

Coronavirus scenarios and FX markets

- **Coronavirus is raising risk premia and pressuring currencies in directly and indirectly affected countries**
- **Lingering activity effects will likely add downward pressure on yields, even if the disease abates**
- **Supply-chain and travel disruption will hurt KRW, TWD, THB, SGD, MYR if a contained infection lingers**
- **If global pandemic fears rose, less exposed and better cushioned EM high yielders will also face losses**
- **Even in a good scenario, tourism is unlikely to bounce back quickly – bad for THB, MYR, SGD, TWD, AUD**
- **USD stands to benefit in many, but not all, coronavirus scenarios**

Coronavirus scenarios have different FX implications

Coronavirus was unknown to asset markets two months ago, may disappear as a factor within a few months, but may also evolve into a major global supply shock if it spreads and intensifies. In the meantime, it is the pre-eminent unknown unknown of recent years. Below (pages 2-3) we lay out the alternative scenarios on how the disease could evolve and what the short-medium term FX responses might be. Our subjective assessment is that current asset market pricing probably lies somewhat closer to the static than good scenarios.

FX winners (W) and losers (L) under our good scenario where the disease abates:

- **W: CAD, CNY, MXN, KRW, IDR, RUB**
- **L: USD, CHF, JPY**

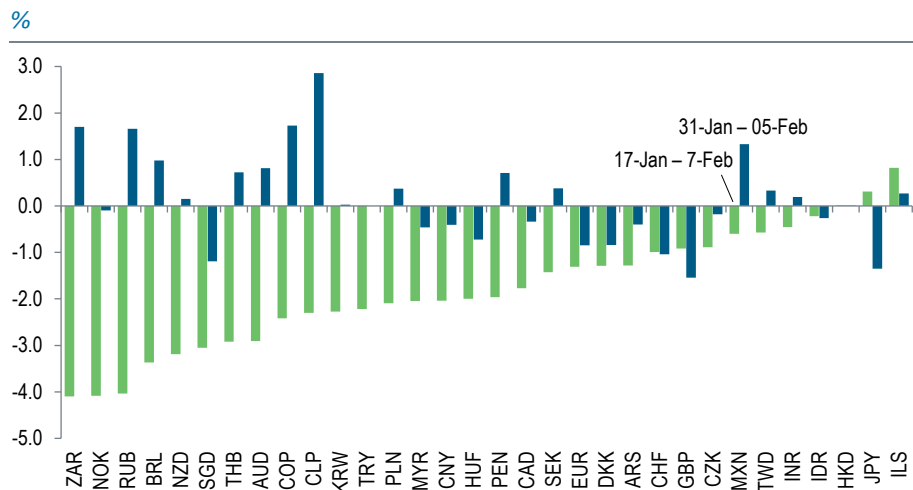
FX winners (W) and losers (L) under our static scenario of neither major intensification nor elimination:

- **W: USD, JPY, CHF, MXN**
- **L: KRW, TWD, THB, SGD, MYR, AUD, NZD, EUR, CNY, CAD**

FX winners (W) and losers (L) under our bad scenario where the disease intensifies and spreads:

- **W: JPY, USD**
- **L: KRW, TWD, THB, SGD, MYR, IDR, INR, AUD, NZD, EUR, CNY, CAD**

Figure 1: Currency moves around coronavirus



Source: Bloomberg Standard Chartered Research

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We analyse coronavirus via three scenarios – good, bad and static

In a market characterised by the absence of volatility, coronavirus-driven appreciation and depreciation of the CLP, RUB and ZAR during the sell-off and temporary rebound were striking for many currencies (Figure 1). The ZAR, NOK, RUB, BRL, NZD and SGD have all depreciated by more than 3% since coronavirus became front-page news. During the brief early February episode of risk-rebound the CLP, COP, ZAR, RUB, MXN and BRL appreciated by more than 1%, but faded when fears revived.

Behind our views is the sense that global growth momentum is not nearly strong enough for most EM currencies to brush off the risk aversion that persistent fear of the disease would bring. In a worst-case scenario the shock to global consumption and production would mean that low-yielding EM and commodity currencies would face ongoing pressure. High-yielding currencies outside the epicentre of the disease might benefit for a while from the search for yield, if activity takes a moderate hit for an extended period, but would likely come under pressure once the yield cushion is gone. Disruption of Asian supply chains may lead international corporations to look for alternatives outside Asia, possibly helping less commodity-intensive CE3 and Latam. The EUR would weaken if the disease continues to hit activity; a decisive fiscal move would be a stabilising force, and could nudge the EUR into safe-haven territory.

Intensification or spread of the disease would likely have a much more durable impact on risk than markets are pricing. Such a bad case scenario would represent a major global supply shock with sustained impact on production and activity. The long-term policy need would be adjusting demand to meet reduced supply, much as occurred after the 1970s oil price shocks. The best performing currencies are likely to be those in which policy makers quickly act to maintain supply-demand balance. Many EM countries and some G10 have faced such issues in recent years, but the US has not. Increased imbalances could put long-term downward pressure on the USD, in contrast to the short-term safe-haven flow that we anticipate.

