

FX Weekly

Review: 6th January – 11th January 2009

Market Focus

- Very eventful week helped the USD consolidate its bright start to 2009 regardless of fresh bad news in the labour, credit and manufacturing sectors
- Sterling staged a strong fight back despite continuing concerns over long-term fundamental weakness in the broad economy
- Euro was the weakest performer last week as it tumbled against all G10 currencies which helped EUR/GBP to drift away from parity
- Very mixed week with rapidly changing attitudes to risk and a tendency for currencies to lag in their assimilation of bad news; sanguine economic figures and sentiment continue to affect all G10 countries, leaving no space for a clear cut preference currency



Market Research

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

Currency pair	Previous Week Open	Current Rate	Nominal Change	% Change
EUR/USD	1.3885	1.335	-0.0535	-3.85%
GBP/USD	1.4538	1.4944	0.0406	2.79%
USD/JPY	92.11	90.08	-2.027	-2.20%
USD/CHF	1.0811	1.1219	0.0408	3.77%
EUR/GBP	0.9545	0.8933	-0.0612	-6.41%
GBP/JPY	133.9	134.6	0.698	0.52%
EUR/JPY	127.92	120.29	-7.627	-5.96%
AUD/USD	0.7139	0.6876	-0.0264	-3.69%
NZD/USD	0.5882	0.5826	-0.0056	-0.95%
USD/CAD	1.205	1.1969	-0.0082	-0.68%
EUR/CHF	1.5017	1.4981	-0.0036	-0.24%
GBP/CHF	1.5728	1.67627	0.1035	6.58%

Correct at 09:05 GMT on 12th February 2009 | Source: Alpari (UK)

USD

The Dollar has a surprising week as it defied all expectations and fluctuated erratically against other major currencies. The USD rose strongly against the Euro (+3.85%) and the CHF (+3.77%) but fell against the GBP (-2.79%) and JPY (-2.20%). Against the commodity currencies the US dollar was largely unchanged as crude oil prices resumed their downward trend towards the end of last week after touching \$50 per barrel on Tuesday.

The headline grabbing news last week was the 524k jobs lost in the US in December 2008 and the 7.2% unemployment figure. Traders were expecting a large increase in job losses so the US dollar didn't react as badly as some had feared. The economic calendar over the week was relatively kind as the ISM Non-manufacturing PMI and unemployment claims both showed better than expected readings. The employment report was disappointing but because market participants were worried about a horrific reading of over 600k, the inline figure of 524k was actually seen as good news i.e. the relief of seeing economic data coming out in line with expectations was taken as a positive sign that the US economy will manage to overcome its economic troubles.

The inconsistent performance of the US dollar can be put into perspective through split opinions over whether the Dollar is actually worth worrying about. Although most fundamental news has been negative, news regarding other currencies has at times been worse which can often have a net effect of being Dollar positive under the current circumstances. Last week showed elements of this principle as record job losses in the US failed to dampen demand for the currency because speculation of deep interest rate cuts by the ECB and a 0.5% rate cut by the Bank of England (BoE) took attention away from the US and focused people's attention on the deteriorating economic conditions elsewhere around the globe. Some market participants have the opinion that the negative outcomes currently being seen in the US are simply a precursor to what will happen in Europe and Asia in the near future. In this scenario such a view would make the US dollar an attractive investment because other currencies have not yet been exposed to the fundamental news that the US has already priced in.

A major piece of news that could affect the US dollar for some time to come was the release of the Fed minutes from their latest meeting. The minutes showed that most Fed members were convinced that interest rates would stay low for some time especially if inflation continues to become less of a problem. The prospect of low interest rates for months if not years to come raised fears that the US dollar would function as a low-yielding risk-averse currency for the foreseeable future; this should have had a negative effect on the US dollar because low interest rates usually signify lower returns for investors which in turn leads to a lower demand for the currency. However, in current conditions, yield is taking on a drastically lower priority for investors when making investment decisions in FX. Investors are focusing on security and value preservation which the USD is managing to provide for the time being.

EUR

The EUR came back down to Earth as its gains against GBP, CHF and JPY from last December were paired back. The EUR plunged against the Yen, Sterling and US Dollar as expectations of a deep rate cuts, a controversial German fiscal plan and some poor economic data all combined to drive the EUR lower. Many market commentators have expressed surprise at the way the EUR has managed to keep its value and seemingly stand out from the crowd in terms of the quality of Europe's economic fundamentals. The performance of the single currency last week showed at least to some that the EUR is just as vulnerable to large scale fiscal plans, inflationary stimulation packages and drastic cuts to interest rates as the US and UK are, despite all the rhetoric suggesting otherwise by several ECB members and some influential European policymakers.

European inflation is falling quickly which is making investors jittery over interest rate policy in the EU. The European Central Bank is firmly focused on bringing interest rates down gradually but as with all market activity, speculation tends to affect sentiment just as strongly as solid facts do.

Speculative activity in Euro currency pairs was primarily focused on selling the Euro ahead of the ECB interest rate decision expected this week. Also, Germany had its first rise in unemployment for 3 years announced last week which brought the labour sector back into focus and reminded market participants that EU growth will be anaemic at best this year.

