Are you ready for 2021?

The ultimate guide for companies navigating currency volatility and scenario planning.

WesternUnion WU | Business Solutions

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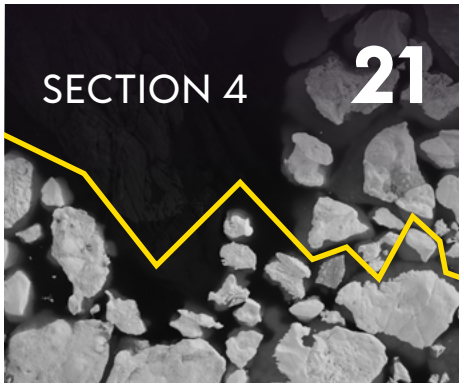


Risk management

Foreword

The rise of geopolitical themes such as trade wars, and the growing influence of political figures on financial markets, has significantly increased the complexity around judging future market trends and their implications for international business. COVID-19, however, brought a whole new dimension to global markets.

The pandemic has triggered a broad and rapid disruption to economies, business operations, technology and infrastructure worldwide. Regardless of size or sector, business leaders have had to respond to the "Great Lockdown" crisis at an unprecedented scale, whilst dealing with levels of sales uncertainty, currency volatility, and cash flow risks previously unseen.

Exchange rate volatility particularly will be brought into the forefront as we look ahead towards 2021, given it has a vast impact on the profitability of international trade in goods and services.

To better appreciate this shift in dynamic, one index measure of economic policy uncertainty showed that index levels in August 2020 were 52% higher when compared to this time last year.[1] Furthermore, measures of anticipated currency volatility rose from record lows in January to an 8-year high by March and remain elevated.[2]

As companies now transition into the 'new normal' and re-structure plans for 2021, the risks to financial objectives from economic and currency fluctuations remain acute. Yet future scenario testing and subsequent risk analysis remains an incredible challenge for many companies, especially SMEs.

For importers that rely on sourcing from abroad or exporters of services, swings in currencies can make or break profits. Despite this, numerous studies, including our FX Barometer Report, continue to uncover that companies from manufacturers to charities still do not fully understand or have the resources to sufficiently hedge this risk and protect profits. Better access to technology, information and expertise are still needed here.

In this report – the latest edition of our annual guide for companies navigating volatility and scenario planning, we uncover the key market trends and events set to reshape financial markets and currencies.

We hope it continues to deliver on our commitment to provide decision-makers better access to information, enabling for more substantial strategy development, and thus producing better financial outcomes.

Andrew Summerill

Andrew Summerill

President, Payments
at Western Union

1. Economic Policy Uncertainty Index. Source: policyuncertainty.com
2. Global FX Volatility Index. Source: JP Morgan, August 2020

SECTION 1

Global outlook

Key global events calendar

The key political dates and economic projections below represent important flash points and illustrate the inherent complexity of currency markets. Yet there are also several ongoing and over-arching global themes that will reshape market trends and drive currency volatility, such as:

- **US-China trade relations**
- **COVID-19 vaccine development**
- **Zero interest rate monetary policy**

2020

OCTOBER

European Council Summit

A key check point on Brexit negotiations and the EU's economic recovery.

NOVEMBER

US presidential election

On Nov 03, Donald Trump faces off against Democrat contender Joe Biden.

DECEMBER

End of the transition period

On Dec 31 the UK will exit the EU customs area. Will a trade deal be in place?

2021

JANUARY

Inauguration of the US president

New president sworn in on Jan 20. How will either Trump or Biden impact the US recovery?

MARCH (1)

UK Budget

UK Chancellor to lay out new plan for government spending.

MARCH (2)

US Federal Reserve & European Central Bank meetings

New policy and economic projections.

2021

APRIL

Release of Q1 GDP / IMF spring outlook

Initial Q1 GDP estimates released / New global growth forecasts from IMF.

MAY

Local UK elections & Bank of England meeting

Local votes to depict national mood amidst COVID / New BOE economic forecasts.

JUNE

US Federal Reserve & European Central Bank meetings

New policy and economic projections.

JULY – AUGUST

Release of Q2 GDP & FED's Jackson Hole symposium

Initial Q2 GDP estimates released / Annual US central bank conference in late August.

SEPTEMBER

US Federal Reserve & European Central Bank meetings

New policy and economic projections.

OCTOBER

National German & Japan elections

Potential change of government in both countries. The German chancellor to retire after four terms.

The big picture

It's always challenging to analyse every single emerging trend impacting an $87 trillion global market; however, when you look at the bigger picture today, it's clear to any observer what is the major macro driving force leading our transition into 2021.

The world is still living through and recovering from its most severe economic downturn in modern history. Amidst the Great Lockdown, more than 90% of countries could experience an annual economic contraction, while emerging markets collectively are at risk of recording their first year without growth in at least 60 years.

The timing of the post-pandemic economic recovery remains highly uncertain and reliance on a vaccine gives the recovery a more binary character which materially polarises any 2021 forecasts. There is hope, and $15 trillion of it too – that's the total estimated amount of both injected and pledged stimulus from the G10 group plus China since the crisis erupted. For perspective, $15 trillion is nearly 20% of world GDP.

This is what will make 2021 especially unique, as this gigantic amount of stimulus and our emergence from the Great Lockdown will come at a time when many other major themes will reach a critical inflection point.

Money-printing 2.0 and a lower bound of zero interest rate policies take central banks into an unprecedented new monetary era. These unconventional policies, designed to save livelihoods, will influence sentiment ahead of major geopolitical outcomes ahead such as Brexit and German elections.

Global trade, which lost considerable momentum under the weight of US-China trade wars will be another major driving force for economic and currency volatility. US elections – a multifaceted catalyst we'll cover in another special report – alongside the acceleration of 'China + 1' trade strategies will also impact the way markets will evolve.

> **"2021 will be especially unique. Our unpredictable emergence from the Great Lockdown will come at a time when many other major global themes will reach a critical inflection point.**

Nawaz Ali
Head of Insights

ECONOMY

THEME 1

The COVID recovery disconnect

The global economy is recovering, but there's a disconnect that's unsettling.

POLICY

THEME 2

New 'lower for longer' paradigm?

Counter-COVID polices have taken the world into a new monetary era.

TRADE

THEME 3

Today's global trade is not like 2008

Joe Biden's $700bn "Buy American" plan could further accelerate the shift in world trade.

POLITICS

THEME 4

Transatlantic battle for dominance

US-EU post-pandemic growth differentials could overhaul the balance of power.

BREXIT

THEME 5

UK trade facing pivotal year

If there was no Brexit, COVID-19 could have actually helped tighten UK-EU trade relations.

CHINA

THEME 6

Try and isolate China

Facing an economic and politic backlash, China will face a year ahead like no other.

CEE

THEME 7

CEE growth model to transform?

The region could eventually establish itself as a frontier market in digital transformation.

EMERGING

THEME 8

EM currencies backed by yield

EM markets are currently offering a '20 times higher' rate advantage.

SECTION 2

Market themes

THEME 1

The COVID recovery disconnect

The unprecedented upheaval in financial markets has delivered record volatility across different asset classes. The sharp fall in stock markets, energy prices and risk-sensitive currencies, ahead of state-forced lockdowns, has been countered with an equally sharp recovery in many cases.

Leading the recovery hopes are equity indices, which in the US have reached new record highs since plunging in March, despite the global economy slipping into the worst recession since World War II. Global fiscal support currently stands at around $11 trillion and has provided investors with confidence about an economic recovery. Moreover, the globally aggregated benchmark interest rate has been slashed to decade lows and the policy environment has become analogous to that seen during the recovery from the financial crisis in 2008.

A world abundant with liquidity, record fiscal stimulus, low interest rates and low inflation has generated a supportive environment for higher yielding risk-asset outperformance. This is creating a growing divergence between stock markets and the real economy, shaping what is arguably a false sense of optimism about a speedy economic recovery.

Amid a prolongation of lockdown measures, an estimated 305 million full-time jobs could be lost globally according to the ILO*. States cannot compensate for this lost income indefinitely though and at some point, the real economy will have to stand on its own two legs.

Should lockdowns be extended, and geopolitical tensions continue to boil, then recovery hopes may dwindle, and stock markets may soon reconnect with the real economy. Although central banks and governments are expected to continue supporting households and businesses, longer-term risks like corporate insolvencies and price uncertainties could increase stress on what is already a fragile global economy. Fitch Ratings for example predicts worldwide corporate bond defaults this year may surpass levels reached during the global recession in 2008.