Other SC research pieces that focus on coronavirus' impact include:

[*Impact of the coronavirus on the global economy*](#)

[*Coronavirus – Outlining the liquidity risks*](#)

[*Coronavirus – Impact on China, global economy and markets*](#)

[*Coronavirus drag on EM*](#)

[*Gold Assay – Coronavirus has led flight to safety*](#)

[*China – Firmer easing bias likely amid coronavirus drag*](#)

[*Commodity Roadmap – Extreme coronavirus scenarios necessitate H1 OPEC response*](#)

[*First oil data after coronavirus outbreak is strong*](#)

Three scenarios

Good – Disease abates within a few months

The disease comes under control and markets and economies do not face immediate production constraints because of the disease. Activity largely, but not fully, bounces back to almost normal within a few months. Factories are likely to reopen quickly and goods trade will likely be restored. Tourism, particularly in Asia, may be below par for a longer period and we could see additional efforts to reduce the geographic concentration of supply chains. By end-Q4, and probably much sooner, we think the path of global GDP would be close to what we expected before the outbreak.

Our static scenario has coronavirus here to stay but not expanding

Static – Sporadic outbreaks, long-term level effect, no growth effect

This scenario shifts the virus from being an unknown unknown to a known factor, but a constant moderate drag on production. Scrutiny of both people and goods crossing borders will likely increase, tourism might become more local, air traffic could be permanently impaired and measures to immunise production from being affected by occasional outbreaks would likely be implemented. We consider this as static – no real intensification of the disease, but no elimination either.

Our worst-case scenario is an intensification and geographical dispersion of the disease

Bad – Spreads to other countries, mutates rapidly

This is our worst-case scenario and looks unlikely given the limited spread and mortality so far outside China. However, it remains a risk. We think asset markets now expect that the intensity of the disease in China will gradually diminish and that incidence outside China will be limited. If these assumptions turn out to be wrong, the implications for asset markets and activity will very likely be severe.

For example, we could see scaling back of large sporting and entertainment events in areas where outbreak risk is high. Working from home would become more common, and some production systems might be redesigned to limit the risk of infection spreading. The long-term structure of supply and demand would have to be adjusted to reflect supply constraints and shifting demand patterns. For simplicity, we will refer to the three scenarios above, as good, static, and bad.

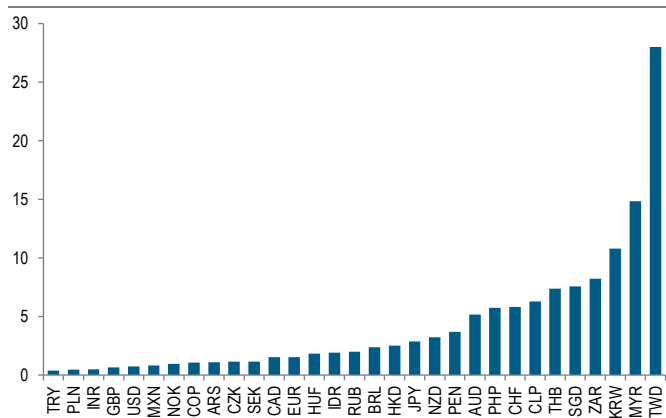
Asia FX – Supply-chain disruptions, tourism impact

The impact of the ongoing coronavirus is likely to be felt across Asia via both economic and financial channels. Asset markets appear to have found some assurance in the aggressive response from China's and global authorities, including unprecedented lockdown measures and travel bans, which may be able to contain the situation. However, the longer these measures remain in place, the bigger the stress via economic channels.

Apart from loss of aggregate demand, lockdown measures in China are starting to disrupt global supply chains. For example, automobile makers in South Korea and Japan have had to shut down production due to lack of intermediate goods sourced from China. Economies with strong goods trade linkages with China are likely to be most affected by these disruptions, leading to underperformance for the TWD, KRW, SGD, MYR and THB (Figure 2) even in the static scenario, where the situation is prevented from turning into a global pandemic but lingers in a contained state, thereby hurting regional supply chains.

