Rockefeller
Strategic Currency Briefing©

Thursday, May 6, 2010
Price Quotes as of 5:00-6:00 am EST
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	SPOT	CURRENT POSITION	SIGNAL STRENGTH	OPEN DATE	OPEN RATE	POSITION GAIN/LOSS
USD/JPY	93.72	LONG USD	WEAK	03/24/10	91.93	1.91%
GBP/USD	1.5043	SHORT GBP	WEAK	04/29/10	1.5249	1.35%
EURO/USD	1.2774	SHORT EURO	WEAK	04/23/10	1.3326	4.14%
EURO/JPY	119.72	SHORT EURO	WEAK	04/28/10	123.47	3.04%
EUR/GBP	0.8490	SHORT EURO	WEAK	03/24/10	0.8922	4.84%
GBP/JPY	141.10	LONG GBP	WEAK	03/25/10	137.22	2.83%
USD/CHF	1.1137	LONG USD	WEAK	04/23/10	1.0759	3.39%
USD/CAD	1.0350	LONG USD	WEAK	04/29/10	1.0035	3.04%
AUD/USD	0.9042	SHORT AUD	STRONG	05/05/10	0.9104	0.68%
AUD/JPY	84.75	LONG AUD	WEAK	02/17/10	81.62	3.83%
USD/MXN	12.7319	LONG USD	STRONG	05/05/10	12.5015	1.81%

Position Gain/Loss (%) is calculated on the difference between Open Rate and Spot. The Gain/Loss is hypothetical—we do not claim to execute trades at these levels. Note that Gain/Loss does not account for the cost/earning of carrying a position, which can be substantial. It is therefore unrealistic and not comparable to a true Gain/Loss accounting of real-world trades done at the same levels. The purpose of the Gain/Loss entry is to show roughly whether the current forecast is right. **This morning FX briefing is an information service, not a trading system. All trade recommendations are included in the afternoon report.**

Summary: The dollar is up across the board (except the yen) as risk aversion continues to spread after a warning by Moody's yesterday that it may cut Portugal's Aa2 sovereign rating by up to two notches. BBK chief Weber said Europe faces "grave contagion effects." The US 10-year yield fell to 3.55%, stocks everywhere are retreating, commodity prices are crashing, and the pressure on ECB Trichet at this morning's press conference is now crushing. The ECB left rates at the same 1%, as expected.

What's Happening This Morning: The euro continued its almost uninterrupted one-way drop yesterday, from 1.2925 at the US open to 1.2815 by the close. Asia sold it off to a low of 1.2736 as traders returned to Tokyo after Golden Week, but in early Europe, Spain managed to auction €3 billion of 5-year notes (the FT says €2.4 billion) and the euro got a respite, if only by about 100 points to 1.2826. The yield on the new Spanish paper rose from 2.8% to 3.58% but this is considered okay in light of 13.3% that Greece had to pay. Reuters points out that yesterday, Portugal sold €500 million in six-month Treasury bills at a yield of 2.955%, about four times the rate at the last sale on March 3 but this was also okay, and "seen as a moderately positive sign by analysts."

The Greek parliament votes today on the latest austerity package and is expected to approve it, but yesterday's riots (with 12 dead) were shocking and suggested that lawmakers may pass laws but it's a different matter to get them enforced. Even if everything goes tickety-boo this week and money is disbursed next week, the crisis won't be over—Greece still has to implement austerity.

The ECB meets today with the rate announcement at 7:45 am EDT and the press conference a few hours later. It is meeting in Lisbon this time. Nobody expected a rate change but Trichet will get peppered with questions about liquidity management. We are a little puzzled about this—while it's true that the ECB is now accepting lower-quality paper from Greece than the rules originally allowed, wasn't it already doing that during the 2008-2009 crisis, anyway? It was accepting just about any old asset and for a while, lending against that paper for as long as a year, hardly the intent and normal practice of the repo market. How the ECB manages to hold on to "credibility" is a public relations triumph.

The press is under-reporting Swiss intervention. The WSJ says the Swiss franc "soared against the euro after traders said the Swiss National Bank had abandoned efforts to prevent the currency's rise." Bloomberg reports

that the SNB, which had intervened periodically since 2009, may be accepting a new level for the franc against the euro around 1.42. Yesterday and overnight the "Swiss franc appreciated as much as 0.8% to 1.4212 per euro in the biggest intraday advance since March 18, before trading at 1.4228 at 11:47 a.m. in London, compared with 1.4327 yesterday. The currency was little changed against the euro in the previous three days on speculation the Swiss National Bank sold the currency to prevent gains that may hamper the nation's economic recovery." A SNB spokesman declined comment, Bloomberg makes the connection between intervention and deflation, the original trigger of SNB intervention in March 2009, but now Swiss CPI is up 1.4% y/y in April, the highest since Nov 2008 and over forecast. Another view, from UBS, is that "the SNB is letting the market do the work without standing in the way. The sentiment is against the euro, and investors are selling it, without the SNB buying on the other side."

Financial Markets: The Dow fell 0.54% and the S&P fell 0.66%. It was fun to see Kudlow (and Forbes et. al) on TV saying despite the big three-day drop, the US market is still a buy. No, it's not. See the S&P chart. This is a downside breakout with plenty more possible, and nobody knows where it stops.

US markets were followed in Asia by the Nikkei down a whopping 3.27%. In China the Shanghai tanked 4.11% to the lowest in over 8 months and the Hang Seng fell 0.96%. Other Asian markets also fell, each with its own interpretation of the contagion story. Expectations of slower growth in China from tightening policies was just barely acceptable but worsened on the forecast of a European slowdown that will cut imports from China. Commodity and banking stocks got hit hard in many places.

The WSJ reports that resource stocks tumbled across the [Asian] region as the dollar's strength hurt commodity prices. Rio Tinto fell 3.8% in Sydney, commodities trader Mitsubishi fell 5.4% in Tokyo and Cnooc gave up 2.4% in Hong Kong. Exposure to Europe hurt some exporters, like Canon)-3.1%) and Nikon (-3.5%).

Everyone wonders whether this is a realistic response to events with real economic clout, or a hysterical over-reaction. After all, Greece accounts for only 2.6% of eurozone GDP. But the impact of Greek failure is bigger than the GDP implies because the eurozone is an idea. It's a Big Idea and a key founding assumption is being proven false (that you don't need to be an actual sovereign with taxing ability to issue a currency, just strict fiscal rules and a really good central bank).

The FT reports the FTSE All-World equity index fell 1.1% on the new low in the euro. "Markets have been rocked over the past few days as the danger to the global economy of unsustainable budget deficits has hit home hard. Riots in Athens have illustrated how the severe austerity measures designed to tackle such deficits have implications not just for economic growth but also for social cohesion. The dollar and highly-rated government bonds have been pushed sharply higher on haven flows, while New York's benchmark S&P 500 has lost 3 per cent in two sessions as investors considered the implications of such scenes being replicated in other European states." See "Economies" below for the WSJ's take on the contagion effect to the US.

Economies

In the US, the April service sector ISM came in a little weaker than expected at 55.4, unchanged from last month. Well, it's not an outright negative for the economic outlook and could get overshadowed by good same-store sales today and payrolls tomorrow.

In the UK, the election today overshadows everything, but analysts note that signs of recovery are spotty. Today the April service sector PMI fell unexpectedly to 55.3 from 56.5 instead of rising to the forecast of 57.

Economic Consequences of Greece: Why should US markets much care if Greece defaults or gets bailed out? In fact, why should the big countries of Europe much care? As the WSJ says, economically, so far Europe "has been able to largely shake off the effects of Greece's fiscal crisis. For all the trouble in Greece

and, to lesser extent Portugal, those two countries account for less than 5% of the region's GDP. Even when Ireland and Spain are added in, the troubled periphery accounts for less than one-fifth of euro zone GDP. And as investors pull money out of Greece, they're putting it into Europe's safe havens, particularly Germany, where the 10-year bund yield is now less than 3%, down about half a percentage point since the beginning of the year and near an all-time low. French interest rates are also down. The two countries account for half of euro zone GDP."

This is the same thing as a rate cut. "Lower financing costs and a roughly 15% slide in the euro since December are a powerful mix for Germany's investment and export-dependent economy. Though Germany's GDP stalled at the end of 2009 and was likely affected by a severe winter in the first quarter, business surveys point to a strong pickup in the second quarter." A JP Morgan Chase economist told the WSJ that Q1 eurozone GDP could be 1.5%, led by 4% in Germany—while the EC itself is far less optimistic about growth.

As for the US, "Greece is far too small to have much effect directly on the U.S. Its economy is about 2% the size of the U.S.'s and it takes in less than 0.1% of U.S. exports. But Europe as whole has powerful ties to the U.S. through trade, investment and finance. U.S. banks hold more than $1 trillion of European debt, according to the Bank for International Settlements. Bruce Kasman, J.P. Morgan's chief economist, estimates that the 16 nations of the euro zone account for about 14% of U.S exports, apart from petroleum products.