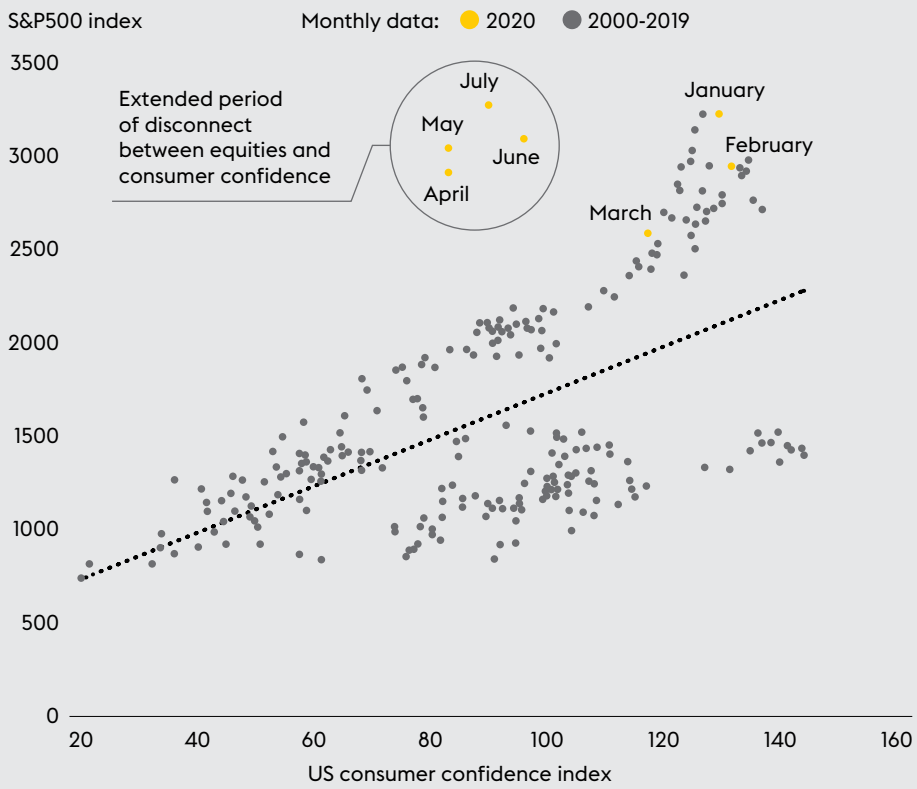
> **“Stock market euphoria reflects how huge stimulus measures have revived the hunt for yield, but signals from the real economy suggest this confidence is misplaced.**

George Vessey
Currency Strategist, UK

* International Labour Organsiation

This divergence is a problem

Elevated equities vs. collapsed consumer confidence



There is a disconnect between stock markets and the economy. Investors remain optimistic about the economic turnaround on the horizon, but the reality is far from certain. If the risk of long-term economic damage rises, this optimism will likely fade and weigh on risk-friendly currencies, including Sterling, and boost safe-havens like the Japanese Yen.

Chart sources: Refinitiv, Western Union Business Solutions – August 2020

New 'lower for longer' paradigm?

Fighting against an economic or financial crisis is never an easy task, especially if the struggle is against an invisible enemy like the coronavirus. To soften the initial blow to their respective economies, central banks started a global and coordinated easing cycle, cutting their benchmark rates more than 170 times since the beginning of the year. But compared to previous crises, the impact of these conventional policy measures are limited because of the magnitude of the recession and an already ultra-low policy rate environment inherited from the past crisis.

A more than two-year long trade war, European political hurdles, the Brexit saga, and a Chinese slowdown have worn down policymakers. Thus, the scope of further rate cuts and the margin of error were slim. Against this backdrop, more and more central banks leaned toward unconventional tools and started increasing their purchases of government bonds. What was first used by the Japanese central bank in 2001 to fight deflation, and was once reserved for policymakers in developed economies, has worked its way around the world.

In the wake of the increase in money supply, fears of inflationary pressures building are staging a comeback, seen by the capital inflows into inflation-protected bonds and gold (record high in August), but also a recovery of long-term inflation expectations. Concerns about high inflation in the medium term still seem to be overdone, given the deflationary effects currently in place. But this could change in the long term, especially with the preference for higher inflation being prevalent to erode some of the recently issued debt.

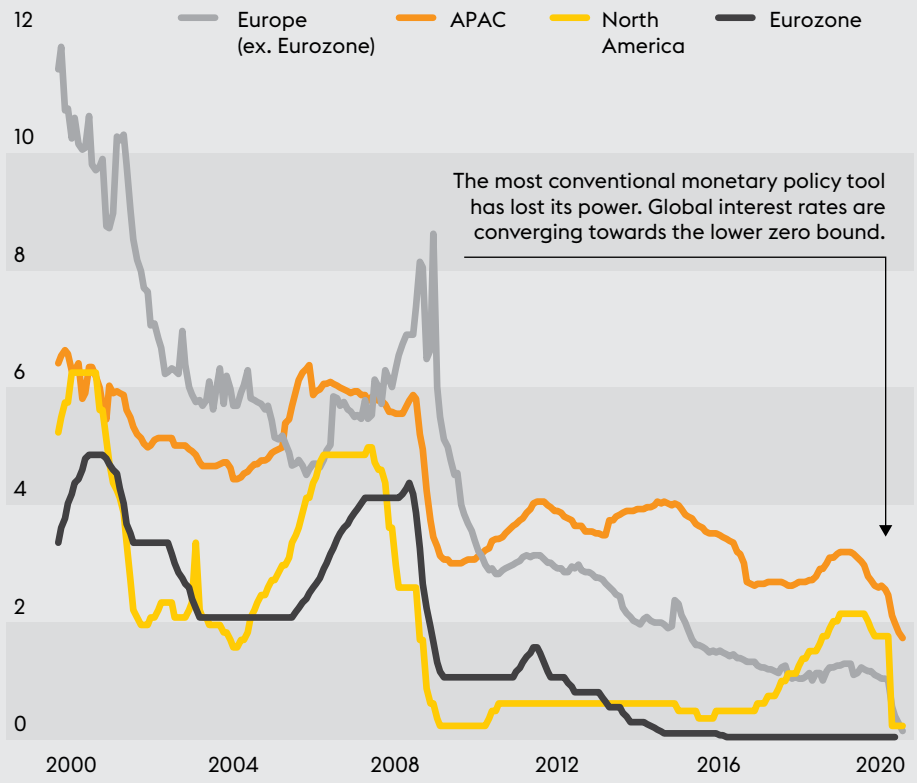
In emerging markets, rating agencies have warned that the danger of monetary financed fiscal debt could lead to a deterioration in confidence and macroeconomic soundness. Given the massive issuance of new debt and the rise of zombie companies in the developed world, the efficiency and effectiveness of monetary policy is now in question.

> **"Negative rates and massive injections of liquidity have created asymmetries that could govern the behaviour of financial markets for years to come.**

Boris Kovacevic
Currency Strategist, CEE

Global interest rates are converging

Average regional benchmark interest rates (%, unweighted)



Zero interest rate policy (ZIRP) has now become integral and could anchor rates at lower levels for longer. Markets are not expecting any rate increases in the Eurozone, the US and Japan in 2021, which could establish fiscal policy as the main driver of volatility.

Chart sources: International Bank for Settlement Database, Western Union Business Solutions – August 2020

THEME 3

Today's global trade is not like 2008

COVID-19 highlighted unexpected and adverse effects of globalisation on trade. For instance, western economies are overly reliant on, and exposed to the Asian continent – especially China – for producing health care goods and medical materials. As a result, there's now a global call from policymakers demanding a domestic relocation of overseas production across some strategic and mission-critical sectors.

Historically speaking, officials generally resort to inward-looking solutions during times of crisis, and it may not be so different post-COVID. The so called $700bn "Buy American" investment plan unveiled by the Democrat's US presidential candidate, Joe Biden, or even the reference to 'home relocation' used by new French PM Jean Castex during his introductory speech, are two examples illustrating the shift towards more protectionist policies in the short run.

Beyond this global picture, we cannot overlook other potential hurdles that may drag on trade, like geopolitical tensions (ongoing US-China dispute), distressed company balance sheets after the crisis, or the likely reintroduction of tariffs between the EU and the UK next year. However, it will be interesting to see how faster digital transformation, enabling increased services trade, could counter this stress in global goods trade.

