

FX Briefing

30 October 2009

Highlights

- EUR-USD retreats to below 1.50
- US economy grows again in Q3 for the first time
- Buba president Weber unwilling to continue long-term tender “for too long”

Some respite for the dollar

After losing ground for the last three weeks, the dollar now seems to be getting some respite. EUR-USD, which was over 1.50 at the beginning of the week, slipped to below 1.47 temporarily, only to recover to around 1.48 towards the end of the week. Scandinavian and eastern European currencies and also commodity currencies such as the Australian and Canadian dollars, the rand and the yen, posted similar or, in most cases, higher losses. The pound sterling and the yen gained ground against the US dollar; both currencies had already benefited from dollar appreciation against the euro in the past.

The dollar's recovery coincides with somewhat lacklustre trading in equity markets over the last few days. Now that the most important quarterly earnings reports in the US have been published, there is little impetus to push equities higher. Many market participants might not be fully convinced about the sustainability of economic recovery; as the end of the year is approaching, equity market players could perhaps be starting to contemplate locking in their profits.

The dollar was given a temporary boost on Thursday when US GDP data for the third quarter was published. The preliminary estimate showed that the US economy grew again in Q3 for the first time after shrinking for four consecutive quarters by a total of 4%. In the third quarter, real GDP increased by almost 0.9% compared to the previous quarter, or 3.5% (annualised quarter-on-quarter). This is somewhat higher than consensus estimates.

The main driver was private consumption, which contributed 2.4 percentage points to growth. Primarily due to an improvement in residential construction (0.5 percentage points), fixed investment also made a positive growth contribution again of 0.3 points. The slower pace of decline in inventories contributed almost one percentage point, and government purchases half a percentage point. Net exports, on the other hand, shaved off half a percentage point, mainly due to the sharp increase in imports.

Car purchases were responsible for about half of the rise in consumer spending and can be put down to the car scrappage scheme, which has now run out. Excluding car purchases, real GDP would have only grown by 1.9%. The results in the third quarter are therefore likely to paint a far rosier picture than is warranted by the underlying economic fundamentals.

Exit strategy comments by Axel Weber

In a speech on Thursday, Bundesbank president Axel Weber made some interesting remarks about the ECB's exit strategy. First of all, he distinguished between interest rate policy measures, which reflect the macroeconomic environment and in particular inflation risks, on the one hand, and “unconventional” policy measures to provide liquidity on the other. He said the liquidity measures were a way of neutralising disruptions in financial markets, particularly with regard to refinancing the banks. When the situation in financial markets eased, these measures would no longer be necessary, according to Mr Weber.

Axel Weber appears to think that this could soon be the case. "Given the latest developments on financial markets and the corresponding stabilisation on banks' refinancing markets", he said, "it is inappropriate to continue the current operative regime without any changes for too long".

Mr Weber sees the withdrawal of the unconventional measures as a gradual process. Initially, the very long-term loans to banks could be scrapped i.e. presumably, 6 and 12 month refinancing operations. The 3-month tender could also be offered as an interest tender again, but Mr Weber did not mention this. At a later date, the ECB would stop providing unlimited liquidity within the framework of its main refinancing operations. And as a third step (if the macroeconomic envi-

ronment was right) interest rate changes could be considered.

Presumably, other members of the ECB governing council share Bundesbank president Weber's opinion. As far as next week's ECB council meeting is concerned, however, we are still expecting the central bank to restrict itself to gradually becoming more upbeat in its assessment of the macroeconomic situation and gently hinting that exit will be necessary "at some point". But in December at the latest, when its commitment to provide unlimited liquidity runs out, the ECB will have to say to what extent it intends to continue the unconventional measures.

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Key indicators and important events

Country	Indicator / Event	Release date	Forecast (in % mom/yoy)	Prev. period (in % mom/yoy)	Comments
US	ISM manufacturing / Oct	2/11	52.6	52.6	
US	Factory orders / Sep	3/11	0.8	-0.8	mom
US	FOMC interest rate decision	4/11	0.25	0.25	
US	ADP employment chg. / Oct	4/11	-230k	-254k	
EMU	ECB interest rate decision	5/11	1.00	1.00	
UK	BoE interest rate decision	5/11	0.50	0.50	
GE	Industrial new orders / Sep	6/11	2.0 / -12.6	1.4 / -21.1	
US	Labour market / Oct	6/11			
	> change non-farm payrolls		-210k	-263k	
	> unemployment rate		9.9	9.8	
World	G20 finance ministers meet	6-7/11			

Money and foreign exchange market quotations

	Spot vs. EUR	Change vs. EUR	Interbank offered rates		
	30/10/09	in % week-on-week	1 month	3 months	6 months
EUR	–	–	0.39	0.67	0.99
USD	1.4809	1.6	0.24	0.28	0.56
JPY	135.03	2.1	0.16	0.33	0.53
GBP	0.8960	2.3	0.51	0.59	0.81
CHF	1.5155	-0.1	0.09	0.26	0.38
SEK	10.3790	-1.2	0.35	0.50	0.72
PLN	4.2283	-1.1	3.52	4.18	4.31
CZK	26.458	-1.9	1.62	1.91	2.09
CAD	1.5868	-0.2	0.30	0.50	0.83
AUD	1.6247	0.2	3.62	3.92	4.46
NZD	2.0317	-2.0	2.88	3.02	3.30
SGD	2.0680	1.3	0.41	0.65	0.61
ZAR	11.4177	-1.8	7.65	7.85	8.15

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