BHF BANK
PRIVAT SEIT 1854

FX Briefing

16 October 2009

Highlights

- Equities hit highs on recovery hopes, bond yields pick up
- Markets discuss the international role of the dollar
- ECB council member Mersch sees inflation expectations “edging up slightly”
- BoE signals pause in asset purchases, Sterling rebounds

1.50 mark within reach

The dollar is continuing to tumble. This week too the US currency fell markedly against most major currencies. On Thursday morning, EUR-USD hit a new annual high of 1.4967, and was still around 1.49 towards the end of the week. The 1.50 mark is within reach.

Once again the dollar movement was fuelled by equity markets, which had soared to new highs on the release of the first quarterly earnings, as well as some improved economic data from the US. Retail sales had in fact dropped by 1.5% because of car sales falling back again after the cash-for-clunkers programme ended. But the drop was smaller than expected, and, excluding cars and fuels, sales were up slightly. This confirms the estimate that private consumption in the US probably made a strong contribution to growth in Q3.

Even more surprising was the fact that the Empire State Manufacturing Index had soared from 18.9 to 34.6 in October, the highest level since spring 2004. Furthermore, for the first time, the employment component is showing an increase in employment again. However, the Empire State Index is only regional and relatively volatile. The Philadelphia Fed Index, for instance, fell slightly after having increased in the previous months. But it too is still well over the expansion threshold and shows improvement in some important components.

It is somewhat schizophrenic when markets’ confidence in the US economy is growing and US equities are soaring from one high to the next, that the dollar, the same country’s currency, is on a losing streak. But there is still much discussion as to whether the US currency could lose its special status as global reserve currency. Some are complaining that rising public debt in the US is undermining foreign investors’ confidence in the dollar. Others are referring to shifts in the global structure of economic power in favour of emerging markets. Thus a report published by a British bank this week attracted a good deal of attention: it stated that only just over a third of inflows of global reserves went into dollars in the last three months.

In Europe, the bond markets, which had been very firm for many weeks despite the signs of economic recovery and rising share prices, have been under heavy pressure in the last few days. Since the ECB governing council meeting, 10-year Bund yields have risen from 3.12% to 3.30%. There is movement at the short end of the curve too. 2-year Bund yields have gone up almost 20 points to 1.41%. After the ECB meeting, the rates had risen slightly at first, until ECB governing council member Yves Mersch remarked that inflation expectations were edging up. This triggered a substantial interest rate hike, which also had an impact on the exchange rate against the dollar.

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Sterling rebounds

The yen and the pound are deviating somewhat from the general trend. Whereas the yen had appreciated during the last few weeks in the wake of dollar weakness, the pound had tended to be even weaker than the dollar. Now there has been a turnaround: cable has risen by around 2% to 1.63, while USD-JPY has increased by over 2.5% to above 91. The fact that this movement occurred simultaneously in both currencies suggests the extensive closing of GBP-JPY short positions.

This was probably triggered by Paul Fisher, the deputy governor of the Bank of England responsible for markets and a member of the MPC. He stated that the BoE would probably pause in its asset purchase programme and not complete it. The asset purchase programme has almost been used up: £162 bn of £175 bn have already been spent. At the current pace and size of the tenders, the funds will be used up in about three weeks – i.e. around the time of the next MPC meeting on 5 November.

Mr Fisher's remarks suggest that the BoE has no plans to stock up the funds at the moment, but wants to highlight the possibility of continuing its asset purchase programme should this become necessary. Up to now, markets had been speculating on the BoE extending quantitative easing once again in November.

Mr Fisher was clearly making a tentative attempt to correct the Bank of England's seemingly dovish stance. With regard to the next Inflation Report due to be published on 11 November, he said that the conditions for a turn in the economy were all there. Third quarter growth would probably turn out to be flattish; however, towards the middle of next year, growth rates could be around the long-term trend again – albeit fluctuating considerably in certain quarters. In reply to a question about the weakness of the pound, Mr Fisher said that the BoE was not trying to talk exchange rates up or down: comments made by the bank were generally backward looking.

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Key indicators and important events

Country	Indicator / Event	Release date	Forecast (in % mom/yoy)	Prev. period (in % mom/yoy)	Comments
EU	Eurogroup / Ecofin	19/10			
US	Housing starts & building permits / Sep	20/10	620k 610k	598k 579k	
UK	BoE minutes of 7-8/10	21/10			
US	Fed's Beige Book	21/10			
FR	Business climate / Oct	22/10	87	85	
BE	Business climate / Oct	22/10	–15.8	–17.8	
US	Leading indicators / Sep	22/10	0.7	0.6	mom
GE	Ifo business climate / Oct	23/10	91.3	91.3	
GE	PMI manufacturing / Sep	23/10	49.6	49.6	
EMU	PMI manufacturing / Sep	23/10	49.8	49.3	

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Money and foreign exchange market quotations

	Spot vs. EUR	Change vs. EUR	Interbank offered rates		
	16/10/09	in % week-on-week	1 month	3 months	6 months
EUR	–	–	0.39	0.69	1.01
USD	1.4902	-1.1	0.25	0.28	0.59
JPY	135.68	-3.4	0.16	0.33	0.53
GBP	0.9157	0.8	0.51	0.57	0.77
CHF	1.5189	0.0	0.10	0.27	0.39
SEK	10.3845	-0.9	0.36	0.55	0.84
PLN	4.2120	0.8	3.50	4.15	4.30
CZK	25.728	0.4	1.56	1.98	2.15
CAD	1.5391	0.5	0.30	0.50	0.95
AUD	1.6180	0.6	3.55	3.90	4.49
NZD	2.0054	-0.4	2.96	3.10	3.41
SGD	2.0779	-1.2	0.38	0.65	0.59
ZAR	10.9673	-0.9	7.67	7.75	8.15

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