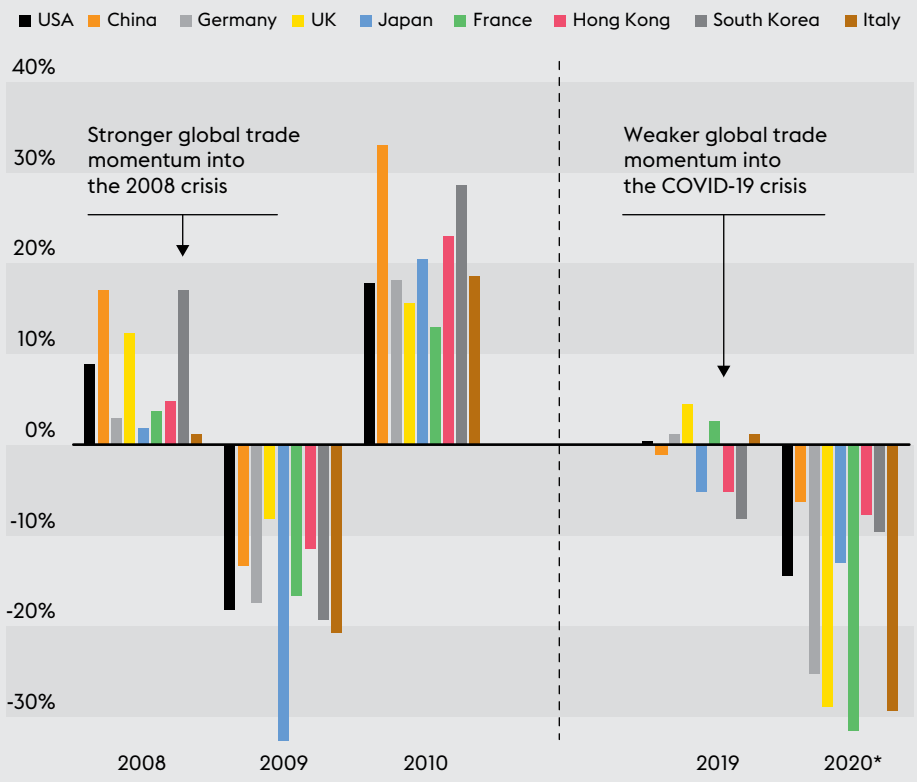
What can we learn from 2008? It's difficult to compare as the context, pre-crisis trade momentum, and crisis itself was completely different. This time both global supply and demand factors are at play, so the effects could last longer. If the WTO considers a "V-shaped" recovery in global trade as a likely scenario in 2021, it may be overly optimistic given global demand could remain distressed due to higher corporate insolvencies and weaker purchasing power of consumers. In addition, more protectionist behaviours could also keep trade activity near to its lowest level over the past 10 years.

> **"The recovery of global trade could be very gradual as protectionist practices are a common tool used by policymakers in the aftermath of a crisis.**

Guillaume Dejean
Currency Strategist, France

Global trade outlook different this time

Annual change in trade volumes (goods & services) by country



Unlike previous crisis, we could see a slower and uneven recovery of trade following COVID-19. The existing growth trajectory, and narrative around protectionism is vastly different versus 2008. Furthermore, weaker global demand caused by increasing unemployment and bankruptcies may cap 2021 prospects.

Chart sources: National Customs Services & Ministry of Trade, Refinitiv, Western Union Business Solutions, 2019.
Performance based on comparison between H1 2019 and H1 2020 periods.

THEME 4

Transatlantic battle for dominance

The role of the US as the undisputed financial capital of the world has shaped the 21st century. The depth of its financial markets has attracted global investors, searching for safe yield in an ever-more yield-less world.

Since 2010, the US stock and debt markets and the US Dollar have outperformed the rest of the world. However, confirmation of Europe's recovery plan, arguable US-mismanagement of the pandemic, and the rise of China's Renminbi, have put into question the "exorbitant privilege" of the US currency. In combination with domestic US issues like the long-lasting debate about the US twin deficit, and a rise of social unrest, investors have started to look for alternatives. But since 2010, it seems investors have failed to find a credible substitute for the greenback.

This search was also intensified by the US-Sino trade war and rising global geopolitical tensions; both resulting in decreased global trade and a sell-off of procyclical assets.

As the second largest economic region, Europe's gaining attention. Still unclear, but the recent confirmation of a joint European debt issuance could constitute a "Hamiltonian moment". The term refers to the first joined debt issuance of the United States, initiated by Treasury Secretary Alexander Hamilton. This step fundamentally changed the fiscal structure of the country. Now, market participants are wondering whether Europe's stimulus package will ignite a new EU impetus, including more coordination and solidarity policies.

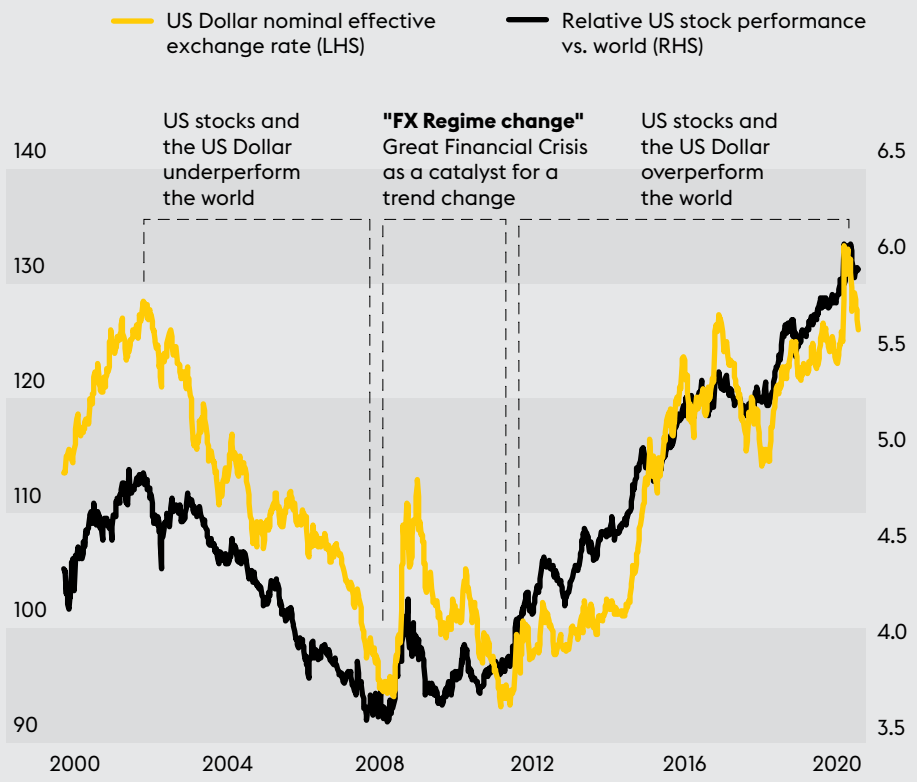
The decreased short-term risk of a break-up could potentially compensate for the debt inflows that vanished in the Eurozone after the introduction of negative interest rates. However, 2021 German elections will officialise Angela Merkel's farewell, who is widely considered the 'EU's engine'. Those seeking long-term diversification out of US dollars will know that the Euro will be vulnerable to pre-election populist and Eurosceptic rhetoric.

> **"With global interest rates converging, proper crisis management and economic growth differentials could overhaul the balance of power on the world stage after the recession.**

Boris Kovacevic
Currency Strategist, CEE

US Dollar facing multi-year turning point?

COVID-19 may transform currencies just like 2008



The first signs of a capital rotation into risk-prone assets are emerging. A depreciation of the US currency will be dependent on a continuation of this trend, but COVID-19 may just trigger a major multi-year global FX regime change.

Chart sources: Refinitiv, Western Union Business Solutions – August 2020

THEME 5

UK trade facing pivotal year

The UK's role as a trading nation 'should' change significantly in 2021. Once the Brexit transition period ends this year, future dealings with third countries will likely be defined by the UK's eventual relationship with Europe. Yet UK-EU negotiations remain challenging and failure to reach a trade deal is still a prospect, which may lead to the introduction of both tariff and non-tariff barriers next year. In a world gripped by virus-related supply chain disruption and growth concerns, a no-trade deal Brexit could exacerbate the economic shock.

It is unclear whether shortening or diversifying supply chains would have helped companies avoid the blow caused by COVID-19, but many are now looking at doing so in the future. Supply chains can be flexible, but it takes time to find alternative sources of a comparable quality. Consequently, the UK will be left even more exposed if a trade deal isn't agreed with Europe. Supply chain simplification and 'nearshoring' by UK firms could have resulted in much closer UK-EU trade relations in 2021.

The EU accounted for almost 50% of the UK's total trade in goods in 2019, but UK-US trade also matters. In fact, the US is Britain's biggest individual export destination and Britain is the fourth-largest destination for US exports. Thus securing a free trade deal with the US may greatly benefit some sectors but hopes of reaching a deal before US elections in November have faded.

In the absence of a trade agreement with the EU, reverting to WTO rules could intensify supply chain challenges. COVID-19 imposed shocks on food supply chains for example and the rapid response of these supply chains has underscored the importance of an open and predictable international trading environment. In a no-trade deal scenario, supply chain resilience will be tested further. A British cereal manufacturer for example, could face complicated non-tariff barriers on top of tariffs of 14.9%.

