

FX Weekly

Review: 9th – 16th February 2009

Market Focus

- Nervous but volatile week gives safe-havens the upper hand. JPY stronger across the board
- GBP suffers further losses as central bank estimates reaffirm worries of deep recession
- Possible Euro weakness in the medium-long term via exposure to Russia becomes realistic possibility



Market Research

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

Currency pair	At Open on Feb 9th	At Close on Feb 13 th	Nominal Change	% Change
EUR/USD	1.2970	1.2861	-0.0109	-0.84%
GBP/USD	1.4810	1.4354	-0.0457	-3.08%
USD/JPY	92.11	91.85	-0.26	-0.29%
USD/CHF	1.1599	1.1606	0.0007	0.06%
EUR/GBP	0.8754	0.8960	0.0206	2.35%
EUR/CHF	1.5043	1.4929	-0.0114	-0.76%
GBP/CHF	1.7175	1.6658	-0.0517	-3.01%
GBP/JPY	136.41	131.82	-4.59	-3.36%
EUR/JPY	119.49	118.27	-1.22	-1.02%
CHF/JPY	79.36	79.09	-0.27	-0.34%
AUD/USD	0.6721	0.6565	-0.0156	-2.32%
NZD/USD	0.5294	0.5223	-0.0071	-1.34%
USD/CAD	1.2195	1.2352	0.0157	1.29%

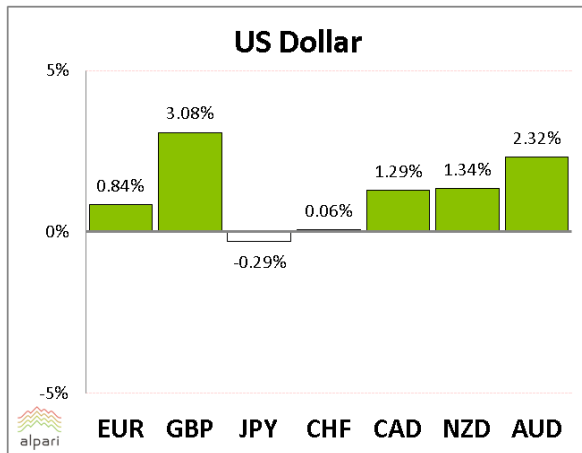
Source: Alpari (UK)

USD

A nervous start to the week as a US stimulus package was delayed. Stocks fluctuated and finished poorly although financials were broadly stronger. The risk tolerant mood remained from the previous week but eventually failed late on Monday as investors lost patience and ran for cover. JPY strength came back into the market during Tuesday's Asian session as many investors were worried about whether the \$700bn - \$900bn plan was enough to achieve the goals set by its creators.

Stimulus plan announced by Geithner and Obama failed on Tuesday after several days of hype and build-up. A larger than expected figure of \$1.5 – \$2 trillion was announced but no concrete actions or frameworks laid out. The language was vague and suggested that many decisions still needed to be made. The report was considered by market participants as a hashed effort. US stocks fell sharply as currency flows surged into safe-havens. GBP along with NZD, AUD, CAD predictably fell alongside confidence that the financial crisis would stabilise anytime soon.

The leading gainers were JPY, CHF, USD and EUR in that order which highlighted severe anxiety and disappointment about how the plan was formed and delivered. Many traders felt that the package was too little too late under the circumstances which wouldn't help aggregate demand



substantially. The issue of what to do regarding devalued and risky debt on bank balance sheets was not addressed to the satisfaction of market participants. A public/private partnership was considered far too optimistic and hopeful because there was no mention of losses being guaranteed. Other controversial elements such as 'Buy America', executive bonuses and a \$50bn scheme to help US homeowners ensured that the plan came across as disjointed to

many market participants. In addition, several politicians and economists criticised the plan for its lack of foresight and multilateralism.

In the days following the announcement several opinions regarding the stimulus package were priced in as US officials went on a media offensive designed to convince sceptics and boost public opinion. Although an overall negative bias remained (and to a large extent still does to this day) towards the 2nd bailout, some market participants have the impression that the Obama administration is sending out the right signals and is providing good solutions, especially when compared with other nations. Since the 2nd announcement on Wednesday confidence is still lacking but at the same time markets are not as panicked or anxious as they were following Geithner's 1st announcement.