"Those ties can become weaknesses in bad times. One big surprise of the U.S. housing crisis was how many European banks held securities tied to worthless U.S. mortgages and how much they lost. A recession in Europe followed quickly on the heels of one in the U.S. Even before the Greek crisis, the IMF estimated that the euro zone, whose economy contracted by 4.1% in 2009 would grow at just 1% this year. Anything short of that could curb U.S. exports and weaken what is projected to be an already humdrum recovery.

"Perhaps the biggest wild card is uncertainty itself. The financial panic of 2008 has made investors skittish of a repeat performance. Some may view that Greece's problem with a heavy debt load will be mirrored over the next few years in the U.S., U.K and other wealthy countries. Investors are less tolerant of contagion than in past crises. The Dow is down 3% from the high this year and the dollar is up 12% against the euro, which "has siphoned anxious investors from other currencies. As the dollar strengthens against the euro, U.S. exports to Europe become more expensive, and U.S. businesses face a competitive disadvantage against European firms in Asia and elsewhere.

Offsetting that drag on the U.S. economy is the fact that turmoil in Europe has driven investors into U.S. Treasury bonds, helping to hold down the long-term interest rates at which home buyers and businesses borrow. It also has helped to hold down commodity prices, restraining inflation and keeping market interest rates from rising. "So far, the U.S. market reaction has been orderly—and mostly mild. Corporate borrowers with credit ratings below investment grade—known as "junk," or high-yield, borrowers—are paying about a quarter of a percentage point more to borrow over risk-free debt than they did a week ago. A Bank of America Merrill Lynch index tracking high-yield debt returns has barely budged from a high set just last week."

But "The mechanism by which financial-market unrest spreads is never immediately clear, nor direct. The 1997 Asian crisis, for instance, contributed to the 1998 Russian crisis by driving down the price of oil, which hurt Russian government revenue, and later spread to Latin America. This time, losses on loans to Greece and other weaker European nations could produce big losses for European banks, which borrow from U.S. banks, causing a general panic and freezing lending."

We are unconvinced by the logic that has default/bailout in a small European country somehow contaminating US growth. The financial sector at some level, certainly, but not core activities. US growth is driven by the consumer. While it may be true that US consumer product companies operating subsidiaries in Europe (soap, packaged food, IT stuff) will suffer, this is minor in the grand scheme of globally recovering earnings. Sales in China and emerging Asia should more than make up for it.

Greek Debt Drama: The Greek Parliament will vote today on the new austerity package. The WSJ says "The measures are likely to pass, with the government holding a 160-seat majority in Greece's 300-member

parliament…. Late Wednesday, Greek President Karolos Papoulias warned that the country stood on the 'edge of the abyss' after violence rocked the capital, and appealed for solidarity in the face of the crisis. 'It is the responsibility of us all to not take the step into the void,' said Mr. Papoulias. 'What is at stake in coming days is to keep social cohesion and social peace.'"

Other Markets: Oil closed down dramatically again at $79.97 from $82.74 with the low at $78.87, and everyone cheered the drop under $80, but it is back over the $80 level at 7:45 am EDT. Bloomberg manages to report on big price changes without mentioning yesterday's usual inventory report until the last paragraphs. The Energy Dept reported US crude oil imports up 2.8% to 9.95 million barrels a day, the highest level since the week ended July 24. Fuel imports surged 9.9% to 3.1 million barrels a day, the highest level since the week ended Feb. 5. Crude oil inventories rose 4.9% to 36.2 million barrels, the highest level since the department began reporting on supplies at the hub in April 2004. Wait a minute—we have high demand but it's being stored?

Yes. Bloomberg says "WTI for prompt delivery traded in New York are at a discount of $2.97 a barrel to July contracts, close to the widest spread in more than a year. This market situation is known as a contango." A SocGen analyst says the rises in inventory are "still bearish for the front of the WTI curve. Refiners continued to increase run. However, crude oversupply also continued. The product demand recovery is slow and fragile."

Bloomberg also connects the price of oil to the dollar naturally. "Oil has lost 6.9 percent in New York since May 3, the biggest three-day decline since a slump that concluded on Feb 5. Yesterday the euro tumbled to its lowest level against the dollar since March 2009 on concern Greece's bailout may have to be extended to other indebted nations."

In sum, oil traders don't know which end is up. The gold market is similarly confused. It has buyers who hate the reappearance of sovereign debt problems (the "told you so" crowd) but they are offset, seemingly, by the "commodity complex" being in thrall to the dollar.

The Main Event: The yield on the 10-year note fell to 3.55% from 3.613% as the safe-haven big continued on the euro and stock market routs. Market News reports an upcoming shortage of Treasuries—the Treasury will sell $3 billion less in the May refunding than expected. The new amounts are "$38 billions 3s next week vs. $40 billion in the February refunding and $24 billions 10s vs. $25 billion last time. Bonds were unchanged at $16 billion. A statement from the Treasury Borrowing Advisory Committee suggested meaningful reductions in 2s, 3s, and 5s ahead and smaller cuts in 7s, 10s and 30s. The Treasury market rallied and the curve resteepened after days of flattening…

Note that the 2-year note hit a low yield of 0.81% from 0.96% the day before, with $44 billion in 2-year notes sold only last week at 1.02%. "Likewise, $42 billion 5s sold last week at 2.54% and they reached a low yield of 2.24% Wednesday morning before settling at 2.30%." Pity the poor shorts.

Outlook: We get same-store sales today (continuing), with a forecast of an April rise of 1.7%, says Reuters, after a drop of 2.7% last year. This comes after a record 9.1% rise in March and "Many industry experts are looking at the combined two-month results as a better gauge of consumer strength… An April increase would also mark the eighth consecutive month of rising sales after a year's worth of declines as consumers warm up to spending on nonessential items again and retailers craft new strategies to entice shoppers…"

Despite the overwhelming appeal of the Greek contagion story, the payrolls data tomorrow is not to be neglected. It has been the biggest release anywhere for several years and not to be outshone by anything. Yesterday ADP estimated that April private payrolls rose 32,000 (compared to the 19,000 revised March reading), a smallish number in the context of overall payrolls probably up 200,000 (including the public sector). ADP is less relevant this time because it has been getting the number almost as wrong as everyone else of late, but also because new money flowing into the economy doesn't care whether it comes from private or public sector. All money is green, so to speak. If we really do get 200,000 new jobs, it's dollar-favorable. Perhaps recovery in the US is U-shaped but it's not L-shaped, as Stephen Jen puts it, and on the whole, the FX market

rewards growth.

We said earlier this week “watch the Canadian dollar” as a proxy for risk aversion. Canada is the country with the least deficit problem and it’s the biggest beneficiary of a US recovery, as well as a “commodity country.” They probably don’t like that appellation north of the border, but it’s true. When global investors bail out of the C$, something big is happening that is not likely to get reversed in a hurry. Yesterday the USD/CAD made a new high but did not close near the high. Everywhere else the dollar did close near the high—the C$ is the sole exception. It did close in the top 1/3 of the bar, but let’s take warning.

It is said that investors hate uncertainty. Well, maybe so, but traders love it. We worry about an abrupt reversal on a new perception—as in the C$, on perception that it’s “cheap” in light of the near-universal forecasts for a higher level, or the UK, where sterling could bounce just because the election is over, whatever the outcome. As for markets feeling spinsterish about excessive debt, this comes along periodically and causes a crisis but is soon forgotten. Yes, the US is next in line if debt phobia were to get a grip, but in 30 years of reporting FX we have never seen debt-phobia rule, even when that nitwit Gingrich closed down the US government. In short, this too, will pass. Just not yet.