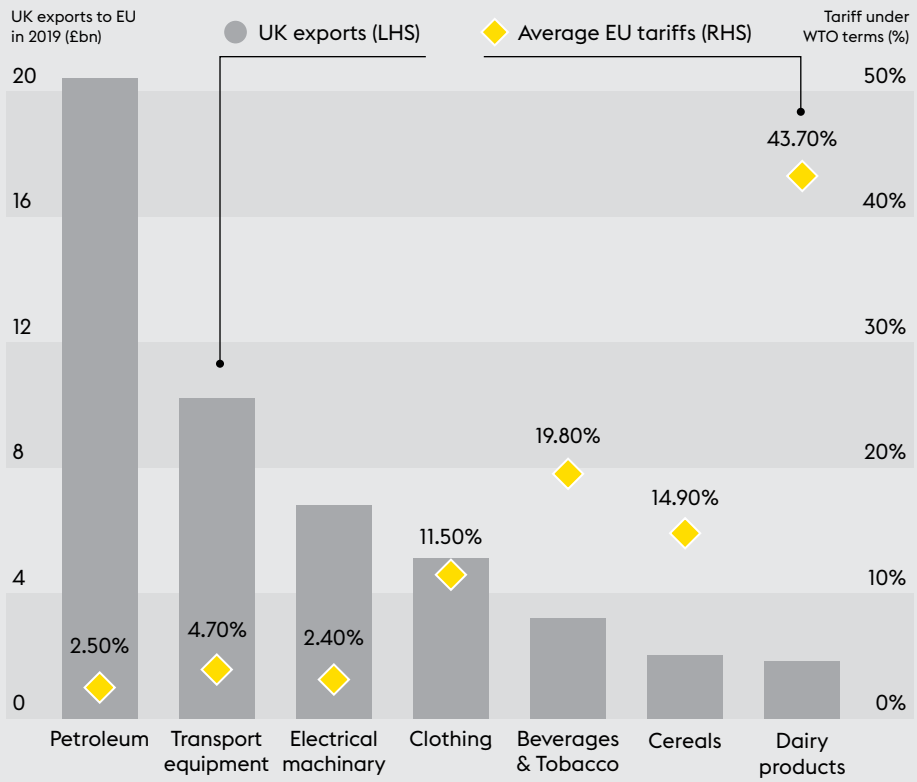
Time is running out for the UK and EU to resolve their differences and the longer the negotiations go on, the more costs businesses might have to incur to protect themselves from a disruptive no-deal scenario.

> **"Supply chain simplification and 'nearshoring' by UK firms could have resulted in much closer UK-EU trade relations in 2021.**

George Vessey
Currency Strategist, UK

Tariffs could upend UK-EU trade

UK exports to EU & possible tariffs under WTO rules



There are currently no tariffs on trade between the UK and EU member states. If a UK-EU trade deal is not in place by Dec 31, 2020 though, resulting barriers to trade with EU and non-EU countries could significantly damage export and import business and derail economic recovery hopes.

Chart sources: UK Trade Info, ONS, WTO World Tariff Profiles, Western Union Business Solutions – August 2020

THEME 6

Try and isolate China

China established itself as the engine for global growth, accounting for around 30% of world GDP (source: IMF, period 2013-2018). However, will the world's second largest economy maintain the position of being the world's main locomotive post-COVID?

The supply shock following the Great Lockdown of 2020 highlighted the reliance of western economies on China, especially in the manufacturing process. Indeed, manufacturers suffered from severe disruptions across their supply chain when Chinese factories suddenly shut down in January. Driven by risk mitigation strategies, China may now suffer from a gradual decrease in foreign investments in the years ahead.

Relocating some industrial production to countries where labour costs are cheaper than China, like Vietnam, will be considered. India is already increasing competition with China as it offers an attractive blend of expertise and low costs.

For the Chinese economy, a global trend of manufacturers reducing their reliance on China could cause severe damage in 2021.

Looking beyond business, China is also suffering from a political and economic backlash from several of its peers who fear the rise of its influence across the globe, whilst also condemning what they consider an authoritarian regime. The introduction of a new national security law in Hong Kong led US officials to withdraw the former British colony's special economic status. The recent ban of telecommunication company Huawei from building its British 5G network is a further example of the threat that is hanging over China: international isolation.

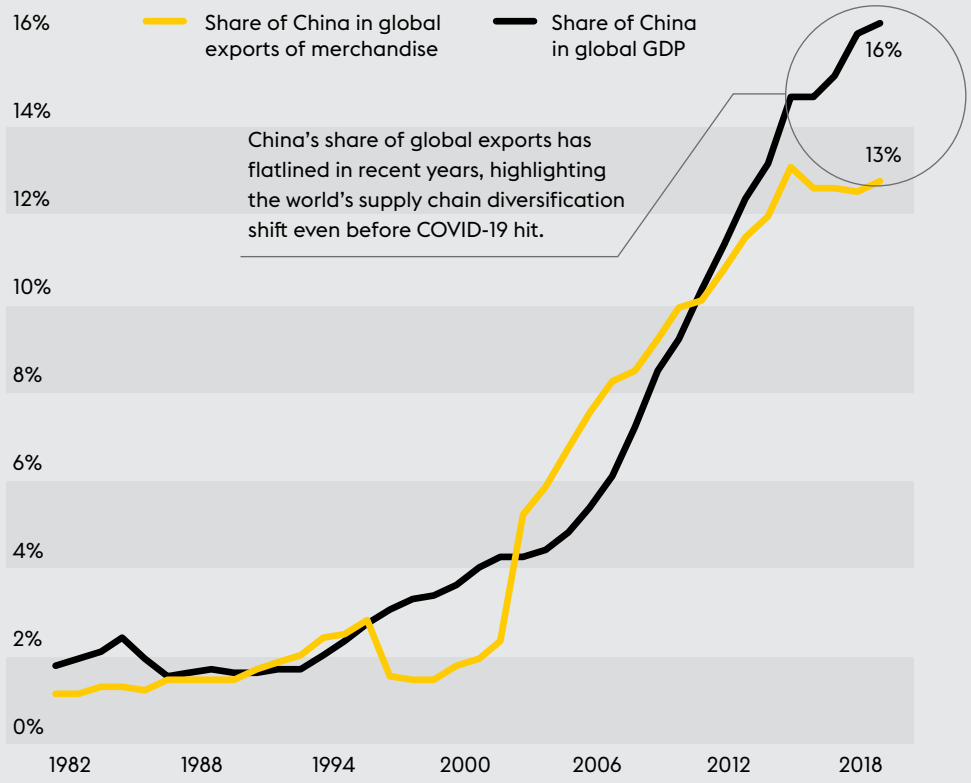
However, given the high interest of western economies in China, how much can the world disconnect itself from such a huge market? It's important to remember China boasts 1.3bn consumers and its 2021 GDP growth forecast of +8.2% (source: IMF) looks highly attractive in a post-crisis era.

> **"China faces a year ahead like no other amidst trade protectionism, global supply chain diversification, as well as a political backlash regarding Hong Kong.**

Guillaume Dejean
Currency Strategist, France

Supply chain diversification hitting Chinese trade?

Measuring China's cut of world GDP and exports



If a resurgence of trade conflicts and international sanctions on China dampen its post-COVID economic recovery, there will be consequences for the world economy too. Volatility in China's currency is also a key area of focus, especially if China seeks to 'revalue' its Renminbi to support trade.

Chart sources: World Bank, Western Union Business Solutions, 2019 annual data

THEME 7

CEE growth model to transform?

Central and Eastern Europe (CEE) has made remarkable progress since its transition to market economies. The major turning point in the modern economic history of the region was in 1997, when the region experienced its first economic growth after the fall of the Soviet Union. Since then, CEE has grown at double the rate of Western Europe, making it an attractive place to invest.

A unifying factor in the convergence of the CEE economies was the strong emphasis on capital inflows, facilitated by market reforms, competitive wages, and low-valued currencies. These flows – largely catered to the manufacturing base – have made the region vulnerable to exogenous shocks.

The geographical proximity to Germany and reliance on the automotive industry amplifies this procyclical connection. This contributes to shaping the region as manufacturing exporters with a strong bias towards Europe. The recession experienced after the initial COVID-19 shock stands as a testimony to these dependencies.

The period after the Great Financial Crisis demonstrated the limits of the post-transition growth model. Therefore, it could get increasingly harder for the region to replicate the growth rates registered between 1997 and 2007, especially with the rise of Southeast Asian exports and structural changes across the automotive sector.

