



	SPOT	CURRENT POSITION	SIGNAL STRENGTH	OPEN DATE	OPEN RATE	POSITION GAIN/LOSS
USD/JPY	80.16	SHORT USD	WEAK	05/31/11	81.58	1.77%
GBP/USD	1.6429	LONG GBP	WEAK	05/27/11	1.6428	0.01%
EURO/USD	1.4668	LONG EURO	STRONG	05/31/11	1.4419	1.73%
EURO/JPY	117.60	LONG EURO	STRONG	06/01/11	117.19	0.35%
EUR/GBP	0.8926	LONG EURO	STRONG	06/03/11	0.8889	0.42%
GBP/JPY	131.71	LONG GBP	STRONG	05/27/11	133.07	-1.02%
USD/CHF	0.8337	SHORT USD	WEAK	05/27/11	0.8575	2.85%
USD/CAD	0.9758	LONG USD	WEAK	06/06/11	0.9807	-0.50%
AUD/USD	1.0694	LONG AUD	WEAK	06/01/11	1.0728	-0.32%
AUD/JPY	85.74	LONG AUD	WEAK	06/01/11	87.25	-1.73%
USD/MXN	11.7214	SHORT USD	WEAK	06/01/11	11.5639	-1.34%

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. Trade recommendations are delivered ONLY in the afternoon report.**

Summary: The dollar is up against the yen and AUD this morning but resumed its downmove against the euro and others, led by on-going perceptions that US weakness could lead to a delayed Fed exit, if not QE3. Also weighing on the dollar is yet another comment from a Chinese FX official saying it's risky to hold "excessive dollars" and the dollar will continue to fall. Both of these factors are familiar and not particularly strong. Equities took a dive yesterday and commodities were moribund, with the CRB and oil falling.

What's Happening This Morning: The euro fell all through the US day yesterday from 1.4593 at the open to 1.4554 around 2-3 pm. It sure looked like a bigger pullback was in store, and indeed, in the Asian session a European bank was a major seller and got the rate down 40 points in short order, indicating longs were weak. But euro bulls came back and were ready to increase long positions after eurozone retail sales came in stronger than expected. Now the market is settling down on some minor profit-taking to wait for Trichet's press conference on Thursday, with hopes high that the July rate hike will be confirmed, whatever mess the EMU may be in over failing to deal with Greece properly.

Dollar/yen, which flirted with intervention-land under 80 yesterday, recovered after PM Noda warned against the yen's rise, saying Tokyo would "closely watch developments in the market."

In Australia, the RBA left rates on hold, as expected, but sounded more dovish than forecast, saying the "current mildly restrictive stance of monetary policy remains appropriate." We have noticed a distinct wariness of AUD bulls near highs of late.

The most interesting development is in sterling. Market News writes that it has closed in New York at 1.6350 and opened in early Europe about the same, 1.6357, after a roller-coaster ride in the Asian session. First it rose to a high of 1.6360 but dropped alongside the euro to 1.6324, helped along by a bad BRC retail sales report. Then it met support at the 55-day moving average at 1.6326. "Rate picked up fresh demand into Europe, though early gains were countered as a US investment bank took euro-sterling above stg0.8940, extending cross gains from Asian lows of stg0.8908 to stg0.8945. However, the cross ran into real money sales which



pressed this rate lower, allowing cable to catch up on euro-dollar's stronger rally, with break above \$1.6400/20 taking the rate on to an eventual high of \$1.6474, with the cross pressed back to stg0.8910.”

UK data includes the BRC like-for-like retail sales in May down 2.1% y/y. Market News says “The weaker May numbers represent a return to reality following April's bank-holiday led growth, the BRC said, with Easter and the Royal Wedding national holiday both falling in April this year. The BRC also cited the cooler weather in the second half of May as a factor weighing on sales.”

Eurozone Data: German factory orders rose 2.8% in April, reversing a March slump of -2.7% and surpassing forecasts of only 2%. The rise is 10.5% y/y, zowie.