Figure 2: Goods trade exposure

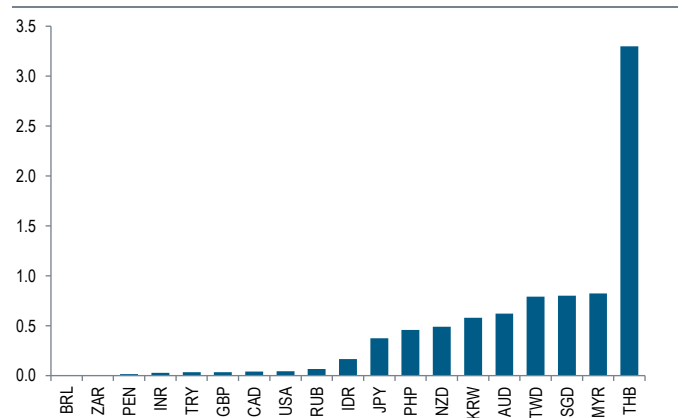
Goods exports to China as % of GDP, latest



Source: Bloomberg, Standard Chartered Research

Figure 3: Tourism exposure

China's tourism receipts % of GDP



Source: Local agencies, Standard Chartered Research

AXJ is exposed via goods trade and tourism

Even in the good scenario, in which the situation returns to normal within a couple of months, we believe tourism in Asia may be affected for longer due to a cautious attitude among people as well as lingering hurdles to travel. The THB stands out as the most exposed to a slowdown in tourism from China, while the MYR, SGD, TWD and KRW are also likely to face material impact, noting that AUD has the largest exposure (Figure 3). These currencies may pare recent losses with the recovery in risk sentiment in the good scenarios, but investors may still prefer the likes of the IDR, which are economically insulated and offer higher yields.

The exposed currencies discussed above are likely to suffer the most in the bad scenario, where the virus spreads rapidly, leading to pandemic fears. However, even the IDR, INR and PHP would unlikely be spared from the resulting upheaval in global asset markets. Foreign investor positioning in Indonesian bonds and Indian equities may come under pressure in this scenario, leading to currency weakness.

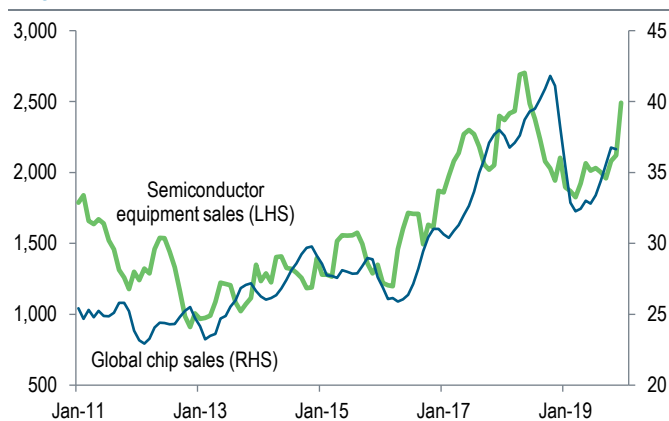
KRW and TWD – TWD outperformance may be coming to an end

Taiwan and South Korea have the strongest economic linkages with China in Asia. Apart from the high goods trade exposure, tourism from China to these countries has ballooned in recent years and now contributes 0.8% to Taiwan's GDP and 0.6% to South Korea's. A further lingering or worsening coronavirus situation could threaten the nascent recovery in the semiconductor industry by hurting demand from China (smartphone shipments are already expected to take a significant hit in Q1) as well as disrupting supply chains (Figure 4).

Overall, FX markets seems to be currently pricing in the good scenario. However, even between the KRW and TWD, we believe the TWD is pricing in lower risk premia than the KRW for a lingering or worsening crisis. On the other hand, if the situation resolved quickly and the global semiconductor recovery gained steam, the KRW would have room for more upside than the TWD. The period of TWD's outperformance vs the KRW is therefore coming to an end, in our view (Figure 5). We previously argued that the outperformance was driven by differences in product segments, foreign equity positioning and supply-chain relocations (see [Semiconductors – Deep dive](#)). But these reasons no longer apply in 2020.

Figure 4: Nascent chip recovery may be at risk

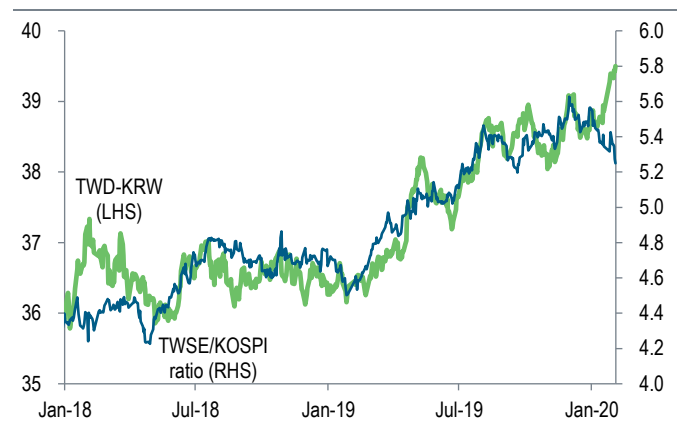
North America semiconductor equipment sales (LHS, USD mn) vs global chip sales (RHS, USD bn)



Source: Bloomberg, Standard Chartered Research

Figure 5: TWD's outperformance vs KRW may be coming to an end

TWD-KRW (LHS) vs TWSE/KOSPI ratio (RHS)