The US Trade balance narrowed to -39.9bn USD. Imports fell heavily and so did exports. Net effect has been the smallest trade balance deficit in 6 years despite a strengthening USD. Consumption, imports and exports have fallen due to deteriorating demand across the globe. Very strong retail sales numbers on Thursday suggested that consumer spending may be rebounding after several months of consecutive decline. Strong retail sales were tempered by news that jobless claims rose for yet another month which may suggest that the rebound in retail sales was temporary; possibly due to discounting over the holiday period. Stocks initially rose following the retail sales number but were soon moving lower as the ramifications of the figures were digested.

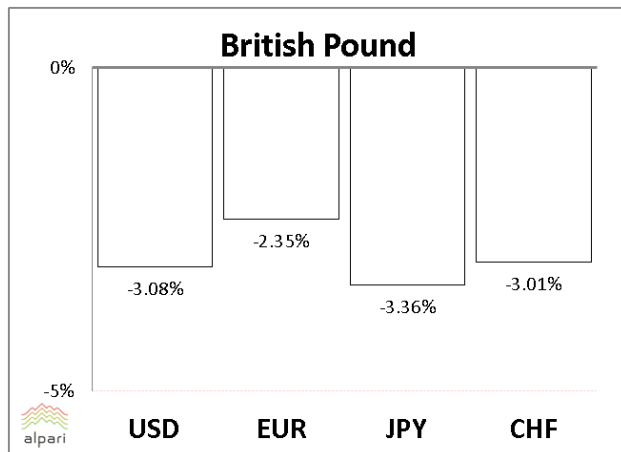
Over the weekend, several quotes from the G7 meeting in Rome made headlines. Most comments were filled with political rhetoric and generalised statements. Support for Geithner and his stimulus plans came from Trichet plus other European central bank officials. Political support was mixed as some politicians criticised the plans for their unilateral approach. In relation to FX, there was a notable absence of any currency related comments, whether it be current fluctuations or possible future developments.

GBP

A better than expected Trade Balance misled some market participants for a brief time by suggesting a weaker Sterling was beginning to filter through to a better imports/exports balance. Traders received the news with optimism but were disappointed that the majority of

the improved trade balance was a fall in imports (-2.5%) rather than a rise in exports (+0.5%). The figures underlined weakness in global trade and export demand. This trend suggests that weakening global growth is the primary influence rather than currency valuations when it comes to trade balances within current economic conditions.

More downward pressure came down on Sterling as Mervyn King suggested that unconventional easing could soon take place after interest rate policy had been exhausted, in the form of central bank buying of Gilts. The constant speculation surrounding direct central bank purchases of government debt has cast a shadow over currencies in the past few months because



conventional monetary policy has almost been exhausted in most of the G10 nations. If and when 'unconventional' policy actions take effect, it will be almost impossible to know exactly when and to what extent central bank buying will occur. In this scenario speculation and volatility become increasingly likely.

Over the course of the week Sterling fell against all its counterparts with the largest falls understandably coming against JPY (-3.36%) and CHF (-3.01%).

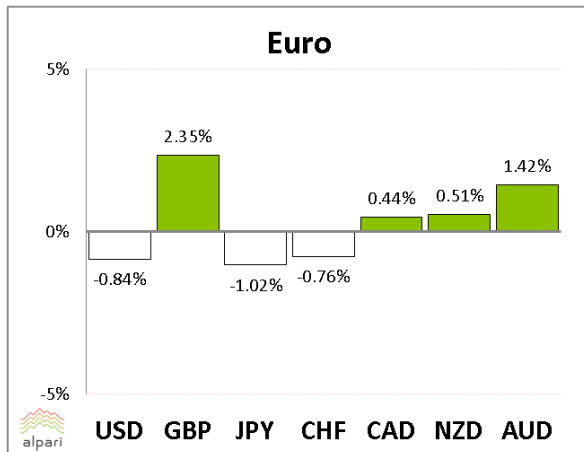
Also in the UK, unemployment increased in line with expectations from 6.1% to 6.3%. The Bank of England Inflation report predicted that inflation is very unlikely to turn into deflation (inflation to remain below target of 2% for some time) and for GDP growth to return somewhere between Dec 2009 - June 2010. The predictions were considered by some as very optimistic considering that economic indicators are currently deteriorating at an increased rate. We noticed a strong emphasis on import price inflation making an effect on UK CPI but no mention of potential effects on inflation resulting from central bank intervention/money supply expansion.

