

FX Briefing

26 June 2009

Highlights

- Fed sticking to monetary policy stance, sees situation stabilising gradually
- ECB injects €442bn into the money market in one-year tender

Dollar weaker after FOMC meeting

During the course of the week, the dollar has retreated somewhat. EUR-USD rose to about 1.41, whereas, towards the end of the week, USD-JPY was around 95.50. The Swiss franc did not follow this movement, however, nor did some commodity-linked currencies such as the Norwegian krone, the Canadian and Australian dollar.

The US currency started the week on a firm footing against the euro. This probably reflected market participants' more sceptical view of the economic outlook, which was also evident in falling equity and commodity prices. Furthermore, the World Bank revised its global economic growth forecast for 2009 down substantially from -1.7 to -2.9%. Markets were worried that the Fed could take action to prevent interest rates rising at the long end of the curve, and thus dampen their cautious optimism even further.

On Tuesday, the dollar lost ground. As the day progressed, EUR-USD rose – as though pulled by a string – from around 1.3830 in the morning to over 1.41 towards the evening. The reasons for this are hard to discern. Maybe markets had come to the conclusion that the Fed and other central banks would maintain their extremely expansive monetary stance, in order to kick-start economic recovery. Remarks made by a member of the rating agency Moody's confirming the AAA rating for the US (and also for the UK) could have played a part as well. Last but not least, the auction of a staggering \$104bn of T-notes could have had an impact too.

Then, on Wednesday, EUR-USD dropped below 1.3950. This movement was probably triggered primarily by two factors: first, the ECB's first one-year refinancing operation, which, at a record €442bn, exceeded all expectations, which had been high anyway. Market participants interpreted this as a sign that the ECB regarded the situation as more critical than indicated in the official statements. Second, the US currency benefited from the intervention of the Swiss National Bank in the forex market. The SNB made no formal declaration, but traders reported of massive intervention by the SNB and, on its behalf, the BIS. For the first time, US dollars were purchased as well as euros.

The FOMC meeting on Wednesday evening ended with no big surprises. The statement contains something for everyone: the Fed sees gradual stabilisation progressing, but maintains that economic activity is likely to remain weak for a time. Moreover, the central bank dropped the warning that inflation could run below desired levels for a time. All in all, however, the open market committee confirms its monetary policy stance, and its intention to continue to purchase agency debt, agency MBS and Treasury securities. The Fed now states, however, that it will make adjustments to its credit and liquidity programmes as warranted.

After the statement, the dollar firmed initially, but started to weaken again later on. In our view, this is mainly due to the markets' interpreting the Fed decision as "balanced and growth oriented": fears that either an increase in long-term interest rates or an early exit from QE could suffocate

any nascent economic recovery, seem to have subsided somewhat after recent yield falls and the reassuring FOMC statement. For the forex market, the continuation of the expansive monetary policy means that international investors' risk appetite will grow, which would theoretically bolster carry trades.

In this "best of a bad bunch" scenario – economic stabilisation and low interest rates – the dollar is losing ground. How the US currency would react in less favourable circumstances, remains to be seen, however. At first glance, a fresh escalation of the crisis should boost the dollar as a safe ha-

ven; at present, there is a close correlation between EUR-USD and the equity market. However, this will not necessarily be the case: the US debt situation and financing requirements – particularly in connection with the discussion about its role as a reserve currency, are more against the dollar. Furthermore, it is feasible that the US might step up political pressure to depreciate the dollar, in order to kick-start its economy again. On the whole, the risks for the dollar could predominate slightly at present.

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Key indicators and important events

Country	Indicator / Event	Release date	Forecast (in % mom/yoy)	Prev. period (in % mom/yoy)	Comments
EMU	Economic sentiment / Jun	29/6	70.7	69.3	
GE	Labour market / Jun >absol. change unempl. sa >unemployment rate sa	30/6	+35k 8.3	+1k 8.2%	
EMU	Money supply M3 / May	30/6	3.9	4.9	yoy
EMU	HICP flash estimate / Jun	30/6	-0.2	0.0	
US	Chicago PMI / Jun	30/6	38.0	34.9	
US	Consumer confidence / Jun	30/6	54.0	54.9	
US	ISM manufacturing / Jun	1/7	44.5	42.8	
EMU	ECB interest rate decision	2/7	1.00	1.00	
US	Labour market / Jun > change non-farm payrolls > unemployment rate	2/7	-325k 9.6	-345k 9.4	
US	Factory orders / May	2/7	1.4	0.7	mom

Money and foreign exchange market quotations

	Spot vs. EUR	Change vs. EUR	Interbank offered rates		
	26/06/09	in % week-on-week	1 month	3 months	6 months
EUR	–	–	0.76	1.12	1.33
USD	1.4087	-1.1	0.31	0.60	1.10
JPY	134.37	0.5	0.23	0.46	0.69
GBP	0.8555	-0.9	0.66	1.20	1.42
CHF	1.5304	-1.2	0.20	0.40	0.51
SEK	11.0077	-0.6	0.77	0.99	1.34
PLN	4.5064	0.2	3.75	4.42	4.60
CZK	26.067	1.3	1.86	2.11	2.31
CAD	1.6168	-2.9	0.32	0.60	1.10
AUD	1.7493	-1.1	3.27	3.50	3.80
NZD	2.1844	-0.5	2.90	3.12	3.39
SGD	2.0485	-1.0	0.31	0.44	0.56
ZAR	11.2377	0.6	8.35	8.50	8.80

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