Fundamental | FX

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FX Weekly

Review: 1st December – 7th December 2008

alpari

Market Research

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Market Focus

- Resilient US Dollar defies its critics despite woeful economic data
- Sterling plummets as looser monetary policy expectations as well as core fundamental concerns were priced into the market
- Euro held up well within a risk-averse environment and a 75 basis points rate cut

Currency pair	Previous Week Open	Current Rate	Nominal Change	% Change
EUR/USD	1.2694	1.2909	0.0215	**1.69%**
GBP/USD	1.5381	1.5045	-0.0336	**-2.18%**
USD/JPY	95.54	93.48	-2.06	**-2.16%**
USD/CHF	1.2147	1.2089	-0.0058	**-0.48%**
EUR/GBP	0.8249	0.8578	0.0329	**3.99%**
GBP/JPY	146.91	140.62	-6.29	**-4.28%**
EUR/JPY	121.31	120.66	-0.65	**-0.54%**
AUD/USD	0.6516	0.6683	0.0167	**2.56%**
NZD/USD	0.5444	0.5462	0.0018	**0.33%**
USD/CAD	1.2371	1.2505	0.0134	**1.08%**
EUR/CHF	1.5423	1.5608	0.0185	**1.20%**

Correct at 09:15 GMT on 8th December 2008 | Source: Alpari (UK)

US Dollar

The US Dollar remained remarkably resilient over the course of last week as weak labour market numbers in combination with weak manufacturing numbers failed to dampen investor demand. As of this morning the USD was mixed against various currencies [see table]. The big news from the US last week was the record fall in employment in the month of November. The US economy lost a net total of 533,000 jobs which was a record fall not seen since the 1970's after the oil price shock that put an end to the post-war economic boom. The US dollar managed to hold onto gains versus GBP, CAD, NZD and NOK despite almost every single economic indicator throughout the duration of the week coming out significantly below expectations.

This phenomenon is very much contrary to the traditional assumption that negative economic numbers signal lower economic growth and lower interest rates thus reducing the value of the currency. In the current market environment however, interest rate expectations and their differentials are taking second place to risk-averse plays that have been predominant in the 4th quarter of 2008. The JPY has been the lowest yielding currency for some time now and yet it is finding the most support during these unprecedented economic times. Risk-averse investors are buying USD despite the overwhelmingly negative economic numbers because there is a strong belief amongst some market participants that holding USD assets may be better than holding historically less reliable currencies such as CAD, AUD, NZD, EUR and even GBP. The USD is still the world's reserve currency so the rationale behind being exposed to the USD is that as more and more countries fell the effects of the financial crisis, their currencies will suffer more so than the USD in the coming months because the US is already taking steps to remedy many of its problems. The political effect of Barrack Obama being elected has also given a boost of confidence to those holding USD denominated assets.

UK Sterling

Sterling was the worst performer from the major currencies as it fell by over 4% against the EUR, 2.3% against the USD and 4.6% against the JPY. GBP has been incredibly weak against most G10 currencies in recent months as lower rate expectations have been priced into the value of Sterling. Last week saw another 1% cut in the Bank of England's base rate leaving it at 2%. The UK interest rate has now fallen by 3% in the past 8 weeks. This level of monetary easing has never been seen before in the UK which has given many market participants a sense of fear rather than re-assurance which has in turn helped to put further downward pressure on Sterling. GBP is finding some support from the fact that actual interest rates paid and received by investors will not be reduced by the major financial institutions; if this situation changes Sterling could well fall even further against strong risk-driven currencies such as the JPY, CHF and USD. Some market commentators are suggesting that parity with the EUR is quite possible considering the current account deficit in the UK and the additional fiscal stimulus being planned by the current UK government. UK manufacturing figures released last Monday were below expectations at 34.4 against 39.8 expected. A reading of below 50 shows industry contraction and above 50 shows industry expansion. HBOS house price figures showed a 2.6% fall in house prices in the month of November. Overall, negative news combined with falling rates and their expectations put severe pressure on Sterling last week. In other news, Royal Bank of Scotland (RBS) released figures showing that only 0.24% of required new capital was raised from investors. The remaining 99.76% came from the UK government which now owns 60% of the company.

Euro

The Euro managed to gain ground against the USD, GBP and CHF whilst only giving up 0.5% against the Yen last week despite the European Central Bank (ECB) cutting interest rates by 0.75% (0.25% more than most analysts expected). In usual circumstances this would be negative for the Euro but because other currencies are seen to be in more trouble than the Euro by comparison, the Euro has seen strong support. The ECB has been relatively slow in comparison to other central banks in easing monetary policy although European rates were relatively lower to start with; this has helped to support the Euro as investors look for the best trade-off between yield and security.

