

FX Weekly

Review: 24th December 2008 – 6th January 2009

Market Focus

- The USD finished 2008 strongly and began 2009 with good momentum as it regained ground against most other G10 currencies
- Commodity currencies were the story of Christmas as the Kiwi, Looney and Aussie all bounced strongly on the back of rising crude and other commodity prices
- Very little economic data over the past 2 weeks combined with reduced volumes dampened any significant developments in the price action although some pairs stood out more than others



Market Research

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Currency pair	Previous Week Open	Current Rate	Nominal Change	% Change
EUR/USD	1.3968	1.3437	-0.0531	-3.80%
GBP/USD	1.468	1.466	-0.002	-0.14%
USD/JPY	90.71	93.65	2.939	3.24%
USD/CHF	1.0777	1.1184	0.0407	3.77%
EUR/GBP	0.9514	0.9164	-0.035	-3.68%
GBP/JPY	133.12	137.27	4.15	3.12%
EUR/JPY	126.69	125.84	-0.848	-0.67%
AUD/USD	0.6823	0.7068	0.0245	3.58%
NZD/USD	0.5742	0.5828	0.0086	1.49%
USD/CAD	1.2094	1.1965	-0.0129	-1.07%
EUR/CHF	1.5057	1.5029	-0.0028	-0.19%

Correct at 08:40 GMT on 6th January 2009 | Source: Alpari (UK)

The Christmas holiday period was volatile in parts as clearly lower volumes failed to discourage traders from speculating in the FX market. Although late December is traditionally quiet, this year was different because of the unparalleled events that have occurred over the course of the year. Many traders, especially short term speculators, were expecting significant movements in various currencies due to investor anxiety and consequently the potential for large swings in the event of fresh market moving news.

USD

The USD was broadly stronger against other major currencies such as the EUR, CHF and to some extent the GBP although it weakened against the AUD, NZD and CAD. Commodity currencies were stronger across the board as renewed demand for crude oil helped prices to rise by almost 10 USD per barrel. Many analysts were surprised to see such resilience from the USD as it rose almost 4% against the EUR and over 3% against the CHF and JPY; considering its performance the week previously where it fell

by close to 10% against the EUR. Opinions vary as to why the greenback paired back the severe losses it made during December. Some believe that profit taking was the root cause while others are looking for a more complicated explanation being that the USD is in a strong position overall in comparison to other nations because of the stimulus plans being enacted in the US. So despite the prolonged USD weakness against other G10 currencies throughout December 08 there seems to be some support for the opinion that the US stimulus plans will work by helping to generate economic growth and thus help the USD make solid gains in the long term as the financial crisis fades. At worst, the US will have been the first to engage in such optimistic and large-scale plans which will help the currency once other countries decide to do the same.

EUR

The other big news over the holiday period was the speculation that the EU would succumb by adopting the same fiscal incentives proposed by the UK and the US in 2008. This news took support away from the EUR because up until now European policy makers have been resistant to applying Keynesian economic policy of trying to pull out of the current economic crisis via overwhelming government expenditure. The EUR fell by over 3% against both GBP and the USD although it held its ground against the CHF and the JPY. The Euro's mixed performance against the major currencies adds weight to the argument that profit taking was the primary market driver for currencies over the past 2 weeks because a fundamental shift in sentiment and/or confidence would not have left the EUR/JPY and EUR/CHF pairs unchanged over the same period.

GBP

Sterling was significantly stronger versus the EUR and JPY but unchanged against the USD as some welcome rest bite finally came Sterling's way. The most eye-catching event was Sterling's strong resistance at close to parity against the Euro. GBP rose over 3% against the Euro which defied most analysts' expectations that the 1.0000 level would be tested before any significant rejection. The price action was also surprising when you consider the anaemic house price data made available on January 2nd that showed UK house prices falling by the highest amount in a single year since records began. UK house prices are now at 2004 levels. Considering this news Sterling managed to strengthen and hold onto those gains at the time of writing this report.

CHF

The Swiss Franc had a very mixed performance as it was unchanged against some (EUR, JPY) and weaker against others (USD, GBP, CAD and AUD). Risk appetite rose over the past 2 weeks as the New Year seems to have brought renewed optimism to financial markets; this helped to dampen demand for the low yielding CHF.

JPY

The reduced risk aversion around financial markets was bad news for the Yen as it fell across the board, only managing to minimise its losses and remain largely unchanged versus the CHF and EUR. The Yen weakness was probably welcomed by Japanese officials as speculation was mounting that the Bank of Japan was close to intervening in the currency market. This speculation may persist as the Yen fall against the USD was not very pronounced which could signal further weakness for the Yen in the weeks to come.

Preview: 6th January – 11th January 2009



Looking ahead

- Most focus will be on the US unemployment report on Fri with a forecast of -475k. Beware of huge volatility that is likely to occur next Friday as market participants return for 2009 in conjunction with the most keenly anticipated economic indicator in the US calendar
- Considerable attention is likely to be on the UK interest rate decision on Thu as rate expectations in the UK continue to fluctuate prior to the announcement. There is still some uncertainty over the magnitude of the reduction with some investors looking for a 1% cut. A 0.5% move could even lead to GBP strength because of the wide spectrum of expectations

In 2008 we witnessed plummeting asset prices on all almost every asset. Stock indices were between 30% and 50% lower over the year while crude oil fell 55%. The only asset that rose in percentage terms was Gold (+5%). The USD performed well over the course of the year which is reflected in the fact that the Dollar Index (a measure of the USD relative to a basket of foreign currencies) rose 6% in 2008. Last year will always be remembered for the emergence of the largest financial/economic crisis since the 1930's, the effects of which may remain with us for the next decade. Due to such significant news and the prospect of the economic crisis unravelling further, 2009 is certain to contain very significant developments that will influence the price action in the FX market.

There are currently very mixed opinions on the future direction of the US Dollar. The USD has staged many surprises over the past few months including the unexpected renewed strength over Christmas. Essentially, the division of opinion is centred on the approach the US authorities are taking to stabilise the US economy. Some market participants believe that the large-scale bailout and fiscal stimulus conducted in the US in 2008 have put the US economy on the right track in the long term which will boost US Dollar demand once the dust has settled.

The other opinion is that the various methods of stimulus are all relatively ineffective because confidence, sentiment and growth are all falling alongside house and commodity prices. Furthermore, the stimulus plans do very little good because they reward the same people that helped to create the financial crisis which in the long term does very little good because confidence in the US dollar could suffer as a result of so much excess liquidity on top of the huge amount of debt already present in the US economy.

With regards to the coming week, the UK interest rate decision will interest many Sterling traders because there is scope for both significant gains and losses this week because of uncertainty regarding the magnitude of the expected reduction. US Dollar traders will undoubtedly be interested by the ADP employment report on Wednesday followed by the non-farm unemployment report on Friday. The US economy is expected to have 500,000 more unemployed from December with an unemployment rate of 7.0%. Worse than expected figures are likely to weigh on the Dollar disproportionately compared to if they were above expectations. The reasoning behind this comes from the fact that investors have been bombarded with bad news for months so more bad news would have a relatively lower impact on the USD price compared to

good news which is likely to be taken as a sign of better things to come and the early beginnings of an economic recovery.



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