will be needed in 2020.

Any pending rate cuts subsequently tend to lead to a depreciation of the Pound against major currencies. This decision, however, will most likely occur in the first half of the year as the Bank of England will be under pressure to act if GDP, retail sales and inflation doesn't start to improve.

The British Chamber of Commerce is expecting GDP growth to slow in 2020 to approximately 1% after spending most of 2019 around 1.4%. Tax revenue is expected to weaken and expectations are that the government will be required to enact fiscal policy. To continue the trend of weakening, business investment is also expected to further contract to 0.7%. This has a direct relationship to Brexit and the associated costs of doing business in the UK rather than in Europe.

Bringing this back to foreign exchange, if these forecasts eventuate the Pound could find itself under real pressure. As we saw in the GBP sell-off after the General Election, if Brexit is placed on the back burner and the poor state of the economy is highlighted it is likely that the depreciation of the Pound will be the trend for 2020.

United States Dollar (USD)



Looking back at 2019, it's obvious the single most important market driver was the dramatic escalation in geopolitics, dominated by the US-China trade talks and Brexit. In 2020 we see Geopolitics continuing to drive the USD index.

However, in contrast to 2019, we see 2020 as the year that the risks associated with the trade war and Brexit dissipate. As such we anticipate a deal to be struck by the US and China in the months leading into the US election in November. Trump will want to legitimize a second term with a heated stock market, and a deal should do the trick. We also expect significant progress to be made towards securing Britain's exit from the EU. Boris Johnson won the election on "Getting Brexit done", and whilst the reality is that they are still a long way from realizing this claim, we do expect progress to be made.

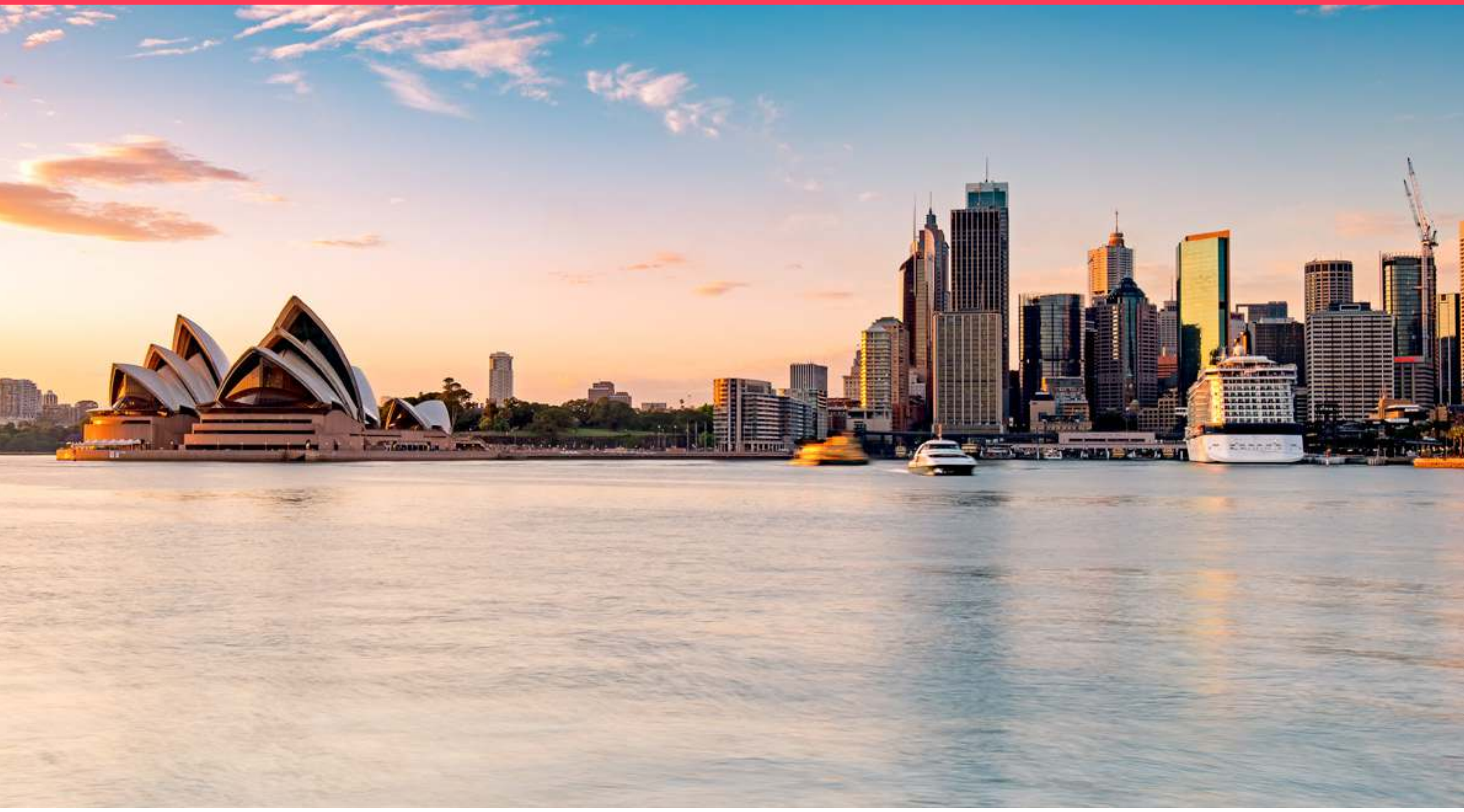
With the already partial rollback of the September 1 tariff to 7.5% from 15%, USD/CNY should be well supported. This along with further deals will also benefit emerging market currencies, particularly those that are intricately linked with the Chinese supply chain.

