

FX Weekly

Review: 7th – 13th September 2009

Recap

- Equity markets were in the driving seat as fresh buying interest sustained the ongoing risk-rally
- Gold prices breached \$1000 for the first time since February; Dollar weakness aided moves higher in base metals and commodities
- Despite the goodwill sentiment across several asset classes, bond yields remain lower and suppressed
- USD and JPY diverge from risk-driven themes; USD was the weakest while JPY was the strongest



Market Research

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Currency pair	At Open on Sept 7 th	At Close on Sept 11 th	Nominal Change	% Change	Volatility
EUR/USD	1.4305	1.4569	0.0264	1.85%	2.32%
GBP/USD	1.6391	1.6655	0.0264	1.61%	2.56%
USD/JPY	92.96	90.70	-2.26	-2.43%	3.32%
USD/CHF	1.0604	1.0382	-0.0222	-2.09%	2.54%
EUR/GBP	0.8724	0.8745	0.0021	0.24%	1.26%
EUR/CHF	1.5173	1.5129	-0.0044	-0.29%	0.53%
GBP/CHF	1.7385	1.7293	-0.0092	-0.53%	1.36%
GBP/JPY	152.40	151.06	-1.34	-0.88%	1.81%
EUR/JPY	133.02	132.15	-0.87	-0.65%	2.14%
CHF/JPY	87.63	87.31	-0.32	-0.37%	1.97%
AUD/USD	0.8514	0.8631	0.0117	1.37%	1.94%
NZD/USD	0.6884	0.7070	0.0186	2.70%	3.07%
USD/CAD	1.0858	1.0764	-0.0094	-0.87%	1.91%

| Source: Alpari (UK)

Financial markets resumed their unassailable trawl higher with the M&A market making headlines for the first time in months. Most major indices made new highs and commodities were bid; Gold prices tested \$1000 while the Dollar was heavily sold across the board. Fresh appetite for risk ensured sidelined US Dollars were reallocated which helped equities and cyclical currencies to advance further. The recovery continues to look robust in the eyes of investors even though limited macro data was made available. Multiple interest rate decisions came in as expected with no drastic shifts in stance or policy.

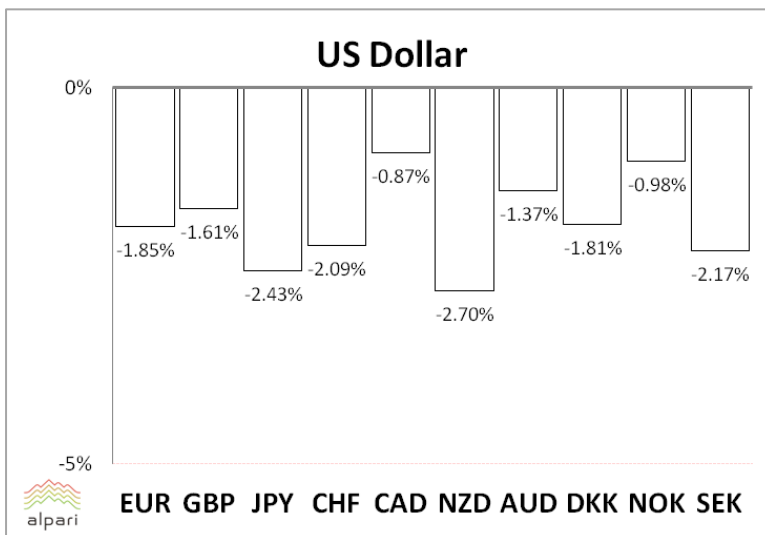
This coming week we are focusing on inflation estimates and retail sales figures from the US and the UK. Both announcements will affect the ongoing rumour mill regarding monetary policy at the Fed and Bank of England. Furthermore, UK policymakers will testify before the Parliament's Treasury Committee on Tuesday which is likely to be eventful given the sharp divergence of opinions amongst them. More broadly,

continuing uncertainty regarding which countries will recover first and thus raise interest rates first is likely to remain a key theme for most asset classes.



