

# FX Weekly

## Review: 11<sup>th</sup> January – 18<sup>th</sup> January 2009

### Market Focus

- Very mixed week in terms of market sentiment and direction for most currencies. There were no significantly large moves despite an eventful economic calendar
- Past week was dominated by developments from the equity markets with particular focus on the poor performance of financials stocks. The knock-on effect was a bias towards buying low-yielding currencies such as the USD, JPY and CHF
- Weakness in commodity currencies brought about the largest moves of the week as the NZD fell by almost 7% against the USD and the AUD fell by 3%
- The USD strengthened over the course of the week as it digested conflicting economic data releases
- Speculation of fresh government intervention in the UK banking sector instilled anxiety into market participants as all eyes turned to the following week for more clarification



### Market Research

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Currency pair	Previous Week Open	Current Rate	Nominal Change	% Change
EUR/USD	1.3461	1.3289	-0.0172	-1.28%
GBP/USD	1.5071	1.4717	-0.0354	-2.35%
USD/JPY	90.03	90.51	0.476	0.53%
USD/CHF	1.1113	1.1212	0.0099	0.89%
EUR/GBP	0.8933	0.9029	0.0096	1.07%
GBP/JPY	135.66	133.21	-2.448	-1.80%
EUR/JPY	121.2	120.32	-0.884	-0.73%
AUD/USD	0.6992	0.6773	-0.0219	-3.14%
NZD/USD	0.5883	0.5488	-0.0396	-6.72%
USD/CAD	1.1897	1.2419	0.0522	4.39%
EUR/CHF	1.4962	1.4902	-0.006	-0.40%
GBP/CHF	1.6749	1.6502	-0.0247	-1.47%

Correct at 08:41 GMT on 19<sup>th</sup> January 2009 | Source: Alpari (UK)

### USD

It was a difficult week for the USD as downbeat retail sales (-2.7% in December) and TIC data anchored any gains that were likely to be made due to a surprisingly strong trade balance and strong CPI figures. Safe-haven demand was strong once again last week as worrying developments in banking stocks depressed risk appetite. US and UK banks suffered steep falls in their share prices as speculation surfaced that many banks were unable to meet their capital requirements. This came on top of record losses and more write downs also announced last week. The Dollar was strongest against the

Aussie (+3.14%), Kiwi (+6.72%) and Looney (+4.39%) as crude oil prices continued their downward trend thus making it cheaper to buy crude oil which is already experiencing lower demand.

News of fresh government support for the banking sector received mixed reactions because although confidence was given a boost at the prospect of the US and UK authorities supporting major components of their economies, there was also more anxious sentiment at the fact that a round of more bailouts was needed in the first place. For now market participants have not actively traded the possibility that either the US or UK governments will simply run out of money to support a seemingly endless demand for capital from ailing banks.

One other intriguing piece of news concerning the USD was the news that Long-term TIC flows were negative for the month of December (-\$21.7bn) which means that long-term foreign investment in the US is beginning to fall and capital is leaving the US which could pose a big problem for the USD if the rate at which capital is leaving escalates.

### **EUR**

The major news regarding the Euro last week was the 0.50% interest rate cut which was in line with most expectations. ECB's delicate shift to a more dovish policy stance has not weakened the Euro significantly. The price action following the interest rate decision on Thursday last week reflected this. The EUR actually managed to post modest gains against other G10 currencies despite an interest rate cut that was expected to disappoint by being either too small or too large. The ECB was stuck in the unenviable position of possibly being criticised for easing too little (0.25% for example) or too much (0.75%). A 0.50% reduction was considered by many market participants as being too small so there was a strong possibility that the EUR would fall regardless of the decision taken.

Overall the Euro performed modestly as it gained against the broadly weaker Sterling but weakened against the USD and JPY.

### **GBP**

Sterling was weaker across the board as it was announced that a second wave of capital was required to bailout several banks in the UK banking sector. Several UK banks announced fresh losses due to the financial crisis in addition to news that several UK banks did not have enough capital in order to preserve required capital ratios. From a macroeconomic perspective, last week saw the release of a worse than expected trade balance despite Sterling's weakness in recent months; this worried many investors because theoretically the UK should be experiencing an increase in exports as a result of a weaker currency. The reality however is that demand for British exports is deteriorating faster than Sterling is deteriorating in the FX market. GBP/USD took the brunt of the selling on Tuesday as US trade balance figures surprised the markets, coming in at -\$40.4bn vs. -\$51.4bn expected.

