

# FX Weekly

## Review: 26 January - 2 February 2009

### Market Focus

- A broad correction to sentiment took place last week as risk tolerance returned to the FX market
- Substantial rescue packages and bailout news announced in the US, UK, Canada and EU all helped to boost confidence
- British Sterling made the headlines for the 2<sup>nd</sup> week running as it gained against all major currencies



### Market Research

**George Tchertakov**  
Head of Market Research  
gtchertakov@alpari.co.uk

Currency pair	Previous Week Open	Current Rate	Nominal Change	% Change
EUR/USD	1.2917	1.2751	-0.0166	-1.29%
GBP/USD	1.3685	1.4435	0.0750	5.48%
USD/JPY	88.4	89.66	1.26	1.43%
USD/CHF	1.1565	1.1635	0.0070	0.61%
EUR/GBP	0.9437	0.8832	-0.0605	-6.41%
EUR/CHF	1.4942	1.4839	-0.0103	-0.69%
GBP/CHF	1.5825	1.6793	0.0968	6.12%
GBP/JPY	120.94	129.40	8.46	7.00%
EUR/JPY	114.23	114.32	0.09	0.08%
CHF/JPY	76.40	76.99	0.59	0.77%
AUD/USD	0.6531	0.6357	-0.0174	-2.66%
NZD/USD	0.5270	0.5075	-0.0195	-3.70%
USD/CAD	1.2335	1.2270	-0.0065	-0.53%
EUR/USD	1.2917	1.2751	-0.0166	-1.29%

Correct at 00:00 GMT on 2nd February 2009 | Source: Alpari (UK)

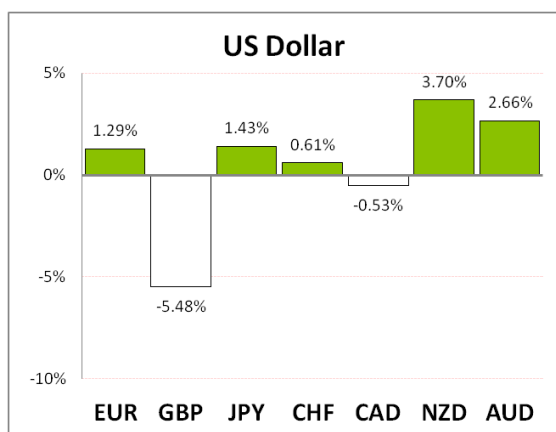
### USD

The currency markets went from gloom to boom on Wednesday as a 2<sup>nd</sup> bailout package was announced in the US accompanied by a plan to pool the toxic, unsecured debt from bank balance sheets into one dedicated entity, nicknamed the “bad bank”. As if this news wasn’t stimulatory enough, the US also held interest rates at 0% - 0.25%, stating that rates would remain low for some time as some expectations only foresee an increase in late 2010. This combination of events helped banking stocks surge as market participants reconciled the economic crisis with the realistic prospect that both the US and UK governments would not allow any Tier 1 financial institutions to fail or be allowed to have problems lending to consumers; Barclays, RBS and Lloyds were all 20-50% higher in a single day and the overall US and UK financial sectors rose by over 10% respectively.

Overall, the US Dollar had a turbulent week however as a multitude of news buffeted the global reserve currency. The week started poorly as it fell unexpectedly against all

major currencies despite strong existing home sales figures. However, it was worth noting that many of the home sales included in the figures were actually repossessed/foreclosed homes which had been sold quickly and at a discount. The labour market was next to receive bad news as several firms announced redundancies on Monday; media reports focused on the issue and came up with a number of 72,000 jobs lost in a single day. Although this figure was completely anecdotal and to a large degree irrelevant it still managed to sway investor sentiment in a negative way.

