

FX Weekly

Review: 22nd – 28th June

Recap

- Currencies were subdued as price action was limited to tight ranges
- Equity markets continued their retreat from May highs as consolidation prevailed in several asset classes
- SNB intervene again leading to sharp CHF depreciation
- Commodity currencies were relatively unchanged as the risk theme was largely absent



Market Research

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Currency pair	At Open on <date>	At Close on <date>	Nominal Change	% Change	Volatility
EUR/USD	1.3949	1.4054	0.0105	0.75%	2.24%
GBP/USD	1.6504	1.6521	0.0017	0.10%	2.39%
USD/JPY	96.23	95.20	-1.03	-1.07%	1.77%
USD/CHF	1.0798	1.0835	0.0037	0.34%	3.64%
EUR/GBP	0.8450	0.8503	0.0053	0.63%	2.34%
EUR/CHF	1.5062	1.5228	0.0166	1.10%	2.46%
GBP/CHF	1.7818	1.7903	0.0085	0.48%	3.61%
GBP/JPY	158.81	157.23	-1.58	-0.99%	3.02%
EUR/JPY	134.24	133.81	-0.43	-0.32%	2.65%
CHF/JPY	89.06	87.81	-1.25	-1.40%	3.35%
AUD/USD	0.8048	0.8073	0.0025	0.31%	3.69%
NZD/USD	0.6423	0.6451	0.0028	0.44%	3.63%
USD/CAD	1.1347	1.1524	0.0177	1.56%	2.67%

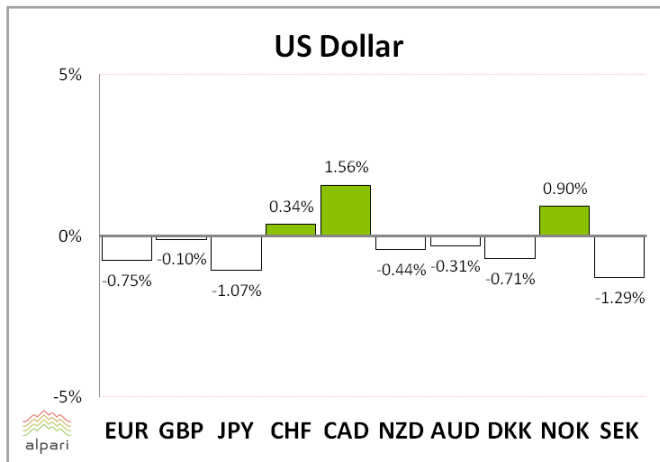
| Source: Alpari (UK)

Equity markets continued their moves lower from recent highs last week as recovery expectations suffered again. Short-term support levels were broken in several markets with risk appetite continuing to fall. The sharp risk-rally from March in multiple asset classes is seemingly running out of track as investors ramp up their scepticism of improving economic conditions. The Fed's monetary policy meeting drew most attention as higher interest rate expectations, quantitative easing and the outlook for future growth were the main issues thus news of the US recession easing added stability to equities and the US Dollar. Oil prices pushed confidently through the \$70 support level while Gold prices fell sharply only to recover later in the week – neither managed to breakout of short-term ranges.

USD

A mixed week for the Dollar once again as contrarian data releases swayed sentiment not only regarding USD pairs but also the economic recovery overall. Slightly below par housing market data, both for existing housing stock (4.77m vs. 4.82m exp.) and new home sales (342k vs. 360k exp.) was counterbalanced by upbeat durable goods orders (1.1% vs. -0.2% exp.) and an upward revision to quarterly GDP figures (-5.5% vs. 5.7% exp.). The ambiguity surrounding USD fundamentals led to range trading in all USD pairs for the majority of the week as market

participants focused solely on the Fed's interest rate decision and the accompanying statement for direction. By market close, most USD pairs were at the same levels as at market open five days earlier – the largest gain was against CAD (+1.56%) and the largest loss was against SEK (-1.29%). Currencies continued responding to country specific events rather than broad inclinations towards risk.



