# Challenging Times in FX markets

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As we came to the end of January, the global outlook looked very promising. We had finally moved into the transition period with confirmation that the UK would formally leave the EU on 31st January 2020, the global economic slowdown had appeared to bottom out and Central Banks were on track to hold rates stable for the most part of 2020. Early 2020 tensions in Iran had subsided and progress was being made in the US-China trade talks. By the end of January, however, the number of victims infected with COVID-19 in China had surpassed 10,000 and the world was beginning to sit up and take note as this pandemic was in early session.

According to Bloomberg, as recently as 31st January, EURUSD 3-month ATM volatility hit an all-time low of 3.75%. 6 weeks later on the 19th March it would peak at 15.44%. While not as high as the 29.32% of December 2008, this was a clear sign of volatility being experienced not just within foreign exchange, but across every asset class. Volumes multiplied four times normal averages and spreads widened to levels not seen since 2008.

Having anticipated a relatively benign year for Monetary Policy, in the space of three weeks we saw a 1.75% cut from the US Federal Reserve, 65bp from the Bank of England, a 1.5% cut from the Bank of Canada, 50bp from the Royal Bank of Australia (since Feb) and other measures from many other Central Banks around the world. The significance of the FED cutting outside of their normal cycle of meetings should not be underestimated, as they have only ever done so a handful of times before: during the 2008 Financial Crisis; September 11th2001; after the tech stock bubble bursting; and to deal with the aftermath of Russia’s financial crisis and the collapse of Long Term Capital Management.

Equities carry a huge amount of volatility. On the 12th February 2020, as European countries started to experience early cases of the virus, the Dow peaked at 29,568 (+60.7%). By 23rd March 2020 as COVID-19 escalated to a pandemic and spread across to the US, the Dow hit a low of 18,213. With the whole world coming to terms with this virus, corporates are now dealing with new challenges, like remote working, Treasury team communication, network connectivity, sufficient broadband and children jumping into the background of conference calls!

The COVID-19 crisis has created significant disruption for corporate clients across different segments. As Treasurers struggle to understand the impact of these issues, that lack of visibility poses one of the greatest threats. For many companies, forecast visibility is a common problem which has been exacerbated by an uncertain global outlook. Whether it’s a consumer goods company trying to discern if the pick-up in demand is temporary or a new trend in shopping, or a tech company trying to assess impacts on supply chain, forecasting underlying business exposures will no doubt be a major focus for all businesses across the remainder of 2020. Treasurers around the world have reverted to their core and are now focusing on liquidity, to ensure that ample capital is available to deal with ongoing unpredictability. Revolving credit facilities have been drawn down the world over and there has been a surge to Debt Capital Markets issuances by sovereigns and some of the biggest corporate names. In some cases, there is no immediate plan for these increased cash levels; however, with such high levels of uncertainty, liquidity can help navigate the inevitable challenges ahead.

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Many corporates are expressing particular concern around managing their foreign exchange risk at present. Are hedging contracts that are currently in place now redundant given the shift in underlying economic activity? What expected future activity is predicated on potentially obsolete revenue forecasting? Many are finding themselves over-hedged but struggling to quantify exact exposures at this stage in the cycle, so are therefore continuously monitoring and adjusting, adopting strategies of rolling, restructuring or unwinding trades. We are in a new paradigm where re-forecasting and re-budgeting is frequent exercise.

In speaking to a number of European and US treasurers, we have observed material differences from country to country with as many as 75% US and German corporates maintaining a BAU approach to their risk management strategy within Treasury, whilst within Southern European countries like Spain, Italy and Portugal only circa 15% of corporates were maintaining their ongoing process[i].

This reliance on current processes at times of distress illustrates the need for a robust hedging policy which ensures adequate risk management is in place but also allows for a degree of flexibility to adjust or take advantage of a changing market environment. It will also ensure corporates have ample access to credit, while balancing their counterparty risk to ensure they are not overexposed.

We have also seen many European corporates take proactive measures to adjust their FX strategies in recent weeks. Forward curves have moved dramatically and with USD rates moving lower, USD sellers (predominantly to EUR) have taken advantage of flattening forward curves to extend hedging further out in tenor, with some manufacturers taking the opportunity to extend hedging as far out as 2024/25, way beyond the uncertain immediate horizon.

Conversely, greater volatility in emerging markets (EM) has been an increasing concern. USD rates have moved lower at a faster pace than EM currencies, increasing cost of carry and therefore cost of hedging. However, the volatility represented by emerging markets has led to clients considering hedge accounting friendly solutions, such as FX collars, to manage such exposures – to both address hedging cost and allow for some flexibility as markets normalise.

The recent market dislocation and relocation of staff has not just affected the execution of FX hedging policy; it has also had a significant effect on FX executed through its payment providers.

Due to the lockdowns and restrictions on movement imposed by governments around the world, it has not been possible for most employees to get to offices. Therefore, corporates who have automated their FX processes by leveraging their bank's electronic FX payment channels have found it easier to ride this storm. Employees working from home have been able to carry out the payment runs while adhering to their internal payment approval processes and realised the straight-through-processing (STP) benefits of their FX payment services over the manual voice dealing channels.

During the peak of volatility in markets during March, we also saw a widening of bid-offer spreads. Businesses are looking at alternative execution methods in an attempt to minimise this impact and improve their ability to see transparent pricing. For example, some have recognised the benefit of using algorithms whereas, for EM currencies in particular, many are working with their relationship banks to voice-deal exposure. In addition, FX payment channels have the ability to display live mid-rates and the client margin, helping corporate clients to know the FX rates in advance of making cross-currency payments and giving certainty on the cost of the payment.

Some corporates are also reaping the benefits and protection of solutions implemented pre-crisis. For example, some of our eCommerce clients in the retail and travel sectors have witnessed very high levels of cancellations and refunds due to the disruptions; however, they have been insulated from the full currency impact of these adjustments as they had outsourced FX risk management via a guaranteed rate service called BARX NetFX. Guaranteed FX rates have helped our ecommerce clients to price their products in different currencies while protecting their business margins. Additionally, this solution removes FX risks associated with refunds and cancellations up to a pre-agreed threshold level.

Corporate clients have been exposed to extreme volatility during the first quarter and are now in an environment full of uncertainty and potential disruption. In looking at currency markets, some of the moves have been sizeable and it is clear that FX volatility is back. There is no obvious playbook for the coming weeks and months ahead but it is clear that companies will need to revisit plans, reforecast and reassess how to think about FX risk management going forward. It is during these times that most can be gained from speaking with your banking partners, peers from industry and the IACT to get an understanding of what measures are being taken by others at these difficult times.

**For more on how Barclays can help you manage exposure to currency and interest rate movements, visit:**

barclayscorporate.com/solutions/corporate-banking-solutions/foreign-exchange/

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[i] These statistics are approximations drawn from conversations with a proportion of our Corporate FX client base, not a formal survey.