

FX Weekly

Review: 2nd – 8th March 2009

Market Focus

- Huge, varied economic calendar led to several changes in direction for many currencies. Ranging markets a common feature
- Multiple interest rate decisions overshadowed by speculation regarding quantitative easing
- Anxiety, nervousness and fear regarding the financial crisis continued to influence trading decisions as the banking sector captured more headlines. Equity markets worldwide suffer heavy losses touching late mid-1990's lows
- Tendency to stay away from risk prevailed once again although it was the Swiss Franc which led gains as opposed to USD or JPY
- Yen flatters to deceive as early signs of regaining equity market correlation faded throughout the week



Market Research

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| Currency pair | At Open on 2 nd March | At Open on 9 th March | Nominal Change | % Change |
|---------------|----------------------------------|----------------------------------|----------------|----------|
| EUR/USD | 1.2616 | 1.2674 | 0.0058 | 0.46% |
| GBP/USD | 1.4269 | 1.4126 | -0.0143 | -1.00% |
| USD/JPY | 97.64 | 98.25 | 0.61 | 0.62% |
| USD/CHF | 1.1716 | 1.1577 | -0.0139 | -1.19% |
| EUR/GBP | 0.8838 | 0.8969 | 0.0131 | 1.48% |
| EUR/CHF | 1.4784 | 1.4671 | -0.0113 | -0.76% |
| GBP/CHF | 1.6718 | 1.6353 | -0.0365 | -2.18% |
| GBP/JPY | 139.32 | 138.78 | -0.54 | -0.39% |
| EUR/JPY | 123.23 | 124.53 | 1.30 | 1.05% |
| CHF/JPY | 83.30 | 84.83 | 1.53 | 1.84% |
| AUD/USD | 0.6370 | 0.6413 | 0.0043 | 0.68% |
| NZD/USD | 0.4967 | 0.5032 | 0.0065 | 1.31% |
| USD/CAD | 1.2775 | 1.2842 | 0.0067 | 0.52% |

Source: Alpari (UK)

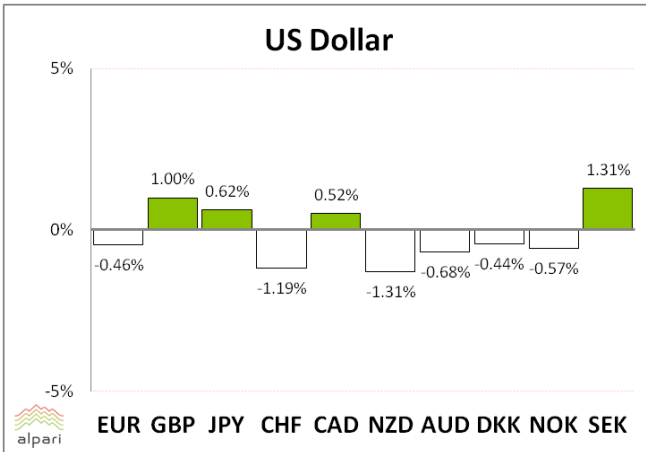
USD

The major theme in the currency markets last week was the unexpected shift of risk-aversion preferences away from the US Dollar, the Japanese Yen and the Euro into the Swiss Franc. The extensive economic calendar ensured that trading desks around the world were kept busy throughout the week so it was no surprise to see see-sawing sentiment. The net result was that many currency pairs traded within tight ranges as no clear opinion or direction was formed by market participants.

It should be noted that last week was a significantly bad week for equity markets as the financial sector brought forward fresh bad news. Citigroup and Bank of America suffered large falls as confirmation that renewed government support has not been received well. The spectre of nationalisation is still firmly in view. It was widely



reported that without U.S. government intervention AIG's losses would spark credit rating downgrades thus incurring further losses for the insurer. AIG is being labelled a "systemic" risk by market participants because it has thousands of trading partners that rely on it remaining solvent. Investors were shocked that this level of exposure and risk could be attained within an apparently tight regulatory environment (AIG guarantees about \$300 billion of asset-backed securities. U.S. and European banks are counterparties on many of AIG's outstanding derivative contracts). Following the



announcement of government bailouts AIG promptly reported the largest quarterly loss in history - 61.7bn USD for Q4 2008. Canadian GDP data showed GDP fell 1% in Feb 2008, worse than expected adding weight to bearish sentiment towards CAD and brought November 08 highs in USD/CAD into view.