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Chart Prices as of the NY close on
Wednesday, May 5, 2010

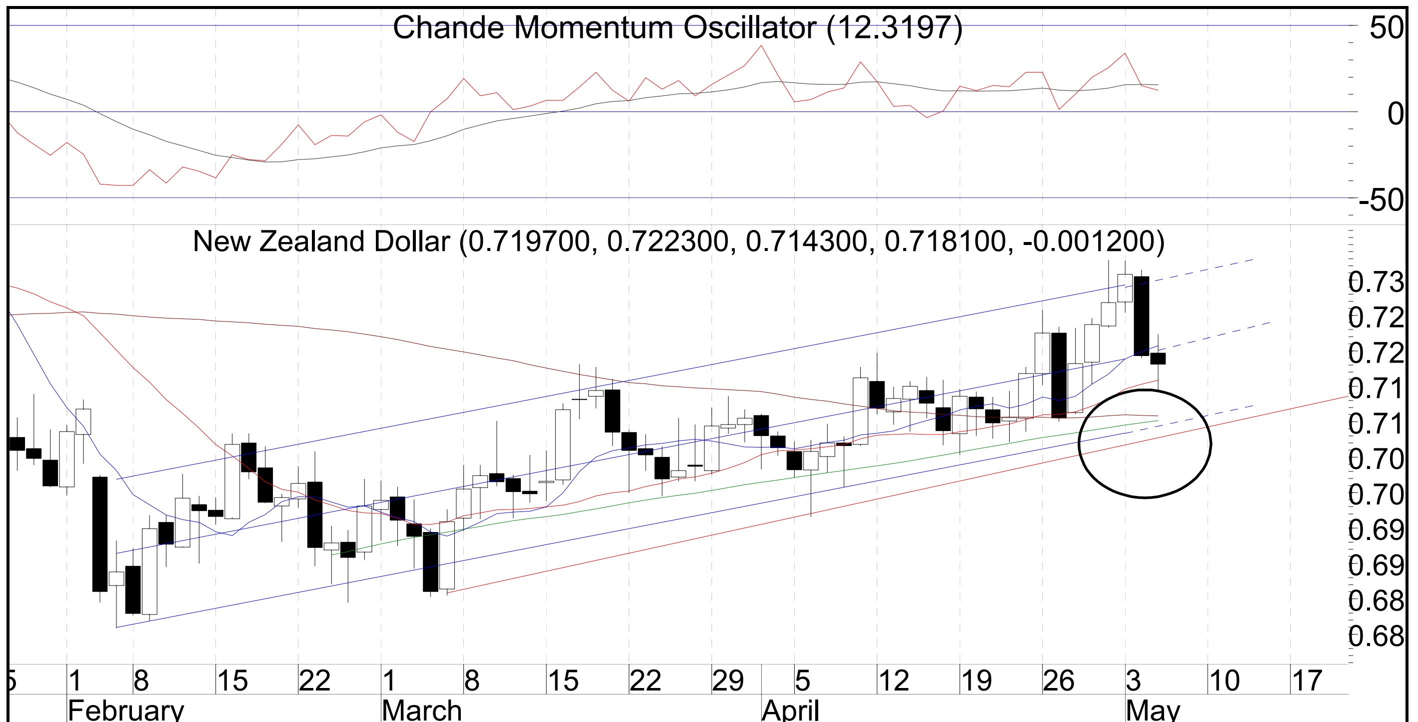
Daily Morning Chart Package

Chart Legend

Top Box: Chande momentum oscillator (relative strength index).
Center Box: Momentum (today's close divided by the close x days ago).
Bottom Box: Previous Trading Day Open-High-Low-Close.
9-day moving average in Dark Blue.
20-day moving average in Red
55-day moving average in Turquoise.
100-day moving average in Dark Red
200-day moving average in Green.
Active linear regression channel in Blue. Previous linear regression channel in Gray. Competing linear regression channel in Red. Linear regression forecast in dotted blue. Linear regression alone in double black (occasionally). Key previous high or low horizontal line in Dark Yellow (occasionally). Hand-drawn support or resistance in red (occasionally). Vertical Blue lines mark dates of signal change from buy to sell or sell to buy.

Spot data from eSignal. Futures data courtesy of Reuters. Charts prepared in Metastock.

New Zealand Dollar

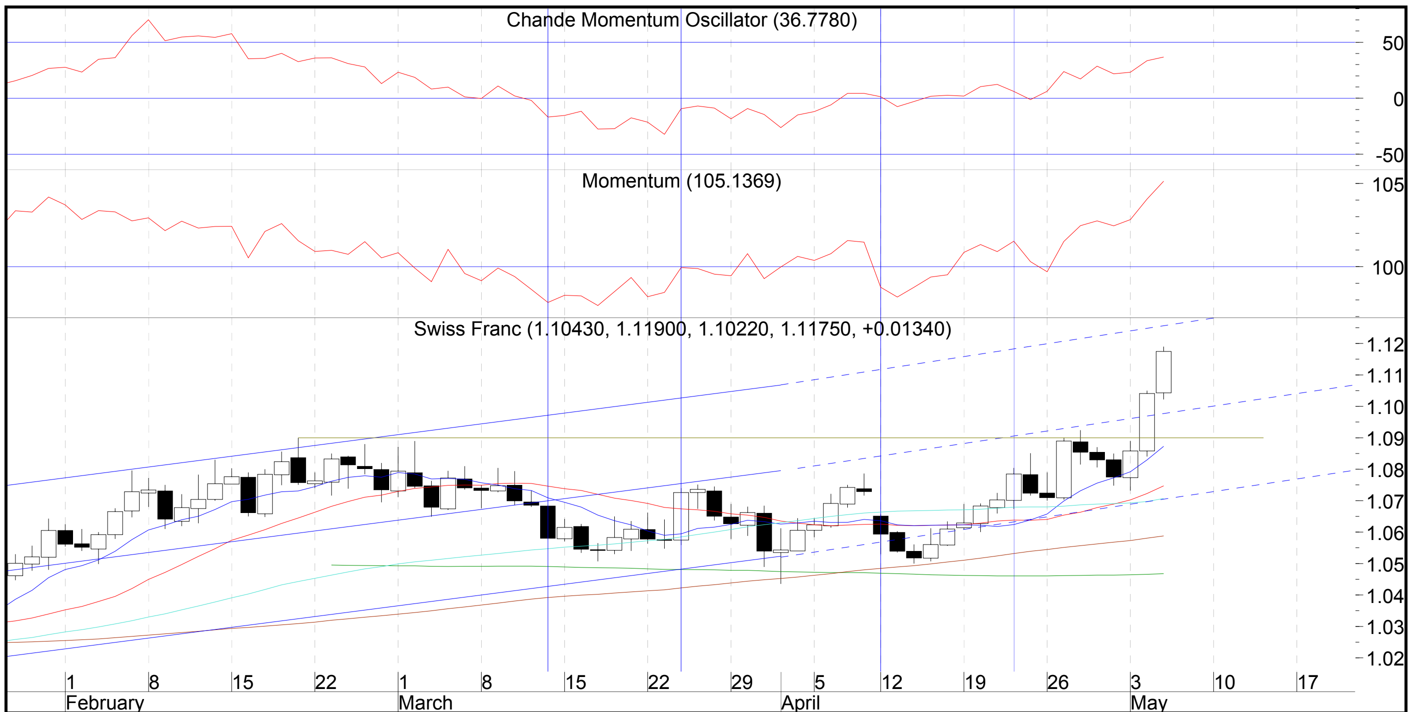


Another down day if with less violence. The bar spans the 9-day (blue) and 20-day (red). See the green 200-day converging to the dark red 100-day. That's the long-term trend—up.

EURO/USD

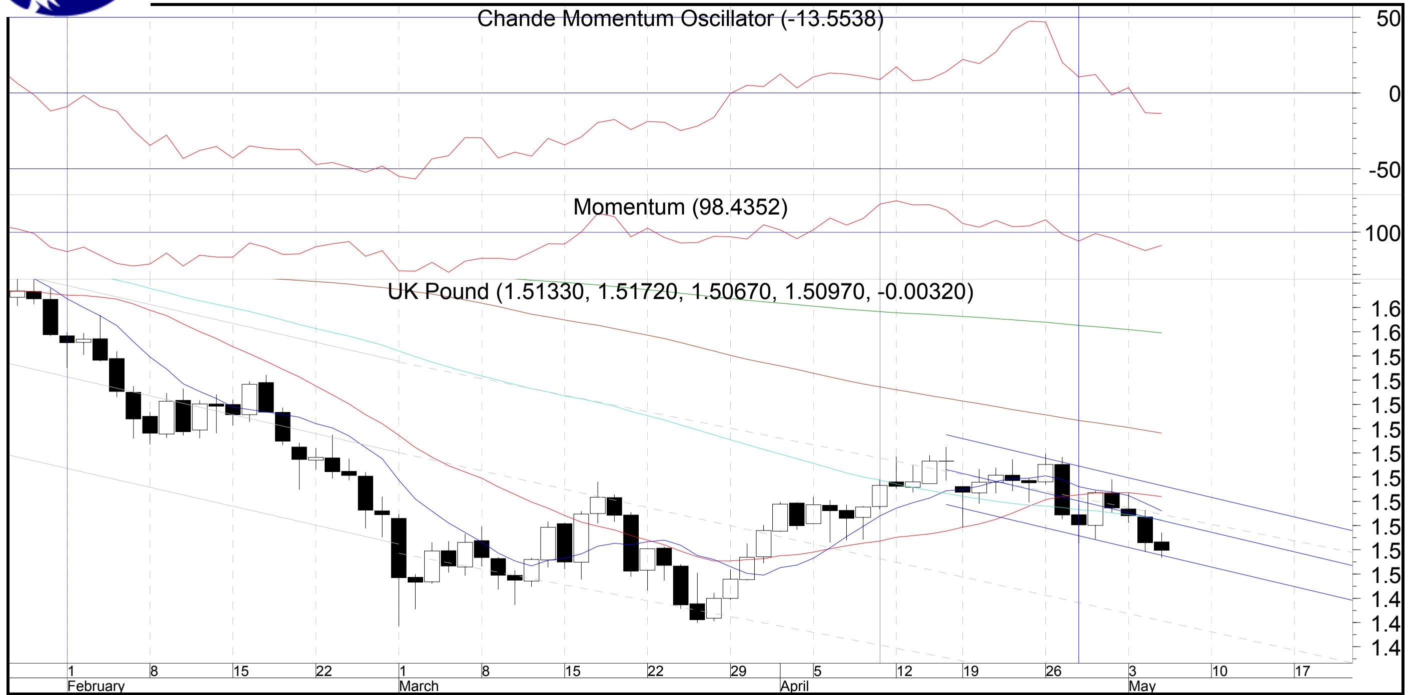
The euro closed down heavily for the third day. The channel bottom is 1.2634 on Friday.