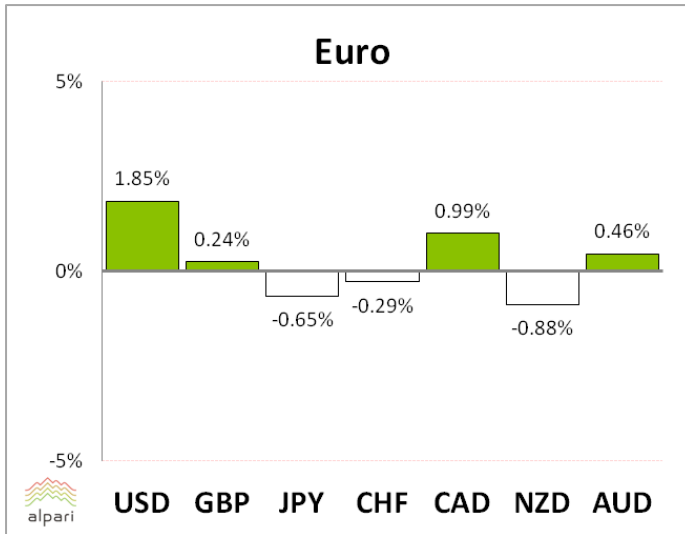
USD

Last week's US Dollar performance can be seen best through the Dollar Index. The index measures the Dollar's performance against a basket of currencies so it is good measure of broad performance. It is trading at Q3 2008 levels at which point Lehman was making all the headlines and creating all the shocks. The Dollar has been weakening as sidelined USD capital is being re-deployed following a financial crisis that shook the financial world and induced huge safe-haven flows into USD over the course of 2008 and 2009. Although some estimates were suggesting that safe-haven Dollar reserves had run their course, in hindsight we may be seeing a dual effect of Dollar out flows into more riskier currencies *in addition to* a perceived threat of future Dollar 'disconfidence' in response to hyper-loose Fed policy. In our opinion, the second part of that theory seems irrational because the majority of anti-USD sentiment was most prominent over 2 months ago around July as several central banks were voicing concerns about Dollar value and Dollar over-reliance. Nevertheless, the issue of Dollar remaining as the prime reserve currency is likely to run and run for years to come so attaching explanations to intra-weekly moves may not be so useful.



As a result of the extended Dollar weakness, Gold prices (as well as Silver and other commodities) were elevated – managing to test, and break, the \$1000 per troy ounce barrier for the first time since February 2009. The move was likely to have been speculation driven and closely linked to USD weakness because risk-aversion remained low throughout the week.

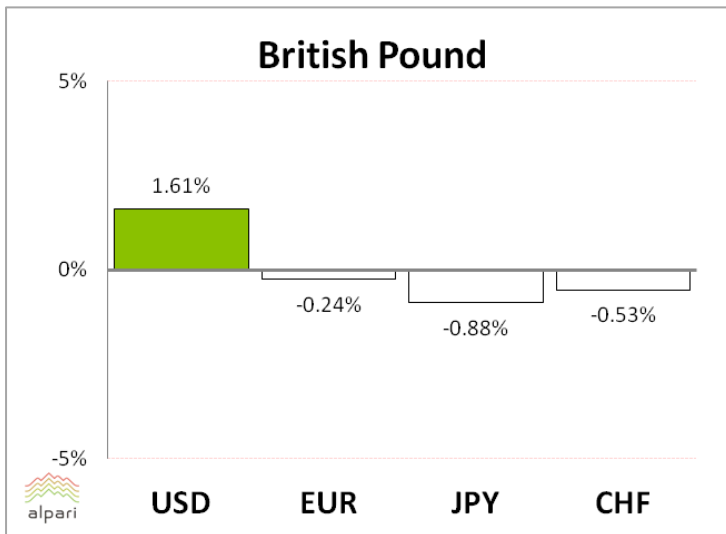
By market close on Friday, the Dollar was weakest against NZD (-2.7%) and JPY (-2.43%). If we look at the distribution of the losses made, the Dollar was down pretty evenly across the board. Over the past few months the Dollar has been much weaker against the typically higher yielding cyclical (AUD, NZD, CAD, NOK, SEK) currencies and less weak against other majors (CHF, JPY, GBP). Now with sentiments in the Dollar flattening, we can see a more even distribution of losses. The Fed will be blamed in the short-term but as the road to recovery becomes less bumpy, we could see the anti-Dollar sentiment recover quite strongly; more so against the more volatile commodity and Scandinavian currencies.

EUR

A very mixed picture in EUR pairs last week. Substantial or convincing macro data was lacking which created choppy trade with no clear direction. Standout performance was against the Dollar (+1.85%) as US fundamentals (or the perception of) took a turn for the worse. On the Euro side, EUR bulls only had Factory Orders from Germany (3.5% vs. 2%) to get their horns into which proved to be a short-lived and transitory price driver.