Opinion on USD was split which led to volatile, choppy trade throughout Monday. Later in the week equity markets fell further as worries over bank solvency and US government exposure to the bailouts intensified. Ben Bernanke, the Fed chairman, said that more support for US banks may be required subject to 'stress tests' that are being carried out. Investors are fearful because government support seems to be limitless as increasing amounts of public money continue to be injected into ailing financial institutions. The level of uncertainty and panic is so great that many market participants are left stunned as to how to react to developing market information. Despite sanguine news regarding US banks and the financial sector, core PCE, personal spending and ISM manufacturing numbers were all better than expected, boosting confidence in the US economy and supporting the US Dollar. Recent psychology in the FX market has urged investors to buy USD on sharply weaker data due to risk-aversion but also to buy USD after positive news because of traditional motivations.

| | Short-term data (economic releases that are likely to influence the US economy only in the short-term; with the long-term view remaining intact) | Long-term data (economic releases that are likely to influence the US economy in the long-term; possibly after the economic crisis has receded). |
|---|--|--|
| Positive economic data (above expectations) | ↓ USD | ↑ USD |
| Negative economic data (below expectations) | ↑ USD | ↓ USD |

On Wednesday we saw a lull in falling risk tolerance generated by equity market weakness. Despite a much weaker ADP employment number stocks rose around the world, commodity prices pushed higher and Treasuries fell on speculation that China would add further fiscal stimulus to its economy (on top of the \$585 billion already planned) and that US authorities would

enact plans to reduce mortgage defaults. Higher unemployment as measured by the ADP estimate (-697,000 vs. 620,000 exp) failed to push the US Dollar lower but increased the likelihood that Friday's non-farm number would show a downside surprise. The recent tendency for USD to rally on soft US data continued and the broad confidence coming from Chinese stimulus plans were also taken as USD positive. It seems that the US Dollar is slowly taking on a paradoxical mantle of falling when there is positive short-term data or negative long-term data which could mean that market participants are increasingly looking at USD long-term effects, preferring to buy USD in the short-term purely for risk avoidance purposes.

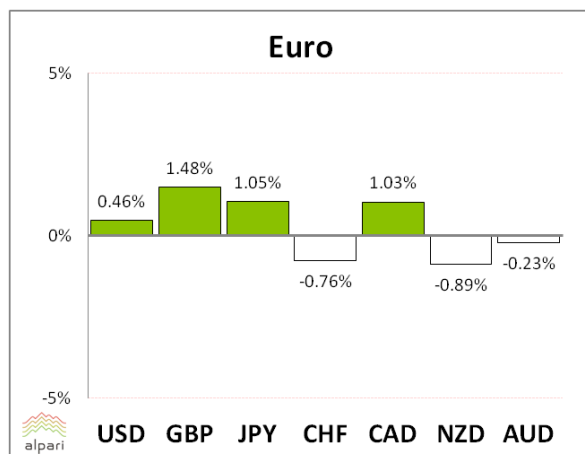
The upbeat mood didn't even last for 24 hours as Chinese officials were quick to dispel speculation of further fiscal expenditure. The news came as a 'false-start' to investors and encouraged equity selling. Several financial sector firms fell significantly; Citigroup's share price fell below \$1 for the first time ever as credit rating agencies came close to downgrading America's three largest banks.

The most important data release of the week for many traders was non-farm payrolls in the US. The report showed that the US lost 651,000 jobs in February pushing up unemployment to 8.1%. Reaction in the USD was mixed as it weakened against EUR, CHF, DKK, NOK and SEK but strengthened against GBP and JPY.