Source: Bloomberg, Standard Chartered Research



THB – tourism unlikely to recover quickly

THB – Caught in the eye of the storm

China tourism receipts account for roughly half of Thailand's entire current account (C/A) surplus. Bearish THB has become a consensus view among market participants given (1) the direct negative impact on Thailand's economic growth and external balance of the coronavirus outbreak, (2) Thailand central bank policy easing, (3) expectations of higher USD demand from one-off sale of domestic assets, and (4) upcoming negative seasonality in Q2. Not surprisingly, the THB has been among the worst performers across EM Asia FX in recent weeks, following the coronavirus outbreak. The THB nominal effective exchange rate (NEER) declined 4% in January 2020, the sharpest monthly decline in almost five years. Perhaps the only positive for the THB is that short THB positioning seems stretched, particularly for real-money funds (see [SC FIRST](#)). In the absence of fresh negative triggers, further THB underperformance seems unlikely given recent weakness and stretched positioning.

SGD – Rising market expectations of MAS policy easing

The SGD NEER has declined sharply by 200bps over the past two weeks, according to our model (from 120bps above mid-band to 80bps below mid-band). Market expectations of Monetary Authority of Singapore (MAS) policy easing in April have increased given the downgrade of the global growth outlook and the resultant impact on Singapore as a small and open economy. At current levels of the SGD NEER, market pricing seems to indicate a flattening slope but not a re-centring lower of the policy band at the next policy meeting. The MAS has indicated that a policy change is unlikely ahead of the next scheduled meeting in April ([link](#)). As such, the risk-reward to be short SGD NEER has deteriorated, especially for our good scenario for the coronavirus outbreak.

Other major exposures – AUD, NZD, RUB, ZAR

AUD and NZD exposed via goods trade and tourism

AUD

The AUD faces downside risks in the bad or static scenarios, where worsening or lingering infections hurt activity in China and its imports of iron ore and coal, Australia's two biggest goods exports. The AUD is also the most exposed to the risk of a significant slowdown in tourism from China among FX majors (Figure 3). Broad asset market weakness in the bad scenario would also hurt the AUD as a risk proxy. On the other hand, in the good scenario, where the virus situation improves within a couple of months and China employs infrastructure spending to stimulate growth, the AUD could benefit from higher demand for its commodities exports as well as improving risk sentiment.

NZD

The NZD outlook is similar to the AUD's, apart from its slightly smaller reliance on China for trade and tourism. China accounts for 28% of New Zealand's exports and its dairy industry could be vulnerable to a slowdown in consumption demand from China; whole milk prices have already weakened c.10% in the past two weeks. Apart from being another popular risk proxy, the NZD may be further vulnerable if the proactive Reserve Bank of New Zealand (RBNZ) signals easier policy to support the economic outlook.



RUB

Lower oil prices hurt RUB

We are positive on the RUB, on the baseline view that oil prices will stabilise and fiscal expansion will support the local economy (see [Russia – EM safe haven in FX and credit](#) and [Short USD-RUB](#)). However, with oil prices already down 18% YTD, coronavirus-induced global demand fears are visible in the RUB. As a result, both the good and bad scenarios are relevant.

In the good scenario we would expect USD-RUB to trade down to our year-end target of 60. In the bad scenario, the oil price impact (if not met with substantial supply cuts) might see USD-RUB test the 2019 highs of 67.

ZAR

South Africa is exposed to China via exports; ZAR at risk in the bad scenario

South Africa has the largest export exposure to China in EMEA/Latam; as a result, USD-ZAR is up 7.5% YTD. The 4% rise in gold prices provides a marginal offset for the ZAR, but not enough to overcome the open nature of the economy and the liquid nature of the ZAR (and hence its use as a global EM proxy). In the good scenario, USD-ZAR should recover most of its YTD move, with a return to 14 likely. The bad scenario opens up chances of a fresh multi-year high of 16.

CNY – Limited depreciation pressure ahead

CNY has stayed relatively resilient, despite sharp growth downgrades

USD-CNY showed has shown great resilience amid the outbreak of coronavirus so far, despite the material downgrade of China's near-term GDP growth to sub-5%. USD-CNY spot has retreated just 2.0% from its recent low, and the CNY has still appreciated 1.23% against the CFETS basket YTD.

We see USD-CNY hovering around 7.0 if coronavirus stays largely contained within China and remains under control in the foreseeable future. In an optimistic case, if the situation peaks in the coming two to three weeks, USD-CNY may appreciate modestly to 6.8-6.9; in an adverse case, if the virus situation deteriorates further, we think USD-CNY would test a near-term high of 7.2. In the worst-case scenario, where the virus spreads abroad, other EM currencies will likely come under more pressure than the CNY. Recent price action suggests that the market remains somewhat optimistic about the outlook for virus developments. However, we take a more cautious stance.