At the end of the week investors were once again buffeted by bad news from the banking sector which limited a late-week Sterling rally. Lloyds reported a loss of more than £14bn (within newly acquired HBOS) sparking renewed fears of further insolvency in the UK banking sector, this time in UK's largest bank which has only recently been bailed out. Risk aversion rose at the end of the European trading session as earlier upbeat mood was expunged.

EUR

The Euro had a solid week against most currencies with the exception of the USD, JPY and CHF. Risk aversion prevailed in a week that seemed so promising for risk seeking investors in view of Geithner's stimulus plans. However, sentiment fizzled out and due to the Euro's current risk neutrality compared to other currencies, thus it remained range-bound for the duration of the week. The Euro's feat was more even more impressive considering that German (-2.6% in 2008) and French GDP (-1.2% QoQ) figures were announced, both falling by more than expected.

Worrying news for medium-long term EUR investors surfaced on Wednesday as possible Russian default on over €300bn of debt began to look more likely as speculation spread that many

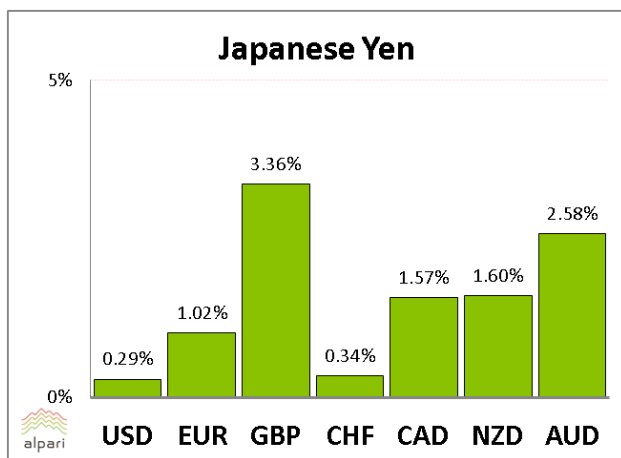


Russian firms will be unable to repay Euro loans. EUR fell sharply despite a statement by Russian authorities that these were just rumours. Considering that Russian foreign FX reserves are falling rapidly any defaults may not be supported by the Russian central bank. Our research suggests that from the €300bn+ of loans outstanding, only 30% are actually on the books of Russian banks/firms suggesting that some, if not most, of the outstanding debt has been spent on loss making activities rather than being invested

for future growth. Tension regarding this issue has put a drag on the EUR as market participants await further developments.

JPY

The Japanese Yen was the star performer again this past week as an absence of economic data helped risk-averse flows into the Yen. Risk tolerant mood evaporated following Geithner's disappointing announcement until Thursday's European session where some aspects of the rescue plan began to boost investor confidence. The \$50bn provision that aims to help



homeowners directly was given some media attention and may have had an effect on risk sentiment. JPY has been a very consistent risk barometer as it tracks higher on negative economic news, almost without fail. At the time of writing this report we have seen Japanese GDP figures for Q4 2008 at -3.3%. On an annualized basis that would equate to an eye-watering 13.2% decline in GDP. Japan has been hardest hit so far because it is an export driven economy and exports fell

14% in Q4 2008 as global demand continued to contract. Despite such astonishing numbers, the Yen opened much stronger against all its counterparts early on Mon 16th Feb. It seems that even horrific domestic performance will not tarnish the Yen's reputation for being the safest safe-haven. Market participants are taking the view that all nations are now assumed to have poor economic performance (to approximately the same extent in the long-term) so the discriminating factors are likely to be size of the investable market, fiscal balance and even core basics such as level of infrastructure, technological advancement, political stability and social structure. It really is a sign of worrying times when a -3.3% fall in GDP in one quarter boosts the affected currency.

CHF

The Swiss Franc benefited from market uncertainty elsewhere around the world. The raging speculation over the US stimulus plan gave CHF a bid against GBP, EUR and the Commodity currencies and ensured it stayed range-bound against the USD and JPY. In terms of economic releases, larger than expected falls in inflation both on the producer and consumer sides raised some questions as to where monetary policy would go if prices fell further seeing as interest rates are already at 0.5% and are unlikely to fall further. Some speculators are looking at the possibility of the SNB in co-ordination with the Swiss government generating inflation via a controlled expansion of the money supply. This would be a risky move but it may well be better than the alternative of deflation which would discourage all borrowing and investment which would severely temper GDP growth.