EUR

Most of the focus last week was on the ECB interest rate decision, but more importantly, investors were watching out for comments coming from the ECB regarding quantitative easing (or credit easing) which has been making headlines in the UK and Japan recently. There has been growing speculation (and in some investor's minds growing consensus) that the ECB will soon be embarking on explorative monetary policy beyond interest rate adjustments. Despite the speculation all references to money supply expansion etc were denied and dispelled as the ECB maintained its tough traditional stance.

At the start of the week expectations were firmly in place for a 0.5% reduction although these expectations were paired back somewhat after the higher than expected CPI figures on Monday (1.2% vs. 1% exp). Higher inflation expectations usually encourage tighter monetary policy to avoid runaway inflation. ECB comments last week suggested the ECB isn't expecting either inflation or deflation to be a problem so interest rates can be reduced for now.



EUR selling intensified after a decision to cut rates from 2% to 1.5%. The decision was not unanimous which empowered speculators to believe that EUR rates would fall further in 2009. Although the Euro zone maintains an interest rate premium over many other G10 nations the Euro fell against all other currencies because market participants began to expect further monetary policy easing later in the year. In addition, the overwhelming pressure on the ECB to conduct buying of

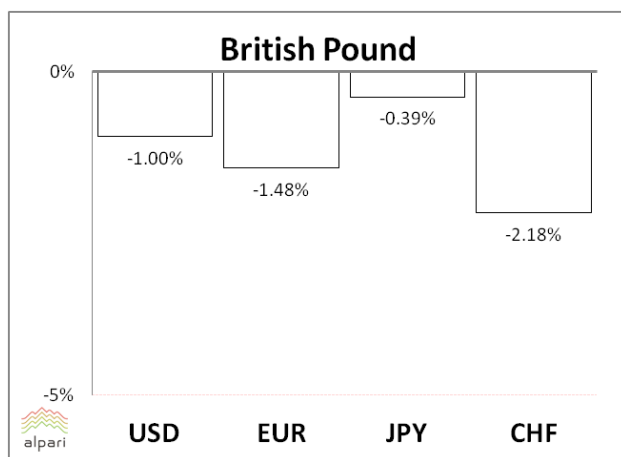
private assets led some investors to believe that quantitative easing is inevitable in the EU. If these expectations ease up EUR demand could increase, especially if similar policy attitudes fail in

other countries. Another factor that pushed the Euro lower was the downward revision to EU GDP growth expected in 2009 from -0.5% to -2.7%.

Overall, the single currency held up very well over the course of the week. The surprise was its weakness against the New Zealand Dollar considering the Kiwi's vulnerability in risk-averse environments alongside so much equity weakness. Commodity prices bounced well on the back of prospects that Chinese growth will be around 8% in 2009. Considering that China is one of the largest consumers of natural resources in the world, including oil, the news sent several commodities higher. The New Zealand Dollar potentially got a boost because it is known as a commodity currency; a currency which depends heavily on the export of raw materials for a large proportion of its total demand. Broadly, commodity currencies did extremely well last week. The star performer was the Australian Dollar (+0.68% vs. USD, +0.23% vs. EUR, +1.30% vs. JPY) as the Reserve Bank of Australia (RBA) held interest rates at 3.25%, going against all expectations in the market. The announcement pushed AUD sharply higher although gains were capped by dogged expectations that interest rates must fall much closer to zero for any resolution to the credit problems affecting Australia to be resolved. Interestingly, AUD was the best performing currency against CHF, falling only 0.56% which was relatively better than any other currency in the world. Later in the week Australian GDP for Q4 2008 was announced at -0.5% vs. 0.2% expected leading to AUD falls across the board. AUD fell on concerns that Australia is now in its first recession for over 20 years. AUD weakened in an immediate response to the data release but all losses were clawed back despite the weaker number as investors discounted the data for its relative insignificance. Every country in the G10 is seeing weaker GDP numbers so downside surprises have a lesser impact; especially in FX where each currency is valued relative to another and not for its inherent value. Since July 2008, the RBA has reduced interest rates by 4% to the lowest levels since the 1960's but has now paused at 3.25%. This halt in momentum surprised investors and sent a signal to the markets that not all central banks are willing to take up extremely loose monetary policies. This theme took precedence and discounted the lower growth figures.