USD/SWISS FRANC



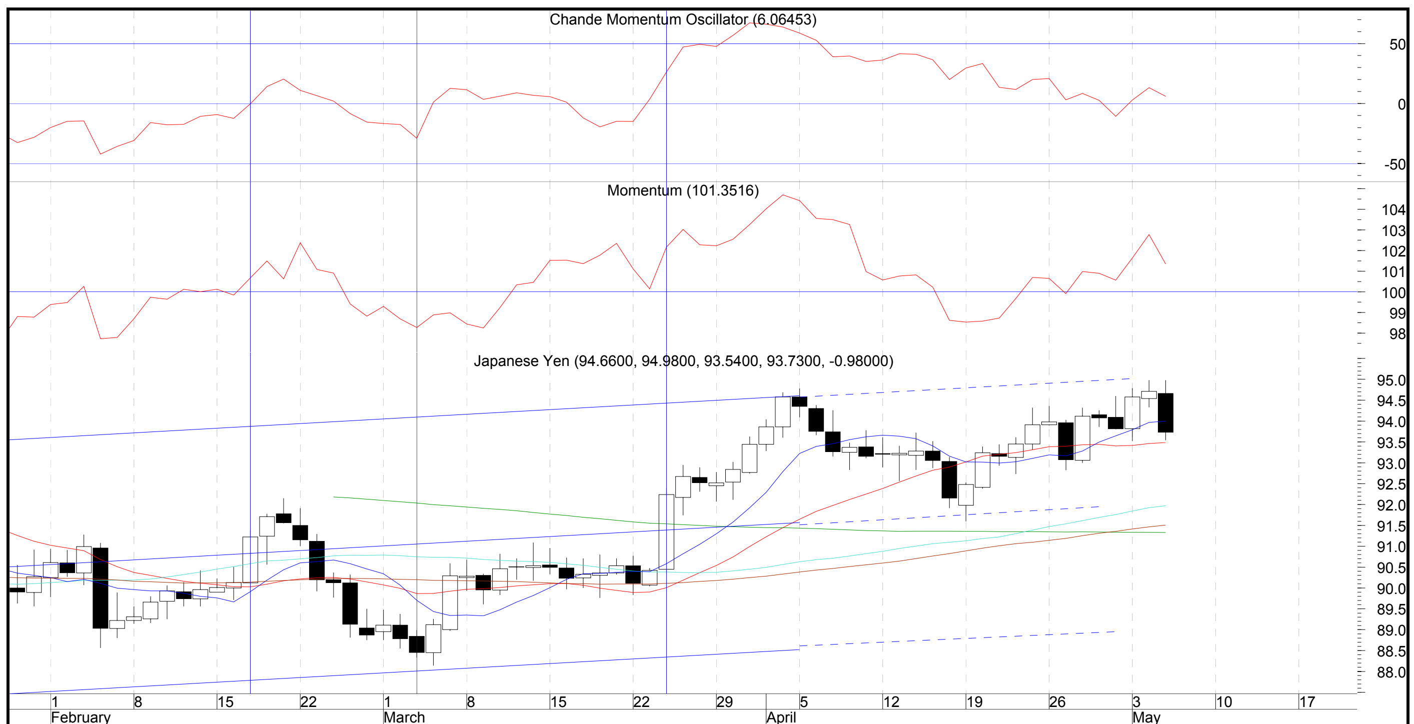
The dollar closed up strongly for a third day.

UK POUND



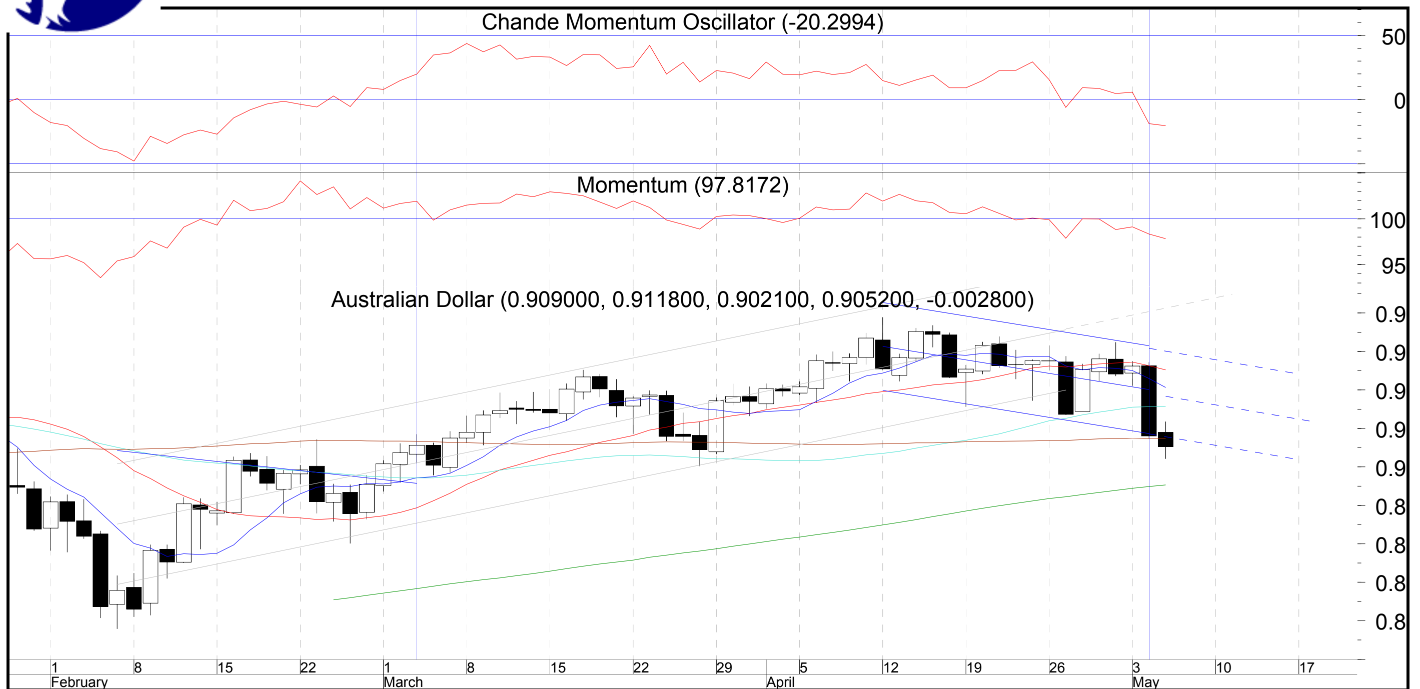
The pound closed lower for the 4th day. We still expect a bounce.

