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# January 2021 Outlook



## Introduction

December was a relatively quiet month for markets as investors mostly took stock after the busy month of November. The Electoral College certified the election result for Joe Biden, despite protests from Donald Trump, and in early January Congress confirmed the result. Subsequently, Donald Trump now has no path to get back in the White House, despite political posturing and ugly scenes at Capitol Hill. Markets generally ticked upwards despite the discovery of a new Covid-19 strain that is more infectious than the original one. This has led to more lockdowns globally and many European countries have set out restrictions for the entirety of January. The US fiscal stimulus package which looked close to gaining approval in late December was blocked by Mitch McConnell and now that both Democrats have won their respective run-off elections, Joe Biden and Nancy Pelosi will look to increase the size of the fiscal stimulus. Finally, the Brexit saga was resolved at the eleventh hour, as a new UK-EU trade deal was confirmed and signed into law just before Christmas.

January will likely be a low-key month for policymakers as most of the world enters another Covid-19 shutdown. The major event in the month on 20<sup>th</sup> January will be the inauguration of Joe Biden who will be sworn in as new President of the United States. He will be accompanied by a Democratic Senate and House, which will be key for him to enact policy. The most pressing issue for the new President is new fiscal stimulus, which is still unresolved after Congress came so close at the end of December. This is also the first month after the Brexit transition period concluded and although it is unlikely we will see queues of lorry drivers at Dover stretching over the horizon, there are bound to be some hiccups for businesses that need acclimatise this month. Markets will most likely be subdued in January as investors return from a busy Christmas period.

## USD

The dollar opened at \$1.2239 against the euro and at \$1.3646 against the pound at the start of the month. The dollar is expected to lose value against these currency pairs and in general in the short, medium and long term. This is due to loose monetary policy, fiscal stimulus, the vaccine rollout and a Joe Biden presidency.

In the short term, the dollar will be predominantly affected by the Coronavirus pandemic and the vaccine rollout. Due to increased travelling over the Christmas and Thanksgiving period, Covid-19 cases in the US have started to increase since the beginning of December and so there is scope in the immediate term for investors to seek haven in the dollar if the US decides to increase Coronavirus restrictions further. However, over the next three months, the consensus is that the vaccine rollout will continue without any hiccups (more than 5 million Americans have already received their first dose) and restrictions will be eased accordingly. It is unlikely that we will see a 'business as usual' scenario in the next three months however, businesses and investors will see the global outlook improving will continue to place their funds into riskier currencies.

Once the Joe Biden presidency is in full swing the US will start to see his policies enacted. The most important one, for the dollar, being a large fiscal stimulus for workers and businesses. In a surprising turn of events, both Democrats won their run-off election for the Senate in Georgia, and now the makeup of the Senate is 50-50, giving the edge to the Democrats as Vice President, Kamala Harris can wade in as a tie breaker if needed. This is excellent news for Joe Biden, who will be able to implement policies without Republican opposition and he and Nancy Pelosi can pursue a larger fiscal stimulus than originally planned. Based on negotiations conducted before the November election, Nancy Pelosi will most likely put forward a massive stimulus package worth ~ \$2.5 trillion. This is beneficial for businesses and investors who will have extra capital and will most likely lead to a fall in the value of the dollar as investors look to invest in riskier assets internationally. Although, businesses will not feel the effect of this stimulus for some time, it is likely that the dollar will weaken as soon as the stimulus package is announced which will probably be within three months.

Over the next twelve months, the dollar will likely weaken further as the risk appetite of investors increases, and after a volatile period dominated by politics and major events, the greenback will be dictated by economic fundamentals such as the interest rate differential. The Fed is expected to keep monetary policy "ultra-loose" until 2023 as Fed Chair Powell is cautious about the long-term economic effects of the Covid-19 pandemic. In the most recent Federal Reserve meeting, the committee kept the federal funds rate unchanged and the language used by Jerome Powell in the accompanying press conference confirmed their ultra-dovish approach. Ultimately, with the US bank rate set to remain very low for the next few years, this means that investors will look at other currencies for a more profitable interest rate.

In conclusion, the dollar decline seen over the last three months is likely to continue throughout 2021. Long term, a Democratic congress will likely increase corporate taxes which could impact US investors however, for the time being investors are taking more risk as the economic outlook improves, which will likely weaken the dollar. The average forecast for a host of major banks, including Goldman Sachs predict that GBPUSD will hit 1.44 and EURUSD will hit around 1.30 by end-2021, which gives an indication on how much the dollar is anticipated to weaken.