Confidence did begin to creep back into the market on Tuesday as speculation of a President Obama backed fiscal stimulus package and a dedicated bank to handling toxic assets was announced. Once it was official that an announcement would be made on Wednesday, the Japanese Yen and the Dollar fell because investors were



eager to take early positions looking to profit from re-emerging risk appetite. The past 6 months have seen USD demand stay healthy because Dollars were used as a risk moderator; last week gave speculators a glimpse of hope that risk aversion would begin to decrease from now on after the Obama led rescue plans began to filter through the US economy. The

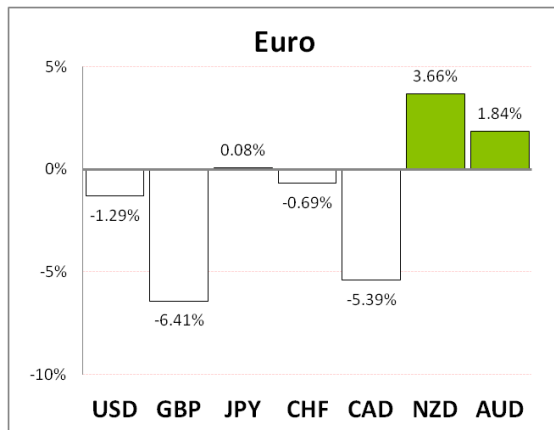
perceived change in focus and direction by some speculators ensured healthy volume but no clear direction for the USD as our chart illustrates.

The USD gained against the EUR, JPY, CHF, NZD and AUD but was almost unchanged against CAD and fell heavily against Sterling. Wednesday of last week was a continuation of Tuesday's speculation as risk aversion fell away significantly which greatly helped the Scandinavian currencies (NOK, SEK and DKK) and gave support to AUD, NZD and CAD in particular, despite persistently weak crude oil prices which have fallen away dramatically in the midst of the financial crisis.

## EUR

Overall the Euro had a bad week as a European budget deficit more than double its expected level severely weighed on sentiment. Investors have been looking to the Euro for strength ever since the global economic crisis took hold. The reason for this is because the currency is considered as the 2<sup>nd</sup> reserve currency partly because many of the world's central banks are holding Euros as their 2<sup>nd</sup> largest foreign currency reserve. Market participants have been patient regarding the Euro's woes but if fiscal stability is disregarded we could see a change of perception towards the Euro as central banks rush to diversify away from the single currency. Despite a disappointing current account figure the Euro found some support via a better than expected IFO number (data release that measures business sentiment in Germany). In addition, inflation figures released on Wed and Fri showed that European inflation fell to its lowest level since 1999. This ensured the Euro remained well supported as nerves were calmed concerning higher inflation because the worst thing for savers/depositors is to

see inflation rising in an already low yielding environment so a better (lower) than expected inflation level adds to investor confidence if capital is held in Euros.



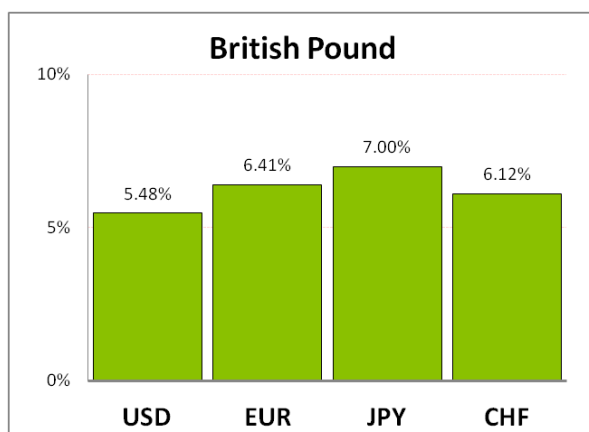
The Euro performed worst against GBP and CAD but was largely unchanged against all other G10 currencies. The biggest surprise was its performance against CAD because as the Loonie outperformed both the Euro and the Dollar in a week where oil prices remained suppressed.

