

USD lower pressured by reassessment of US rate outlook

- **USD:** Lower, pressured by reassessment of US rate hike speculation, China may diversify away from USD
- **JPY:** Higher, supported by gains in cross trade to EUR, leading indicators rise
- **EUR:** Higher, German industrial output falls, IMF calls on EU to take action to support the financial system
- **GBP:** Higher, UK house prices improve, BRC retail sales decline, political turmoil eases
- **CAD and AUD:** AUD & CAD higher, crude prices /risk appetite rise, Flaherty says the economy is bottoming

Overview

With no major US economic data scheduled for release Tuesday the USD drifted lower pressured by a statement from the World Bank's Zoellick that China may diversify reserves away from the USD and a reassessment of the possibility that the Fed will raise interest rates. According to a Bloomberg report, speculators that expect US interest rates to head higher this year are wrong. The report surveyed 15 of the 16 primary dealers that deal directly with the Fed and the majority predict no US rate increase until at least the second half of 2010. In Monday's trade the USD was supported by speculation that improving US economic outlook would encourage the Fed to raise interest rates by year end. A number of analysts are warning that it's too early to be pricing a US rate hike as the global economic outlook remains uncertain. The job market, housing market and financial markets must show considerable improvement before the Fed hikes rates. Japan's finance minister said it's too early to tell if the global economy has bottomed and the IMF says that the EU economy remains weak and the EU must take urgent action to support EU financial system and come clean about EU bank losses. EUR edged higher despite an IMF report urging the EU to take action on banks and report of weak German industrial output. EUR was supported by report that Latvia will maintain its peg to the EUR. GBP was supported by improving UK house prices and easing UK political turmoil. CHF traded higher despite report that the Swiss KOF lowered its 2009 GDP forecast from -2.4% to -3.3% and said that the Swiss economy is in a long recession. Commodity currencies rallied supported by higher crude prices and firmer equity market trade. Canada's Flaherty says the Canadian economy is bottoming. Today's USD price action suggests that the recent USD rally was corrective and that the trade looks to sell USD on rallies.

Today's US data:

April wholesale trade falls 1.4%, a 1.1% decline was expected.

Upcoming US data:

On June 10th, April trade balance will be released expected at -29.00 bln compared to -27.5 bln last month. Also on June 10th, May Treasury budget will be released expected at -195 bln compared to -165.93 bln last month. On June 11th, initial jobless claims will be released for the week ending in 6/06 expected to fall to 610 K from 621K last week. May retail sales and business inventories will also be released on June 11th. Retail sales are expected to rise 0.3% compared to 0.4% last month. Business inventories are expected at -0.8% compared to -1% last month. On June 12th, June University of Michigan consumer sentiment is due for release expected at 70 compared to 68.7 last month.

JPY

JPY traded higher mainly supported in cross trade with the EUR pressured by an IMF report which calls on the EU to take urgent action to support the EU financial system. The IMF also says that the EU economy remains weak. JPY was also supported by a statement from the World Bank president Zoellick that China may diversify reserves away from the USD. Zoellick noted that China has been buying USD to manage its Yuan exchange rate. The Governor of the Bank of China recently called for the creation of the super sovereign reserve currency and the Chinese PM has expressed concern that the weaker USD will hurt China's US investments. Zoellick went on to say that the change will not take place overnight Zoellick expects the Chinese economy to surprise on the upside but warned that the global economy is still in a very fragile situation. He compared the impact of fiscal stimulus to a sugar high which soon fades. Chinese officials downplayed today's latest USD diversification story. The JPY was supported by a statement from Japan's finance minister that it's too early to tell if the global economy has bottomed but the worst for the economy appears to have passed. Japan's April leading economic indicators rose 1.0%. The rise in Japan's leading indicators supports the recent upgrade of Japan's economic assessment by the Japanese government.

This week's Japanese economic calendar includes the June 9th release of April leading indicators expected at -12 compared to -16.4% last month. On June 10th, April machinery orders will be released expected at 3% compared to -1.3% last month. May GCPI will also be released on June 10th, expected at -0.2% compared to -0.4% last month. On June 11th, Q1 GDP will be released expected at -4%. On June 12th, revised April industrial output will be released expected at 5% compared to 1.6% last month.

Key technical levels to watch in USD/JPY include support at 96.56 the June 5th low with resistance at 98.90 the June 8th high.