Eurozone Crisis: Bloomberg reports this morning that Trichet has said, for the first time, that he would not disapprove of investors being encouraged to buy new Greek bonds to replace maturing securities—that would not be default. As long as it's not default, the ECB doesn't have to face de-funding Greece and all the banks using Greek bonds as collateral. This was always going to happen but we feel disappointed in Trichet all the same.

The FT reports that an outfit named Open Europe says the ECB has a €75 billion exposure to Greece and overall, a €444 billion exposure to Spain, Italy, Portugal and Ireland, as well as Greece. Open Europe says “There is a hidden – and potentially huge – cost of the eurozone crisis to taxpayers buried in the ECB's books.” The FT reports the ECB disputes the numbers but has to face at Thursday's policy meeting whether to extend the “emergency” policy from last July of offering unlimited loans to European banks on just about any old collateral. Among that collateral are the Greek bonds now rated junk. Bini Smaghi said last week that the ECB's opposition to Greek bond haircuts is a matter of principle, not self-interest, but the FT goes on to wonder about the lack of transparency in the “eurosystem” overall, meaning the combined banks plus the ECB. Has anyone added up the cascading risk of default? To say a Greek default hurts only Greek banks is not correct.

The senior IMF rep in Greece, one Mr. Traa, opposes any kind of debt restructuring, soft or otherwise. “There is no such thing as being a little bit pregnant. Once you unleash a restructuring scenario, this is not very helpful.” Once you start down the slippery slope of partial restructuring, you can't control the process.

Pimco's Mohamed el Erian has a splendid piece in Reuters today saying that Greece and probably others are doomed by an “increasingly incoherent policy response” by leading institutions. The two things wrong with Greece are not being addressed—indebtedness too high and growth too slow. “Yet the rescue of Greece involved making new loans to the country and was asking for a very ambitious fiscal adjustment effort. Neither the size of the debt nor growth reinvigoration were properly addressed.”

The new initiative, consisting of privatizations and extending tenors, only kicks the can down the road again. Neither fixes solvency or promote growth. The only gain is to give others a chance to scurry around for fixes, like Spain recapitalizing cajas. But the overall approach is wrong and applying it to Ireland and Portugal means “the overall cost of this unsustainable approach is even larger.” A more efficient methodology to reduce contagion risk would be to safeguard the European system directly. As it is, the EMU faces “growing cooperation challenges.”

El Erian is right, but we think he might be missing, at least in this editorial, that privatizations managed like the Russians did theirs are destructive of trust in government, social cohesion and other aspects of public welfare. We already know Greek society is corrupt in many different ways. No matter how much money the privatizations achieve, they are likely to enlarge the oligarchy at the expense of the public and the public is not stupid—it knows when it is being robbed. And then to add insult to injury, the money raised will be squandered and siphoned off, and in the end, not help the solvency problem. At a guess, proposals to have the Germans oversee the privatization process is a very good idea. Left to their own devices, the Greeks will do it the Russian way.

As the process begins, the WSJ reports that German companies are hunting for bargains in Greece.



Separately, the Chinese are hunting for investments in Europe generally.

You **can** borrow your way out of debt if the money is used to promote a revenue-generating activity whose cash flow is greater than the principal plus interest over the life of the loan and you end up with a net increase in wealth at the end—but the plan for Greece is not one of these plans.

Kenneth Rogoff, co-author of “This Time is Different,” has a piece in the FT today pointing out that “the euro experiment is at a crossroads. Either the eurozone will deepen into a fiscal union, or the weak members will be forced to break off. But the euro experiment has also brought us to a crossroads in the whole international monetary system. Will our grandchildren inherit a world with a huge number of national currencies, or a very small number of multi-country currencies? If the euro survives and goes on to assume co-reserve currency status with the dollar, surely there will eventually be a strong trend towards consolidation elsewhere. Other blocs will form to mimic the euro’s success. They will aim to enjoy lower interest rates, and greater resilience to financial crises.”