**GBP**

Despite several positive factors in the UK - which ensured the FTSE index breached 5,000 and come close to October 08 highs (5,052) – Sterling was unwilling to follow to the same degree. The largest gain was against USD (+1.61%) while the largest loss against JPY (-0.88%).



Very strong manufacturing figures (0.9% vs. 0.3% exp.) were a very positive surprise but the upside moves in GBP pairs could not be sustained. All week long market participants were keenly anticipating the BoE interest rate decision because of recent confusion and speculation regarding asset purchases. A divergence of opinion is in full-swing among BoE members as to where QE will be laid to rest. Some are advocating an

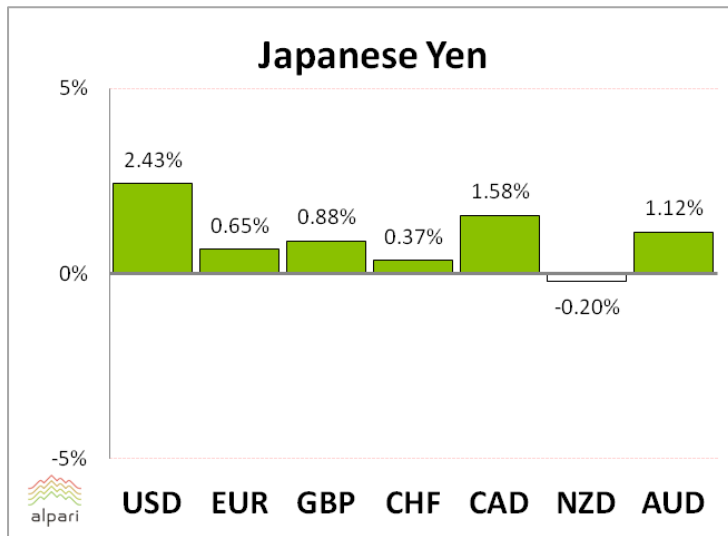
expansion up to £200bn while others to keep the current £175bn. Expectations of yet more stimulus measures are now working higher because of Governor King's preference to increase asset purchases.

UK rates were left unchanged at 0.5% and QE left at £175bn. GBP rose as speculative shorts ran for the exits. Due to persistent surprises by the BoE over the past 12 months, a significant amount of market participants looked to stay short over the figure. The 'as you were' nature of the announcement had a positive effect on Sterling in all pairs. Against USD, Sterling rose up to 1.6635 - the top end of the range from May 09. GBP/USD has found it difficult to sustain breaks beyond the 1.60 - 1.66 range which has been holding the pair in a sideways pattern for almost 6 months.

Also, judging by the timing of BoE asset purchase announcements and news, a case could be made that the BoE is looking at adjusting QE every quarter rather than every month. By that rationale, November's inflation report could be the next instance where QE is increased (more likely) or decreased.

JPY

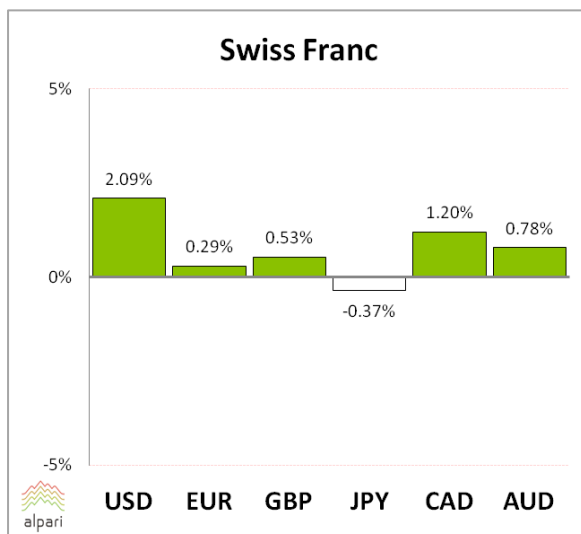
The Yen was the strongest currency in the G10 while the US dollar was the weakest. This is quite different from the usual pattern of Yen and Dollar moving in the same direction, backed by common risk preferences. Last week, The Yen and the Dollar diverged massively suggesting that regardless of whether risk preferences were a factor, there was definitely severe anti-USD sentiment.



Also, despite another bout of 180 degree turns in the form of Core Machinery Orders plummeting 9.3% and Q/Q GDP at 0.6% thus confirming a stagnant recovery, the Yen was able to carve out small gains and hold onto them last week. Japanese macro-data has proven to be very non-linear and has been unable to find any consistency. Investors have picked this up with relative optimism because at the height of the financial crisis, macro indicators

were going sharply in one direction – down. Now that a semblance of recovery has been established, however small, market participants are interpreting this volatility as uncertainty which is understandable in the current environment.