A stable CNY is a common interest for China and the US

China is unlikely to materially weaken the CNY to support growth

We see a low probability that China would use a weaker exchange rate to support growth. The current economic weakening is primarily due to sharply weakened consumption, which accounts for c.60% of China's total growth; and the disruption in production due to extended holidays. External demand is unlikely to weaken right away, with the virus having a limited impact on growth outside China so far.

The sharp decline in overseas tourism and likely decline in imports due to lower domestic demand may lead to short-term improvements in China's trade and current account balances. Ongoing foreign portfolio inflows also support China's capital account balance.

The China-US interest rate gap will likely stay relatively wide. The 10bps cut to the open market operation (OMO) rate on 3 February will likely soon be followed by a similar cut to the 1Y medium-term lending facility (MLF) rate and a 10-15bps decline in the loan prime rate (LPR). The next OMO cut is likely to take place in Q2. Without a sharp deterioration of the virus situation, the People's Bank of China (PBoC) may revert to 5bps cuts at each rate adjustment.

The PBoC has avoided obvious FX intervention as CNY supply-demand has been balanced

Plenty of tools to combat depreciation pressure, if needed

CNY supply-demand has so far been largely balanced, as indicated by its strengthening below 7.0 without obvious signs of central bank intervention. The PBoC has also been less aggressive in setting the daily fixing recently. We expect the PBoC to refrain from showing an overly strong bias via its daily fixing until the supply-demand outlook changes materially. This suggests limited incentive for China to engineer a strengthening currency amid slowing economic growth, and USD-CNY will likely stay market driven in the foreseeable future. The 'phase-one' US-China trade deal limits China's ability to deliberately weaken the currency beyond market forces, but does not guarantee CNY appreciation and does not suggest there will be any hard line of defence due to changes in fundamentals, in our view.

The PBoC has plenty of available tools to stabilise the CNY when it is necessary, limiting the scope of potential depreciation even under the worst case. These include:

1. Signalling more obvious CNY strengthening via its daily fixing
2. Increasing offshore PBoC bill issuance, to tighten CNH liquidity when it is needed
3. Directly intervening

The US is seen as modestly affected economically, and as a safe haven in global asset markets

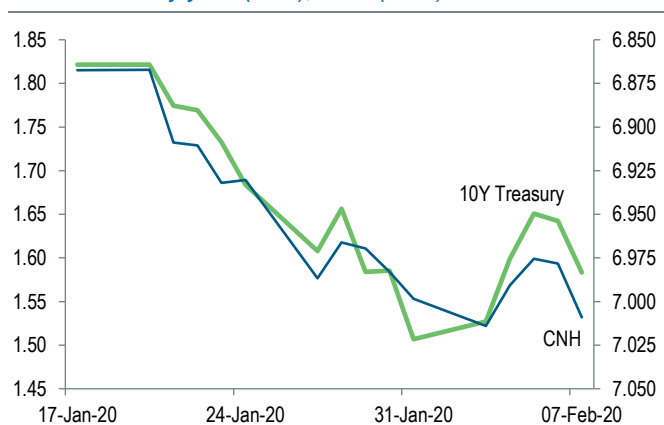
USD – Safe haven, isolated, Fed may have a heavy trigger finger

The defining characteristic of the USD in recent weeks has been its role as a safe haven. The safe-haven aspect of US assets has also been visible in USTs, which moved in lock-step with the CNH in both directions (Figure 6). The early February rebound in risk appetite reversed about half of the USD's gains, and the USD is likely to weaken further if risk appetite is restored under our good scenario. USD weakness on a risk rebound would be similar to that of early January – currencies with carry and stable economic or financial fundamentals would be most likely to appreciate.

Even if coronavirus comes under control, the USD response might not be entirely symmetric. In the good scenario, the US activity impact is likely to be more modest than the impact on Asia, especially if the disease impact is visibly receding within a month or so. There may not be a need for a US policy response, whereas Asia and even Europe may face headwinds for longer even if the disease abates. The USD downside risk is if the Fed eases monetary policy because it sees a slump in inflation and activity as a bigger risk than stimulus that turns out to be unneeded.

Figure 6: Trade exposure

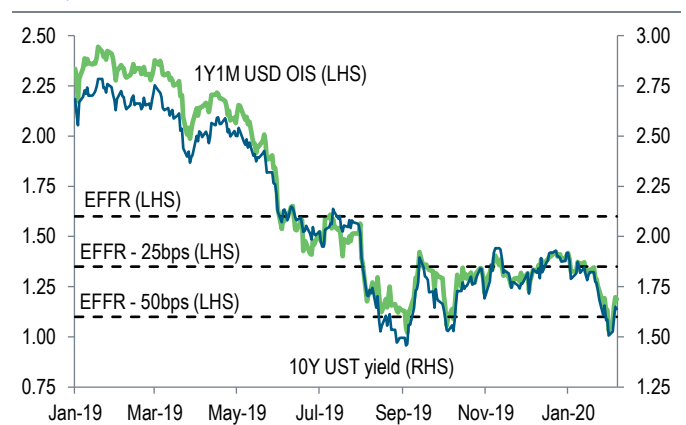
% 10Y Treasury yield (LHS), CNH (RHS)



