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Market Insight

A New Year with the same old troubles

Currencies finished 2008 with a note of confidence as traditional safe-haven currencies were sold in exchange for risky alternatives such as the CAD, NZD and AUD. However, the Christmas period was short lived and the FX market soon returned to the prevailing trends of 2008. Risk appetite rose slightly but was soon quashed by renewed bad news, economic statistics and depressed sentiment; taking on risk continues to look a daunting proposition as investors remain anxious and subdued.

Equity markets have made things worse as bellwether stocks have begun to report Q4 earnings. Company results have been mostly negative, especially in the banking sector which has brought the subject of government bailouts to the fore once again. Equity indices have been dragged down by widespread fear that if the economic crisis is affecting large firms then it must necessarily be affecting smaller firms. Plummeting equity prices tend to translate into demand for safe-haven currencies such as the JPY, USD and CHF so this scenario may well be prevalent under current market conditions. The added woe of large increases in unemployment in all G10 countries has reduced sentiment further.

One of the biggest surprises over the past 2 weeks or so has been the reinvigorated GBP compared to the EUR. Since mid-2008 Sterling has been in a depressed state against all G10 currencies with EUR/GBP taking the headlines because of their approach to parity. The reasons for these declines were largely linked to a rapidly faltering UK economy, historically quick interest rate cuts and the hasty decline of the British financial sector; a sector that generates almost 10% of UK GDP. Several banks were nationalised and confidence in Sterling fell accordingly. Since the beginning of 2009 Sterling has managed to appreciate by close to 10% against the EUR as economic news and investor expectations have caught up with the EUR leaving many market participants in difficulty because all currencies (not just the GBP, EUR and USD) are suffering in the midst of the financial crisis and deciphering which country has worse news compared to another has become a tougher task.



Market Research

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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 its tenacious holding of value despite so many Dollar negative news announcements and such loose monetary policy. 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 financial crisis has subsided.

The other opinion is that the various methods of stimulus are all relatively ineffective because confidence, sentiment and growth are all still falling alongside house prices 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 is counterproductive in the long term 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.

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