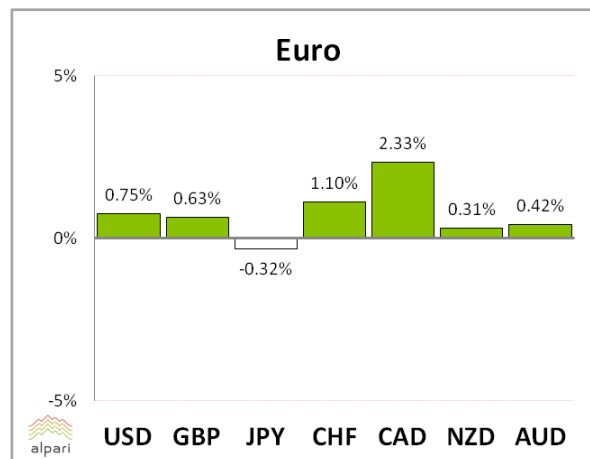
The Fed's last meeting before August was broadly USD supportive despite no surprises in the content of the statement (rate decision: unchanged as expected). The Fed signalling sooner rather than later rate hikes and/or outlining plans for the unwinding of quantitative easing measures were the factors likely to affect USD value so the lack of developments on these two fronts helped USD to stay stable and refrain from testing either the up or downsides.

Other significant developments included the \$104m Treasury auctions that took place over the course of the week. Investors were anticipating the uptake to gauge the level of confidence in the US debt market; yields were also a key element as recent concerns over rising long-term rates focused attention on whether particular dated Treasuries would breach key resistance levels i.e. 4% in 10yr, 3% in 5yr and 1.45% in 2yr. The outcome was positive for confidence and USD supportive without actually seeing extended USD moves higher. The psychological aspect was of most importance as strong demand for US debt diminished the chances of a sharp reduction in exposure to US assets by market participants around the world. Long-term yields also fell, easing pressure on mortgage rates and recovery optimists.

Indications of an easing recession came from Fed commentary and better than expected (less bad than feared) GDP figures. A final revision showed that the US economy would not contract by as much as first thought leading to broad USD gains although a more important aspect of this news was the continuation in the re-alignment of USD price action with US data. Over the course of the financial crisis, USD pairs have mostly traded in response to changing sentiment to risk i.e. better than expected US data led to falls in USD pairs on the back of improving risk tolerance. As economic conditions have begun to improve, a more intuitive reaction to US data is slowly returning - the relatively upbeat GDP figures led to USD appreciation.

EUR

In Europe, focus was on sentiment indicators and the largest ECB liquidity operation in its history. PMI readings showed moderation in the rate of recovery in Europe; this didn't translate into EUR weakness as some had expected mainly because the data set was not significantly disconnected from expectations to dissuade Euro bulls. In fact, the EUR had its strongest up move following the release because the ongoing recovery story continues to hold. Regardless of the interpretation, the European manufacturing/services sectors are both in perceived contraction since May 2008.



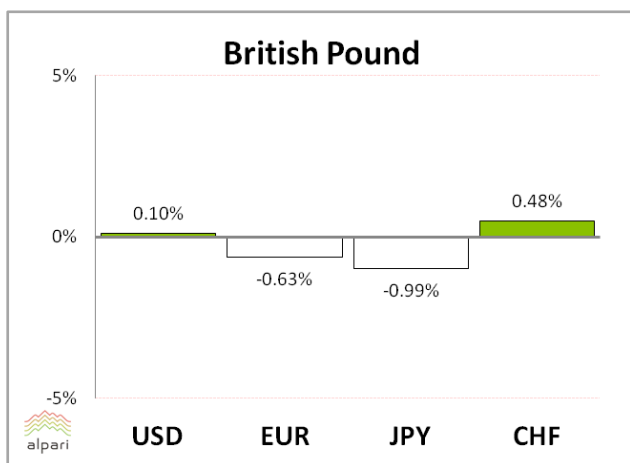


Purchasing Managers Index readings in Europe			
Flash PMI readings	Previous	Expected	Actual
French Manufacturing	43.3	44.8	45.5
French Services	48.3	48.8	47.5
German Manufacturing	39.6	41.1	40.5
German Services	45.2	46.0	44.3
EU Manufacturing	40.7	42.4	42.4
EU Services	44.8	45.8	44.5

>50 indicates industry expansion; <50 indicates industry contraction
Source: Markit

The ECB's expansion of liquidity amounted to €442bn, offered to 1,121 European banks, for one year, at a rate of 1%. This was the largest liquidity provision in European history leading to speculative EUR selling prior to the event. After the event, concerns of "back-door QE" were dispelled because the comparative risk in withdrawing liquidity in the future is higher for the US, UK, Switzerland and Japan considering their much heftier easing measures. This theme has the potential to be EUR negative if the liquidity injection stokes inflationary pressures however.