The consensus on its performance seems to be Canada's 85bn CAD support package for its economy

announced on Tuesday. Although the nominal size of the number is small and comparatively insignificant to the rescue package proposed in the UK and US the fact that the Canadian authorities are being pro-active and taking firm action similar to other major economies suggests to investors that holding Canadian dollars as a partially risky speculative investment may not be a bad idea.

## GBP

The current market environment is saturated by speculation, possibly more so than ever before considering the current market environment. GBP was the worst performing currency 2 weeks ago as gloom descended over the British economy. Banks were on the brink of collapse, further rate cuts were priced into expectations and UK's fiscal balance was worrying market participants enough for Britain's AAA rating of government debt to be put in question. One week later and Sterling outperformed every currency out there with its largest gains coming against the risk-based Yen (+7%) and Swiss Franc (+6%).



The primary reason for this sea change in sentiment was quite clearly the bank bailout news alongside a rescue package for the UK automobile industry. In the past 6 months UK economic policy has eerily resembled the economic policy of the US and vice versa. Both nations have gone step for step by first announcing one banking bailout each, then a rescue

of the whole economy, then another banking bailout and now both have announced support for their respective car industries via loans, investment and direct aid.

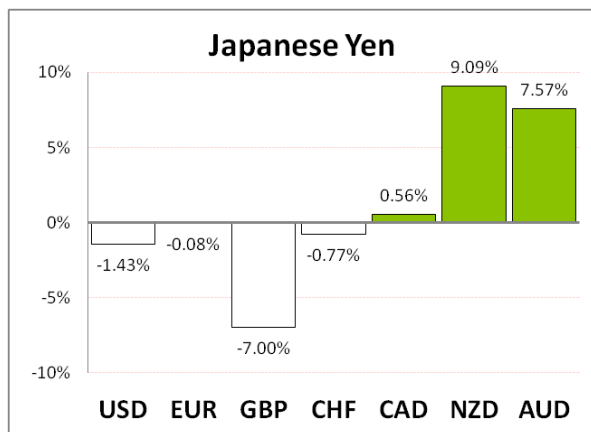
Sterling's push higher last week was extended by the feeling it was oversold the week earlier. GBP pairs gained last week approximately as much as they lost the week

previous which is a sign of speculative motives due to the short time frame and the magnitude of the moves.



## JPY

The Yen performed very strongly against the NZD and AUD but was marginally weaker against all other pairs with the exception of CAD. Last week saw a broad reduction in risk aversion and anxiety due to the US rescue plans designed to resolve problems at the heart of the financial crisis. The scale and timing of the investment expected to go into the US economy helped investors reconcile investing in currencies such as the GBP, EUR and CAD. However, the Japanese Yen began to appear fallible and lost some of its safe-haven allure it has enjoyed over the past 12 months.



Significantly lower retail sales (-2.7% vs. -1.6% exp) numbers, higher unemployment (4.4% vs. 4.1%), lower industrial production (-9.6% vs. -8.9% exp) and lower household spending (-4.6% vs. -3.6%) helped to remind market participants that the current economic problems are global so no currency is truly safe. Despite the depressing economic statistics,

the Japanese Yen held its ground on the back of the view that all other nations are suffering and experiencing similar fundamental frailties.

Significant strength against the NZD was due to New Zealand's central bank cutting interest rates by 1.5% and not 1% as expected. The increased risk appetite of last week failed to cover up investor concern of rapidly narrowing interest rate differentials between all G10 currencies so with an absence of a higher yield, peripheral currencies such as the NZD, AUD and to a large extent CAD have tended to suffer against the Yen.

## CHF

The Swiss franc was largely unchanged last week, with its largest decline coming against GBP which dominated all other currencies. Very interesting comments from SNB's Hildebrand stating that the SNB is "willing to take unconventional measures to boost the economy" weighed on sentiment as many investors found it difficult to interpret. Unconventional could mean anything from indirectly expanding the money supply to expanding fiscal expenditure in order to boost economic growth. Whatever the exact meaning, investors perceived this comment as a continuation of last week's (SNB would actively control CHF appreciation) and promptly sold CHF due to anxiety and fear that the current economic crisis could force some governments into reckless actions hence impacting the value of a currency.