USD/JAPANESE YEN



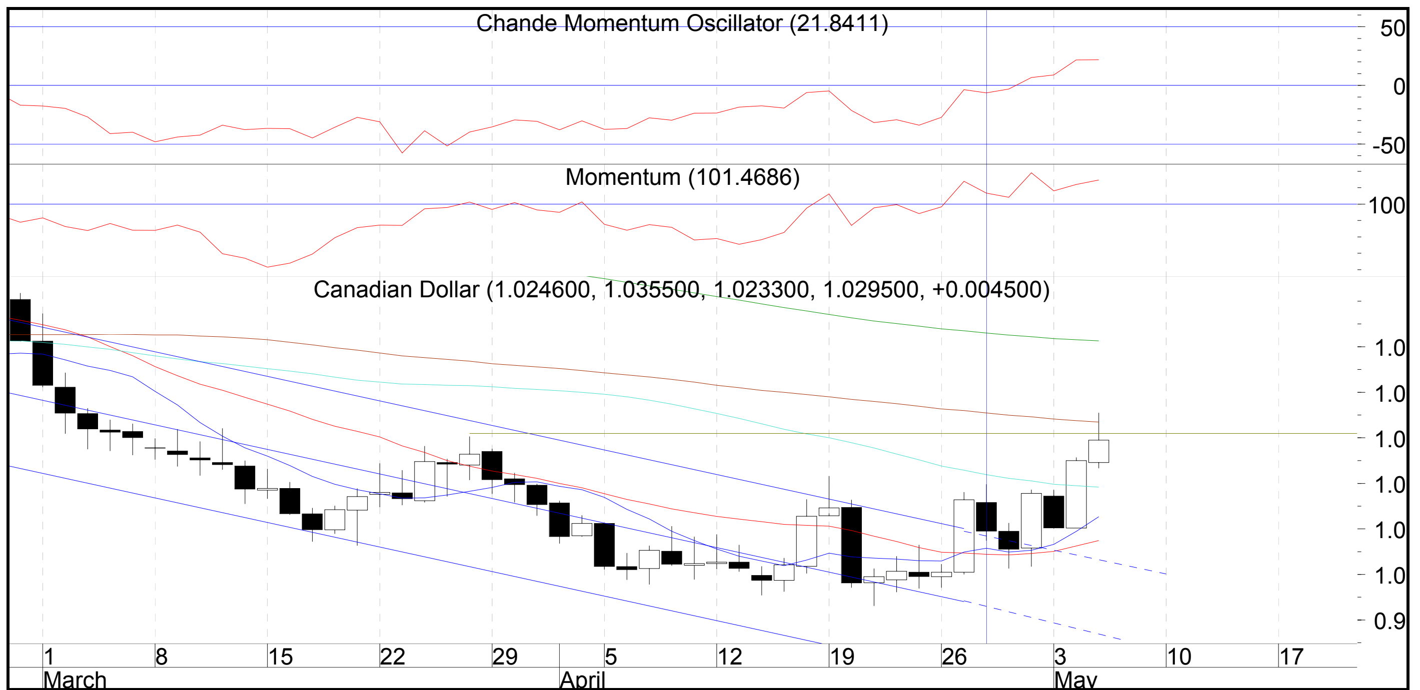
The dollar closed lower and almost at the 20-day. Hmm.

AUSTRALIAN DOLLAR/USD



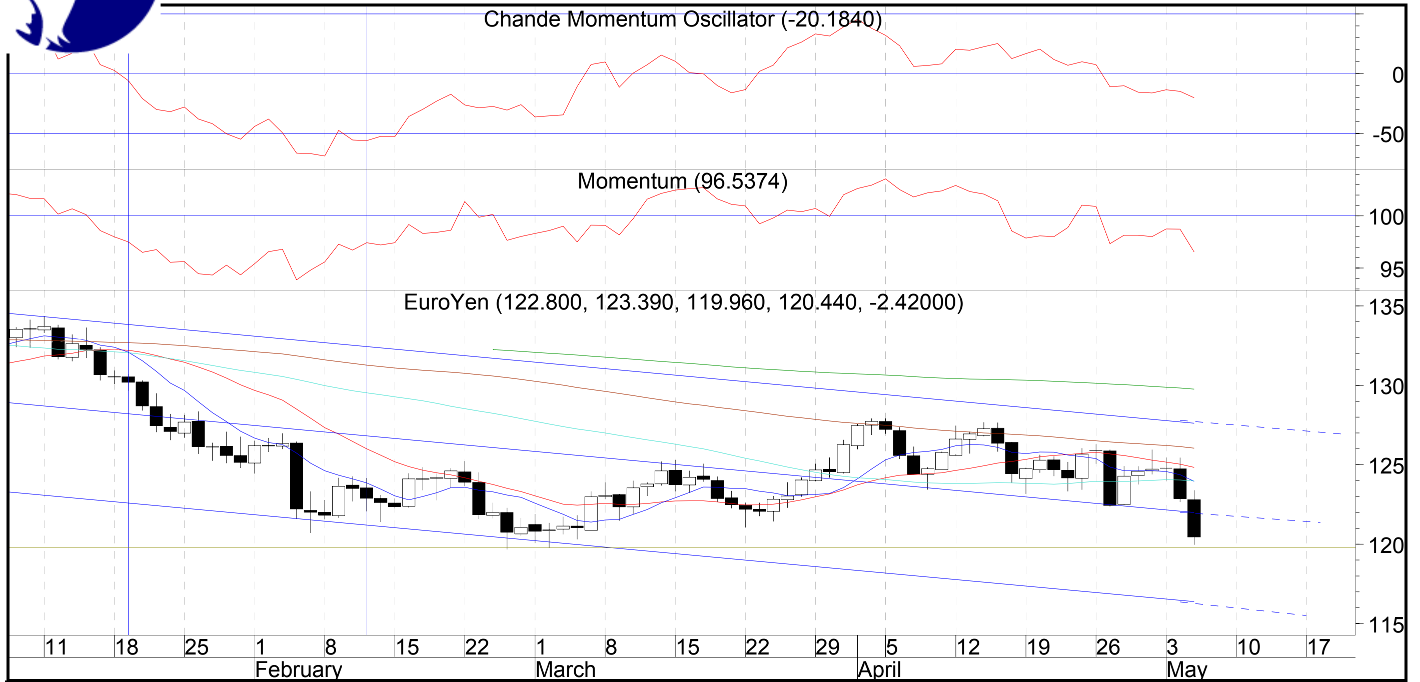
The AUD closed lower and under the dark red 100-day.

USD/CANADIAN DOLLAR



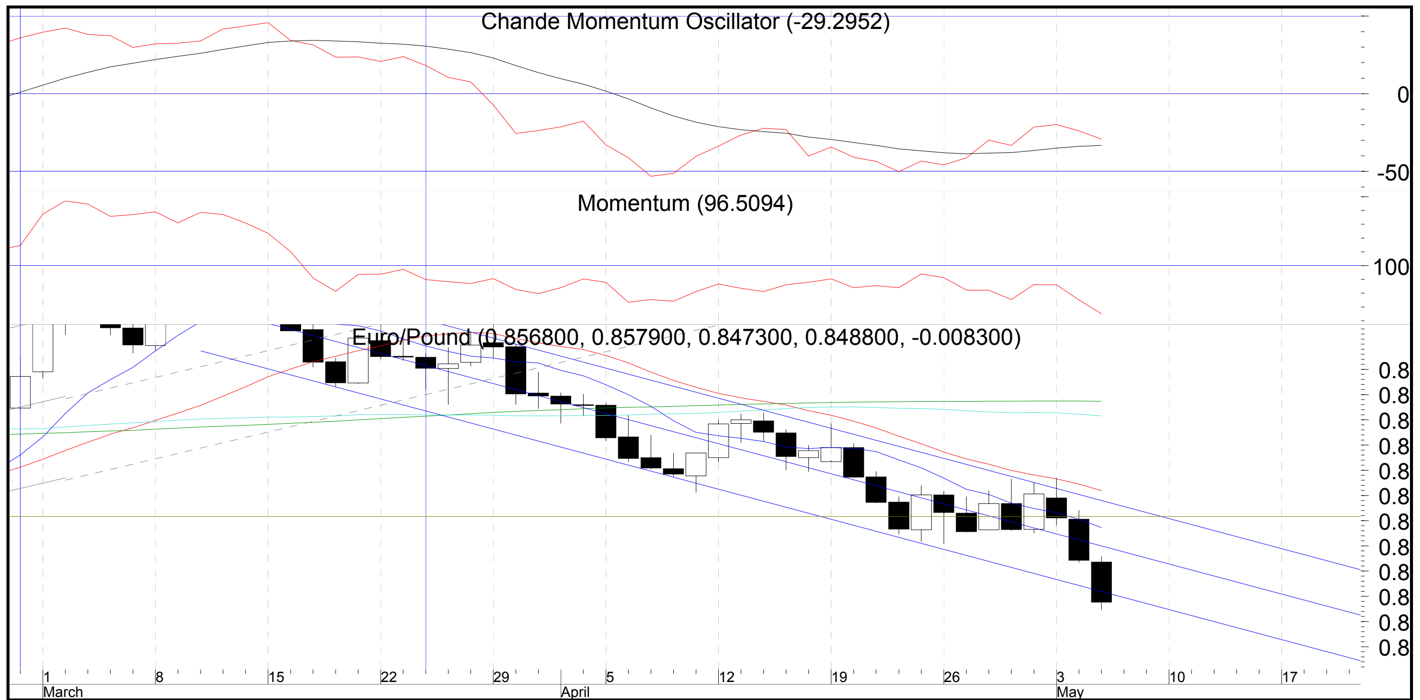
The USD closed higher with the high surpassing the last high from March and also over the dark red 100-day.

