

23 September, 2009

# Forex News

## USD CHF JPY

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**Dollar remains under pressure**

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**SNB sticks to expansive policy – for now**

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**Yen still strong – positive interest rate differential to USD**

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## US dollar

The EUR/USD exchange rate rose above 1.44 about two weeks ago and remained on its upward path until recently, when it started to oscillate around 1.47. The data sets of both economic areas have only seen minor changes. Both Euroland and the USA will get out of the recession in the current quarter and post positive economic growth – with the USA probably coming out on top. However, the markets are less interested in current indicators and rather more focused on the question of how sustainable the economic upswing is – and the answer to this question is very dubious.

We believe that the current economic acceleration is due mainly to temporary factors such as the stimulus packages and the inventory cycle. This applies to both economies. Still, Euroland has already recorded a positive surprise in that the economy of the entire region will make it out of the recession at the same time as the USA. Traditionally the Euroland economy would emulate the development of the US economy with a time lag of numerous quarters. We expect the economy to remain weak in both economic regions in 2010, after a short acceleration in the second half of 2009. This means that neither of the two currencies should derive stimulus from this front. The crucial aspect in our forecast is the environment of economic recovery. The US budget deficit will exceed the one in Euroland by a long way; the US central bank has been pursuing a considerably more aggressive path since the beginning of the crisis, and will now have to find its way out. Both aspects increase the risk on the dollar. However, the higher dependency of the Eurozone on exports should contain the depreciation of the dollar. Overall the risks are not equally distributed in our forecast, but are skewed towards a stronger depreciation of the US dollar.

## Swiss franc

The SNB has decided to continue their expansive monetary policy as expected. It was stated that due to the high uncertainty prevailing, the additional measures to relax the monetary conditions (additional provision of liquidity, purchase of bonds denominated in francs, interventions on the FX markets) are still needed, and that the current level of the target for the 3M Libor is still appropriate.

Furthermore, the economic outlook has been revised significantly upwards for the first time since the onset of the crisis. The stabilization of the global economy as well as the less negative than anticipated downturn in Switzerland were the main reasons for a forecast revision by +1% to -1.5% to -2% of GDP growth for the year 2009 (the reading for the second quarter was also the main reason for our own forecast revision to -1.7%). At the same time, it was said that this evolution implied a revision of the inflation outlook, from which it could be deduced that if the expansive policy was maintained, then the inflation rate should significantly exceed the target of below 2% at the end of 2011. Thus, the SNB should leave interest rates low for the moment, yet an interest rate hike seems to show up on the horizon.

Indeed, we expect the SNB to continue their “wait-and see” stance for some time, especially the FX interventions to counteract an excessive strengthening of the franc, which are still needed in our opinion. Thus, we do not expect the first rate hike before that of the ECB, as such a step would cause additional franc strengthening. But if the situation on the FX markets gets more relaxed, and if the franc weakens again, there would be (at the earliest from 4Q10 on) space left for a rate hike.

## Japanese yen

The yen strengthened vs. the USD to 90.5, but has since returned to USDJPY 92. The interest rate differential between the US and Japan, which has been negative for the first time in years, could be an important driver for this. The USD Libor is now quoting at 0.29%, which is the lowest among the currencies we are considering (JPY:0.35%, CHF:0.30%); this might be an incentive for carry trades in USD, thus weakening the US currency. The fact that money market interest rates are lower in the US than in Japan and Switzerland could be related to the rapid expansion of the monetary aggregate M0 by the Fed, providing American banks with significantly more liquidity (and at a lower rate) than before the crisis. Nevertheless, this phenomenon should be limited, as we expect the Fed to hike rates before the BoJ – although certainly not before next year. Even though the BoJ has once more upgraded its outlook for the economy, monetary policy was left unchanged, as expected. In our view, deflationary risks still prevail in Japan; thus, we do not expect a rate hike anytime soon there.

