FX Briefing

3 April 2009

Highlights

- Equity markets hope for economic turning point
- G20 pump extensive additional resources into IMF, reduce country risk
- Half-hearted ECB interest rate cut to 1.25%

Crisis? What crisis?

This week, the dollar weakened significantly. EUR-USD, which had dropped to 1.31 at the beginning of the week, rose above 1.35 temporarily on Thursday. The pound sterling and the Australian and New Zealand dollar were also on the winning side, gaining 2 to 3%. Those currencies which had suffered particularly over the past weeks gained the most ground. The zloty, for instance, appreciated over 6% against the dollar, the forint almost 5%. Other emerging market currencies such as the Turkish lira, the rand, the Mexican peso and the Brazilian real also strengthened considerably. The Asian currencies, however, only made very moderate gains. The yen actually weakened against the dollar; USD-JPY is now trading at around 100 again.

The developments in the forex market reflect an initial glimmer of hope for the economy, which has grown stronger partly because of the measures agreed at the G20 summit. Against this backdrop, equity markets also posted significant gains. But the ECB's decision to cut the refi rate by 25 basis points only probably played a part too.

Mixed economic signals and G20

Equity markets rallied worldwide. Bullish technical signals could have made market participants more inclined to see the economic indicators, which were mixed for the most part, in a favourable light. The ISM manufacturing index as a whole, for example, only improved marginally in March to 36.3. The increase in the orders component from 33.1 to 41.2, however, was regarded as a ray of hope. The unexpected rise in US vehicle sales in March was also seen as a good sign. And finally, pending home sales increased, as new and existing home sales had done before, confirming the idea that the housing market could have bottomed out.

After the economic crash over the last few months, it is hardly surprising that things are stabilising somewhat, particularly in the troubled housing and automobile sectors. The Fed's quantitative easing measures are also having an impact. However, unemployment is continuing to soar. At the end of March, initial jobless claims hit the highest level since 1982. The unemployment rate rose to 8.5% in March; in the first quarter as a whole, almost two million jobs were slashed. We fear that the contractive effect of this will continue to dampen economic activity for some time to come.

G20: political milestone, but not a miracle cure

The G20 summit in London was undoubtedly a great political success. A further massive cash injection into the IMF, additional funds for the World Bank and the regional development banks, a commitment to free trade, and extensive measures to promote exports, a fundamental agreement on strengthening financial market regulation – no small achievement, given the diverse interests of the participants.

However, the measures agreed at the G20 are not a "miracle cure" for the crisis. The additional

Economics Department
+49 69 718-3642
volkswirtschaft@bhf-bank.com

Foreign Exchange Trading
devisenhandel@bhf-bank.com

Jörg Isselmann
+49 69 718-2695
Matthias Grabbe / Klaus Näfken
+49 69 718-2688

funds will give the International Monetary Fund the necessary resources to be able to offer effective help to member states with balance of payment problems. This lowers the risk of country defaults, and country risk premiums, which are very high at present, should go down. From this point of view, it is easy to understand why currencies of countries with weak balance of payments have strengthened. The $750bn are not to be used to finance additional expenditure or economic packages.

Oops! They did it again

At its meeting last Thursday, the ECB governing council decided to cut the refi rate by 25 basis points to 1.25%. This disappointed markets, which, after comments made by ECB vice-president Lucas Papademos and other council members, had been expecting a 50 basis point cut. Yields on Bunds went up by about 15 points to 3.15% at the long end, and in the two year maturity segment by more than 20 points to 1.46%. Within two days, the interest rate advantage over the equivalent US Treasuries widened by 14 to 57 basis points.

At any rate, President Jean-Claude Trichet indicated that he sees further scope for interest rate cuts. Moreover, he announced that a decision on possible unconventional measures would be taken at the next policy meeting in May. However, neither Mr Trichet nor the governing council gave any explanation as to what results they are expecting the gradual cuts to have in the current economic environment.

Market participants are interpreting the ECB's half-hearted step as a sign that the ECB is not really willing to adopt the aggressive strategy of other central banks – in the US, the UK, Japan, Switzerland. The interest rate gap in the euro's favour is thus likely to remain positive. It therefore comes as no surprise that the euro is approaching record high levels on a trade-weighted basis.

Stephan Rieke   +49 69 718-4114

Key indicators and important events

Country	Indicator / Event	Release date	Forecast (in % mom/yoy)	Prev. period (in % mom/yoy)	Comments
JP	BoJ monetary policy meeting	7.4.			Interest rate unchanged at 0.10%
GE	Trade balance and current account / Feb	8.4.	€7.0bn €6.0bn	€8.5bn €4.2bn	
GE	Industrial new orders / Feb	8.4.	–4.1 / –37.8	–8.0 / –35.2	
US	FOMC minutes	8.4.			
JP	BoJ Monthly Report	8.4.			
GE	Industrial production / Feb	9.4.	–3.0 / –21.7	–7.5 / –19.2	
IT	Industrial production / Feb	9.4.	–2.0 / –16.9	–0.2 / –15.4	
EMU	ECB Monthly Bulletin / Apr	9.4.			
UK	BoE interest rate decision	9.4.	0.50	0.50	
US	Trade balance / Feb	9.4.	–$37.0bn	–$36.0bn	
FR	Industrial production / Feb	10.4.	–1.5 / –15.2	–3.1 / –13.8	

Economics Department
+49 69 718-3642
volkswirtschaft@bhf-bank.com

Foreign Exchange Trading
devisenhandel@bhf-bank.com

Jörg Isselmann
+49 69 718-2695
Matthias Grabbe / Klaus Näfken
+49 69 718-2688

Money and foreign exchange market quotations

	Spot vs. EUR	Change vs. EUR	Interbank offered rates		
	03/04/09	in % week-on-week	1 month	3 months	6 months
EUR	–	–	1.07	1.48	1.66
USD	1.3430	-0.9	0.48	1.16	1.71
JPY	134.10	-3.4	0.40	0.59	0.77
GBP	0.9112	2.3	0.99	1.61	1.84
CHF	1.5245	-0.2	0.23	0.40	0.54
SEK	10.8120	0.8	1.14	1.20	1.26
PLN	4.4594	3.5	3.63	4.12	4.25
CZK	26.650	2.5	2.26	2.45	2.59
CAD	1.6641	-0.8	0.73	1.02	1.40
AUD	1.8812	2.3	3.56	3.70	3.82
NZD	2.3028	1.3	3.52	3.79	3.90
SGD	2.0213	-0.2	0.44	0.44	0.63
ZAR	12.3134	3.5	10.25	9.25	11.00

Economics Department
+49 69 718-3642
volkswirtschaft@bhf-bank.com

Foreign Exchange Trading
devisenhandel@bhf-bank.com

Jörg Isselmann
+49 69 718-2695
Matthias Grabbe / Klaus Näfken
+49 69 718-2688