EURO/YEN



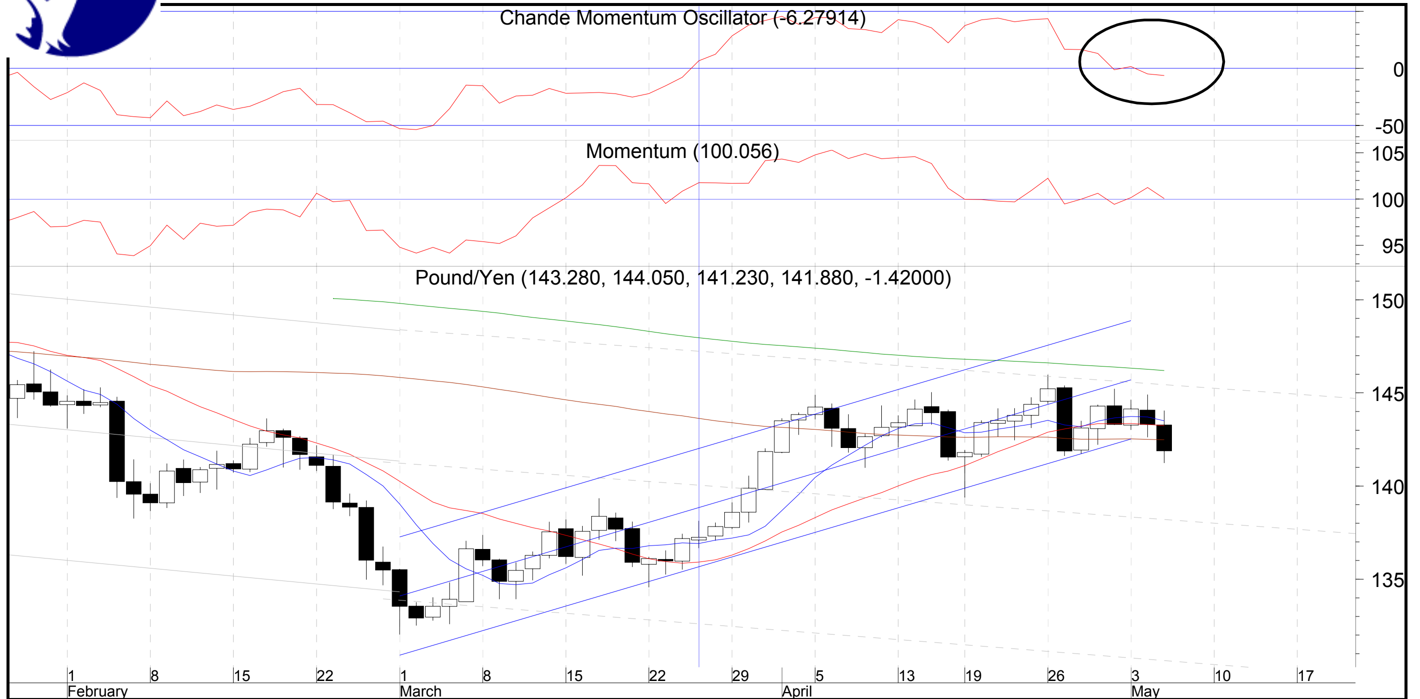
The euro closed lower and almost at the Feb lows.

EURO/POUND



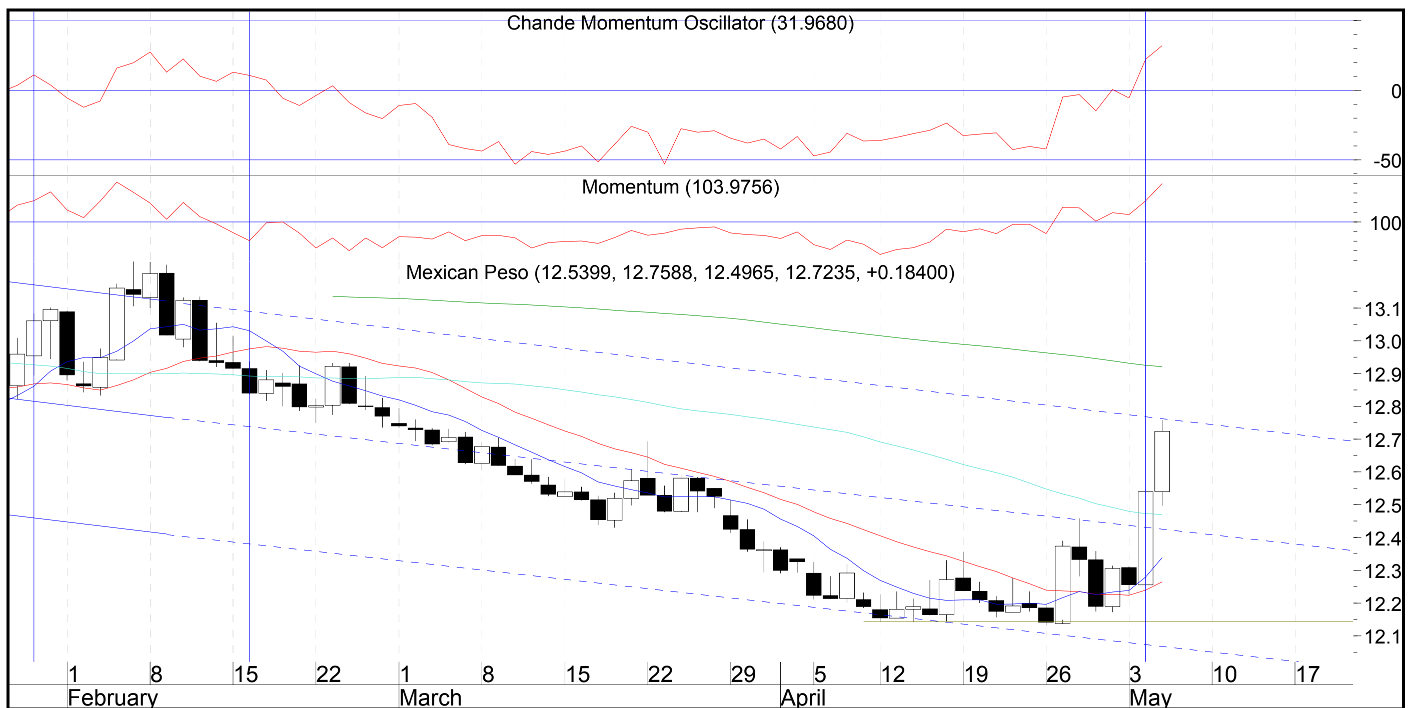
The euro closed lower after breaking the congestion band.

GBP/JPY



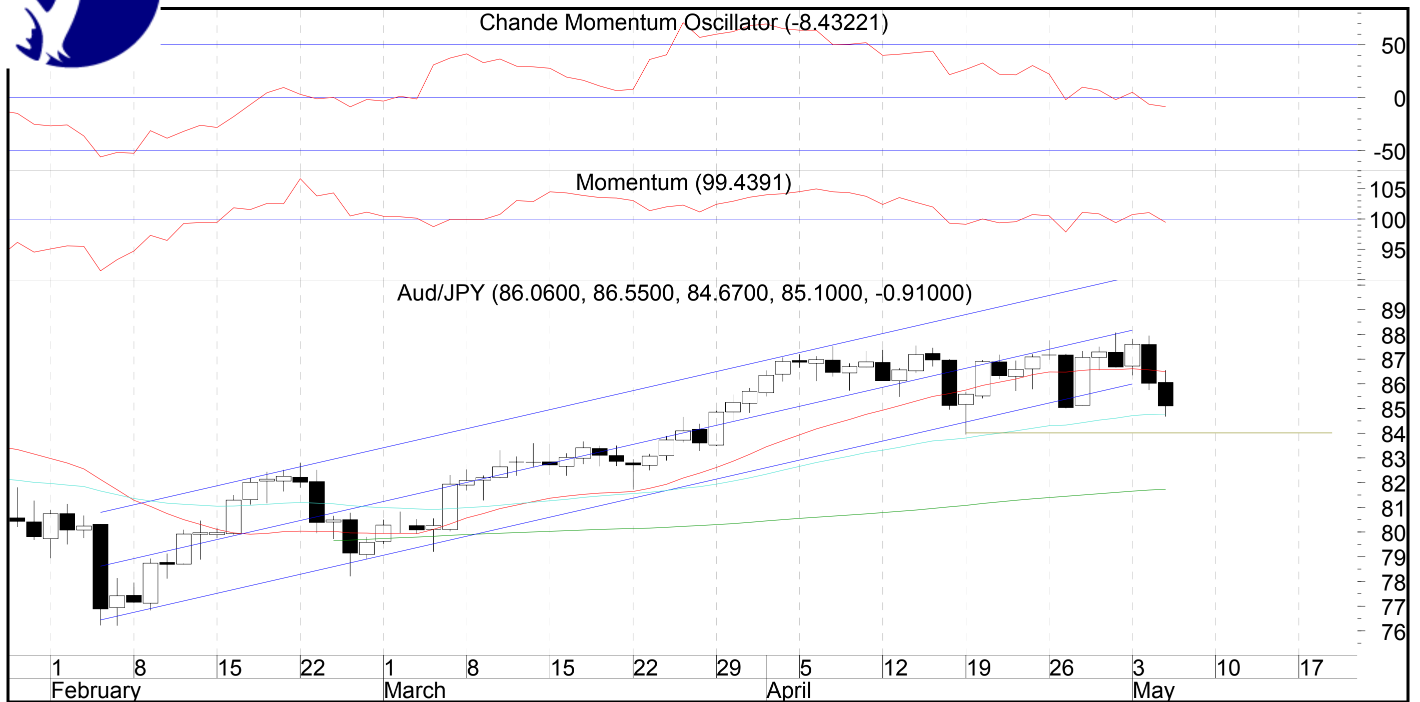
The GBP closed lower , breaking the channel, and under the 100-day. We could get a repeat of Feb.