## Forex News – Macro/Fixed Income Research – September 23, 2009

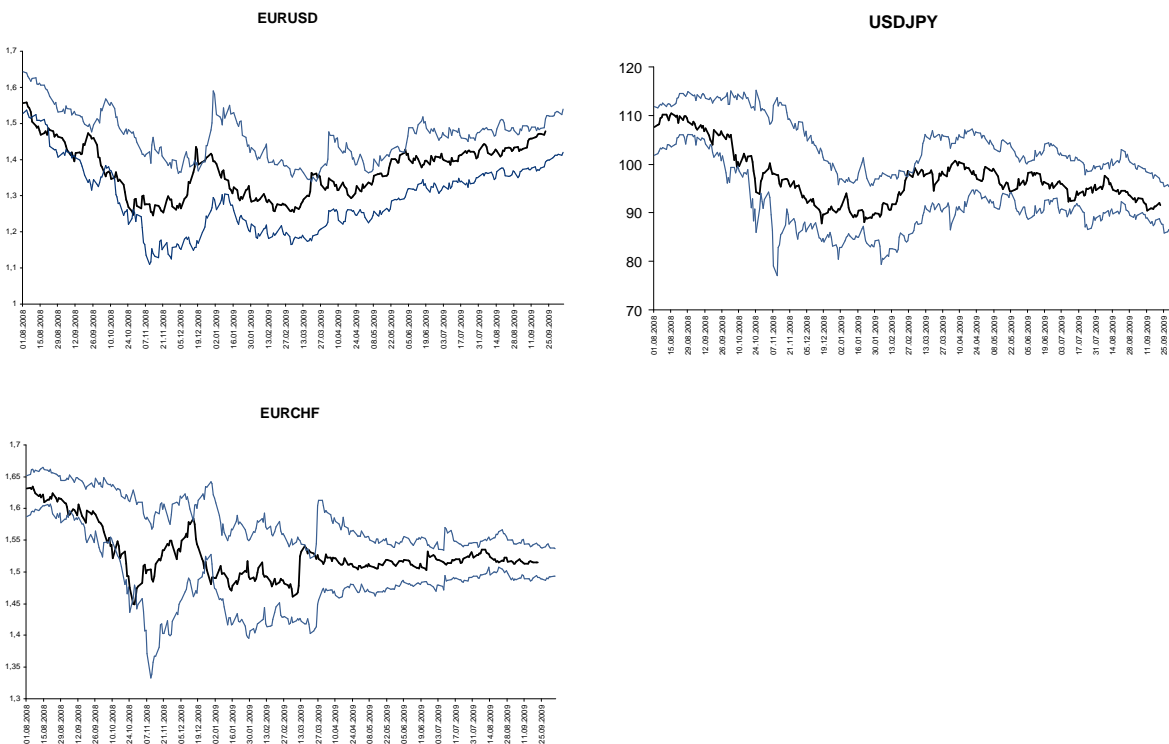
In contrast, the safe haven property of the yen seems to have vanished, as increasing equity markets and decreasing volatility should in principle lead to a weaker yen. Increasing exports and the recent change of government could have contributed to the strengthening. Indeed, the new minister of finance claimed that he was “in principle against interventions on the FX markets,” which is a surprising statement, given the strong exchange rate. On the whole, these arguments point to a (short- to mid-term) shift of the exchange rate to levels at USDJPY 90-95, which has led us to our new forecasts.

### Bandwidths for next two weeks

The following bandwidths were prepared based on market estimates of future exchange rate risks. Starting with today's exchange rate, an upper and a lower limit can be estimated for the exchange rate two weeks from now. This covers the most likely scenarios.

We have compared the forecasted bandwidth with the actual exchange rate in a chart.

