

11 May 2009

Headlines

- EM and commodity currencies surge as risk positive sentiment rises
- EUR/USD breaking higher, pushing through 9-month trend line
- Inflation expectations grind higher, weighing on USD

Overview

The downward trend in the USD has intensified with the DXY index closing below its 200-day moving average and in danger of recording a head and shoulders reversal formation. The chart across indicates USD weakness last week – the USD has lost most ground against high yielding growth sensitive currencies (EM and commodity linked currencies).

EUR/USD has also broken through its 200-day moving average as well as closing through the downward trend from the July 2008 (all-time) high. The trend line currently provides support at \$1.3517. Daily RSI and stochastic indicators continue to provide upside risk for the currency pair.

The USD weakness has been driven by 3 key issues. Firstly, improvement in economic data has led to the perception that the worst is now past. Leading indicators continue to improve (US ISM's are bouncing higher despite remaining in contractionary territory) whilst the pace of job destruction in the US has fallen (the latest non-farm payrolls report indicates 539k jobs lost in April which is an improvement from the 741k jobs lost in January). Secondly the bank stress test results have shifted the focus away from the financial sector, removing the financial sector led risk aversion (USD positive) factor. Thirdly, US inflation expectations have continued to drift higher providing a mild USD negative factor.

The important US data this week is trade balance, retail sales, empire manufacturing and CPI reports. A further improvement in retail sales and empire is likely to weigh on the USD as risk positive sentiment rises. Additionally we also see an upward risk to the inflation report, any increase here will also be USD negative.

Sterling

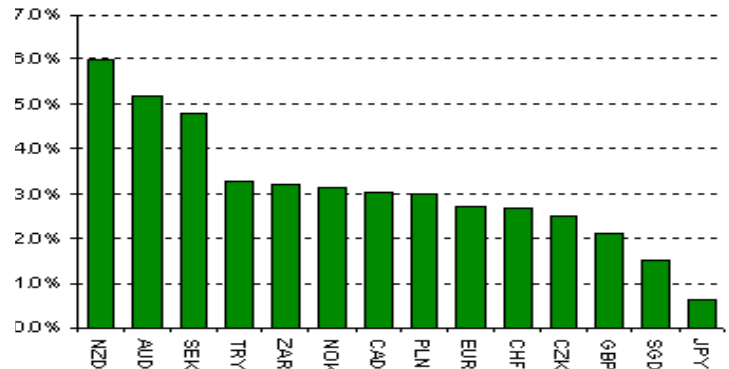
GBP/USD continues to drift higher, supported by broad based USD weakness. The currency pair is now at a 4-month high with the next major level at \$1.5373.

The spread between 2-year EZ/UK interest rate swaps continues to narrow (against the euro). Alongside an improvement in the financial sector (which is sterling positive) and upward data surprises we look for EUR/GBP to resume its downward move.

The key data focus this week will be the Quarterly Inflation Report, which gives the Bank of England an opportunity to outline its latest inflation and growth forecasts as well as providing an update on the quantitative easing programme.

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	0.88	0.81	0.13	0.73	0.93	-0.14
Gold	0.65	0.46	-0.38	0.29	0.61	-0.50
S&P 500	0.83	0.85	0.10	0.67	0.92	-0.20
2Yr US YLD	0.24	0.17	-0.17	0.09	0.37	0.08
10Yr US YLD	0.68	0.59	-0.08	0.47	0.76	-0.28
EU-US 2Yr SPD	-0.64	-0.54	0.22	-0.36	-0.66	0.42
EU-US 10Yr SPD	-0.37	-0.32	0.28	-0.14	-0.42	0.48

