alpari.research

Fundamental | FX

31st August 2010

FX Weekly

Preview: 31st August – 5th September 2010

Market Research

George Tchetvertakov
Head of Market Research
gtchetvertakov@alpari.co.uk

Looking ahead

- Large swathe of data across the G20 suggests volatility will spike higher this week
- Two interest rate decisions (Riksbank, ECB) – event risk is significantly higher in Sweden rather than the EMU
- US growth + additional QE will be the core themes with US employment and ISM surveys bearing huge significance given the timing and current circumstances facing the US recovery
- BoJ Yen intervention issue should remain on the sidelines despite recent JPY strength as volatility stays subdued

Currency pair	At Open on Aug 23rd	At Close on Aug 27th	% Change	Week High	Week Low	Volatility
EUR/USD	1.2704	1.2760	0.44%	1.2779	1.2588	1.50%
GBP/USD	1.5538	1.5525	-0.08%	1.5618	1.5372	1.58%
USD/JPY	85.60	85.20	-0.47%	85.66	83.59	2.42%
USD/CHF	1.0347	1.0276	-0.69%	1.0450	1.0220	2.22%
EUR/GBP	0.8177	0.8215	0.46%	0.8235	0.8141	1.15%
EUR/CHF	1.3145	1.3116	-0.22%	1.3191	1.2970	1.68%
GBP/CHF	1.6079	1.5957	-0.76%	1.6163	1.5829	2.08%
GBP/JPY	133.01	132.27	-0.56%	133.33	128.78	3.42%
EUR/JPY	108.76	108.72	-0.04%	108.88	105.42	3.18%
CHF/JPY	82.69	82.87	0.22%	83.12	80.32	3.39%
AUD/USD	0.8869	0.8986	1.32%	0.8998	0.8770	2.57%
NZD/USD	0.7052	0.7103	0.72%	0.7141	0.6947	2.75%
USD/CAD	1.0492	1.0503	0.10%	1.0667	1.0444	2.13%

| Source: Alpari (UK)

This week will be a lively one with masses of activity and sentiment data being supplemented by rapidly developing global FX themes. In recent weeks, most attention and speculative price action has surrounded US data underperformance. Mildly positive data in the first half of 2010 has turned crudely negative in Q3. This has led to reinforced QE/policy easing expectations, and given the Dollar's significant weakness against funding currencies yet more momentum. Over the course of August we've seen steep declines all major equity indices, larger risk premiums on government debt and widespread Dollar strength, against everything aside from the Yen.

Against the Yen, Dollar weakness has pushed BoJ intervention squarely into the spotlight with all time lows around 79 drawing ever closer. Yesterday, BoJ officials were merely tentative in their policy response to a stronger Yen/stagnant growth scenario currently ongoing in Japan. Consequently, the level of BoJ intervention (if any) should be a focus point for investors for the duration of the week. We see JPY intervention as an unlikely possibility for the time being because volatility in JPY pairs has been fairly subdued while the currency has risen against all its counterparts. Also, the level of capital required to make a sizeable impact on the USD/JPY rate in the medium-long terms is very large. From a historical perspective, JPY selling intervention attracts more speculative USD shorts rather than the desired effect of USD buying. Speculators also take more long JPY positions in the weeks following intervention commencing in the expectation that BoJ actions will ultimately fail.

If the Fed opts for a second bout of QE, the effects should be similar to the effects seen in March 2009 i.e. USD weakness. However, given the extent to which funding/credit rates have fallen since the Fed began its ultra-loose monetary policy two years ago, the marginal impact of added QE should be low. QE is generally positive for bonds and low-yielding currencies as risk-tolerance falls and investors re-position appropriately. If the stimulus measures have an effect and macroeconomic indicators point to a re-acceleration in US growth, this should translate into USD weakness accompanied by stronger equities, commodities and cyclical currencies. In EUR/USD, price action has been fairly stable given the amount of fundamental themes in play in 2010 – especially so since the calming of the sovereign debt crisis in May. Usually, equity market declines would weigh on EUR/USD but Germany's stellar growth figures and broadly strong data from the rest of the EU has helped the Euro to outperform the US dollar – if only on sentiment grounds while market participants assess whether the US and Europe are decoupling or simply lagging behind each other.

The ECB is scheduled to announce its latest policy decision this week. Rates will almost certainly remain at 1%. Market participants are anticipating an extension of full allotment repos until the end of 2010 primarily because of verbal hints about the ECB doing so by Axel Webber last week. If confirmed, such a measure should be EUR negative but seeing as so much QE has been done across the G20, investors may see looser ECB policy as trivial compared to the Fed, BoE and BoJ. Therefore, we think volatility will be sharply higher going into the first trading days of September but the EUR/USD rate is unlikely to break out of its 1.26 – 1.32 barrier – there is strong EUR demand below 1.25 while on the upside, European macro data strength has not given market participants enough confidence to warrant a concerted push higher.

The other interest rate decision this week comes from the Riksbank. We are expecting a 25bp hike and market expectations suggest this move is 65%-75% discounted. Also, approximately 100bp of more hikes is expected over the next 12 months – more than any other central bank in the G20. SEK should therefore stay well supported over the coming months.

Bond auctions in peripheral Europe are more or less non-existent this week but the danger lies in sentiment being hit should an auction fail or raise capital at exorbitant rates. Investors are keeping a close watch over how Europe as a continent, recovers from its huge fiscal malaise – this week, €1.6bn of Portuguese t-bills on Wednesday and €3.5bn of Spanish bonds on Thursday are due to be auctioned. A lacklustre auction in the periphery could severely dent investor confidence not only in Europe but for all risk-assets globally considering how nervous market participants are right now.

alpari.research | Fundamental | FX

alpari

FX Sensitive Calendar Events

Monday 30th August (NZD) Business Confidence (JPY) Interest Rate Decision + Statement (GBP) Bank Holiday (CAD) Current Account (USD) Personal Spending	*Tuesday 31st August* (JPY) Retail Sales (JPY) Industrial Production (AUD) Building Approvals (AUD) Retail Sales (GBP) Lending to Individuals (GBP) Mortgage Approvals (EUR) CPI (EUR) Unemployment Rate (CAD) GDP (USD) Fed Meeting Minutes
Wednesday 1st September (CNY) Manufacturing PMI (AUD) GDP (GBP) Halifax HPI (GBP) Manufacturing PMI (USD) ADP Employment Report (USD) ISM Manufacturing PMI	*Thursday 2nd September* (AUD) Trade Balance (CHF) GDP (GBP) Nationwide HPI (CHF) Retail Sales (GBP) Construction PMI (SEK) Interest Rate Decision + Statement (EUR) Interest Rate Decision + Statement (USD) Pending Home Sales (USD) Factory Orders
Friday 3rd September (CHF) CPI (GBP) Services PMI (EUR) Retail Sales (USD) Non-Farm Employment Report (USD) ISM Non-Manufacturing PMI	