Source: Bloomberg, Standard Chartered Research

Figure 7: Fed pricing hand-in-hand with 10Y UST yield

Yield, %



Source: Bloomberg, Standard Chartered Research



The Fed would likely emphasise activity over inflation initially

The static scenario is more pessimistic than investors now assume, in our view. At a minimum, we would expect some initial USD buying as investors back away from the view that pre-coronavirus normalcy would be restored. US Q1 GDP growth could be 0.2-0.4% lower under the static scenario and some weakness could spill into Q2 growth. Curtailed tourism from China, reduced travel on US airlines and lower goods exports to Asia would be second-order effects, but might have a visible impact on activity measures. Reduced imports from Asia because of supply-chain disruption would probably not have a direct GDP effect, but the value-added that the US distribution system contributes in transporting and marketing imported goods would be a net negative for activity and the USD.

The Fed initially would likely look through any inflationary effect of supply reduction. If activity weakened, the Fed could use its remaining stimulus to spur activity. Even with a fairly aggressive response, the safe-haven USD advantage would likely prevail in this scenario. The US has the advantage of distance from the disease epicentre.

There is a USD-negative possibility, if Asia uses fiscal tools to build infrastructure to deal with the disease and the Fed uses monetary policy to stimulate US demand; but this does not seem the most likely outcome, although the potential policy divergence is something to look out for.

The bad scenario of intensification and spreading of coronavirus could cause a global supply shock. Policy makers would likely initially try to maintain aggregate demand, but this could result in persistently higher inflation, however unlikely this risk seems at present. The 1970s policy mistake was believing that potential growth would quickly be restored to pre-energy shock trends, and that maintaining aggregate demand was the priority. Given the recent history of low inflation, it would not be surprising to see policy makers assume that the inflation environment would persist.

This would lead to a divergence between short- and long-term USD response in the bad scenario. Overall, the increase in risk aversion would likely lead initially to appetite for both the USD and USTs as safe-haven assets. Pressure on global activity would likely reduce the attractiveness of commodity and high-beta currencies.

If the virus is a permanent supply shock, adjustment would ultimately be necessary

The USD positive response might not last indefinitely. The sustainable policy response to a persistent negative supply shock is to 'live within your means'. If the US uses macro stimulus to cushion the impact of the supply shock on demand, its imbalances could grow and the USD would weaken. But it would take a while for cumulative imbalances to outweigh the safe-haven status of the USD.

We consider potential Fed rate-cut pricing under the three scenarios and estimate the 10Y UST yields that could result

UST market outlook

We assess the UST market outlook under the three scenarios through the lens of likely Fed pricing and estimate 10Y UST yields consistent with such pricing. Fed policy rate expectations over the next 12 months, as reflected in 1Y1M USD OIS, are highly correlated with the 10Y UST yield (Figure 7). Our year-end forecast for the 10Y UST yield is 1.25%, as the market starts to price in the resumption of Fed rate cuts, which we expect in 2021.

During the last 10 days of January, Fed policy rate expectations moved from around one 25bps cut priced in over the next 12 months to slightly more than two, as coronavirus contagion concerns escalated. In the process, the 10Y UST yield fell

from c.1.80% to a low of 1.50%. Rate-cut expectations have retreated and the 10Y UST yield has bounced in recent days, as the market has shifted towards the view that the outbreak will be contained and have a fairly short-lived economic impact.

For the good scenario, Fed rate-cut pricing is likely to settle around 25bps with a 1.80% 10Y yield

Under the good scenario, we expect Fed policy rate pricing to level off in the near term, with around one 25bps cut priced in on a 12-month horizon. We estimate this to be consistent with a 10Y yield just above 1.80%, which we feel justifies our recommendation to start re-building long positions at 1.70-1.75% yield (see [Macro Strategy Alert, 4 February 2020, '10Y USTs – Watch for a tactical bounce in yields'](#)).

Under the static scenario, 50bps of Fed easing is likely to be priced in, leaving the 10Y yield at 1.60%

Under the static scenario, we think the market would remain concerned that downside growth risks had risen persistently and Fed policy rate pricing would shift towards c.50bps of easing. We are mindful that the consensus 2020 forecast for world growth is already just 3.1% and the IMF has historically considered growth below 3% as “equivalent to a global recession”. Moreover, we estimate that a 10Y UST yield of 1.60% is consistent with 50bps of rate-cut pricing, which would leave the 3M/10Y curve flirting with inversion again, leaving the New York Fed’s recession probability model elevated.