Still, every crisis comes with risks and opportunities. CEE governments on average enjoy more fiscal freedom to lead structural changes. The region is uniquely positioned to diversify to a knowledge-based economy by focusing on investments in innovation. The large pool of talent and the increasing importance of the digital economy could help the region establish itself as a frontier market in digital transformation.

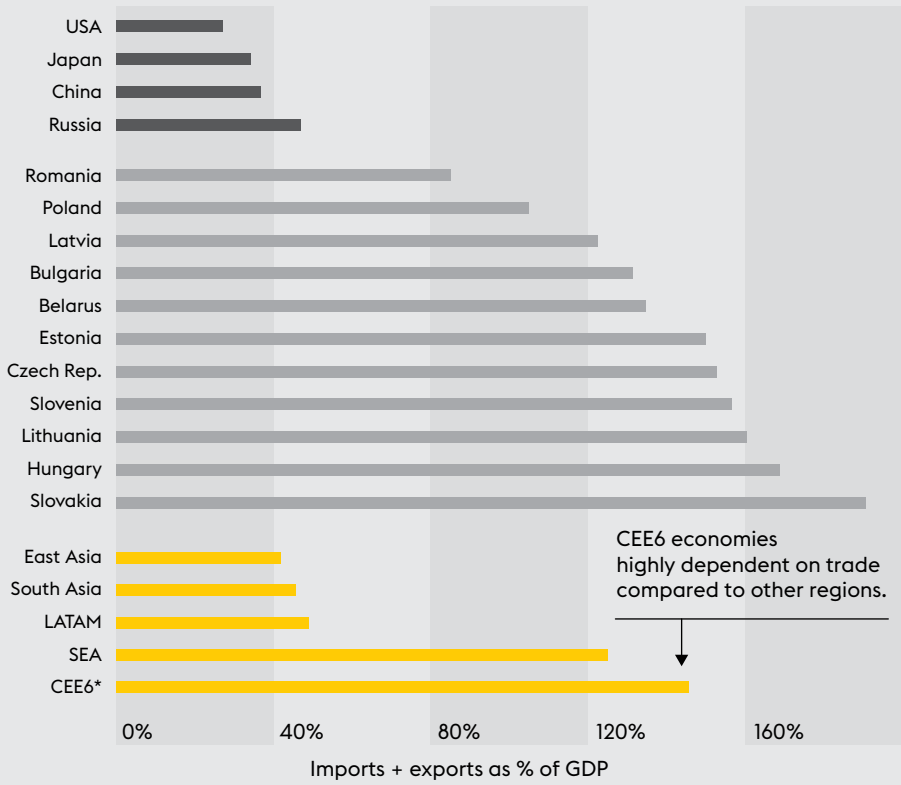
Given the similar starting points and common challenges the region faces, cooperation between countries could unleash the potential to fully capture scale effects and share best practices.

> **“Its growth model is at risk. Yet fiscal freedom across Central and Eastern Europe could just help the region establish itself as a frontier market in digital transformation.**

Boris Kovacevic
Currency Strategist, CEE

CEE’s trade openness a blessing or a curse?

Imports and exports as a share of Gross Domestic Product



The global economic profile of most of Central and Eastern Europe has significantly affected the region as global trade has plummeted. CEE economies could shrink by an average of 5.4% this year before we see a 2021 counter strategy materialise.

Chart sources: Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), “The Next Generation of the Penn World Table”, Western Union Business Solutions – July 2020; Data from 2017;
* CEE6 = Czech Republic, Poland, Hungary, Slovakia, Bulgaria, Romania; SEA = Southeast Asia

THEME 8

EM currencies backed by yield

It's been a painful year for Emerging Markets so far after they experienced record capital outflows during the pandemic, losing $83.3bn in March alone (source IIF). When investors get nervous and market volatility spikes, EM assets are usually the first ones to be cut across investment portfolios. Consequently, several EM currencies collapsed this year, with some reaching record lows.

Yet this collapse to rock bottom could eventually see a material recovery in 2021 if EM currencies are 'first in and first out' of the crisis. Considering we have a near-zero interest rate environment across developed markets, and no rush from central bankers there to tighten monetary conditions after the crisis, conditions could turn favourable for EM assets. Offering investors a good mix of high returns and cheap valuations, these assets could gradually catch the eye of those in the search of yield. However, two boxes need to be ticked in 2021 to make that scenario happen.

Firstly, we should witness a sharp rebound of global growth next year, meaning no further extension of the pandemic. If a second wave of COVID-19 triggers a renewed risk-off market, history suggests this would clearly dampen demand for assets with a high risk/reward profile across the emerging world.

Secondly, debt matters. In a post-crisis environment where investors' confidence is frail, fundamentals will count during asset allocation decisions. Investors may shun countries that display high debt, a current account deficit, and weak economic growth.

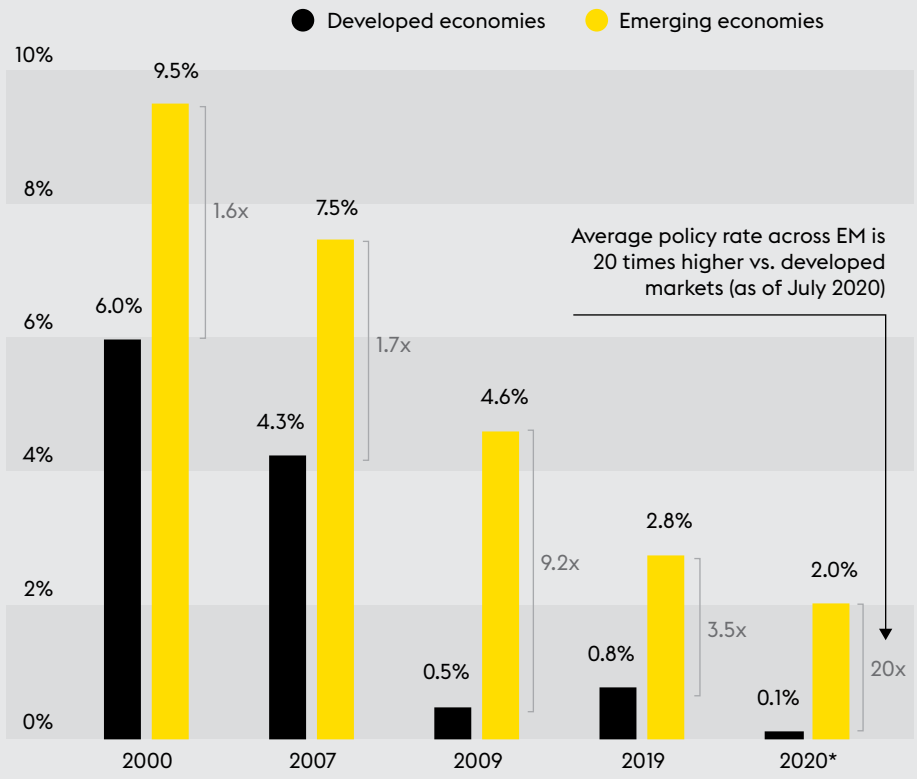
While Brazil, South Africa or India's currencies look very cheap and attractive today, their upside potential will become evident as their growth prospects emerge. CEE currencies like the Polish Zloty look less attractive from a yield perspective but would offer more guarantees as Eastern European economies could benefit from a strong recovery across Western Europe.

> **"Will a catastrophic year be followed by massive inflows back into emerging markets? Potentially, if global growth returns and the '20 times' higher rate advantage can be maintained.**

Guillaume Dejean
Currency Strategist, France

Yield gap to benefit EM currencies in 2021?

Average policy rates, developed vs. emerging countries



While emerging currencies footed a large part of the crisis bill, they could see a material bounce back in 2021 if global risks ease. In a near-zero interest rate environment across developed markets, higher returns and very cheap valuations make EM currencies more attractive.

Chart sources: BIS, Western Union Business Solutions - June 2020. Average rate based on monthly policy rates of 38 developed and emerging countries collected and published by the Bank for International Settlements.

SECTION 3

FX forecasts

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The dollar's rise and fall

While Brexit news has driven the GBP/USD rate over the last few years, recent price action was largely down to USD moves. GBP/USD spiked to $1.35 following the UK election victory late last year as investors welcomed political stability and hoped UK-EU talks would become more straightforward. But the coronavirus outbreak then rippled its way around the world and upended sterling's recovery.

Financial markets were sent into a spin when governments forced nations into lockdown. Sterling was sold aggressively against the safe-haven and highly liquid US Dollar.

Investors steered clear of the pound, concerned by the UK government's belated reaction to the crisis and the dire forecasts that the UK would register its largest recession in 300 years. No-trade deal Brexit concerns also resurfaced as the government refrained from requesting an extension to the transition period.

