

# FX Weekly

## Review: 26<sup>th</sup> – 31<sup>st</sup> July

### Recap

- Several risk dominated pairs (GBP/USD, AUD/USD, EUR/NZD) broke out of consolidation ranges as risk picture turned more positive; validating the sharp recovery story
- Macro-data risks remain and threaten to deflate confidence. Economic recovery story continues to look fragile and susceptible to a turnaround
- The breaks above May highs in equities seemed to falter although strong support was found late in the week
- Good Q2 earnings continued to encourage demand for cyclical currencies, at the expense of the majors



### Market Research

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Currency pair	At Open on 26 <sup>th</sup> July	At Close on 31 <sup>st</sup> July	Nominal Change	% Change	Volatility
EUR/USD	1.4229	1.4256	0.0027	0.19%	2.09%
GBP/USD	1.6447	1.6710	0.0263	1.60%	2.40%
USD/JPY	94.72	94.66	-0.06	-0.06%	1.97%
USD/CHF	1.0697	1.0683	-0.0014	-0.13%	2.63%
EUR/GBP	0.8649	0.8527	-0.0122	-1.41%	2.10%
EUR/CHF	1.5224	1.5230	0.0006	0.04%	0.89%
GBP/CHF	1.7594	1.7852	0.0258	1.47%	2.73%
GBP/JPY	155.77	158.18	2.41	1.55%	3.03%
EUR/JPY	134.81	134.96	0.15	0.11%	2.45%
CHF/JPY	88.48	88.56	0.08	0.09%	2.57%
AUD/USD	0.8181	0.8356	0.0175	2.14%	2.95%
NZD/USD	0.6566	0.6612	0.0046	0.70%	2.41%
USD/CAD	1.0854	1.0775	-0.0079	-0.73%	1.70%

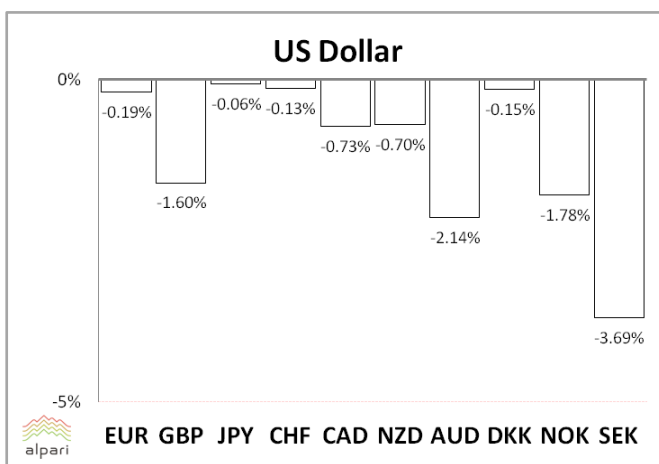
| Source: Alpari (UK)

Range trading in equities, FX (more so in cyclical pairs) and commodities has prevailed over the past few months so the question on everyone's lips was when breaks would begin to occur and to what extent. Last week there were breaks higher for cyclical currencies against defensives like the USD, JPY and CHF. The Euro also fell but to a lesser extent. Commodity currencies such as the AUD, NZD, CAD plus Scandies (SEK, DKK and NOK) all outperformed last week, bathing in the risk tolerant environment made possible by continuingly good earnings results and strong demand for commodities. Expectations of a slow recovery at worst and a trampoline recovery at best seem to be cementing as shocking downside surprises become more and more rare. There is still scope for a sharp re-evaluation of how valid the bounce in all risk assets from March lows has actually been but in the meantime, investors are content with buying into the recovery story despite a lack of support from macroeconomic factors.

The worst performing currencies last week were the majors - USD, JPY, CHF and EUR, in that order which suggests further moves away from liquid cash that was sidelined in response to the financial crisis. The risk aspect of FX was again dominant last week, like most weeks over the past year because of the high uncertainty in financial markets leaving market participants no choice but to primarily concentrate on risk following the staggering developments over the past 2 years. Now that investment opportunities become more attractive and less hazardous to engage in, sidelined capital is being redeployed with more conviction because the fear of substantial loss has ebbed away.

## USD

- Depreciated in all pairs as risk tolerance persisted – supported by positive developments in stocks
- Largest falls were against SEK (-3.69%), AUD (-2.14%) and NOK (-1.78%). Stronger



macroeconomic indicators weighed on the Dollar because the boosts in confidence attained from seeing improving conditions, inclined investors to diversify Dollar holdings into riskier, higher yielding currencies.

### Key Data:

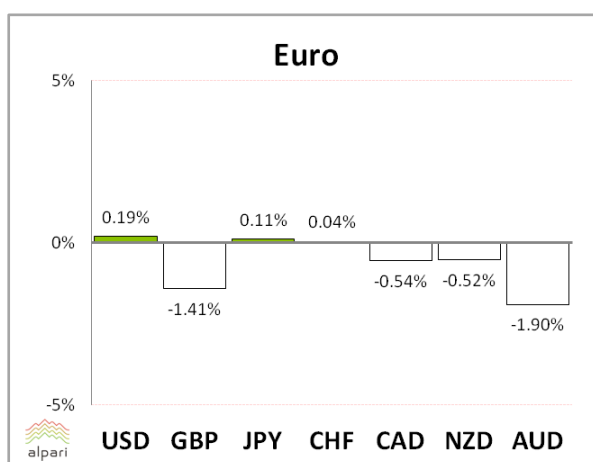
New Homes Sales (384,000 vs. 353,000 exp.)