GBP

Sterling had a poor week as severe equity weakness hurt prospects for UK economic recovery and depressed the UK currency. There has been a strong correlation between equity markets and Sterling in the past 12 months because of the large proportion of UK GDP that is derived from financial services; some estimates have that proportion as being close to 30%. The FTSE index fell by 5.33% in a single day on Monday as fear induced by banking underperformance added to



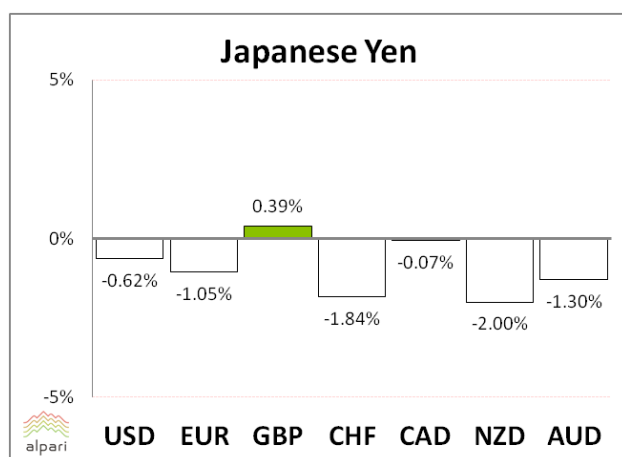
anticipation of large-scale financial sector nationalization. Net Lending to individuals in the UK was lower than expected for the month of Feb: £1.1bn vs. £1.8bn expected. This particular data release is rarely influential but in current market conditions it has an effect because of the connotations it has for the wider economy. The fall in lending pushed Sterling lower because lower interest rates are having no effect. At the end of the week Sterling stood at -1% against USD, -1.48% against EUR, -0.39%

against JPY and -2.18% against CHF. Its best performance was against the Yen; together they were the two worst performing currencies over the week.

On Thursday, the BoE cut its benchmark interest rate from 1% to 0.5% as well as announcing plans to spend £150 billion on government and corporate bonds in an attempt to provide liquidity to the credit markets. Speculation regarding quantitative easing and how UK authorities were going to handle the matter were varied. The announcement combined with an interest rate cut put a drag on Sterling sentiment and helped to erase gains made earlier in the week. GBP weakened slightly against the USD and heavily against JPY. Buying of Gilts will occur twice a week starting on 11th March. The level of demand will be a factor in showing how well received the extra measures are and consequently will act as a gauge to see how well quantitative easing will do in its attempt to capitalize banks and stimulate lending. Media commentary of Thursday's events was mixed with most finance related people agreeing with the measures with some arguing that £150bn is not enough and that more weight should have been added to buying private sector assets rather than Gilts. Media commentary can sometimes be a good indicator of sentiment, mood and confidence in the markets.

JPY

The Yen underperformed beyond most expectations as the previous week's disconnection from risk-averse demand and equity market correlations continued. A large proportion of analysts were sceptical about the Yen losing its safe-haven of choice mantle because of deteriorating economic data. Two weeks on and we are still seeing the Yen weaken due to risk-averse moves AWAY from the Yen. If the Yen plans on remaining the most trusted risk-haven, it couldn't have had a better chance to prove it because equity markets had their worst week so far this year. There were signs of downgrades in several large US firms, quasi bank nationalizations, weak economic data worldwide and falling interest rates for 3 different currencies. At the end of the week JPY managed to rise against only GBP (+0.39%). The largest falls came against NZD (-2%) and CHF (-1.84%).