EUR

EUR traded in a volatile range initially pressured by an IMF report calling on the EU to take urgent action on its financial system and come clean about EU bank losses. EUR was also pressured by report that German April industrial output declined 1.9%. EUR rebounded into the US trading session supported by fresh focus on possible Chinese reserve diversification out of the USD and report that Latvia will maintain its peg to the EUR. The Latvian news helped to reduce fears of expanding Eastern Europe financial turmoil. The EU is also preparing to launch a second tranche of emergency aid to Latvia. EUR was also supported by comments from the ECB's Stark that the ECB will unwind low rates when the economy recovers, that the EU economy is no longer in freefall and that ECB interest rates are appropriate. Some wire services suggest that today's EUR rally reflects higher stock market trade and speculation that the global recession may end this year. For most of the first half of 2009 risk appetite and the direction of equity markets were major market drivers for FX trade. After the release of better than expected US nonfarm payroll the trade appeared to shift focus from risk appetite to speculation that the US would lead the global recovery. Speculation that the Fed may raise interest rates sooner than expected as the economy improves and a spike in US bond yields which are at a seven-month high generate fears that the rate rise may choke off recovery. Rising interest rates contributes to uncertainty about global economy. If US interest rates continue to rise, the EUR may find increased selling pressure above 1.4000 as growth and yield differential moves in favor of the USD.

On June 10th, German May HICP will be released expected unchanged at 0.1%. On June 12th, EU April industrial production will be released expected at -2.2% compared to -2% last month.

The technical outlook for the EUR is mixed as rallies stall above 1.4000. Expect EUR support at 1.3730 the May 21st low with resistance at 1.4120.



GBP

GBP traded higher supported by report of improving UK house prices and a slight easing of political turmoil in the UK. UK May RICS house price balance improved to -44.1 from -58.7 in April. Not all the UK data was positive. May BRC retail sales declined 0.8%. The BOE's Tucker said that the medium term outlook for the UK economy is highly uncertain. He went on to say that it's unclear whether the financial system is generating enough credit to support economic recovery. Despite significant election losses for the UK Labor Party and calls for UK PM Brown to resign, Brown continues to cling to power. The fact that UK opposition party has been unable to oust PM Brown suggests a slight easing of political uncertainty in the UK. GBP traded weaker Monday in reaction to heightened political turmoil in the UK. GBP was also supported by gains in cross trade to the EUR as PM Brown fights off calls for his resignation and EU economic data confirms continuing deterioration of German industrial output. Today's UK housing data encourages speculation that the UK recession is ending. GBP was also supported by firmer equity market trade and return of risk appetite as investors reassess the likelihood that the Fed will raise interest rates before year-end.

On June 10th, April industrial production will be released expected at -0.4% compared to -0.6% last month. UK April trade balance will also be released on June 10th expected at -6.750 bln.

The technical outlook for GBP has improved with today's rally above 1.6200. GBP needs to hold above 1.6000 to regain upside technical bias. Expect near-term support at 1.5960 with resistance at 1.6435 the June 4th high.



CAD

CAD traded higher supported by firmer crude prices and improving risk sentiment as equity markets rally and investors reassess the possibility that the Fed will raise interest rates anytime soon. Crude prices rallied above \$69 a barrel. CAD was also supported by a statement from Canada's Finance Minister Flaherty that the economy is bottoming and he looks for positive Canadian growth in the second half of 2009. Flaherty however warned that Canadian job losses will continue to rise for the remainder of the year and possibly into 2010. Monday, Canada reported May housing starts rose by 9.2%. The rise in Canadian housing starts is a sign that the Canadian economy is beginning to stabilize. CAD is rebounding from a two-week low and remains about 10% higher for the year versus the USD. A survey of analysts by Bloomberg news shows that economists expect the CAD to trade at 115 by year-end. CAD is currently trading at 1.1000. CAD price action is volatile with a recent range of 1.0782 which was last week's low to recent highs at 1.1300. A break of either of these levels is needed to confirm the next price direction for the CAD. Many analysts expect a downside correction for the CAD because the rally had been too much too fast and the USD may benefit if US interest rates continue to rise. CAD price direction remains closely correlated to the price of crude.

This week's Canadian economic calendar includes the June 10th release of April trade balance expected at 1.6 bln compared to 1.1 bln last month.

The technical outlook for CAD is mixed. Look for near-term support at 1.0862 the June 5th low with resistance at 1.1250.