Elsewhere, the Swedish Riksbank cut interest rates from 2% to 1%. The reduction was by more than expected and helped to remind market participants that central banks are trying to stay ahead of market expectations to make sure bank policy doesn't become dislocated with investor expectations. This scenario occurred in the US in late 2007 as large monetary easing was being priced into the market despite official comments suggesting otherwise.

Following Sweden's interest rate cut last week it is now the case that 7 out of the G10 currencies have an interest rate of 1% or lower; the ECB is widely expected to join this club in the near future which makes 8. This standardisation is likely to expunge the traditional tendency of trading according to yield differentials and their expectations. In addition, interest rates are expected to remain low for some considerable time so speculation as to which central bank will begin raising rates first becomes irrelevant for the time being.

Country	Latest interest rate change	Current interest rate
Federal Reserve (USA)	Dec 16 2008	0.25%
European Central Bank (EU)	Jan 15 2009	2%
Bank of Japan (Japan)	Dec 19 2008	0.10%
Bank of England (UK)	Feb 05 2009	1%
SNB (Switzerland)	Dec 11 2008	0.50%
Bank of Canada	Jan 20 2009	1%
Riksbank (Sweden)	Feb 11 2009	1%
New Zealand	Jan 28 2009	3.50%
The Reserve Bank of Australia	Feb 03 2009	3.25%
Norway	Feb 04 2009	2.50%

Preview: 16th – 23rd February 2009



Looking ahead

- Potentially pivotal week for USD as pressure over the amended stimulus plan grows
- GBP on course for another disappointing week if expected data releases follow recent trends
- Risk-aversion likely to be the dominant theme again as Japanese GDP figures show a double-digit decline in Q4 2008 late on Sunday. Yen's risk haven status at risk
- Speculative trade likely to focus on possible central bank actions after interest rates have fallen to zero so member comments may be key

We are seeing daily changes in the focus of market participants. Risk aversion, interest rate differentials, safe-haven demand, government intervention, government subsidies, trade and fiscal balances are just some of the key themes that have influenced FX fluctuations in 2009. The upcoming week will no doubt provide surprises so a daily re-evaluation of market motives and drivers is essential.

USD

The US Presidents Day on Monday could either have a calming effect or induce higher volatility as less liquidity makes it easier for influential market participants to dictate market severity and direction. The rest of the week will provide some interesting US data that will provide an update regarding how the financial crisis is continuing its squeeze on the US economy.

The week as far as US focused traders are concerned could well begin on Wednesday as a raft of data is due. Ben Bernanke is expected to make comments at 6pm London time but just before his comments, FOMC minutes from its January meeting could well reveal important policy themes considering that US interest rates are now as close to zero as reasonably possible. Attention is turning to alternative monetary policy initiatives as market participants examine the possibility of the Fed targeting long-term interest rates through Treasury purchases. Fed members have mentioned several solutions to current credit problems which makes speculation around their comments a key theme in itself. Also on Wednesday we will see Industrial Production figures and Building Permit figures; both are expected to show unhealthy declines from January's readings. It is worth noting that weak economic data has been USD positive in recent weeks as risk avoidance regularly acts as the primary incentive.

On Thursday, PPI and Jobless claims numbers could add their weight to sentiment because unemployment is becoming a heavily politicised issue that tends to grab headlines. The latest stimulus package will not have had any effect on jobless claims numbers but if we see another sharp increase for yet another month, its long-term significance as to how well/how quickly it is implemented would have risen i.e. the pressure on law and policy makers to act more decisively on jobs will rise taking into account Geithner's failure to convince the public and investors of his updated stimulus plan. Generally, sentiment surrounding the updated plan is likely to be an active theme this coming week although attention could turn away from its relevance until concrete details are provided to market participants as to how the funds will be utilized. The initial plan put together in October under the Bush administration has been widely criticized as most economic indicators have hastened their deterioration. In many respects it's not the size of the package that

matters but rather the incentives that come with it. So far, pumping more funds into banks has not incentivized them to lend and neither has support for the car industry incentivized consumers to buy cars, to name just two examples.