## GBP

Sterling opened at \$1.3646 against the dollar and €1.1152 against the euro and has trended consistently higher since November and is likely to continue in January, and throughout 2021, as investors believe the UK will recover well from the Covid-19 pandemic. The outlook for the pound will be determined predominantly by Brexit fallout in the short term and Coronavirus and monetary and fiscal policy in the medium term.

Brexit headlines have dominated the news cycle for the past four years, and despite a UK-EU trade agreement being agreed in December, it is unlikely this will be the last we hear of it. Fisheries and state aid remained the key differences until the very end, finally concessions were made on both sides by Michel Barnier and David Frost which paved the way for an agreement to be drafted on 24<sup>th</sup> December and signed by both parties on 30<sup>th</sup> December. The pound had been positioned for a trade deal, so when the announcement was made, Sterling did not 'skyrocket' as some analysts expected however edged slightly higher. Now, the consensus is the pound will carry on this slow momentum and etch up higher throughout 2021.

However, the truth is that no one really knows what the next few months will entail as no other country has reversed a co-operation trade agreement before and analysts are unsure whether there will be any major hiccups for UK businesses to endure. The Food and Drink Federation has already warned that UK distribution hubs would struggle with full EU tariffs after exporting previously imported tariff free goods from Europe and the UK Government's solution of using transit was deemed as "unworkable". This is just one example of a small misstep overlooked in the new trade agreement and if more continue to surface, this could potentially weigh heavily on the pound as investors lose sentiment that UK businesses can operate at close to normality. Analysts, such as John Springford, former chief economist of the Centre for European Reform explain that barriers of trade will lead the UK to being poorer than their European counterparts, which will likely weaken the pound. However, it is unclear how much of this economic theory is baked into the existing outlook for the pound. In short, the UK being worse off under Brexit, isn't new information, so it will take a significant worsening of UK trade below current expectations to weaken Sterling.

The UK entered a third lockdown on the 5<sup>th</sup> January, to quell rising Coronavirus cases, from the new strain which is reportedly 70 percent more infectious. Although the impact to the UK economy will be severe, senior officials agreed this was necessary after seeing Covid-19 cases hit a record high of 58,784 on the 4<sup>th</sup> January, a huge increase from the 15,539 new cases seen just a month earlier. This corresponded with a fall in the pound, as investors looked towards safe haven currencies such as the Swiss Franc, Japanese Yen and of course the Dollar. However, despite rising cases, the vaccine rollout is on track and has currently been administered to nearly 1.5 million people, which is double the number of vaccinations in Germany, Spain and Italy combined. A successful vaccine rollout has sufficiently countered fears in the markets over a third lockdown and has provided some stability for the pound. It is likely, that if the vaccine rollout continues as planned investors will return to riskier assets which will likely benefit the pound as investors move away from the dollar.

On the monetary policy front, The Bank of England voted unanimously to keep the Bank rate unchanged at 0.10% and leave quantitative easing unchanged at £895 billion in their meeting on 17<sup>th</sup> December, in line with expectations. The notes from the meeting gave nothing away, except Governor Andrew Bailey's surrounding the uncertainty of economic outlook and the vaccine being likely to reduce downside risks. Hardly ground-breaking stuff. In the hour after the policy decision, the pound fell slightly but it is probably foolish to attribute this solely to the monetary policy decision as there was a lot of Brexit noise at that time, making the pound very volatile.

Over the next 12 months, the consensus is for the pound to increase in value relative to most other currencies including the euro and dollar, although this is dependent on how damaging the Brexit fallout is and whether a successful vaccine rollout can adequately quell fears over rising Covid-19 cases.

## EUR

The euro opened at €1.1094 against the pound and \$1.2239 against the dollar after being mostly unchanged throughout December. The currency will be largely dictated by its corresponding currency pair and will generally weaken throughout 2021 except against the dollar, as investors look towards riskier assets as the Eurozone economy is expected to struggle. The euro will also be influenced by the EU-wide recovery fund, the Covid-19 pandemic and any change in monetary policy.

After much political posturing by Hungary and Poland, the EU-wide recovery fund worth €750 billion was finally agreed on the 11<sup>th</sup> December and will be administered by Brussels throughout 2021. It is unlikely that there will be anything that causes this to fall or not be administered by the bloc on time however if there was this would seriously damage sentiment in the continent and would likely lead to a fall in the euro.

Most of Europe, including Germany and Italy are in complete lockdown due to rising cases and look to be worst hit by the new strain compared to the US and other OECD countries. In Germany, new cases hit 45,333 on the 7<sup>th</sup> January which was close to a record high and as cases continue to climb, the vaccine rollout in Europe lags behind other developed countries, especially the US and UK. This will weaken the euro in the long run as it is likely that other developed nations will start to get back to 'normality' sooner than Europe so investors will look for investments away from the continent, sapping demand for the euro.