Core Durable Goods orders (1.1% vs. 0.1% exp.)

Advance GDP (-1% vs. -1.4% exp.)

## EUR

- Lower in most pairs but slightly higher against the other majors as risk-neutral stance supported the Euro against USD (+0.19%), JPY (+0.11%) and CHF (+0.04%).
- Macroeconomic data was quite mixed; inflation is falling quicker than expected but



unemployment is stabilising which prevented a rout of the Euro. Doubts continue to cloud over the Euro zone as European banks are due to report Q2 results this week. Market participants will look for a comparable performance to US banks if confidence in banking globally is to continue its recovery.

### Key Data:

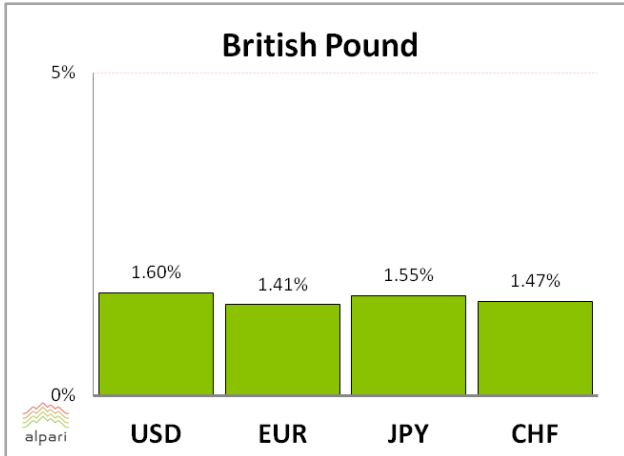
German Preliminary CPI (-0.1% vs. 0.2% exp.)

CPI Flash Estimate (-0.6% vs. -0.4% exp.)

Unemployment (9.4% vs. 9.7% exp.)

**GBP**

- Positive news regarding growth in house prices pushed GBP higher in all pairs. Interestingly, the correlation between Sterling and UK house prices is getting stronger, and now stands at 0.95 (Source: JP Morgan). In GBP/USD Sterling was able to test the 1.6743 level – the high of the range in which GBP/USD has traded since late May 2009. At the time of writing this level has



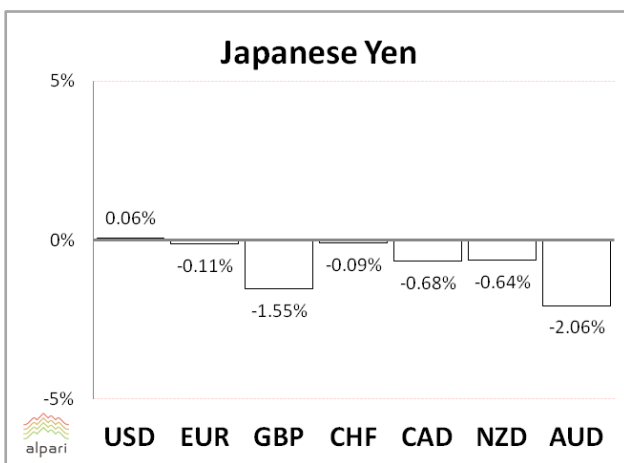
been broken early on August 3<sup>rd</sup> as market participants anticipate strong earnings from UK banks this coming week. Disappointing results or even mixed results could cap Sterling gains because so much positive sentiment and expectation has been priced in already. Barclays and HSBC reported excellent results, exceeding expectations – their shares prices rose 5-10% on the day, dragging stocks and GBP higher.

**Key data:**

Net Lending to Individuals (£0.4bn vs. £1.0bn exp.)  
 Nationwide HPI (1.3% vs. 0.3% exp.)

**JPY**

- A good week for equities and a bad week for the Yen as a lack of risk-aversion meant capital flows went into cyclical, riskier and high-yielding currencies such as AUD which almost reached 79.51, only the second time AUD/JPY has traded at this level since October 2008. More



deflationary signs as well as higher unemployment weighed on the Yen. The Japanese economy continues to stagnate and is unable to generate economic growth despite record low interest rates and government stimulus measures being enacted. The Yen’s status as a safe-haven is beginning to be questioned at least in the medium-long term as downbeat figures overshadow sentiment indicators and central bank commentary suggesting a stabilisation and an imminent improvement of economic conditions.