Nevertheless, the US Dollar weakened extensively from March onwards following US rate cuts and a rise of risk-appetite among investors watching burgeoning signs of a strong global recovery.

After years of having relatively higher interest rates, US rates are now in line with other developed nations: near zero.

The US Dollar might be pressured as the tense political climate restricts stimulus efforts while the rise in coronavirus cases hinders recovery hopes. Moreover, a change of president to the less business-friendly Joe Biden compared to Donald Trump, may also negatively impact the dollar in the future.

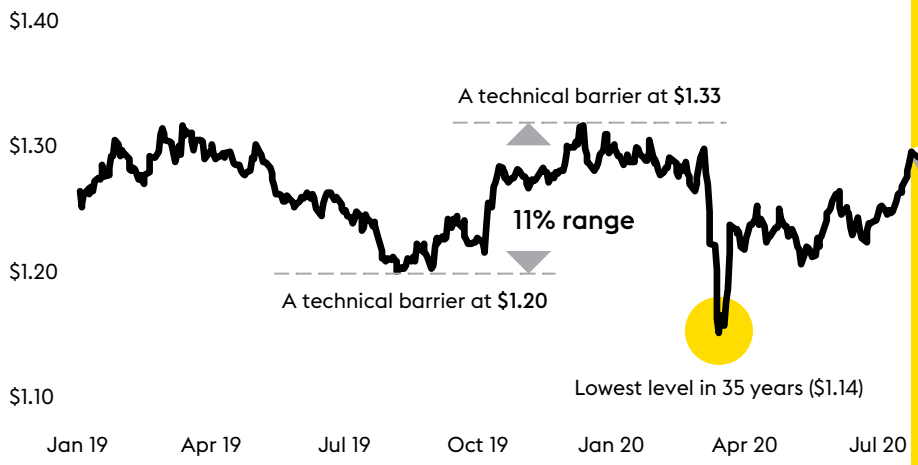
Should the dollar-weakening trend continue, 2021 may allow GBP/USD to press into the higher realms of the $1.30s.

On the other hand, there aren't many positive catalysts driving the pound either. Growing speculation about further UK rate cuts may limit sterling upside as negative interest rate policy remains in active review by the BOE.

Will a change of leadership in the US be good news for the UK? Not if it leads to the US-UK trade deal being postponed. A UK-EU deal, due by 31 December, also remains a major uncertainty, which has the potential to drag GBP/USD back under $1.20.

The pandemic-driven plunge below $1.20

Historical volatility of the GBP/USD exchange rate



Will Brexit boost or bust the pound?

WUBS-Oxford Economics future projections for GBP/USD

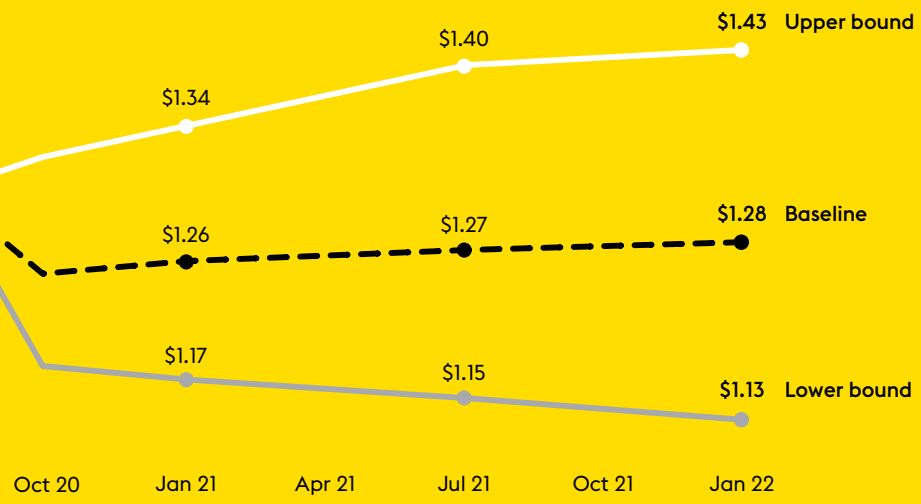


Chart sources: Oxford Economics, Reuters, Western Union Business Solutions – August 2020

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The revival of the Euro

The pound depreciated circa 13% against the Euro from February to March, collapsing from a 3-year high near €1.21 to its lowest level in 11 years near €1.05. Despite a short period of relief, rebounding off the March floor, GBP/EUR steadily descended over the summer months.

Sterling's strong correlation with risk sentiment led to an aggressive sell-off during the height of the market turmoil, but since the revival of risk appetite, GBP/EUR has failed to recoup all of its losses.

Investors avoided the risk-correlated pound, concerned by the UK's growing twin deficit, the government's handling of coronavirus and ongoing Brexit-related uncertainty.

A surge of concerns about a "Hard Brexit" scenario due to the persistent trade talk deadlock between the UK and EU underpinned huge speculative bets against the pound.

Meanwhile, the Euro was boosted as investors cheered the EU's historic €750bn rescue fund to help shore up European economies reeling from the pandemic.

The agreed stimulus package is a clear sign of harmony amongst EU states amid the wave of Euroscepticism and Brexit that has haunted the bloc for years. The ease of political divergences in Europe boosted demand for the Euro and GBP/EUR may continue drifting lower as a result.

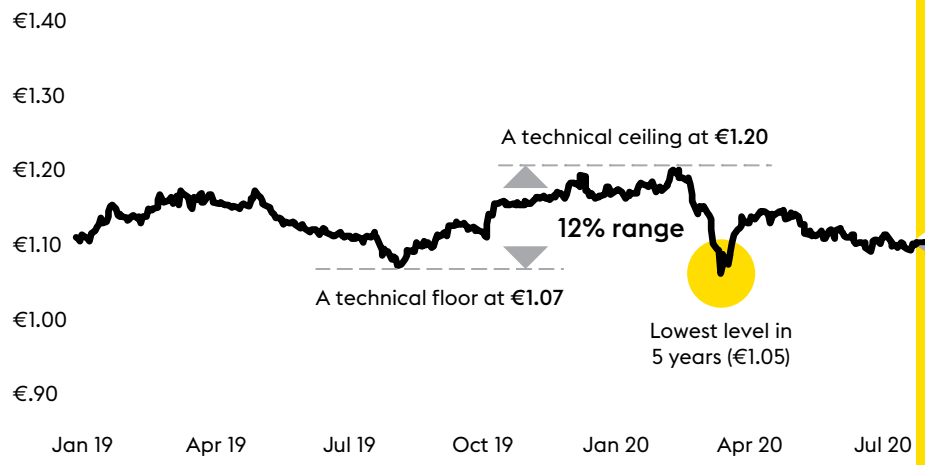
The trajectory of GBP/EUR may largely depend on how successful the global economic recovery is. Will the UK and Europe differ in their recovery speeds and how will a potential second or third wave of the virus be managed by governments in both areas?

The long-lasting impact of coronavirus on the economies of both the UK and the Eurozone may not be realised until late 2020 or even 2021, due to the huge support by policymakers in both regions to help protect jobs and reduce bankruptcies.

A no-trade deal Brexit is also a key risk lingering over both regions, though the UK and thus the pound is expected to suffer more so in the short run. Expectations of GBP/EUR falling towards parity in such a scenario are growing, particularly if it prompts a Scottish independence referendum too. Conversely, a trade deal should help GBP/EUR climb towards €1 20.

A consistent 12% trading range over the last 3 years

Historical volatility of the GBP/EUR exchange rate



To parity or above €1.20?

WUBS-Oxford Economics future projections for GBP/EUR*

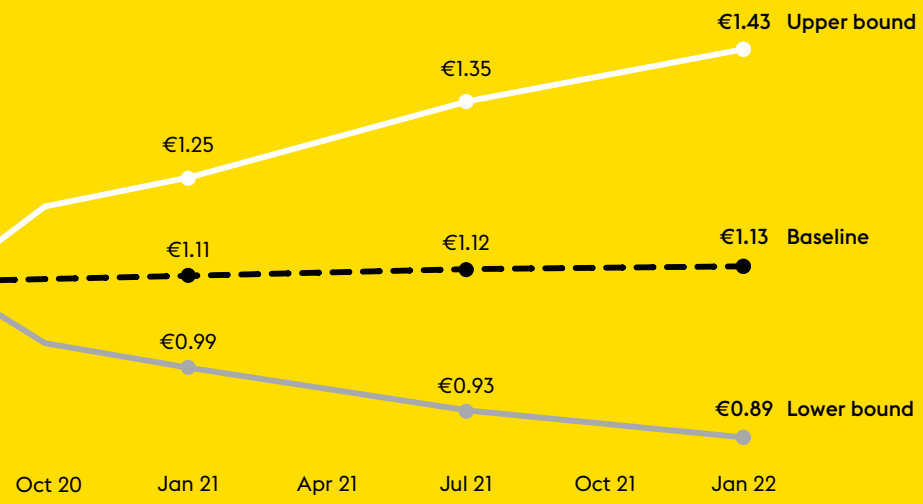


Chart sources: Oxford Economics, Reuters, Western Union Business Solutions – August 2020

* GBP/EUR projections calculated through projections on EUR/USD and GBP/USD rates

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Restored appetite for Aussie

Over the past three years, the pound has steadily climbed against the Australian Dollar, but 2019 and 2020 gains were wiped out in just four months. GBP/AUD peaked at A$2.08 during the height of the pandemic-induced market turmoil in March before falling 15% in just one quarter.