Reports that the UK was the biggest borrower in the EU so far this year worried Sterling investors greatly; this combined with all the other Sterling negative news weighed on the currency significantly and brought forward the prospect of EUR/GBP re-testing 1.00 which was within touching distance at the end of 2008.

### **CHF**

Over the course of the week there was very little economic data that could affect the Swiss Franc so market participants looked to central bank speakers and news from other countries to drive sentiment. The Swiss Franc continued to experience risk-aversion demand coming from investors diversifying out of equities and commodities. CHF made its largest gains against the commodity currencies and GBP but was more or less unchanged against the JPY, USD and EUR. At the close on Friday, the CHF capped an uneventful week in terms of its price action.



### **JPY**

The Yen performed similarly to the Swiss Franc as anxiety coming out from equity markets became the major driver for Yen buying. JPY was strongest against GBP and actually fell against the USD which underlined investor preference for the Greenback in times of instability and as a store of value. The USD has maintained its resilience in the face of overwhelmingly negative news regarding the US economy. For now, investors have kept their enthusiasm for the USD because there has been no other clear substitute that satisfies investor objectives as well as the USD has done throughout the current financial crisis.

# Preview: 19<sup>th</sup> January – 26<sup>th</sup> January 2009



## Looking ahead

- Most attention is likely to be on the UK banking sector and on Sterling as a new bailout is widely expected to be announced on Monday morning. Speculation has been rife over the weekend that the UK authorities will be taking on larger stakes in several UK banks, all at the expense of higher government borrowing. Volatility in GBP pairs is likely to be elevated.
- This coming week may see the USD push higher in the absence of major economic data and central bank speakers. In addition, Monday is bank holiday in the US. If the USD appreciates significantly it may well be because of other currencies' weakness rather than from USD strength.
- Bank of England minutes scheduled to be released on Wed are expected to show a unanimous vote for a rate cut earlier this month. Close attention will be paid to the wording and the reasoning behind the MPC's decision. Any dissenting votes are likely to be positive for GBP.
- This week also sees a Japanese interest rate decision which is almost certainly going to be unchanged due to the current level of interest in Japan being virtually zero (0.10%).

Over the weekend the major story in the financial markets was the upcoming announcement by the UK authorities of a new injection of capital into the UK banking system. The level of saturation that this story has achieved is likely to affect trading decisions amongst market participants once markets open on Monday. It is quite possible that the UK banking system bailout part two will be the dominant story of the week. A reported £200-£300bn figure has been cited as being required to prevent the UK economy from collapse. The veracity of the language used combined with the fact that government, Treasury and bank officials were meeting on a Sunday in order to prepare a statement suggests that this story will have the legs to impact currency movements throughout the week.

Regardless of whether the banking sector bailout remains on the minds of traders throughout the week, the prospect of Sterling being in the headlines is very likely. There will be a large amount of UK economic data released this week including inflation figures (Tue), MPC minutes (Wed), GDP (Fri) and Retail sales (Fri). It is very unlikely that Sterling doesn't make the headlines by market close on Friday so it will be very important for Sterling traders to be aware of all developments as they occur, not to mention the developments to other currencies. Even if the economic data in the UK is seen as dire, GBP could still rise if news affecting other currencies is deemed to be worse in proportion.

Other important events this week will probably be the Canadian interest rate decision (Tue) which is expected to be a 0.50% cut from 1.50% to 1.00%. European economic sentiment will be gauged from the German ZEW figures due out on Tuesday. The Euro has been struggling against its G10 counterparts so far in 2009 so anything that boosts optimism would be welcomed by Euro bulls.

Another factor that may influence currency fluctuations this week could be comments coming out from the incumbent US government due to take over from the outgoing Bush administration. There have been many comments, speculation and rumours regarding what steps Barack Obama will take in his attempt to resolve the financial crisis and more importantly, how the TARP funds

will be allocated in the near-medium term. There are also strong expectations that the TARP fund will be expanded at the expense of US taxpayers. These elements amongst others could play a key part in influencing USD direction so it is important to be aware of comments despite the fact that they may be politicised.



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