*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

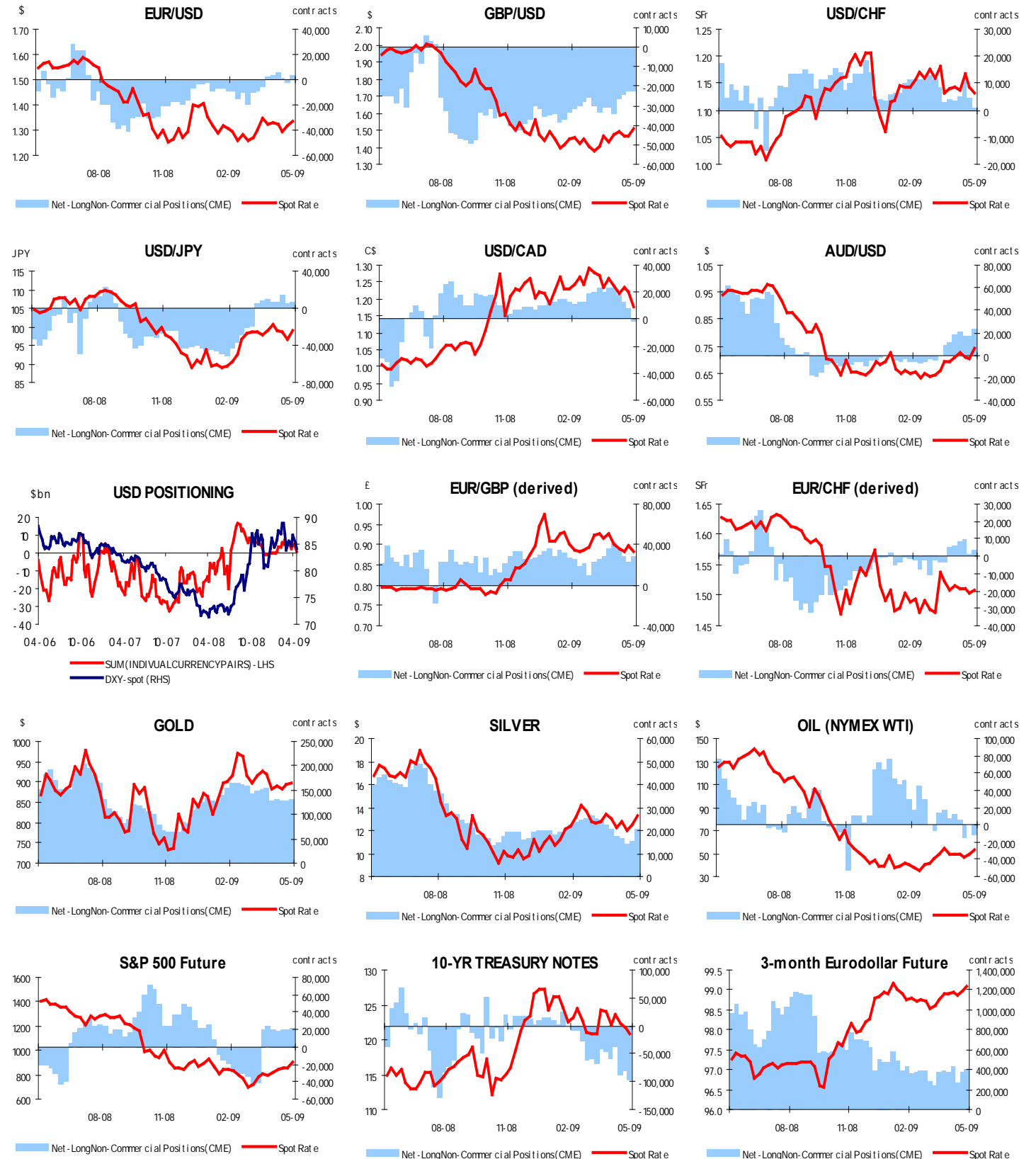
Today's Key Economic Events

Time	Country	Event	Consensus	Previous
13:30	CAN	New Housing Price Index	-0.5	-0.7