Prior to the pandemic, the exchange rate had been influenced by growing US-China trade tensions due to Australia's strong trade links with China. The Australian currency is a proxy for both the Chinese economy and commodity prices.

The March 2020 peak was partly a result of the pandemic-induced economic slowdown in China. Commodity prices also plunged in line with global demand that subsequently dried up under lockdown policy.

However, the GBP/AUD exchange rate staged a sharp U-turn in line with global stock markets as risk appetite resurfaced. Commodity prices recovered which strengthened AUD. Also, investors sought out higher yielding assets such as Australian government bonds.

The trajectory of GBP/AUD largely depends on whether a second or third wave of coronavirus scuppers economic recovery hopes and sparks risk aversion across financial markets. Historically, the AUD outperforms the pound during times of economic recovery.

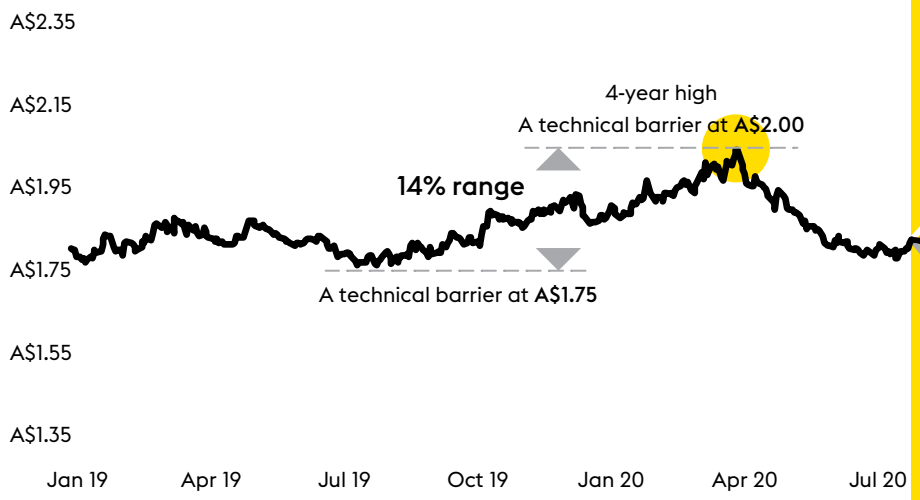
If financial markets reel in the event of a new round of lockdown measures, then investors may ditch high yielding assets, including the Aussie dollar. As per the trend in March, GBP/AUD may drift higher as a result.

China is embroiled in several economic and geopolitical disputes, including with the UK and Australia. An escalation of these disputes could lead to economic sanctions which would pose a serious threat to Australia's recovery hopes.

In late summer, GBP/AUD bounced from a long-term support floor around the A$1.77 mark, largely in line with renewed and stringent restrictions in Australia following a rise in virus cases. A break of the A$1.75 technical barrier would signal more potential downside risk for the exchange rate.

Risk reversal revives Aussie

Historical volatility of the GBP/AUD exchange rate



Will a global recovery drag on GBP/AUD?

WUBS-Oxford Economics future projections for GBP/AUD*

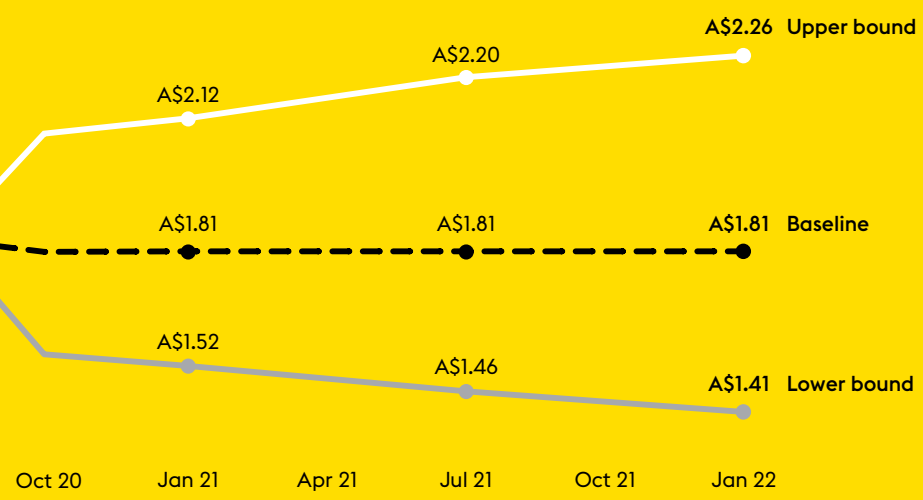


Chart sources: Oxford Economics, Reuters, Western Union Business Solutions – August 2020

* GBP/AUD projections calculated through projections on AUD/USD and GBP/USD rates

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A durable uptrend?

EUR/USD has seen a sharp increase in activity in 2020 and appears to have reversed the downtrend started in 2018. After falling to a three-year low in March when the pandemic crisis peaked in Europe, EUR/USD roared back during spring and climbed by 10% in just three months.

The exchange rate flirted with the $1.15 barrier over the summer, a ceiling that had held since January 2019. Once this level was broken, EUR/USD was catapulted to fresh two-year highs ($1.20) in another sign of improving sentiment towards the Euro.

Another shift in sentiment was seen as the US was hit with a new large wave of infections over the summer months, replacing Europe as the area the most impacted by the coronavirus.

The effective management of the crisis, which appears to be under control in Europe, coupled with the bold response by European officials in terms of economic stimulus, contributed to a revival of confidence towards European assets, which fueled appetite for the Euro. In contrast, the greenback was hurt by political deadlock in US Congress over a new stimulus plan.

A positive summer period peaked with the conclusion of an historical deal by European leaders on a €750bn stimulus plan. Yet there is no guarantee the Euro's climb will continue or at what pace.

The trajectory of EUR/USD mainly depends on two factors: 1) which of the US and Europe will better manage the crisis, especially in case of second or third waves, and 2) which will recover the fastest.

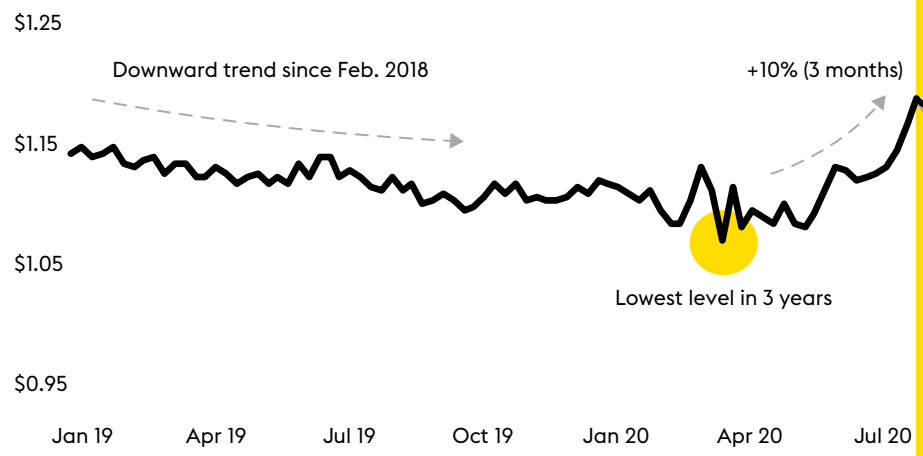
The economic damage in Europe has been cushioned thanks to the huge support from policymakers to save jobs and restrain bankruptcies. However, belated effects could pop up in late 2020 or early 2021 and dampen confidence in the Euro.

For the US Dollar, a switch of president to the less business friendly Joe Biden compared to Donald Trump may negatively impact the US currency, amid a likely sell-off in US equities.

German elections in 2021 will also be an important turning point for currencies. Investors will scrutinise Angela Merkel's successor after her fourth consecutive and final term in charge.