The performance of the Euro last week was made to look even more impressive despite some downbeat economic numbers. German manufacturing orders fell 6.1% in the month of October as demand for German goods seems to have evaporated. This figure was deemed important because Germany is being looked to as an economic leader that will drive European growth in the months ahead. If manufacturing demand in Europe's largest economy slows too quickly, European growth will be lower than forecast which is a negative indicator for the Euro.

Preview: 8th December – 15th December 2008

This week could see the retracement of USD gains made against CHF, EUR and GBP in recent months. Awful US labour data may finally convince investors that the USD may not be the excellent store of value as first hoped. This coming week will see some key US data that may help to reverse US Dollar momentum: EUR/USD has been in the 1.3100 – 1.2300 range since late October 2008 after making substantial gains starting in July 2008 when EUR/USD was trading around the 1.60 level. A UN report released today suggests that USD demand has been derived from a “flight to quality” which could come to an end as investors begin to re-evaluate their medium-long term risks. The USD has been set in a positive trend against the NZD, CHF, GBP, AUD and CAD since the middle of 2008. These USD positive trends may come to an end although what could prompt a change in such heavily weighted dollar interest is still unknown because record falls in employment and manufacturing combined with a banking crisis have not been able to change sentiment up until now.

US equity strength at the end of last week helped to boost the USD against the JPY but not by a significant margin. The fiscal stimulus package proposed in the US has seemingly left some unconvinced as to its potential effectiveness. In addition, the stimulus is only likely to come into effect at the end of January 2009 as this is when the new administration takes office. At this point, judging by historical charts it is unlikely for the USD/JPY trend to reverse from its downward direction.

This coming week could add more weight to the JPY, EUR and CHF if more negative data and news hits the newswires. The interest in low-yielding risk averse currencies has been merited considering the unprecedented economic circumstances so if nothing happens to change the status quo we should see a continuation of current trends. However, the fiscal package being planned in the US could become fashionable and be repeated in other countries. Judging by equity market reactions to the plan late on Friday (very positive), we could see equity, bond and commodity markets take a very upbeat view of the plan and that could feed into risk appetite in the currency markets. In this case currencies such as the AUD, NZD and CAD could re-emerge as strong vehicles for speculative as well as fundamental purposes at the expense of the JPY, EUR and CHF.

Calendar Highlights

One of the major events this week will be ECB’s Claude Trichet’s comments due to be made at 2pm GMT on Monday. Particularly short term investors will be looking at what stance the ECB is taking on monetary policy. As interest rates get closer and closer to zero many market participants are wondering what the driver for currency rates will be once monetary policy has been exhausted. Some authorities are likely to turn to fiscal policy to generate demand and achieve positive economic growth, so countries with healthy budget and current account surpluses are likely to have more stable currencies. Comments made by central bankers are likely to be given more scrutiny in the coming months as decisions made by policymakers take on even more significance than usual.

This week also brings more German economic numbers which are taking on larger significance as investors look for an indication as to how the largest European economy is fairing under the seemingly constant stream of bad news affecting the Euro. German industrial production (Monday) and German ZEW sentiment figures (which indicate the level of sentiment amongst market professionals) on Tuesday are likely to have an effect on EUR based currency pairs.

Elsewhere, the Bank of Canada interest rate decision (Tuesday) will be of interest to CAD traders. The current expectation is for a 0.5% cut although a reduction of 0.75% and even 1.00% is possible considering the large reductions we have seen in the US, Europe, Sweden and UK in recent weeks. Some central banks have taken the approach of trying to stay ahead of market expectations by reducing interest rates by more than expected in order to boost confidence pre-emptively. This was case with the Swedish Riksbank last week as they cut their base rate by 1.75% against expectations of a 1.00% reduction.

The latter part of the week will see US figures take centre stage once again. The US Trade Balance (Thu), Core retail sales (Fri), Producer Price Index (Fri) and Retail Sales (Fri) numbers will all be key factors in deciding USD sentiment going forward, at least in the short term. Retail sales figures will be watched very closely because almost two thirds of US GDP is derived from consumer demand. Retail sales are a good indicator of how consumer spending is fluctuating so a very weak number here could be negative for the USD despite strong risk-averse buying up until now.