Foreign Exchange Commentary – Mid Day Remarks

April 22, 2020

- **U.S. Works to Contain Economic Fallout From Coronavirus**
- **Bank of Mexico Cuts Interest Rates at Unscheduled Meeting**

Commentary

The U.S. Dollar

A new stimulus bill cleared the U.S. Senate and European leaders weighed an emergency loan package to avoid mass layoffs, the latest efforts to prop up economies flattened by measures to contain the coronavirus. Confirmed cases rose past 825,000 in the U.S. and deaths from the Covid-19 respiratory disease caused by the virus exceeded 45,000, according to data from Johns Hopkins University. Globally, the virus has infected more than 2.58 million people and claimed more than 178,000 lives, according to Johns Hopkins data that experts say understates the extent of the contagion. U.S. congressional leaders struck a deal with the White House on Tuesday to send $484 billion in fresh aid to small businesses and hospitals, including funding to expand the country's testing for the coronavirus. The Senate passed the bill by a voice vote, sending it to the House for approval that is expected on Thursday. The Trump administration is also considering offering federal stimulus funds to embattled oil and natural gas producers in exchange for government ownership stakes in the companies or their crude reserves, according to people familiar with the matter. The plans come as oil demand has collapsed, leaving U.S. energy companies reeling. Crude prices fell Wednesday to levels not seen since late last century before oil markets calmed. Global stocks recovered ground. Virus-fighting measures around the world have kept billions of people at home, disrupted trade and crippled economies. At least 18 million European workers have been idled over the last month, according to new government figures, with almost half of French private-sector workers furloughed and a third of all Irish workers without a job. More than 22 million Americans sought jobless aid during the first month in which shutdowns became widespread. European governments have spent heavily to keep workers on paid leave, covering large chunks of their salaries. The cost of such programs could reach €135 billion ($147 billion) in Germany, France and Spain alone, according to economists at UBS Group AG . To help cover the cost, European Union leaders are to meet via teleconference on Thursday to consider a €100 billion loan package for member governments. Fitch Ratings said 2020 is set to be a record year for downgrades of government debt, largely due to the shock from the coronavirus pandemic and the stress on public finances as governments dole out stimulus measures despite lower tax revenues from weaker growth. Fitch has cut ratings on 23 sovereigns so far this year, and with 25 countries currently holding negative outlooks, the number of

Summary

- USD/CAD dollar drops to day's lows as WTI crude pushes higher.
- Euro currency relatively stable within recent ranges despite euro-zone consumer confidence readings much worse than expectations.
- Great British pound trades at lowest level since April 8th on Tuesday as U.K. consumer price index gains 0.2% year/year, higher than forecast, rebounds today.
- U.S. dollar extends advance, rises to two-week high, Japanese yen erases gains.
- Rehn says won't pre-judge ECB decisions on collateral framework.
- U.S. Senate passes more virus aid for small businesses.
- AUD/USD jumps as much as 1.1% on retail surprise, short squeeze.
- U.S. four-week petroleum product demand falls to fresh lows: EIA.
- Brent crude slumps to 1999 lows, CCI falls over 50%.
- Offshore yuan extends drop to 2-week low amid risk asset rout.