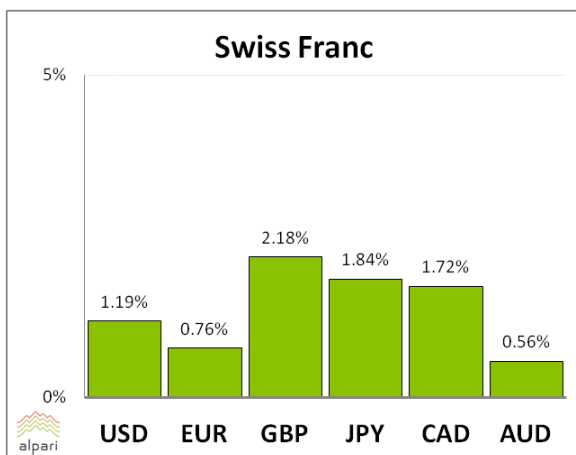
The Japanese economic calendar was very quiet but monetary base and capital spending figures both disappointed. The Japanese monetary base was much higher than expected (6.4% vs. 1.9%) which was interpreted by some investors as inflationary. If we assume that we are close to or at the end of the economic cycle, this interpretation would make sense. Capital spending figures released in the early hours of Thursday showed that Japanese

investment contracted by 17.3% in the previous quarter.

The combination of continuous, deeply pessimistic data and questioning from market participants related to the extent of the Yen's weakness and over what time frame, didn't help demand in a risk-averse environment. Japan maintains relatively good fundamentals as mentioned in previous publications but the sudden and deep deterioration in economic data has definitely frightened investors in some quarters. Developments over the next few weeks should provide good evidence as to what exactly is the sentiment behind the Yen.

CHF

The Swiss Franc was by far the star performer of the week as it gained against every currency. The main driver behind its performance was safe-haven interest as funds were diversified out of traditional safe havens such as JPY, USD and EUR into CHF. Over the past few months there has been a very interesting phenomenon of changing preference between USD, CHF, JPY and EUR under risk intolerant conditions. There seems to be a new safe currency to which everyone runs to in a crisis every week. JPY has had the most weeks at the top over the past 12 months, followed by the US Dollar which has remained resilient despite the economic troubles originating in the US. The Swiss Franc has so far been the next choice due to its political status, banking secrecy laws, strong fiscal picture and excellent gold reserves in proportion to its size. The Euro is a global reserve currency which many central banks use in heavy proportions when managing their portfolios although as a safe-haven currency it has failed to live up to its reputation. In the past few weeks we have seen a potential removal of the Yen from this group although whether this holds up in the medium-long term is yet to be confirmed. The US dollar has also deteriorated in this department; in 2008 flows into USD could be linked closely with equity market weakness and severely worrying news such as banking failures (Lehmann Brothers), bailouts and sovereign debt downgrades. In 2009 we are seeing less interest in the US Dollar around highly stressful times as market participants either change their preferences completely or prefer to buy several seemingly safe currencies.



In terms of economic data, the two most important releases were quarterly GDP (Tue) and the CPI estimate (Fri). Both were significantly above expectations which undoubtedly helped the Swiss Franc push higher. In the existing economic environment, any positive data can build momentum in the demand for a currency. If we consider this effect in conjunction with the aforementioned safe-haven influence it can be seen why the Swiss Franc performed so well.

There are dangers to getting over-confident on CHF because the value of the Swiss Franc is closely linked to the performance of the Swiss banking sector which is going through turbulent times in similar fashion to banking sectors in the UK, EU, US and Japan. The possible introduction of legislation in the US forcing Swiss banks to reveal client details to US authorities could spark an exodus of capital from Switzerland which could hurt the Franc depending on the level of fund repatriation.