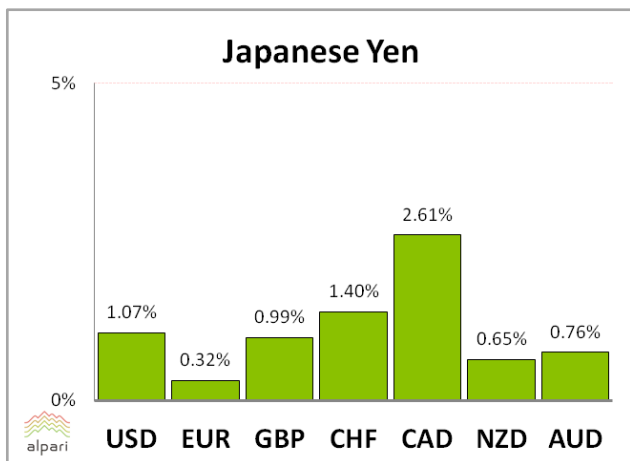
GBP



Sterling had an uncharacteristically slow week; tight ranges in all pairs, low volatility and no macroeconomic developments that influenced opinion. The only data which helped Sterling was a modest rise in mortgage approvals (31.2k vs. 29.5k exp.) which was never likely to affect sentiment significantly, even in a green-shoot environment. By the end of the week, GBP was more or less back where it started - the largest loss came against JPY (-0.99%). From a broader perspective, Sterling continues to range trade in multiple pairs; 160.00 – 155.00 (GBP/JPY), 1.7450 – 1.80 (GBP/CHF), 0.8580 – 0.8450 and 1.62 – 1.66 (GBP/USD).

JPY

The Yen strengthened across the board last week as Japanese recovery hopes were boosted by BoJ commentary. Also, Japan's business confidence survey was a positive factor for JPY as businesses reported



better demand for services and rising stockpiles. A widening trade balance for the first time since August 2008 improved the chances of recovery in view of Japan's heavy reliance on trade (exports) for economic growth. Although exports are still falling, imports are falling faster which is having a net positive effect on Japan's trade balance. Despite an upbeat week for the Yen, major worries remained about Japan's exporting potential in the medium term because exports demand has been largely attributed to approximately \$2.5 Trillion of stimulus

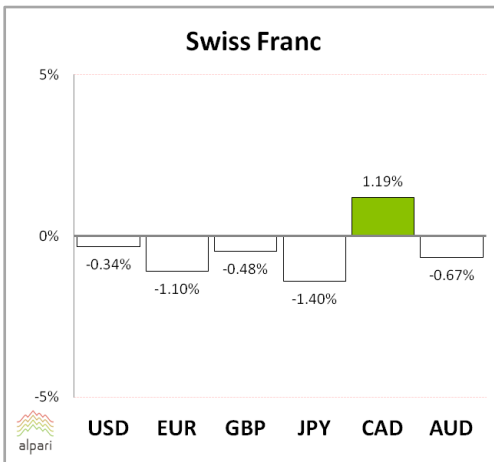
measures worldwide, including \$585m in China, one of Japan's largest export markets. The risk is that export levels will resume their rapid falls as stimulus measures diminish in addition to the currently high

savings propensity by most consumers which makes it less likely that aggregate demand can be sustained as consumers prefer to save for the future rather than spend for today.



CHF

In the absence of any significant new developments relating to the Swiss economy, the SNB grabbed all the headlines after intervening in several CHF pairs on Wednesday. The timing of their open market operations



was obviously picked with care; as most market participants were anticipating a crucial statement from the Fed regarding US monetary policy, the SNB used this as an opportunity to buy into USD and EUR. EUR/CHF and USD/CHF both rose 2-3% in the space of a few hours before retracing some of the gains over the rest of the week. Our view that the 1.50 level in EUR/CHF would act as good support seeing as its likely to be the SNB's point of reference for intervention was proved right.

At market close the Swissie was lower against everything apart from CAD (+1.19%), falling most sharply against JPY (-1.40%) and EUR (-1.10%). The rise in CAD/CHF is probably due to widespread weakness in CAD following developing concerns that the Canadian housing market will follow the path of the US housing market into turmoil and depreciation.

USD/INR

A ranging week with multiple changes to sentiment ensured the pair stayed volatile but flat over the week. The upside could not be extended beyond Rs48.94 and downside was limited to Rs47.78. Most of the volatility was caused by US events because of the heavy news flow, not to mention speculative trade surrounding the Fed's statement on Wednesday.

Preview: 29th June – 5th July



Looking ahead

- Interest rate decisions from ECB and Riksbank scheduled
- Q2 earnings season begins on Tuesday; bulk of announcements to come in mid-late July
- Very eventful economic calendar likely to encourage speculation and volatility in all FX pairs

Looking at this week, the economic calendar is heavy with EU and US events. Focus is likely to be on the usually influential US employment report, due for release on Thursday; although ISM figures, retail sales and an ECB interest rate decision could steal the show as investors scour the markets for fresh information clarifying the rate of economic recovery. Price action could be very erratic considering the close proximity of the week's two major events in addition to public holidays in North America on Friday. Overall, risk tolerance, inflation and status of economic recovery are likely to stay in play as prevailing themes for all asset classes.