An interesting aspect of last week's price action was the continuation of the sharp move in EUR/GBP from a high of 0.9804 set in late December back to around the 0.90 level. It is quite intriguing how it was primarily GBP weakness rather than EUR strength that created the move higher whereas last week it was EUR weakness rather than GBP strength that pushed EUR/GBP lower. Currencies seem to be trading off negative news and discriminating which currency is relatively worse off rather than the opposite because current economic sentiment is so pessimistic that any good news is seemingly too good to be true.

GBP

Sterling had a positive week that included an expected interest rate cut from 2.0% to 1.5%. Despite the reduction Sterling market participants bought the currency because of so many fears that the reduction would be 75 or even 100 basis points. The BoE has cut rates very aggressively in the past 6 months so a moderate cut that met most expectations helped to boost Sterling sentiment and acted as a catalyst for its strength. Some investors are of the opinion that the BoE will be more hawkish from now on and be more hesitant in easing monetary policy via interest rates directly. In the UK, a lot of media coverage has focused on the inability of financial institutions to pass on interest rate cuts to their customers which in effect means that the base rate reductions by the BoE are not as effective as they could be. There is some speculation in the market that the BoE alongside the UK government will attempt to reduce the cost of borrowing by forcing financial firms to pass on previous rate reductions rather than continuing to make fresh reductions. This course of action would be GBP positive and could drive Sterling higher.

CHF

The Swiss Franc had a terrible week as it fell by almost 7% against GBP and 4% against the USD. Despite limited economic data the currency fell rapidly as safe-haven interest dried up. The only negative data made available was the sharp drop in inflation (-0.5% vs. -0.4% expected) yet the currency slid heavily throughout the week. Rumours circulating last week suggested that there are growing concerns over the Swiss National Bank's (SNB's) monetary policy stance. Market expectations are beginning to price in the possibility that the SNB may cut rates even lower than their current 0.5% level. This would leave the Swiss Franc in the same position as the Yen and to some extent the US Dollar. If monetary policy is used too generously a permanent state of low rates may become the expected norm over the long term which would likely put downward pressure on the nation's currency.

JPY

The Japanese Yen had a broadly strong week with its largest gains coming against the EUR. Currency speculators were eager to close Euro long positions which had been funded in the Yen as risk appetite remained subdued and 2009's first full trading week served up more of what 2008 had to offer: anxiety and risk aversion mixed in with speculative trade.

Preview: 12th January – 19th January 2009



Looking ahead

- This coming week is packed with relevant economic data which will probably have an impact as to how various currencies perform over the week. The USD and EUR currencies will take the majority share of headlines as inflation, trade and manufacturing data for Europe and the US are all due for release this week
- ECB interest rate decision on Thu will be very important in gauging the future direction of the EUR because of the dislocation of market expectations and ECB member comments
- USD traders are likely to focus on the US trade balance on Tuesday coinciding with Ben Bernanke's scheduled comments which may shed further light on the broad monetary policy stance of the US. Focus is likely to be on the scale and extent of the 'quantitative easing' measures being planned by the Fed.

The European rate decision on Thu will be very intriguing this week as any ECB move could be seen as negative; not enough of a cut and sentiment could be negative because the ECB would be seen as restricting growth and encouraging deflation. If the ECB cuts too much then investors may gauge yield differentials as being anti-Euro i.e. EUR yields will be converging faster than expected with those of the US, Switzerland, UK and Japan. At the time of writing this report the market had priced expectations of a 0.50% cut. Even a 0.50% cut may induce high volatility in EUR pairs because opinions regarding the EUR are evenly split with no clear consensus as to the size of rate cut required. Incidentally, the ECB rate decision falls on the same day as inflation figures for the European Union; inflation is likely to be a key indicator for the ECB as it deliberates over the veracity of its monetary policy.

In the US, retail sales figures due out on Wednesday will give investors a glimpse of how the retail sector is fairing under the weak economic outlook that has been setup by the ailing labour, manufacturing and credit sectors. This coming week is packed with market moving data releases and several scheduled comments by Fed members. Thu and Fri in particular will see no less than 5 FOMC members giving their opinions on monetary policy.

On Friday we will see the latest TIC purchases data from the US that indicates the level of foreign demand for US Dollar denominated assets. This indicator is keenly anticipated by traders, especially in today's market environment, because it helps them to gauge how US assets are valued by the rest of the world. The US dollar has had strong support in 2008 via foreign demand for US bonds and equities so any large fall recorded here could be seen as very bad news for the US economy and the US Dollar.

Apart from the eventful economic calendar, the major themes that are likely to influence the week's price action will be inflation expectations in the US/EU and yield differentials between the EUR and other G10 currencies. The price action in the past 3 months has been very erratic and there have been clear tendencies for currencies to make very rapid changes in direction (as shown by the EUR/GBP price action so far this year). Considering these points it will be important to evaluate what kind of sentiment is formed by market participants as a result of economic data

released, central bank comments and the influence of fundamental news released in previous weeks.



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