downgrades is expected to beat the record set in 2016, said James McCormack, global head of sovereign ratings at Fitch. “There’s a massive hit to growth,” said Mr. McCormack. “While we are anticipating a recovery once the worst of the pandemic is over, we need to be mindful of the fact that this recovery is still not going to take the global economy to pre-pandemic levels until at least the beginning of 2022,” he said. Signs of economic pain are emerging in corporate earnings reports. Coca-Cola Co. said its global sales volume has fallen 25% since the beginning of April because of pandemic lockdowns and cautioned that consumer spending won’t immediately bounce back as countries begin to reopen. In the U.S., pressure continues to build on states to find a path to lifting lockdowns, but many officials have warned that reopening too early without extensive testing could lead to a surge in new infections. The bipartisan National Governors Association was scheduled to release a plan Wednesday to reopen the economy. The 38-page plan says governors should continue to request that the federal government “rapidly build testing capacity and coordinate distribution to states.” In Iraq, which counts 1,602 coronavirus cases and a declining rate of new infections, the government began easing some restrictions Wednesday while keeping an overnight curfew in place and schools and universities closed. Shops and markets reopened in Baghdad, but many merchants and customers ignored government orders to wear masks and gloves, despite the risk of fines. Some Iraqi provinces kept shop closures and other restrictions in place. In other parts of the world, there were continuing signs of infection rates stabilizing. China’s National Health Commission said there were 30 new cases on Tuesday and no deaths. Hong Kong reported four new cases on Tuesday, all involving people who had a history of foreign travel. It had no new infections on Monday. South Korea on Wednesday reported 11 new cases, bringing the total to 10,694. Japan, along with China and other countries, has been going back to count deaths that may have been missed initially. The Japanese Health Ministry said Wednesday it was adding 74 earlier fatalities to the country’s death toll, plus 17 new deaths, raising the total to 277. The pace of new cases showed signs of slowing, with the government on Wednesday reporting 378 new infections, bringing the total number in Japan to 11,496. In Singapore, which had initial success in containing the spread of the coronavirus, the total number of infections rose above 10,000, the Health Ministry said. The government reported 1,016 new cases Wednesday, the third consecutive daily increase of more than 1,000, as infections continued to spread among migrant workers in dormitories. The city-state has announced an extension of lockdown measures until June 1.

Bank of Mexico Cuts Interest Rates at Unscheduled Meeting

The Bank of Mexico cut interest rates by half a percentage point Tuesday in its second consecutive unscheduled meeting as fallout from the coronavirus pandemic threatens to push the economy into recession. The central bank’s board of governors voted 5-0 to lower the overnight funding rate target to 6% from 6.5%. The board also approved a series of measures to support local markets, bringing the bank’s support for the financial system to around $30 billion, or 3.3% of last year’s gross domestic product. “Although the magnitude and duration of the effects of the pandemic are still unknown, and since available information is still limited, initial estimates suggest that during the first half of 2020, GDP could fall more than 5% as compared to the same period of the previous year,” the central bank said in explaining the rate cut. Mexico shut down schools and most businesses deemed nonessential at the end of March and recently extended the planned shutdown until the end of May as the number of coronavirus cases increases. Aside from the domestic shutdowns, the economy is expected to be hit by a drop in demand for exports, the collapse in oil prices and a sharp decrease in the money that

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Mexicans send home from the U.S., where unemployment has soared. Citibanamex said Tuesday that it now expects Mexico's GDP to contract 9% this year and that the drop could be even greater unless the government applies stimulus to support activity. "Our estimate of the contraction in GDP isn't bigger because we assume that the severity of the recession will force the government to change its current fiscal stance," Citibanamex said. Mexican President Andrés Manuel López Obrador is reluctant to take on more debt to fund additional spending and has so far limited support to low-interest loans for small businesses and microbusinesses and bringing forward pension payments for the elderly and others. The impact of the pandemic on inflation remains uncertain, the Bank of Mexico said. While the weak economy and lower energy prices are likely to ease inflationary pressures, the depreciation of the Mexican peso could put upward pressure on consumer prices, it added. The Bank of Mexico noted the deterioration of global financial conditions which has led investors to favor low-risk assets and reduce their holdings in emerging markets, causing currencies including the Mexican peso to depreciate. It also pointed to recent credit downgrades of Mexico and state oil company Petróleos Mexicanos. "Although domestic financial markets have shown a slight improvement, significant risks to their performance persist," the central bank said. The bank unveiled a raft of measures to increase liquidity in domestic markets and keep bank credit flowing, especially to small and medium-size companies and households that have seen their sources of income dry up. It will give development banks access to the central bank's additional liquidity facility, auctioning more dollar-hedging contracts, and offering more dollar credits using the $60 billion currency swap facility set up with the U.S. Federal Reserve. The Bank of Mexico will extend the kinds of debt eligible for repurchase operations, including local corporate bonds, and will allow more types of debt to be used as collateral for the dollar credits and currency hedges. It may also introduce currency hedges for participants outside of Mexico, given that the peso trades around the clock. The bank also will hold a series of debt-swap auctions, receiving government bonds with maturities of 10 years or more in exchange for debt up to three years.

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