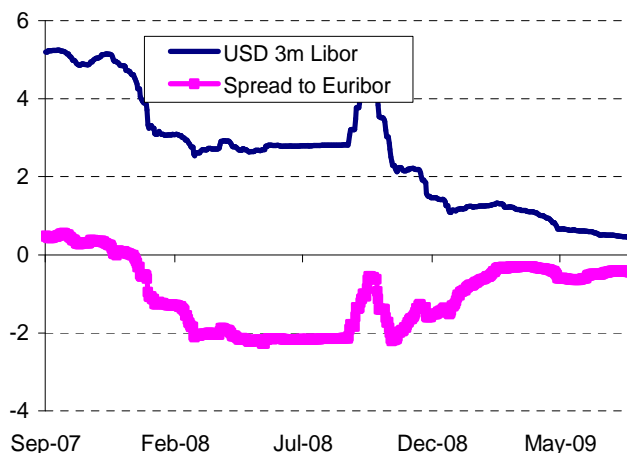
The markets *expect* much wider fluctuations in the future than seen in the past as well, although we have noticed a decline most recently. Thus, the forecasting risk has increased.



**EURUSD**



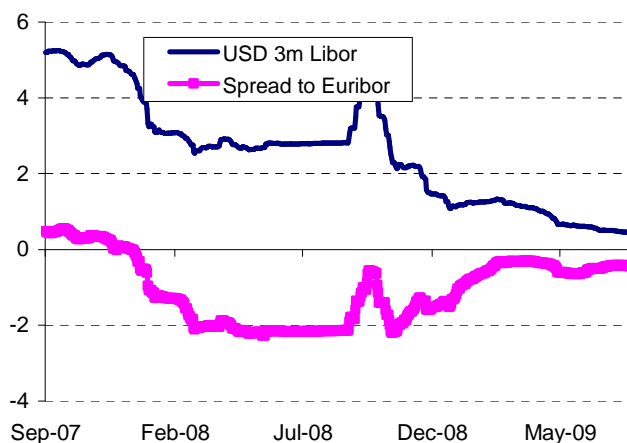
**3m US Libor and Spread to Euribor**



**EURJPY**



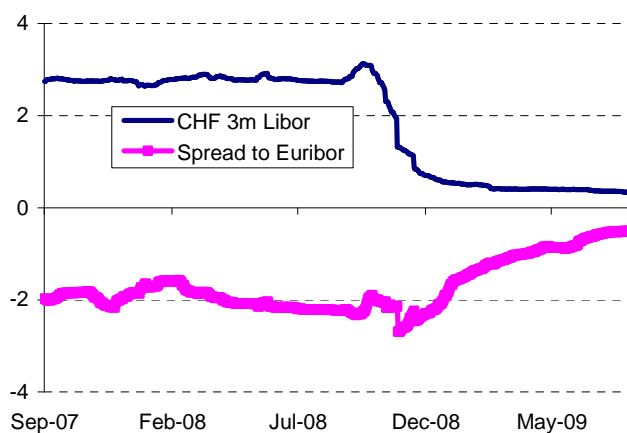
**3m JPY Libor and Spread to Euribor**



**EURCHF**



**3m CHF Libor and Spread to Euribor**



## Forecasts: Exchange Rates

End of Month	Current	Dec. 09	Mar. 10	Jun. 10	Sep. 10
EURUSD	1.4803	1.50	1.53	1.53	1.50
EURJPY	134.65	135.0	137.7	140.8	142.5
USDJPY	90.96	90.0	90.0	92.0	95.0
EURCHF	1.51	1.51	1.51	1.51	1.51

## Forecasts: 3m interest rates

End of Month	Current	Dec. 09	Mar. 10	Jun. 10	Sep. 10
EURO	0.71	1.00	1.10	1.30	1.60
Japan	0.35	0.30	0.30	0.30	0.30
USA	0.29	0.50	0.70	0.90	1.00
Switzerland	0.30	0.25	0.25	0.25	0.30
Spread vs Euribor	-0.41	-0.75	-0.85	-1.05	-1.30

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