MEXICAN PESO



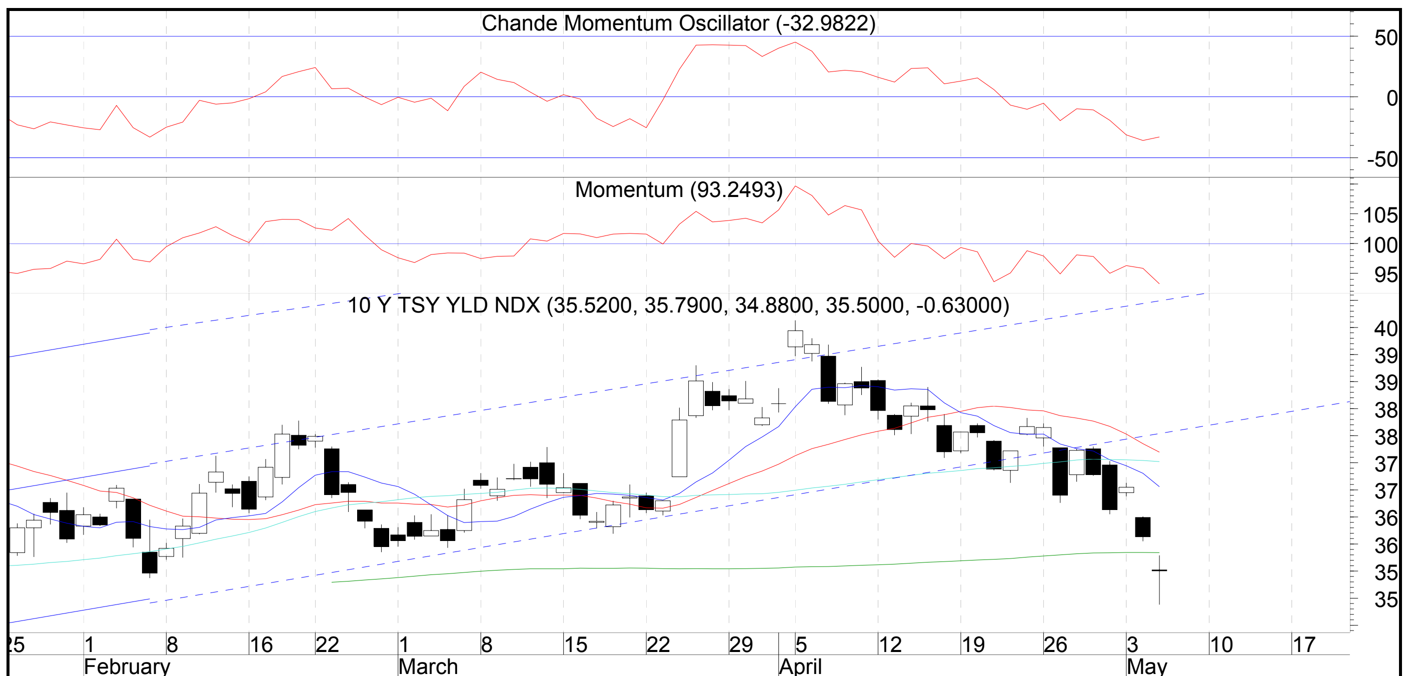
The dollar did it again—a big-bar upmove. The green 200-day is tracking the trendline of the linreg and should be a hard target to reach (12.9211 today).

AUD/JPY



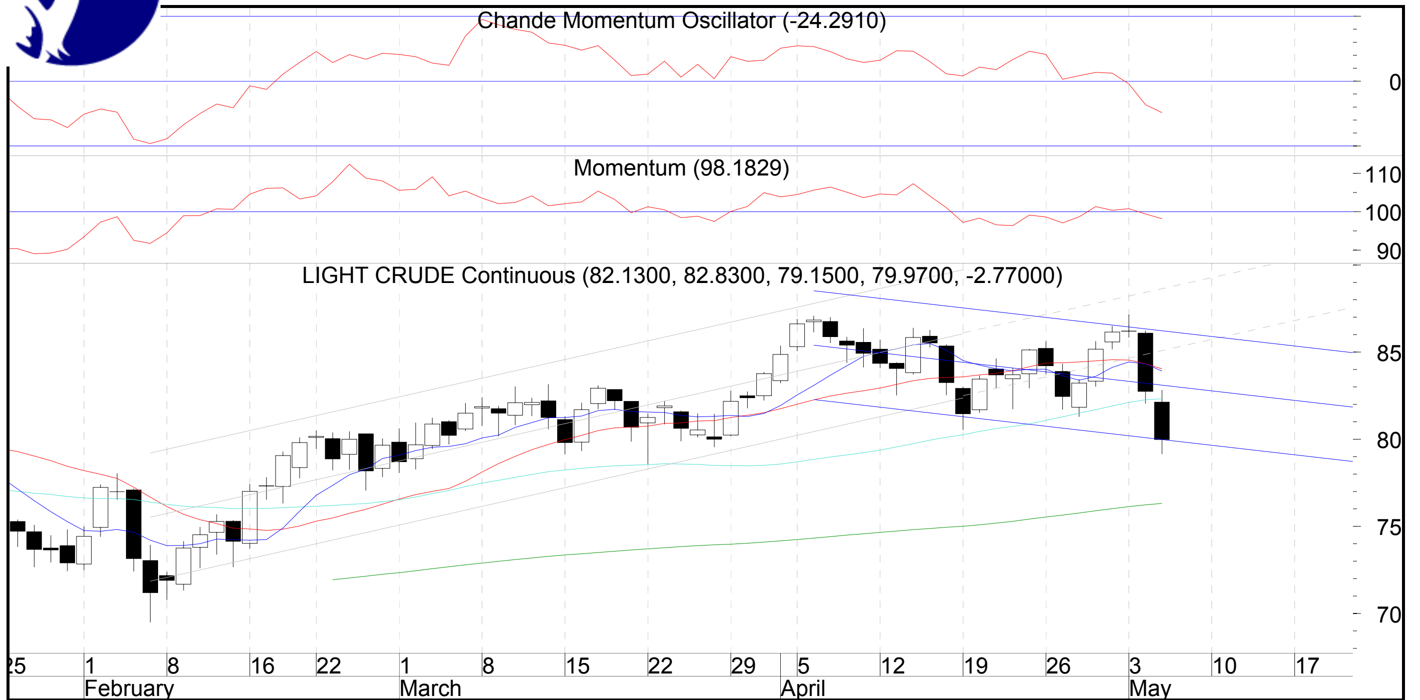
The AUD closed lower again with the low touching the 55-day. The previous low is 83.95 and if surpassed, will confirm a sell signal. With a 4.4% interest rate advantage, for the AUD to be sold against JPY is weird, to say the least.