The bad scenario would likely be the only one of the three to trigger a sharp bull steepening of the curve

We think the UST curve remains quite flat under both the good and static scenarios. The bad scenario could trigger a significant flight to quality into the UST market and much lower yields, but would probably drive a sharp bull steepening move as safe-haven flows become focused more on the short end of the curve.

EMEA and Latam

The direct exposure of EMEA and Latam economies to China is low (Figure 8). These economies are relatively closed other than Europe’s connection to the Czech Republic, Hungary and Poland (CE3) and the US’ with Mexico. As a result, outside of a broader global growth slowdown, export volumes from EMEA and Latam should be little affected.

However, there is large exposure via export prices, specifically commodity prices (Figure 9). Of the nine net commodity exporters in EM, seven are in EMEA and Latam. Russia is exposed via oil prices, Chile copper prices, South Africa precious metal prices (which could go up, not down), Peru copper, Colombia oil, Argentina food and Brazil food and iron ore.

Figure 8: Trade exposure

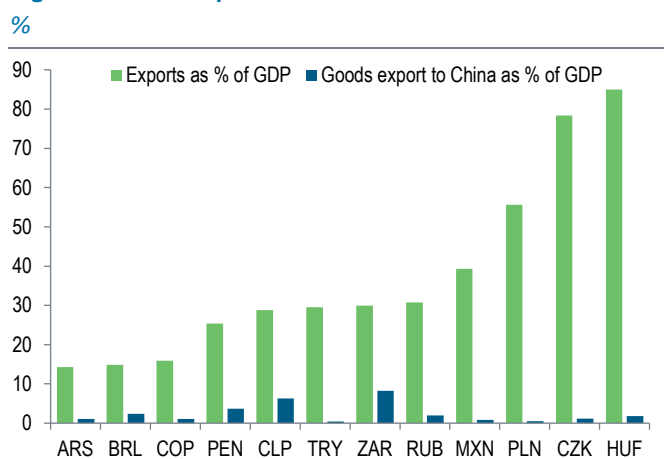
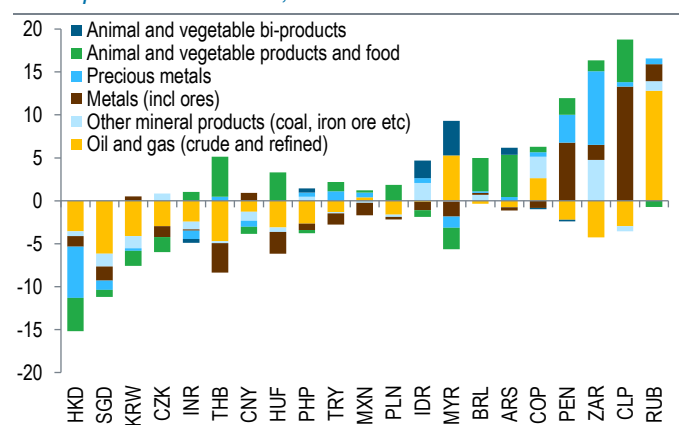


Figure 9: Commodity exposure

Net exports as % of GDP, commodities



Impacts on CE3 are indirect; in the bad scenario HUF is most exposed

CE3

The main potential impact on CE3 economies is via an effect on the euro-area (especially Germany) economy – a China slowdown would likely mean China buying fewer cars from Germany. Less production would be needed in CE3. As a result of the indirect nature of this impact, only the bad scenario outlined above would matter for CE3. In either the good or static cases, we would remain constructive on CE3, as outlined in [FX 2020 – What if Europe bounces back?](#) and [Buy CZK and PLN vs CHF](#). In these scenarios we expect CE3 to outperform, targeting 25.00 in EUR-CZK by year-end 2020, 320 in EUR-HUF and 4.20 in EUR-PLN.

In the bad scenario, we expect rate cuts in both Czech and Poland. Hungary would continue to seek non-standard easing measures. EUR-CZK and EUR-PLN would likely move towards 2019 highs of 26.00 and 4.40, respectively. The move in EUR-HUF would likely be greater, given Hungary's large foreign currency debt. EUR-HUF is already around all-time highs. A move to a 360-400 would be likely (Figure 10).

Coronavirus is relatively unimportant for TRY

TRY

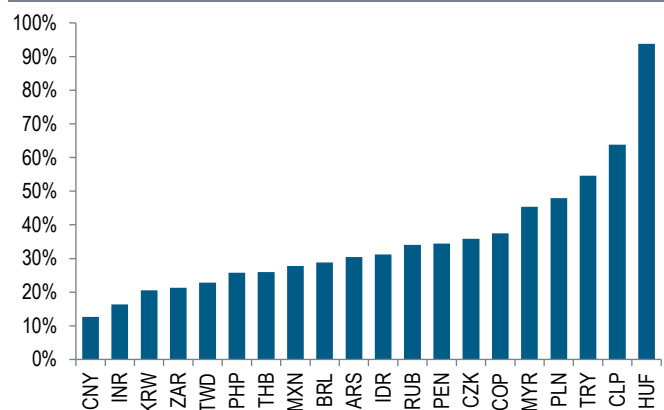
We are cautious on the TRY, due to rapid Central Bank of the Republic of Turkey (CBRT) rate cuts (and resultant negative real rates) and the return of the C/A to deficit (see [Turkey – A call for caution](#)). However, Turkey should be relatively resilient to coronavirus spill-over. The economy is relatively closed and it has the smallest direct export exposure to China across all of EM and G10. What is more, lower oil prices are helpful for Turkey's C/A position as it is a large energy importer. Coronavirus should be relatively unimportant for Turkey.