## Preview: 2 February – 9 February 2009



### Looking ahead

- Extremely busy economic calendar this week is likely to generate a plethora of trading opportunities
- Three interest rate decisions this week have the potential to upset market expectations and sustain volatility
- Focus likely to remain on Sterling following the events of the past 2 weeks
- Monetary policy expectations have the greatest divergence over the Euro so EUR based pairs are expected to see most speculative activity

This coming week is likely to have elevated volatility because of the large data calendar that covers several countries. The primary focus for many traders will be the ECB because of the uncertainty regarding the true direction the ECB may take. There has been a split in opinion developing regarding the Euro which has led to a wide range of expectations. The members of the ECB have given the market reason to think that rates would be lowered close to zero meanwhile rates have been cut much more conservatively in Europe than in any other G10 nation. Some ECB members have commented that a policy of near zero interest rates is counter-productive to the long-term goals of the EU and the Euro which would be detrimental to future monetary policy. As a result of the conflicting pieces of information, market participants are split over Thursday's decision. The thinking behind cutting rates down 1% or even lower is that lower interest rates would stimulate economic activity with the added benefit of higher exports if the currency were to weaken but lowering rates so low could impact future ECB decisions and take away all room for cuts if they are needed. Another incentive for holding rates at 2% is to maintain a slight interest rate differential between Europe and other G10 currencies to give investors an extra reason to hold Euros other things being equal. We have seen in recent months that although the Euro is considered to be a reserve currency, it is less of a safe-haven bet than CHF, USD or JPY. It is worth noting that the currencies which are considered to be the world's safe havens are the same currencies which have the lowest interest rates; US (0.25%), JPY (0.10%) and CHF (0.50%). The ECB is no doubt considering whether to put themselves in the same boat and compete for international capital flows on the basis of preference or whether to differentiate at a time when investors are looking for unique solutions to unique problems.

Also out this week are EU retail sales figures which are expected to show a decline in the month of January. Apart from the economic calendar there are plenty of things to watch out for such as any further government debt downgrades within the EU; banking sector news and developments regarding Germany's 50bn EUR fiscal stimulus could also play a part.

Sterling is likely to grab headlines this week as the BoE is expected to lower rates again down to 1% on Thu. UK interest rates were 5.5% twelve months ago which illustrates the scale of the easing that has been done by the MPC. Sterling has weakened substantially over the past year because the BoE eased faster than most other central

banks thus undermining the UK's interest rate differential advantage. Sterling has priced in relentless bad news, narrowing interest rate differentials, a banking system on the verge of failure, plummeting house prices and even speculation of a UK government ratings downgrade so for Sterling bulls there is still some room for optimism going forward now that so much negative information has been digested. If rates are reduced down to 1% this week, we may still see Sterling strength because as with most interest rate decisions these days, the most important aspect is likely to be the comments that come afterwards rather than the decision itself.

The factor which is likely to have the largest short term impact could be the US employment report due out on Fri. An eye-brow raising 530,000 jobs were probably lost in January which is market moving in its own right let alone how it compares to expectations. At the moment the US Dollar is in peculiar position of trading higher when there is USD positive news and staying flat when there is USD negative news. Risk-averse capital continues to support the Dollar while data releases are largely ignored because it is considered that core US fundamentals are the same if not better than in other countries. Dollar bears seem to have given up shorting the currency amidst current market conditions in the fear that another seismic economic event would send the Dollar higher. If we see a better than expected number it is likely that the US Dollar would rally significantly because the prospect of a turning point in the economic crisis will get closer. A flat number is also likely to be considered as good news because we've seen worse than expected figures so often recently. In fact, it is difficult to see how the US Dollar could fall after Friday's number unless the headline number along with unemployment, rise dramatically beyond all expectations.

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