Preview: 9th March – 16th March 2009



Looking ahead

- Interest rate decisions in Switzerland and New Zealand could induce volatility although commentary following each decision likely to be key
- Quantitative easing likely to remain an influential theme as more countries are drawn into the frame of conducting credit easing policies
- Safe-haven preference remains an important theme as Yen comeback remains a possibility
- Fairly busy economic calendar again likely to spring surprises and drive price action
- Central bank commentary very important once again as investors look for signs of improvement and sources of confidence

This week's economic calendar is likely to play a part in currency fluctuations as usual although the most important factor could be central bank commentary regarding plans to introduce credit easing policies akin to the US, Japan and since last week, the UK. With regards to the UK, it will be interesting to see the level of demand for Gilts at Wednesday's auction following the Bank of England's announcement of conducting quantitative easing through the buying of Gilts. Other central banks are beginning to deny considering these types of policies because of their potential inflationary impact which means that they are either delaying the announcement for maximum impact or market participants don't believe the central bankers. Either way this theme is likely to play a key part even if it's only speculation that acts as the influence rather than the policy itself.

New Zealand is expected to reduce interest rates by 0.75% from 3.5% to 2.75% with further easing later in the year. Switzerland is also expected to cut; from 0.5% to 0.25%. Just to reiterate, the comments that come with the rate decision could be more influential than the rate decision itself.

Some important themes could re-surface this week such as EU exposure to possible default by Central and Eastern European countries. This has been dormant for a couple of weeks now so any developments could be important. Equity and commodity market influences may be important if they are of the same magnitude as last week. Commodity currencies are likely to extend gains made last week if crude oil prices push above \$50 per barrel and it's almost a certainty that all eyes will remain on how the Yen responds to equity market performance. Recent dislocation with the equity markets make it possible for the Yen to bounce back alongside equities if good news is taken up and risk-appetite comes back into the market. At the time of writing this report, current account figures from Japan (released late on Sunday 8th March) showed only a ¥26 Trillion surplus, much lower than the expected ¥40 Trillion. This underlines the damage a stronger Yen has inflicted on Japanese exports. The reaction was mixed with JPY falling against USD, EUR and CHF but rising against GBP, CAD, NZD and AUD. GBP in particular has started the week very poorly following on from previous week weakness.

In terms of the economic calendar we continue with last week's decision of publishing only the economic data releases that we feel are important to influencing current FX themes:

Monday 9th March

(CAD) Housing starts

Tuesday 10th March

(GBP) Manufacturing Production

(EUR) German & French Trade Balances

(JPY) Core Machinery Orders

Wednesday 11th March

(GBP) Trade Balance

(USD) Federal Budget Balance

(NZD) Interest rate decision

(NZD) RBNZ Press Conference

(JPY) Final GDP

Thursday 12th March

(AUD) Unemployment Rate

(USD) Core Retail Sales

(USD) Unemployment Claims

(CHF) Interest Rate Decision

(CHF) SNB Monetary Policy Assessment

(NZD) Retail Sales

Friday 13th March

(EUR) Retail Sales

(CAD) Unemployment Rate

(CAD) Trade Balance

(USD) Trade Balance

(USD) University of Michigan Consumer Sentiment

We are likely to see further downside surprises in manufacturing, unemployment and trade balances this week. It's becoming clear that countries with deteriorating trade balances are the ones suffering most from the economic malaise and not the countries in which the economic problems originated. With 5 different trade balance numbers expected we may well see further evidence of this trend.

More broadly, we are likely to witness more risk aversion and anxiety if fundamental economic data is weaker. In addition, there is a high chance of more developments in the UK banking sector that could affect GBP price action. Lloyds Banking Group was the latest company to cede more control to the UK government in exchange for capital and insurance against losses. If more banks follow this example we could see significant Sterling weakness as investors begin to worry about monetary expansion and the true amount of capital needed to stop the haemorrhaging of bank balance sheets.

Also important this week could be sovereign and corporate debt developments. Bond markets have been largely unaffected in a significant sense so far in this economic crisis. Market participants are likely to be following developments to rating agency comments/actions with respect to government debt and corporate debt. Last week we saw the possibility of General

Electric, General Motors, Citigroup, JP Morgan and Bank of America being downgraded because of insufficient capital. Such actions are likely to have a significant impact on currency markets because risk tolerance would probably fall in this scenario.



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