An aggressive breakout higher

Historical volatility of the EUR/USD rate



Upside momentum facing many hurdles

WUBS-Oxford Economics future projections for EUR/USD

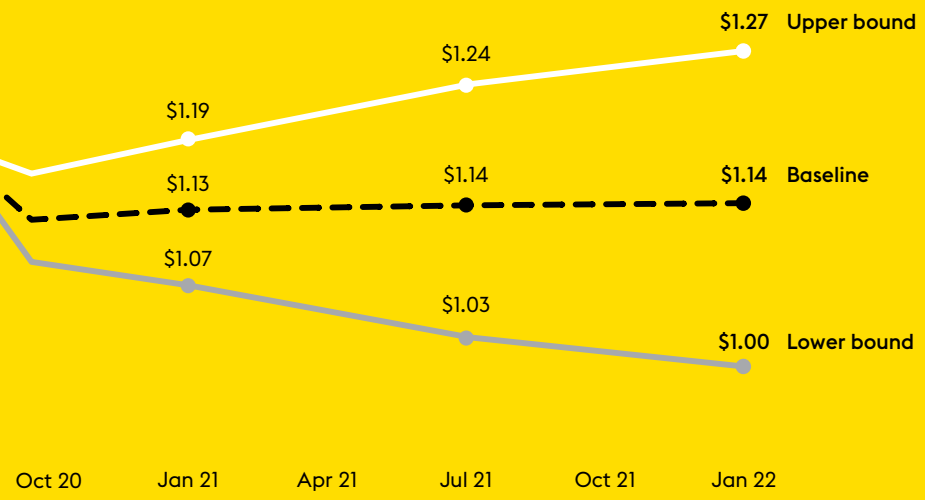


Chart sources: Oxford Economics, Reuters, Western Union Business Solutions – August 2020

SECTION 4

Risk management

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Protecting profits post-crisis

Corporate risk managers face challenges unlike any since the financial crisis of 2008. After decades of steady growth in global GDP and relatively low levels of financial market volatility, treasury professionals and business owners find themselves in a new paradigm as the effects from COVID continue to ripple through both financial markets and global supply chains.

While FX volatility stemming from fundamental forces such as loose monetary policy, negative real interest rates and rising commodity prices continue to be topics discussed among cerebral academics and the financial press, rarely does one hear about the challenges corporate practitioners face amid increased volatility and uncertainty in timing of payments for goods and services.

While there is no one size fits all approach to FX risk management, the overarching objective to achieve cash flow certainty and protect profits from the effects of FX rate movements remain the same.

Looking ahead into 2021, it is important that decision makers stay focused on the basic building blocks of hedge strategy development, and that throughout the year, tactics employed are regularly reviewed to ensure that your company's FX risk management objectives continue to be met.

> **"Rarely does one hear about the challenges corporate practitioners face amid increased volatility and uncertainty in timing of payments for goods and services.**

David Renta
Global Head of Hedging

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A currency risk management strategy could reduce the possibility of unexpected financial losses, make future cash flows more predictable, and potentially provide a competitive advantage against others who may leave themselves exposed to currency risk.

However, any strategy is not simply a collection of financial products that can be used to address specific exposures. Instead, success lies in building an end to end approach and risk mitigation culture, taking a holistic and more disciplined approach to managing currency exposures.

This broader approach is especially critical amidst the COVID-19 post-pandemic market outlook.

In addition, uncertainty around underlying cash flow exposures caused by the pandemic create separate challenges for risk managers, as critical terms like timing and amounts to hedge can change in an instant should supply chain disruption or changes to underlying demand for goods or services occur.

1 Identify currency exposures

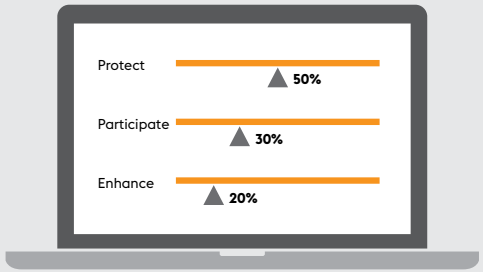
Using our tools like the WU® EDGE Platform, we can help you:

- Get full visibility over your future FX payments and exposures.
- Accurately and easily forecast your foreign cash flows.
- Calculate your currency risk against potential market scenarios.

2 Set your 2021 goals

Review the three common goals businesses like yours usually have:

- Protect profits from adverse currency swings.
- Participate and benefit from favourable currency moves.
- Enhance, outperform competitors or achieve specific targets.



3 Develop your hedging strategy

We can then tailor a bespoke hedging strategy to help you meet your goals:

- Set a minimum hedging threshold so your profits are not left exposed.
- Using market and industry insights, benchmark your strategy against best practices and scenarios.

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Considerations

Although the objective of any risk management and hedging strategy is easy to state, the challenge is to develop and execute the plan in such a volatile and highly responsive environment.

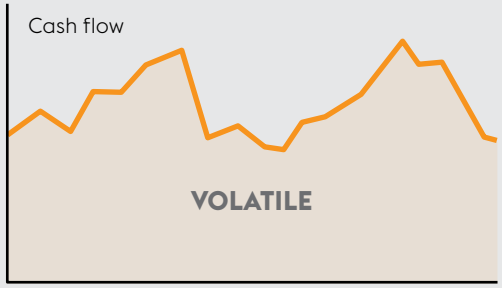
It is more important than ever that companies, especially SMEs, find partners to help them craft, benchmark and validate strategies against best practices, and provide specialist insights into how current events are reshaping the foreign exchange payments landscape.

At Western Union Business Solutions, we are dedicated to helping companies manage these complexities and achieve their international business goals.

Our simple three step approach to risk mitigation is designed to offer decision makers and their advisors with unique insights, enabling smarter strategy development around trade and risk management, and ultimately better financial outcomes.

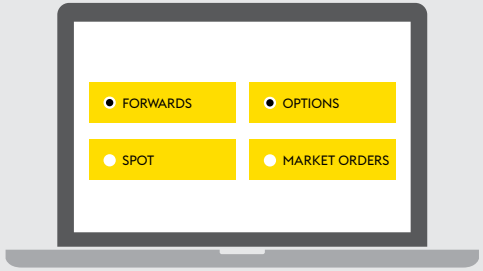
Without a strategy

- Volatile cash flows and profits
- Difficult forecasting
- Chase exchange rates, leave your business exposed



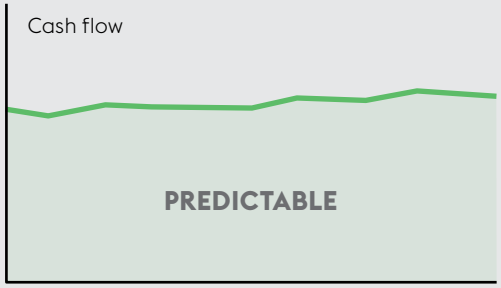
Mitigate your risk

- Forwards – Protect
- Options* – Protect & Benefit
- SPOT – Top up
- Market Orders – Target preferential rates



With a strategy

- Predictable cash flows and profits
- Reliable forecasting
- More control over costs, not worrying about rates



* These alternative hedging products allow you to lock in a rate of exchange to protect your profits, and give you the ability to benefit if the market moves in your favour. There are disadvantages to consider such as a slightly less favourable protection rate versus a comparable Forward, but please speak to our hedging experts to understand more about the costs and benefits which can vary with each Options product.

Are you ready for 2021?

Contact us now to review your strategy

Get started ›

Learn more here:

business.westernunion.com/en-gb/blog

WesternUnion WU | Business Solutions

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Western Union pioneered the idea of moving money around the world and has been connecting people globally for more than a century. As one of the world's leading providers of cross-border business payments,

Western Union Business Solutions is transforming how businesses can expand globally through one of the largest and most diverse payment networks in the world.

Small businesses | **Corporate** | **Financial institutions** | **Legal** | **Educational institutions** | **NGOs**

WesternUnion WU | Business Solutions

WU® EDGE
- Connect with partners
- Real time, fee free*
- Visibility into exposures

International Payments
- Incoming
- Outgoing
- Mass payments

Risk Management
- Hedge specialists
- Improve cash flow
- Help protect profits

Bank Account | **Cash** | **Card** | **Mobile*** | **Global Payment Network** | **130 Currencies** | **200 Countries and Territories**

* Transaction fee-free EDGE Network Payment services are available between fully accredited customers that have registered to use the WU® EDGE platform and are authorised by a WUBS affiliate to access services in Australia, Austria, Canada, Czech Republic, France, Germany, Hong Kong, Italy, Malta, New Zealand, Poland, Singapore, Switzerland, United Kingdom, and USA. WUBS will apply a foreign currency exchange rate, which includes a margin set by WUBS, whenever a transaction includes a currency conversion. Transaction fees may also apply to transactions other than EDGE Network Payment services.

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