A heavy economic calendar has the potential to disturb recently found ranges if there is some kind of clarification regarding the validity of the economic recovery. Otherwise, we can expect to see muted price action as market participants refrain from taking exposure amidst continued uncertainty. Two clear opinions have developed; one suggests that the economic crisis is almost over, supported by improving sentiment, banking sector stability and slowdown in the rate of macroeconomic deterioration. The other viewpoint is that the economic crisis has merely taken a pause due to huge stimulus packages having a supportive effect. The fact that unemployment continues to rise alongside falling house prices may also suggest further weakness to come as consumers struggle to maintain spending. Essentially, the optimists are facing the pessimists so depending on which view prevails will decide the medium-long term outlook for most currency pairs.

Two interest rate decisions are due this week, from the ECB and Riksbank. Both are almost certain to hold interest rates at 1% and 0.5% respectively although the accompanying statements could stimulate market activity. The ECB is expected to make some reference towards their covered bond purchase programme and their liquidity operations; any unexpected expansion in their policy framework could be EUR negative because of the perceived inflation risk further down the line. For the Riksbank, the overhanging issue of exposure to the Latvian economy is continuing to weigh on SEK. Any news that dissuades investors from worrying about the knock-on effect of a Latvian devaluation is likely to prove positive for SEK although just how much faith investors have in promises of limited exposure remains to be seen. At the start of the crisis, banks were adamant that losses would be minimal leaving core businesses unaffected – famous last words which has made investors all the more careful now that investment opportunities creep back into view.

As inflation expectations carry more and more importance in the eyes of investors, this week's initial estimate of Euro zone inflation has the potential to surprise and move EUR pairs significantly. A lower than expected reading could prove EUR positive unless it is exceptionally low at which point deflation fears are likely to be priced in. A level in line with expectations (-0.2%) should be good for the Euro although a significantly higher reading would also be EUR negative as higher inflation expectations reduced EUR demand.

FX Sensitive Calendar Events

<p><u>Monday 29th June</u> (JPY) Preliminary Industrial Production (JPY) Retail Sales (GBP) Net Lending to Individuals (GBP) Mortgage Approvals</p>	
<p><u>Tuesday 30th June</u> (JPY) Manufacturing PMI (JPY) Household Spending (JPY) Unemployment Rate (NZD) Business Confidence Survey (GBP) Nationwide HPI (GBP) Current Account (GBP) Final GDP (EUR) CPI Flash Estimate (CAD) GDP (USD) S&P Case Shiller Home Prices Index (USD) Consumer Confidence</p>	<p><u>Wednesday 1st July</u> (JPY) Tankan Non & Manufacturing Index (AUD) Retail Sales (GBP) Halifax HPI (GBP) Manufacturing PMI (USD) ADP Employment Report (USD) ISM Manufacturing PMI (USD) Pending Home Sales</p>
<p><u>Thursday 2nd July</u> (JPY) Monetary Base (AUD) Trade Balance (GBP) BoE Credit Conditions Survey (EUR) Unemployment Rate (EUR) Interest Rate Decision + Statement (SEK) Interest Rate Decision + Statement (USD) Non-farm Employment Report</p>	<p><u>Friday 3rd July</u> (GBP) Services PMI (EUR) Retail Sales</p>

Q2 Earnings Calendar (US)

30 June 2009	Sealy Corp
07 July 2009	Pepsi Bottling Group Inc
08 July 2009	Family Dollar Stores Inc Alcoa Inc
09 July 2009	3Com Corp
13 July 2009	CSX Corp Goldman Sachs
14 July 2009	Altera Corp Intel Corp Yum! Brands Inc Johnson & Johnson
15 July 2009	Abbott Laboratories Crown Holdings Inc Eaton Corp
16 July 2009	Harley-Davidson Inc JPMorgan Chase & Co International Business Machines (IBM) PPG Industries Inc Google Inc Wells Fargo & Co Charles Schwab Alliance Data Systems
17 July 2009	Mattel Inc Citigroup Baxter International General Electric Merrill Lynch & Co Inc Advanced Micro Devices (AMD) Fairchild Semiconductor International BlackRock Bank of New York Mellon Johnson Controls Morgan Stanley Bank of America
20 July 2009	Texas Instruments Halliburton Lexmark International

Financial services companies marked in red

Source: Bloomberg, J.P Morgan

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