Watch iron ore for BRL impact

BRL

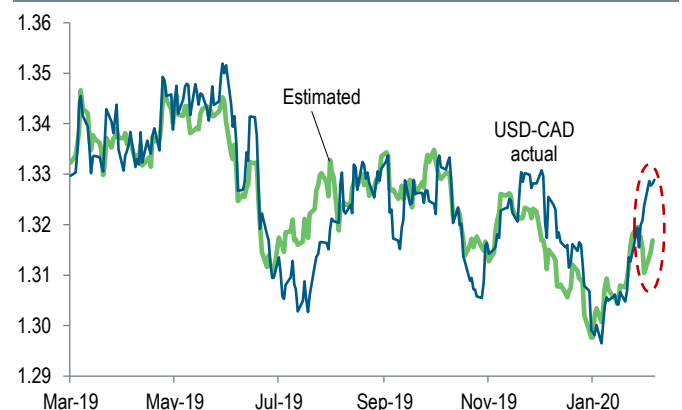
We like the BRL on the expectation that Banco Central do Brasil (BCB) will soon end its easing cycle (see [BCB cutting cautiously](#)), removing carry erosion, which we think hurt the BRL in 2019. As for the coronavirus, Brazil faces very little direct exposure to China and the economy is relatively closed. The main impact of a bad scenario would be via commodity exports (foodstuffs and iron ore). Iron ore prices are 13% lower after the Lunar New Year holidays.

Figure 10: Foreign currency debt
% of GDP



Source: CEIC, Standard Chartered Research

Figure 11: CAD under pressure
USD-CAD



Source: Macrobond, Standard Chartered Research



*Impacts on MXN are indirect;
positioning a potential risk*

MXN

We are cautious on the MXN at current levels, due to positioning, carry erosion and an expectation of C/A deterioration (see [EM stratagem – Telenovela](#)). Regarding coronavirus, Mexico's exposure is akin to that of the CE3 economies – while the economy is open (in Mexico's case to the US), it has very little direct export exposure. At this point something like our good outcome appears to be priced into Mexican assets, although an overshoot below 18.50 in USD-MXN could be expected if the good scenario materialises. The bad scenario would be similar to our current forecast for USD-MXN to trade to 19.50 by Q3.

*No major impact expected for ARS,
COP, CLP and PEN*

ARS, COP, CLP, PEN

These four Latam economies have been linked together due to their similarities in coronavirus exposure. All are relatively closed economies with little direct exposure to China. Where coronavirus would matter is via commodity prices – copper for Chile and Peru, oil for Colombia and foodstuffs for Argentina. As a global barometer for growth, copper prices are most at risk under the bad scenario, which would put upward pressure on USD-CLP and USD-PEN. However, in both cases we note the heavily managed nature of USD-PEN and the promise of more USD selling by the Chilean central bank on spikes in USD-CLP (around 800). As a result, we think these four currencies would be relatively insulated from coronavirus.

Other G10

*European FX exposed on the
growth angle, commodity G10 FX
exposed via trade and tourism*

EUR, GBP, CHF, CAD

The main impact of coronavirus for Europe is growth. The euro area started the year with low growth and an ECB largely out of policy options. The hope was that second derivatives in forward-looking data had started to improve and that fiscal expansion would begin. However, the negative growth shock has reduced this hope; as a result we recently became neutral on the EUR near-term (see [EUR – No trigger for near-term gains](#)).

As markets have priced in coronavirus risks, the CHF has benefited as a logical safe haven little impacted by the virus directly, despite a relatively heavy direct export exposure for Swiss exports to China. EUR-CHF is down 2.6% YTD. The good scenario would likely see this safe-haven bid removed and EUR-CHF return to around 1.09. However, lingering growth concerns would be unlikely to spur much of a bounce in the EUR and GBP. The bad scenario could see an extension of recent moves and EUR-USD may head towards the 1.04/05 lows of the European debt crisis. GBP-USD would likely follow.

The CAD has weakened further than its recent drivers would suggest (Figure 11). Our CAD equation is driven by US-Canada rate differentials, US equity price performance, oil prices and EUR-USD. Our equation suggests that the CAD has depreciated c.1% more in recent weeks than its normal drivers would suggest. Investors might be concerned about a longer-lasting disruption of travel and commercial relations between Canada and China.



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