Another key event important to watch out for is US TIC data due to be released on Tuesday. Under normal circumstances this data release is not market moving but because of the added importance that foreign demand for US assets (and thus the USD) currently has, we could see significant repositioning in USD pairs if US assets are experiencing significantly less (or more) demand. A dominant theme in FX markets right now is the extent to which US repatriation and foreign sales of US securities is progressing.

Our research suggests that Japanese investors remain strong buyers of foreign bonds, primarily US debt. However, the appetite for US government and corporate debt seems to be falling compared to 12 months ago. Japanese demand for foreign equity on the other hand has got stronger, possibly helped by a stronger Yen. These dual effects suggest that US Dollar demand will remain strong for the time being assuming no cataclysmic events dissuade Asian investors from their current habits. Our research also suggests that US investors have been net sellers of foreign stock over the past 12 months with the trend likely to continue. US investors selling foreign stock and repatriating USD points to continued USD support, at least until most unwinding of foreign holdings has been completed.

EUR

Euro focus is likely to centre on only 2 economic data releases. The European trade balance and more importantly the ZEW economic sentiment number are likely to be scrutinised because of their relevance in the current market environment. Business confidence is an important aspect in current conditions because employment, investment, spending and expected inflation are all closely linked to business sentiment and confidence. The ZEW figure is expected to remain negative as it has done throughout 2008 so a really pessimistic number may not necessarily push the Euro significantly lower although even a slightly better than expected reading could be just the incentive for risk tolerant investors to abandon risk-averse perceptions. This week is also very important from an equities perspective; we have seen quite a strong correlation between equity news and developments with shifts in currency perceptions. We are expecting to see Commerzbank, SocGen BNP, Deutsche Bank and AIB all report financial results. Any significant headline grabbing highlights may well spill over into currencies, especially if a large institution suffered unexpected losses that induced speculation of government intervention.

JPY

The currencies most widely accepted as being in danger of intervention are JPY, CHF and RUB. Following the G7 meeting in Rome no consensus on intervention was reached. Although we saw awful GDP figures from Japan owing to a sharp fall in exports (which BoJ officials probably knew about before the meeting) no statement was made regarding Yen's strength being responsible. The likelihood of intervention from the BoJ has probably risen making this a theme to watch out for, however, shorting Yen in the hope that intervention occurs is rather hopeful.

GBP

In the UK, January's inflation data (Tue) will provide market participants with an immediate chance to evaluate the conclusions and predictions of the BoE following their inflation report last week.



The CPI figures are expected to confirm that the BoE is likely to continue with dovish policy as prices slip further in line with falling demand and Sterling. It is quite conceivable that we see the first negative number in the annual RPI for over 40 years. The MPC minutes (Wed) are somewhat backward looking at this stage given the Quarterly Inflation Report released last week included the most recent and forward-looking inflation and rate expectations. Sterling traders are likely to be focused on inflation data and commentary this week (similarly to last week) with the aid of MPC member comments coming from Bean, Besley and Gieve. Commentary from central bank members could take on a larger significance in the coming weeks as speculation surrounding unconventional measures increases. Currencies most likely to be in the frame are the USD and GBP because of the comparable approach the US and UK governments have taken in dealing with the financial crisis. We would also like to point out that in the current economic climate, governments alongside their Treasury and central bank counterparts are assuming ever more key roles in the financial marketplace. Large sections of whole industries are now in the public sector in the UK and if we look at currencies in particular it is clear that governments have *the* key role because only a government backed (and funded) solution will suffice to resolving the current economic malaise.

Disclaimer:

Alpari (UK) provides an execution-only service. The material contained here does not contain (and should not be construed as containing) investment advice or an investment recommendation, or, an offer of or solicitation for, a transaction in any financial instrument. Alpari (UK) accepts no responsibility for any use that may be made of these comments and for any consequences that result. This communication must not be reproduced or further distributed. All information in this publication has been compiled from publically available sources that are believed to be reliable; however we cannot guarantee the accuracy of all information. All information and documentation associated with this report has been produced for the purposes of providing the report only.

Please remember that trading financial markets carries a high degree of risk to your capital. It is possible to lose more than your initial stake. Leveraged products may not be suitable for all investors, therefore please ensure you fully understand the risks involved, and seek independent advice if necessary.