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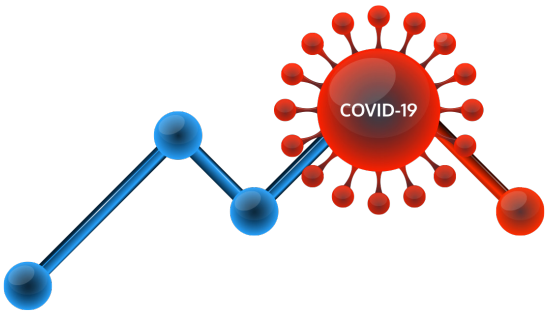
BUSINESS



Coronavirus

The ongoing COVID-19 epidemic continues to roil financial markets as investors closely monitor the spread of the virus across the globe, and the impact that the epidemic will have on the global economy.

While cross-border travel and trade are two areas that will be particularly badly hit by the virus, the broader economy is also likely to suffer as a result of supply chain disruptions, lower business investment, and a fall in demand due to various virus control measures and broader public fear about the virus.

However, due to the fast-moving nature of the virus, and the mounting potential for a co-ordinated global policy response to the epidemic, the precise nature of the economic outlook is clouded with uncertainties.

Policy Response

TRAVEL

Cross-border travel will significantly fall due to the virus – as personal trips fall due to fear over the virus, and business travel declines as firms take an abundance of caution while attempting to continue normal working.

Already, the impact on the travel industry has become clear through the bankruptcy of FlyBe, with IATA expecting a global hit to ticket sales of $30bln and lost revenue of up to $113bln in the global airline industry.

Tourist numbers are also on the decline across the world, as travellers fear going to virus-hit nations, and express concern over catching the virus while travelling.

TRADE

Due to the globalised nature of the world economy, cross-border supply chains have been significantly affected by lockdowns in China, which have hampered the global manufacturing industry.

As a result of the supply chain disruption, global trade volumes will likely fall, with a lack of global demand also contributing to the likely sharp slowdown.

Global Economy Recovery

Scenario One – V Shaped

The best outcome for the global economy, but also the most unlikely, is one where a relatively contained virus outbreak results in a short, but steep, fall in economic output, before an equally steep recovery.

While such a scenario appeared likely – and was heavily priced in – while the virus was largely contained within Chinese borders, the increased spread of the coronavirus across the globe makes such an outcome increasingly unlikely, given the more wide-ranging economic impacts of such a global outbreak.

One of the few ways that such a situation could now come about would be through the rapid development of a vaccine for the coronavirus, though reports indicate that any potential vaccines are unlikely to be ready for around a year.

Expected Market Reaction

Weakness in the JPY & CHF, equities resume rally, government bond yields rise as markets rotate into riskier assets. Volatility would, however, likely remain elevated as markets decipher the situation.

Scenario Two – U Shaped

A more realistic scenario would be one where the global economy experiences a more gradual slowdown as the effects of the virus ripple across the world, before experiencing an equally gradual recovery. This scenario would almost certainly result in the global economy entering its first recession since 2008.

Such a recession would likely come about as a result of a significant reduction in public activity due to virus quarantine measures, resulting in a sharp decline in activity in the services sector, personal consumption and industrial output.

A global recession would almost certainly result in a significant policy response on both the monetary and fiscal sides; though it is questionable whether such actions could cushion the economy against the dual supply and demand shock from the virus.

Expected Market Reaction
The initial fall in output results in solid safe-haven bids (JPY, CHF, USD, Treasuries); the recovery sees risk appetite improve resulting in an equity market recovery, weakness in safe-havens, and bids for antipodean FX.

Scenario Three – L Shaped

The worst-case scenario for the global economy would be a sharp initial slowdown, followed by a prolonged period of stagnation as output fails to recover due to ongoing virus control measures. Lockdowns would potentially be difficult to lift due to the virus' spread, and ongoing fear over a fresh outbreak of the virus would make a return to business as usual difficult.

In an 'L' shaped scenario, the impotence of monetary and fiscal policies would become evident, raising the potential for a seizing up of credit markets, and failing to resolve the twin supply-demand shock caused by the virus.

An 'L' shaped outcome would likely result in a prolonged global recession, a recovery from which doesn't begin until 2021 at the earliest.

Expected Market Reaction
JPY, CHF & USD strength, Treasuries rally with 10yr yields nearing 0%, equities fall into a bear market, weakness in antipodean FX.

No matter which of the aforementioned scenarios plays out, the coronavirus is likely to be met with a co-ordinated policy response of both a monetary and fiscal nature. Due to the nature of the economic shock caused by the virus – on both the demand and supply sides – the efficacy of looser monetary policy remains questionable, especially given the significantly limited policy headroom available to G10 central banks.

As a result, the fiscal response takes on greater significance, and is more likely to effectively juice the wheels of recovery once the global economy eventually gets over the worst of the recovery. Such expansionary fiscal policies will not only take the form of increased healthcare spending, but also targeted tax breaks and credit provision to assist businesses that are struggling to cope with the virus' fallout.

Let us help you take control of your International Payments

Whilst it is unclear exactly how the Coronavirus epidemic will pan out, one thing we can be certain of is the ongoing volatility it will cause in the FX markets. It is at times like these that you need to work with an expert. To help you take control of your payments, simply follow these 4 steps:

- Assess the three global economy recovery scenarios
- Understand what currencies you are exposed to
- Speak to an FX specialist
- Develop a hedging plan to protect your profits

At Caxton we work hard with our customers to help them take control of their international payments and manage the inherent risk of the FX markets to ensure continued profitability.

Please feel free to call us on **+44 (0) 207 042 7649** to discuss the implications of the Coronavirus.