FX-AM

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TREASURY

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Headlines

- Rising risk appetite supports commodity and equity markets
- Interest rate spreads provide a USD boost – correcting from oversold state
- Technical outlook improving for USD DXY index

Overview

Risk appetite continues to increase globally leaving equity and commodity markets close to their high for the year. The S&P500 briefly recorded a new cycle high on Friday, following the stronger than expected US non-farm payroll report (which indicated that only 345k jobs were lost in May). The correlation between the FX carry trade and equities remains high, with AUD/JPY and NZD/JPY also close to their 2009 high.

Stronger US data is now leading to a rise in interest rate expectations. The implied yield on the June 2010 eurodollar futures contract rose by over 50bp on Friday and the 2yr-10yr yield curve has begun to flatten. The spread between 2-year EZ and US interest rate swaps has fallen to an 18 month low, providing a broadly USD positive environment.

From a technical perspective the outlook for the USD appears to be improving. Friday's rally following the earlier key day reversal (recorded on Wednesday) in the USD DXY index is a bullish sign. A close above 81.13 (the late May 2009 high) would suggest a deeper correction towards the 200-day moving average (currently at 83.6).

US economic data are limited this week, with the focus largely around trade and retail sales. The trade report is a key risk for the USD, given the gradual rise in energy prices. A failure for trade to improve further would suggest a rise in the structural risk for the USD.

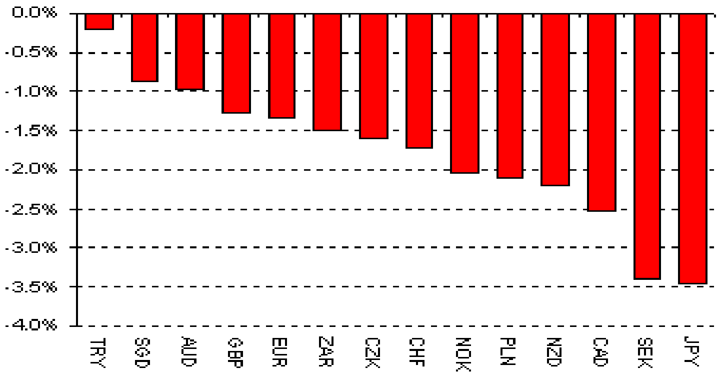
Sterling

Whilst GBP/USD continues to drift lower (driven by broad USD strength – the GBP/USD 200-day moving average lies around \$1.54), EUR/GBP appears to have found strong resistance around £0.8870. The sharp failure at this level suggests that sterling weakness (due to UK political events) is now close to being fully discounted.

Additionally EZ/UK interest rate spreads continue to drift lower, following the high recorded in late May 2009. This suggests that the risks for EUR/GBP now lie to the downside unless resistance up to £0.9040 is breached. With data limited this week, the key data risk for sterling is the latest BoE inflation attitudes survey.

Chart of the Day

Last Week'S Currency Moves Against The Dollar



Source: Bloomberg & BOS Treasury

Market Correlations

	EURUSD	GBPUSD	USDJPY	EURJPY	AUDUSD	EURCHF
Oil	0.89	0.90	0.27	0.91	0.93	0.56
Gold	0.96	0.95	-0.15	0.70	0.89	0.66
S&P 500	0.56	0.55	0.66	0.87	0.74	0.24
2Yr US YLD	0.25	0.26	0.74	0.67	0.38	0.25
10Yr US YLD	0.75	0.78	0.34	0.83	0.78	0.58
EU-US 2Yr SPD	0.54	0.47	-0.46	0.16	0.39	0.24
EU-US 10Yr SPD	-0.61	-0.66	-0.31	-0.70	-0.64	-0.57

*1 Month Correlations - Data Source Bloomberg

FX Trend Analysis

Currency	ST Trend	MT Trend	LT Trend
DXY Index	-1	-1	1
EURUSD	1	1	-1
GBPUSD	1	1	-1
USDJPY	-1	1	-1
EURJPY	1	1	-1
AUDUSD	1	1	-1
EURCHF	1	1	-1
EURGBP	-1	-1	1
USDCAD	-1	-1	1

Today's Key Economic Events

Time	Country	Event	Consensus	Previous
11:00	GER	Factory Orders	n/a	3.3
13:15	CAN	Housing Starts	130.6k	117.6k
16:00	EUR	ECB's Constancio speaks	-	-
17:30	US	Fed's Tarullo speaks	-	-
18:35	EUR	ECB's Stark speaks	-	-

FX & Commodity Futures Positioning

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Data from the major US futures & options exchanges are released each Friday evening and report positions up to the close of business on the previous Tuesday. Traders are classified as either commercial or non-commercial. The positioning of the non-commercial traders can be used as a proxy for the speculative side of the market as a whole. Extreme net long or net short positions are taken as an indication of the market's vulnerability to a sharp move higher or lower. For a squeeze to occur, however, a separate catalyst such as a piece of fundamental news or a breach of a key technical level is usually required.

The latest IMM data report, released on Friday 5th June, covers speculative positions up to Tuesday 2nd June 2009. The data shows that speculators were net buyers of USD against AUD, CAD, & EUR. Speculators continue to build their net short position in USD/CHF, and as such the positioning is looking extreme (currently at the 8th percentile – over 3 year period). The correction in this position is now underway and we believe it has further to run. Positioning in GBP/USD continues to normalise towards the 50th percentile (currently at the 32nd percentile - as measured over a 3 year period). Speculators have been net buyers of sterling (in the latest report), however we suspect that much of this has now been reversed given the sharp sell-off in the second half of last week (triggered by a UK political risk and rising US interest rate expectations.