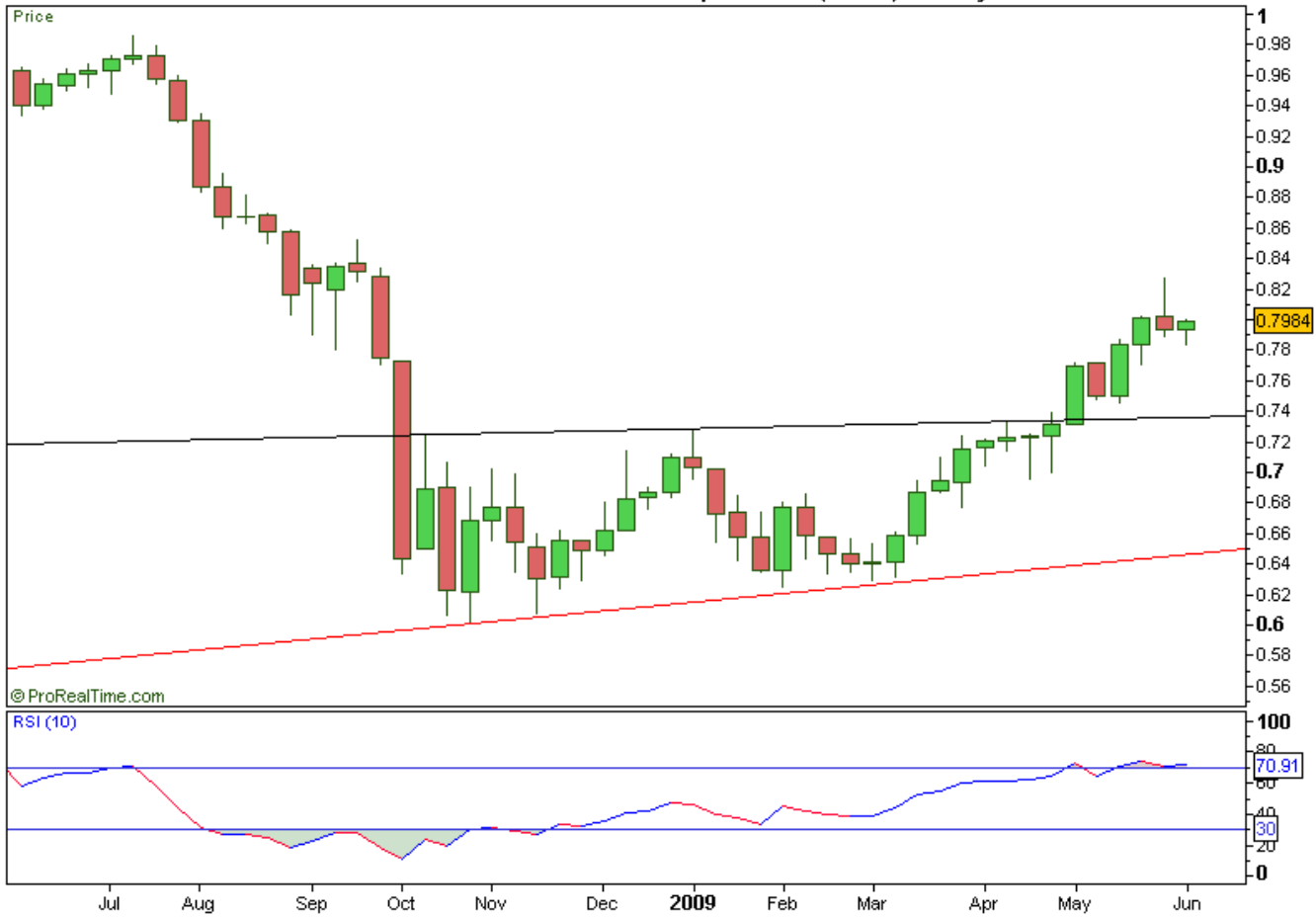


AUD

AUD traded higher supported by an uptick in risk appetite and diminished speculation that the Fed will raise interest rates by the end of the year. AUD reversed early losses that were inspired by weaker EUR trade sparked by an IMF report calling on the EU to come clean on EU bank losses. AUD rallied despite mixed Australian economic data. Australia's May NAB business conditions index declined 4 points to -14. May job ads declined 0.2%. The trade is not focused on Australian domestic data but on the outlook for the global economy and interest rates. As noted above, Japan's finance minister says that the worst for the economy has passed. The BIS says that the global economy is nearing a bottom. Equity markets edged higher Tuesday fueling risk appetite and demand for the AUD. RBA overnight rates remain at 3%. Improved risk appetite encourages demand for higher yields like the AUD. AUD drifted lower in cross trade to the JPY as Japanese officials see improving outlook for Japan's economy as loan losses and bankruptcies fall. The AUD downside should be limited by RBA yield advantage and improving domestic economic outlook in Australia. Look for two-way trade in the AUD with price direction tied to risk sentiment and equity markets.

On June 11th, May unemployment rate and employment growth will be released. The unemployment rate is expected to rise to 5.5% from 5.4% last month and employment growth is expected to fall by 15 K compared to 27K last month.

The technical outlook for the AUD is mixed this week's break below 8000. The break appears to be corrective in nature and expect buyers to emerge near support at 7800. Look for key AUD support at 7853 the June 9th low with resistance at 8123 the June 5th high.



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