On the monetary policy front, and to no surprise, the ECB kept their deposit rate unchanged at -0.5%, while also increasing the size of its pandemic emergency purchase programme (PEPP) by €500 billion. The Euro initially rose against the dollar after the announcement as investors welcomed the increase in monetary stimulus and the euro benefitted from Christine Lagarde's suggestion that the PEPP may not be fully spent, which caused some alarms and opened the door for investors to believe monetary stimulus could be lower than projected.

To conclude, the consensus is that the euro will most likely weaken in January and throughout 2021, as the eurozone is struggling more relative to other OECD countries, and although Lagarde seems to be more hawkish than her British and American counterpart, it is probably too soon to stop monetary injections into the economy, and could end up leading to a fall in economic conditions and sentiment for the euro.



## Central Banks

### USA. Federal Reserve. 17/12/20

In their meeting on the 17<sup>th</sup> December, the Fed decided to keep the Funds rate unchanged at 0-0.25%, and maintain their bond buying at \$120 billion. This was in line with expectations.

The next Fed policy decision is on the 28<sup>th</sup> January, and the consensus is that there will be no change to the Funds rate. It is less clear what Fed Chair Jerome Powell will decide with respect to bond buying, but he has recently tried to put the onus on fiscal policy to support monetary policy and also sees recent vaccine news as positive, but does not change in the economic outlook in the short run.

### UK. Bank of England. 16/12/20

In their meeting on the 16<sup>th</sup> December, the BoE decided to keep the Bank rate unchanged at 0.10% and leave quantitative easing unchanged at £895 billion. This was in line with expectations.

The next BoE policy decision is on the 4<sup>th</sup> February, and there is no general consensus of yet, as the meeting is too far away. The BoE will likely see how the vaccine rollout is progressing and make an informed decision closer to the time.

### Eurozone. European Central Bank. 10/12/20

In their meeting on the 10<sup>th</sup> December, the ECB kept the rate unchanged at -0.5%, and increased the size of its pandemic emergency purchase programme (PEPP) by €500 billion.

The next ECB meeting is on the 21<sup>st</sup> January, and the consensus is that the rate and purchases will remain unchanged. It will be important to pay close attention to Lagarde's speeches to determine what her view is on the economic outlook and whether she backtracks from her hawkish comments in the last meeting, although she is notoriously tight lipped when discussing policy.

### Canada. Bank of Canada. 09/12/20

In their meeting on the 28<sup>th</sup> December, the BoC kept their rate at 0.25% and continued the rate of bond buying at \$4 billion a week.

The next BoC meeting is on the 20<sup>th</sup> January, and the consensus is that both the bank rate and bond buying will be unchanged as the central bank will likely take stock after reducing bond buying, especially as the worst of the pandemic is not behind us.

### Switzerland. Swiss National Bank. 17/12/20

In their meeting on 17<sup>th</sup> December, the SNB kept their policy rate at -0.75%, which was in line with expectations.

The next meeting is on 19<sup>th</sup> March, and the consensus is for the SNB to keep the policy rate unchanged. The rate has been at -0.75% since January 2015.

**Japan. Bank of Japan. 18/12/20**

In their meeting on 18<sup>th</sup> December, the BoJ kept their rate unchanged at -0.1%, and extended their corporate bond purchases by ¥20 trillion. This was more dovish than consensus expectations.

The next meeting is on the 21<sup>st</sup> January and the consensus is that the BoJ will keep rates and asset purchases unchanged after so recently increasing bond buying. The central bank will also have a close eye on how successful the vaccine rollout is.

**Australia. Reserve Bank of Australia. 01/12/20**

In their meeting on the 1<sup>st</sup> December, the RBA kept their rate unchanged at 0.10%, and continued the current rate of bond buying. This was in line with expectations

The next meeting is on the 2<sup>nd</sup> February, and the consensus is for there to be no changes, as in the previous meeting minutes the Board said that they are "not contemplating a further reduction in interest rates [and] continues to view a negative policy rate as extraordinarily unlikely".

**New Zealand. Reserve Bank of New Zealand. 11/11/20**

In their meeting on 11<sup>th</sup> November, the RBNZ kept both their policy rate unchanged at 0.25% and their bond buying programme unchanged at NZ\$100 billion. This was in line with expectations.

The next meeting is on 24<sup>th</sup> February, and so is too early to predict what the central bank will do in their next meeting.

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179 Great Portland Street, Marylebone, London, W1W 5PL

**E:** [info@ballinger.co](mailto:info@ballinger.co)

**T:** +44 (0) 20 3869 1800

**W:** [ballinger.co](http://ballinger.co)