With a trade deal, AUD/USD may rally and consolidate above 0.70.

The main risk here is, despite confidence in a deal being struck, negotiations (as we've seen previously) could fall apart without warning. Emerging market currencies would bear the brunt of this depreciation. With progress towards Brexit, EUR/USD will likely depreciate as news comes to market. On top of this, with European growth expected to remain subdued a dovish ECB will likely intervene supporting a weaker Euro. This could see the EUR/USD trading in the 1.07 handle by year's end.

GBP/USD may outperform to the upside with progress towards Brexit this year. This could see cable trading above 1.34.

Australian Dollar (AUD)



Pressure is already weighing on the Australian Dollar, and is likely to continue throughout 2020. One most recent aspect is the reduced tension between China and the United States, as President Xi JingPing and Donald Trump successfully completed "Phase One" of their trade deal. No date has been set for phase two, and the exact results of this deal will not be analysed for another 10 months after the signing of the agreement (January 15th). If investors continue to be put at ease with this news, it may put the Aussie dollar in a stronger place.

Furthermore, there are concerns China's growth is slowing with their recent lowest reported growth in 29 years. China's GDP should be monitored closely as this will also affect the Australian economy.

The Aussie Dollar - being susceptible to any uncertainty and risk - could suffer on the back of the ongoing news regarding the outbreak of the Coronavirus as Australia's economy could be further hit. Potentially, China's economic growth would decrease as spending would lower, retail sales could go down and then, in turn, weaken the AUD. In 2003, the SARS outbreak caused a USD $12.3-28.4 billion economic loss and an estimated decrease of 1% of China's GDP. Australia being so closely tied to the success of Chinese businesses would see the Australian Dollar be negatively impacted.

Additionally, the upcoming interest rate decision has been setting a dovish tone where we could see the rates drop down to 0.5%. Depending on Australia's unemployment rates, companies are forecasted to have 15,000 new positions from a previous November 39,900 positions. This would suggest that Australia's job market is slowing coupled with Australia's bushfires it could suggest the RBA cut interest rates below the current 0.75% resulting in a weaker Australian dollar.

Consequently, the extremity of these bush fires could slow down Australia's GDP in the short term as consumer spending and tourism could drop. Although long-term this could lead to a bounce-back in construction as the country rebuilds lost property. PMI is expected to be around the 52.00 point in 2020 which signals growth.

The dollar forecasts range from AUD/USD 0.67-0.71 meaning the only guarantee is for the AUD to remain highly volatile for the duration of this year. The key factors for investors to be mindful of are how the trade war events unfold, the severity of how the new virus will affect China, as well as RBA interest rate reactions to the current state of the economy.

Euro (EUR)

Overvalued? That has been the question asked by many throughout 2019 as the Euro continued to perform well against all currencies, particularly the AUD, despite a string of poor economic data releases. In the middle of the year, the AUD/EUR rate meaningfully broke through the 0.60 barrier for the first time in 10 years. This occurred with Germany leading the slowdown in production, which has had a major impact on the other European nations.

A constant spotlight was on the ECB and Mario Draghi to help alleviate the pressure on nations such as Germany, Italy and France through monetary policy. With interest rates already well into negative territory, it was difficult to determine whether further rate cuts would make an impact. This focus hasn't subsided but rather passed on to the new President of the ECB Christine Lagarde.

Christine Lagarde is the former managing director of the International Monetary Fund and a former minister in the French Government. She describes herself as an owl, not a dove or a hawk, so the early months of the year will highlight how she will proceed with the ECB.

President Lagarde is anticipating a growth rate in the Eurozone of 1.1% which is slightly lower than growth in 2019. A global downturn in trade due to many uncertainties and geopolitical risks has led to this forecast. Hindering trade growth has been the wrath of the US, which Europe hasn't avoided with recent discussions about trade tariffs suggesting that the Eurozone could come under further pressure. Currently, President Trump has agreed to delay any further tariffs which should provide some relief to the EUR.

There's some expectation that if the German economy can start to turn around, and effective fiscal spending occurs, the EUR will strengthen in 2020. This may potentially trade higher against the AUD towards the 0.6060 (1.65) mark.

The unknown of 2020 will be how the EU reacts after the exit of the UK. Of course, new expectations are going to be required but understanding the exact economic impact will be discovered in time. We could see the Euro weaken post-Brexit and trade towards the 1.07 handle against USD if the reduction in trade impacts the European economy.

New Zealand Dollar (NZD)

The NZD has had a rough year where the Reserve Bank of New Zealand had to cut twice ending 2019 with a historic low of 1%. The market had priced in a further rate cut for the November meeting where the Reserve Bank of New Zealand surprised by holding the rate at 1%. Following this, the NZD found somewhat of a rally as further positive economic data from consumer spending combined with easing tensions between the US and China put investors confidence back into the NZD.

The RNBZ itself is signalling their commitment to the lower rates until inflation and employment targets are reached and that they will not shy away from further monetary policy adjustments should this be needed. This statement combined with the positive data coming out of New Zealand has the market split into two different sides where one camp expects one further cut to 0.75% and the other side not expecting any further cuts for 2020.

Further data releases later this year will give a better indication into this as inflation data will be key to this. Any further rate cuts could see the NZD move back above the 1.05 mark against the AUD.

Besides domestic economic data, the New Zealand economy is similarly like the Australian economy, exposed to China and the global market. Looking ahead into 2020, there are some indicators for optimism with the USA and China having signed their 'Phase One' trade agreement in January and talks about further easing on the table pending the results from the initial deal. A side note to this optimism is that there are also some areas to stay aware of, such as the Iran and US tensions which can put some pressure on the Kiwi.