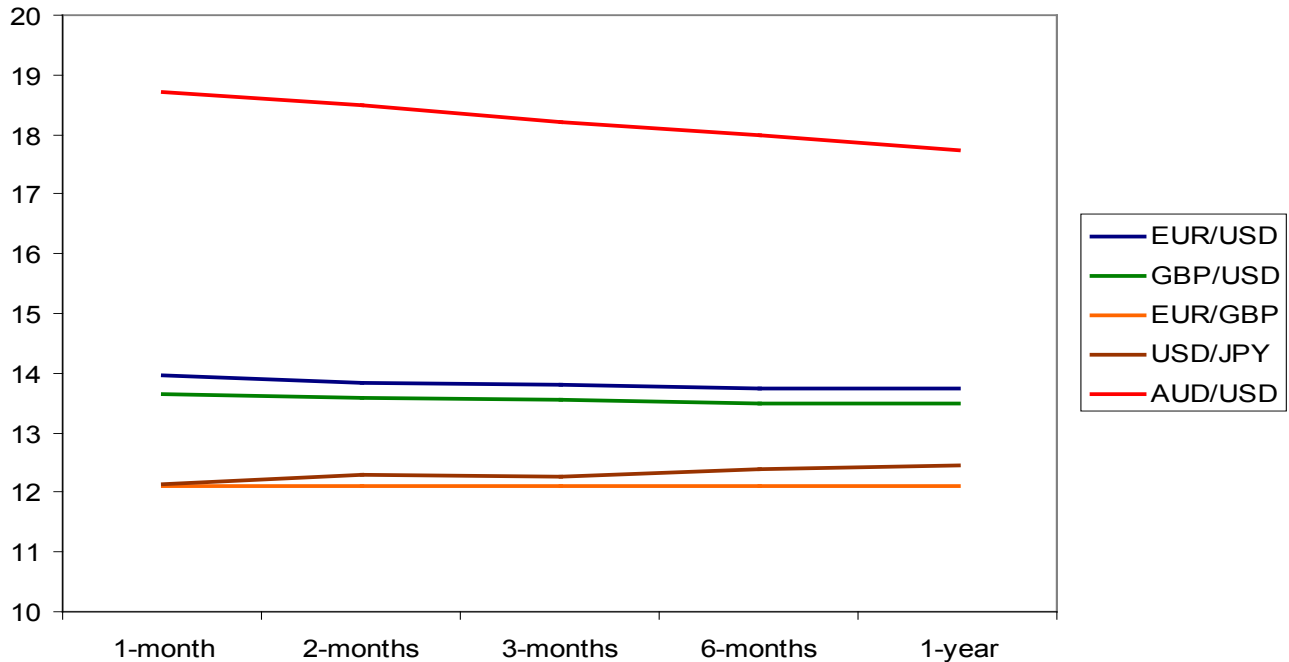
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Data from the major US futures & options exchanges are released each Friday evening and report positions up to the close of business on the previous Tuesday. Traders are classified as either commercial or non-commercial. The positioning of the non-commercial 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 shows a continuation of speculators moving away from the dollar and back into the higher yielding and commodity currencies. Generally positioning is being normalised after reaching the extreme levels a couple of months ago. Positioning in USD/CAD has turned net short for the first time since July 08; this is being driven by speculators appetite to take positions in more risky commodity currencies as the global growth outlook is improving. Long positions in AUD/USD, GBP/USD and USD/CHF all continued to grow, as net positions are normalising compared to historical levels (3 year percentile ranks) the change in sentiment provides some downside corrective risks for commodity and higher yielding currencies against the dollar.



Volatility curves trade flat across most currency pairs



EUR/USD (range 1.3213/1.3645). Last week certainly had key data releases yet the currency pair's actual volatility measured just 13.2 percent for the period. Post long weekend, implied volatility traded lower each day and the 3-month closed at 13.5. The volatility curve is now very flat. We have seen wings become slightly cheaper (butterflies marked lower). There has been interest in ranges and EUR calls with knockouts below 1.2700. Risk reversals have traded higher and calls trade above puts across all dates.

GBP/USD (range 1.4835/1.5252) remained fairly range bound toward the tail of the week with actual volatility 14.5. There has been interest in topside barriers one of note was 1-year 1.7800, we have barriers on our book which are concentrated on the approach to 1.6000.

EUR/GBP (range 0.8765/0.8974). We have seen buying interest across the curve throughout the week but despite this volatility was sold heavily post payrolls. The whole curve is about flat with implieds at 12.2 percent. We have seen interest in ranges.

USD/JPY (range 97.94/99.80) A very confined week for the currency pair actual volatility was just 11.4 percent. Volatility came lower led by the front end. The whole curve trades about 12.3 now. We think AUD/JPY vol looks high trading at 26 percent considering the legs of AUD/USD and USD /JPY are trading at 18 and 12 respectively. Risk to reward may not lend markers maker to be short which has prevented this coming in line.