10-Year Note Index



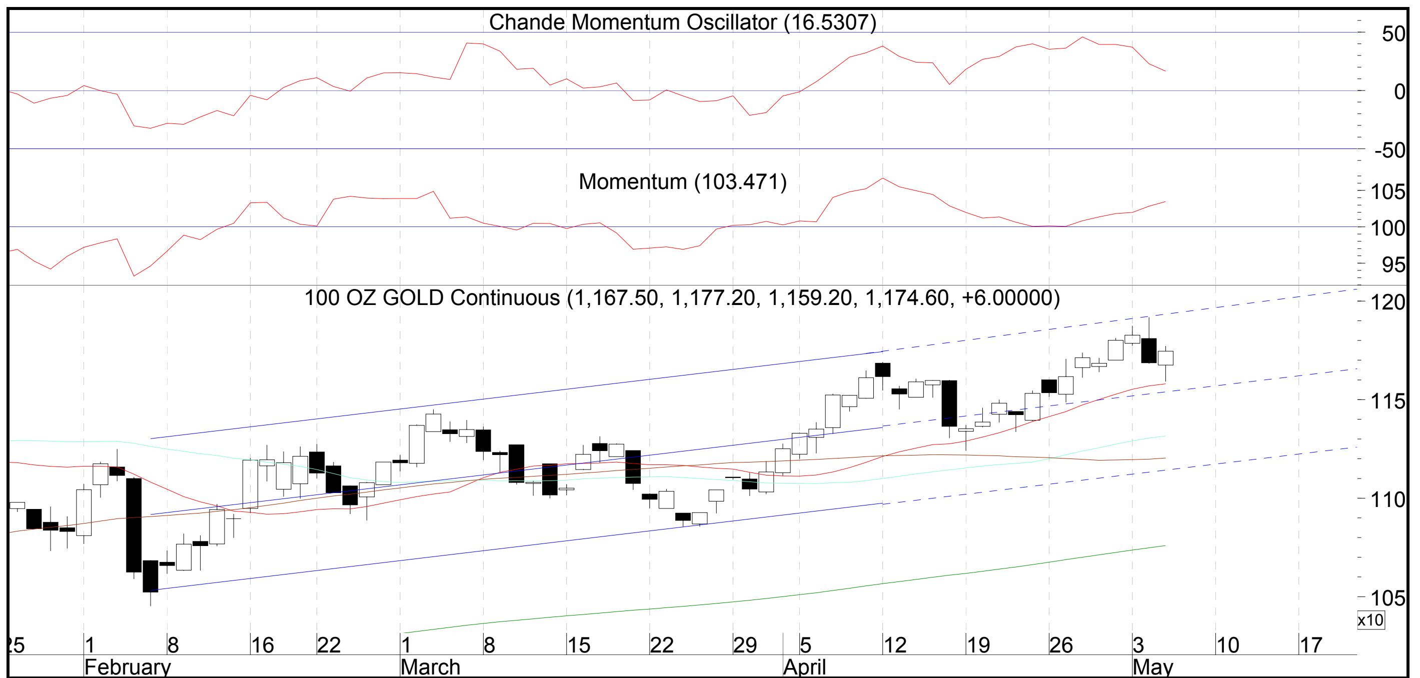
The index closed down at 3.55% from 3.613% on another opening gap and wildly, under the 200-day moving average. Wow, this is a major case of flight-to-quality panic.

NYMEX Light Crude Oil (Continuous Futures Contract)



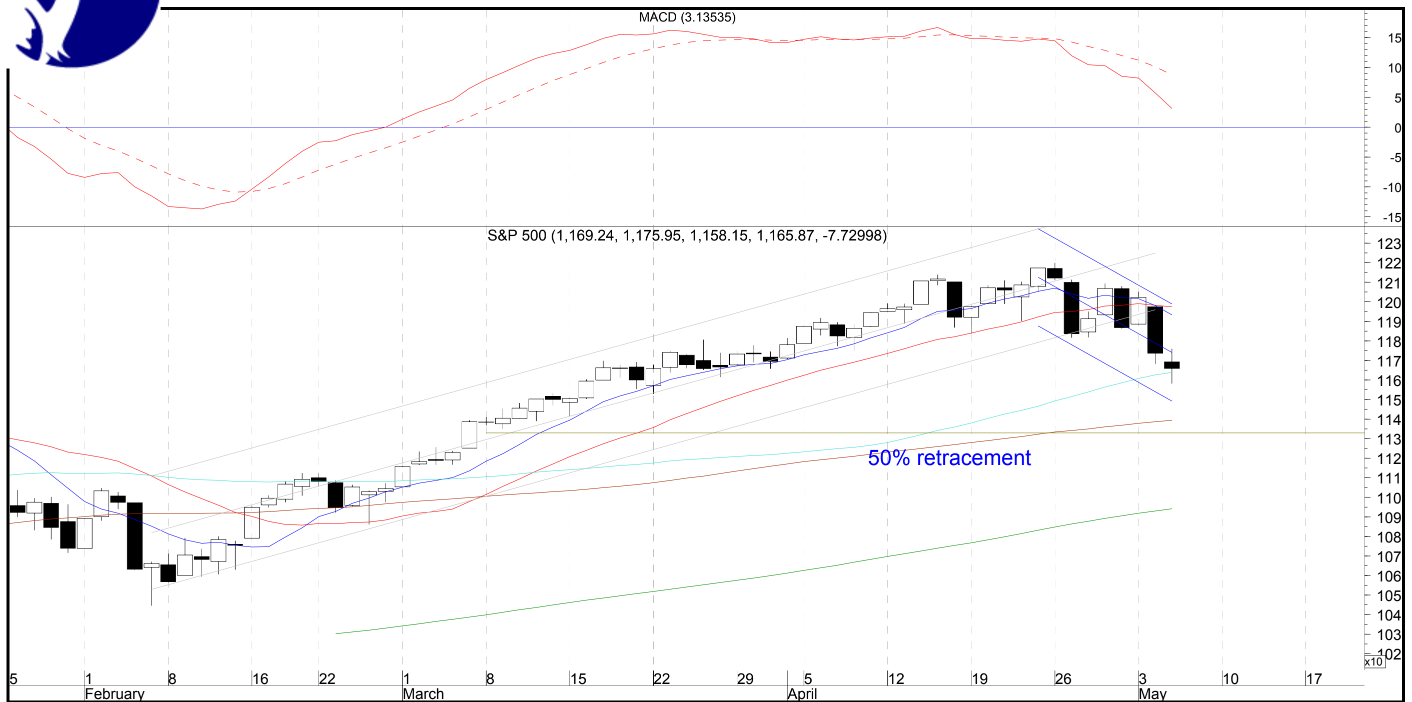
Oil closed down at $79.97 from $82.74 and we have the two moving average crossover. The bar is under the turquoise 55-day—not support! We drew a new downchannel.

Gold Continuous Futures Contract



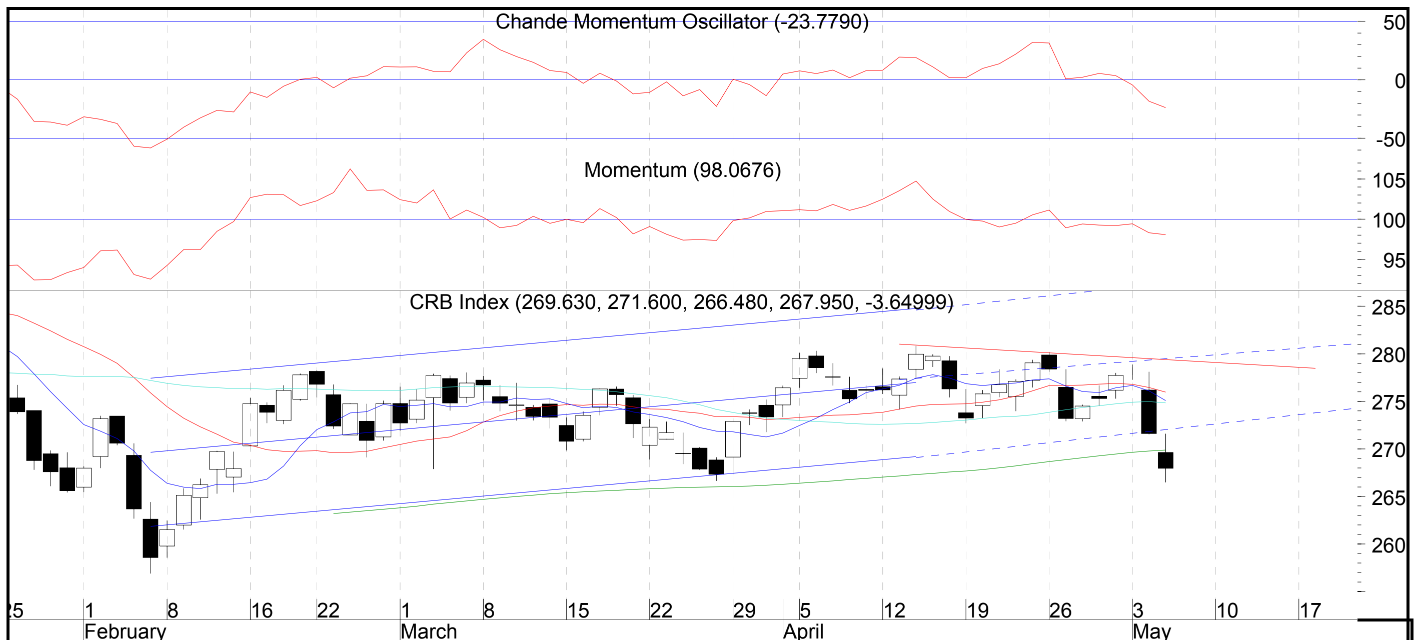
Gold made a lower low although it closed higher on the day at $1174.60 from $1168.60 at the close the day before. Gold is not serving as much of a safe-haven.

S&P 500



The S&P closed closed down at 1165.87 from 1173.60 and just over the 55-day. The 50% retracement lies at 1132.89 and we see no reason why it should not be met.

CRB Commodities Index



The index closed down at 267.95 from 271.60 on an opening gap and closed under the 200-day.

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