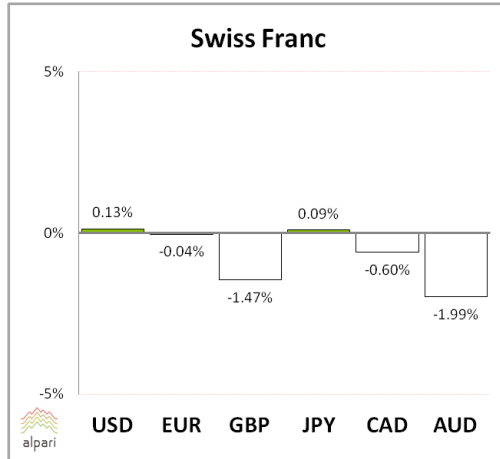
**Key data:**

Retail Sales (-3.0% vs. -2.5% exp.)  
 Manufacturing PMI (50.4 vs. 48.2 exp.)  
 National Core CPI (-1.7% vs. -1.6% exp.)  
 Unemployment Rate (5.4% vs. 5.3% exp.)

## CHF

- Broadly positive macro data helped the Swissie to hold off the risk-rally momentum. As was the pattern in other pairs, CHF (a broadly risk-negative currency) sold off against its cyclical counterparts such as GBP (-1.47%), CAD (-0.60%) and AUD (-1.99%) but held steady against USD, EUR and JPY.

- No central bank intervention was required as the 1.50 level in EUR/CHF remained safely in the distance. The 1.06 level in USD/CHF was tested because of reported SNB intervention around this level earlier in July. Judging by the price action, market participants themselves bought USD against CHF at around 1.06 expecting the SNB to intervene in the worst case scenario of this level being breached. At close on Friday, 1.06 was held although on Monday, early in the afternoon trading session in London, 1.06 was broken.



## Key Data:

UBS Consumption Indicator (0.96 vs. 0.75 prev.)

KOF Economic Barometer (-0.99 vs. -1.48 exp.)

# Preview: 3<sup>rd</sup> – 9<sup>th</sup> August



## Looking ahead

- Three interest rate decisions; UK, EU and Australia. Several themes will be looked at including QE expansion and commentary regarding timing of first rate hikes. All are expected to keep rates unchanged
- ADP and Non-farm payrolls data are again likely to create volatility as investors hope for improvement in the labour sector as a symbol of actual recovery
- Several European and UK banks report Q2 results; focus will be on how these results compare with US banks that reported in the past 4 weeks
- GBP could be affected by Halifax house price data following an unexpectedly strong estimate from Nationwide last week; very upbeat sentiment is being priced into Sterling despite a weak macroeconomic situation in the UK

A weighty economic calendar this week could be the catalyst for extended moves as a consolidation phase with tight ranges looks to be coming to an end. Strong risk appetite last week ensured at least some pairs broke away from their grinds sideways since May so good earnings results may help confidence, sentiment and in turn risk-positive currencies continue their moves higher.

Most attention will probably be on the US this week as employment, inflation, ISM and housing data are all expected. Confidence seems to have been reinvigorated after several months of insecurity and questioning so now investors are likely to expect a continuation in this trend. A significant downside surprise now would create anxiety that a stable and sustained recovery will not be stable but rather sporadic and volatile.

Three interest rate decisions (UK, EU and Australia) are all likely to keep rates unchanged considering the relatively upbeat improvement in economic conditions over recent months and because rates in the UK and EU cannot go much lower. RBoA carries the largest risk of a rate cut although judging by fairly stable economic indicators, market participants could read the move as a signal of an end to rate cuts. The BoE press conference following the interest rate decision will be focused on because the issue of the remaining £25bn is likely to be resolved. In the minutes from their July meeting, BoE officials made clear that a decision would be made at the August meeting which means either a confirmation of the £25bn being utilised or not – either decision is likely to affect GBP pairs.

### FX Sensitive Calendar Events

<b><u>Monday 3<sup>rd</sup> August</u></b> (EUR) Final Manufacturing PMI (GBP) Manufacturing PMI (USD) ISM Manufacturing PMI	<b><u>Tuesday 4<sup>th</sup> August</u></b> (AUD) Retail Sales (AUD) Interest Rate Decision + Statement (CHF) Consumer Price Index (GBP) Halifax HPI (USD) Core PCE Price Index (USD) Pending Home Sales
<b><u>Wednesday 5<sup>th</sup> August</u></b> (AUD) Trade Balance (EUR) Retail Sales (USD) ADP Non-Farm Employment Report (GBP) Manufacturing Production (USD) ISM Non-Manufacturing PMI (NZD) Unemployment Rate	<b><u>Thursday 7<sup>th</sup> August</u></b> (AUD) Unemployment Rate (GBP) Interest Rate Decision + Statement (EUR) Interest Rate Decision + Statement
<b><u>Friday 8<sup>th</sup> August</u></b> (CHF) Unemployment Rate (CAD) Unemployment Rate (USD) Non-Farm Employment Report (USD) Unemployment Rate	

### Q2 Earnings Calendar

03-Aug-09	Barclays Bank HSBC Principal Financial
04-Aug-09	UniCredito BNP Paribas Standard Chartered
05-Aug-09	Societe Generale Lloyds TSB
06-Aug-09	Commerzbank MF Global American International Group (AIG)
07-Aug-09	Royal Bank of Scotland

Source: JP Morgan

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