CHF



A completely empty calendar for the Franc meant Swiss-side fundamentals could not play a role in last week's CHF moves. The Franc appreciated against every currency aside from JPY but this was not due to risk-sentiment. Equities and commodities were bid over the course of the week while the Swiss equity index (SMI) rose back up to a recent high of 6,262.

Others

Disappointing consumer data from Australia surprised speculators and induced a knee jerk reaction in AUD pairs - home loans (-2.0% vs. -1.5% exp.) and retail sales (-1.0% vs. 0.6% exp.) showed a decline in August - contrary to recovery expectations and growing consensus that economic conditions are improving. Recent speculation has focused on the RBoA raising rates sooner rather than later. Last week's macro data questions this consensus and has made a shift towards a tightening bias less likely. AUD was heavily sold across the board because just when AUD buyers were celebrating joining the recovery train early and hoping to take advantage of being long before the tightening phase, show-stopping news brought the party to a halt and clogged up the exits. The saying 'Buy the rumour, sell the fact' could not have a better case study.



Preview: 14th – 20th September 2009



Looking ahead

- Rate decisions (SNB & BoJ) are very unlikely to surprise in any way; SNB statement could hint at diminishing importance of FX intervention – expect fireworks in EUR/CHF and USD/CHF if this occurs
- Several retail sales numbers (Swiss, UK, US) will help update the state of the recovery from a consumer point of view – CPI figures (EZ, US, CAD) could also surprise
- Long-term appetite for US assets and therefore the Dollar will be updated following last week's landslide as TIC data is published

This coming week we are focusing on inflation estimates and retail sales figures from the US and the UK. Both announcements will affect the ongoing rumour mill regarding monetary policy at the Fed and Bank of England. Furthermore, UK policymakers will testify before the Parliament's Treasury Committee on Tuesday which is likely to be eventful given the sharp divergence of opinions amongst them. More broadly, continuing uncertainty regarding which countries will recover first and thus raise interest rates first is likely to remain a key theme for most asset classes.

Another focus will be US Dollar weakness. The rate of Dollar depreciation has been increasing since the start of September; the Dollar Index printed new lows every day last week. Protracted moves tend to attract attention and Dollar moves are already in the spotlight due to the financial crisis and its after-effects. We see the current Dollar weakness as being overdone because US fundamentals are slowly stabilising whereas the Dollar is increasing the rate of decline. Dollar bears often underestimate its resilience and tend to get caught up in the hype of an imminent Dollar crisis. Although demand on the consumer side has not been forthcoming so far in the recovery, this could change quite suddenly as people are tempted back into spending. A Dollar bounce could also occur if recovery outside the US appears more shallow than expected. The G20 meeting scheduled for September 24th has the potential to arrest the slide in USD if investors perceive that the US will return to positive growth in close proximity to other G20 countries. Also, a weaker Dollar is actually quite beneficial as exports rise and economic activity expands because of the comparatively lower exchange rate for importers of US goods.

More broadly, volumes should continue to rise as the end of the summer holiday period brings more market participants back into play. We expect to see at least some currency pairs breakout of their range-bound lethargy over the next few weeks and seeing as range trade has dominated the FX markets over the last few months, we could see substantial moves as market participants reposition. Usually, the longer a range lasts, the more severe the breakout because more people get caught the wrong way as everyone flees for the exit. As everyone stampedes in an attempt to limit losses and/or join the next move, this adds momentum to the price action.

FX Sensitive Calendar Events

<u>Monday 14th September</u> (CHF) PPI (EUR) Industrial Production	<u>Tuesday 15th September</u> (AUD) Monetary Policy Meeting Minutes (CHF) Industrial Production (GBP) CPI (GBP) RPI (GBP) Inflation Report Testimony (EUR) German ZEW Economic Sentiment (USD) Retail Sales (USD) PPI
<u>Wednesday 16th September</u> (CHF) Retail Sales (GBP) Claimant Count Change (GBP) Unemployment Rate (EUR) CPI (USD) CPI (USD) TIC Long-Term Purchases (USD) Industrial Production	<u>Thursday 17th September</u> (JPY) Interest Rate Decision + Statement (GBP) Retail Sales (EUR) Trade Balance (CAD) CPI (CHF) Interest Rate Decision + Statement
<u>Friday 18th September</u> (EUR) Current Account (GBP) Public Sector Net Borrowing	

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