Well, we are among those who dislike the idea of a united states of North America, but the idea of currency unions growing to cover the globe is probably doomed by the management style of the EMU, as Rogoff says. “Unfortunately, as currently construed, the euro is looking very much like a system that amplifies shocks rather than absorbs them.

Rogoff writes “It is ironic that the euro, forged to eliminate speculative exchange rate movements within Europe, is suffering from having an overly strong exchange rate, particularly against the dollar, and at precisely the moment when a huge depreciation would be most helpful. European leaders may mistakenly view this as a sign of confidence in the euro. I think it would be more accurate to say that rightly or wrongly, markets are more worried about the US’s lack of a plan A than Europe’s lack of plan B.”

Further, “Difficult as exchange rates are to predict and explain, perhaps the lesson of the euro crisis will be that it is easier to live with sharp market exchange rate swings than with unpredictable politics.... It is sometimes said that the euro is a creature of politics that would never be justified by economics. The present episode could well turn this statement on its head. Having a smaller number of currencies is a phenomenon that makes a lot of sense economically, economising on transactions’ costs and leveraging economies of scale. The real question is whether common currency is sustainable politically. My guess is that if the current slow patch in global growth does not quickly subside, we will not have to wait long for an answer.”

Equity Markets: The Dow fell 0.50% and the S&P, 1.08%. In Japan, the Nikkei rose 0.67% and the Shanghai, 0.60%. The Hang Seng fell 0.35%. European bourses and US equity index futures are up so far this morning.

The Main Event: The 10-year note yield index closed at 3.02%, where it opened, from 2.997%. The bond boys are still at sixes and sevens. Boston Fed Pres Rosengren said yesterday that it’s too soon to consider QE3, but QE3 is not off the table. The recent slowdown does change the timing of the exit strategy. Rosengren is not a voting member (thank goodness). The day before, Philadelphia Fed Pres Plosser had said the payrolls data was transitory and he doesn’t rule out a rate hike before year-end. Plosser is a voter this year.

Other Markets: Crude oil is trading at \$99.10 this morning at 5:30 am ET after closing down at \$99.01 (from \$100.22 the day before). Whether Opec will raise quotas seems to be the talk of the day. SocGen says, according to Bloomberg, there is a “65% chance OPEC will raise its production quota to lessen the risk high prices will curb demand.” The increase will be 1.5 million barrels a day versus actual production, implying that since actual production is already 1.4 million bpd over quota to make up for lost Libyan production, it’s really a 3 million increase—or is that right? A Frankfurt trader says no, any increase is just to acknowledge the existing over-quota levels plus a little more. “The quotas are irrelevant at the moment.” Well ,that’s certainly true. Opec is the worst-run cartel... producers violate quotas left and right. Venezuela (and the majority of Bloomberg sources) say the quota will be unchanged. Well, if quotas don’t count, why is oil soft?

China: Talk has it China will raise rates or reserve requirements this week or this weekend. Separately, a PBOF advisor said the “yuan exchange rate formation mechanism needs drastic reform.,” reports Market News. Too



much money is going to FX market intervention, expanding the money base and fuelling inflation. (China seems to have no mechanism for sterilization.) But reform doesn't necessarily mean a sharp change in exchange rate. "As long as other institutions can replace the central bank in buying U.S dollars, the yuan exchange rate level can remain unchanged." Huh? But note that this advisor as well as the SAFE official quoted below use the same phrase, "exchange rate formation." This may be the economist's "price discovery." Standard Chartered says the trading band may be widened in coming days, according to Bloomberg.

In addition to the slander against the dollar, SAFE official Guan said "China will expand the channels for capital outflows while increasing the flexibility of the yuan exchange rate," according to Market News. The head of the SAFE payments department, Mr. Guan, said "China now has a favorable window for improving the yuan's exchange rate formation mechanism. The phase-out of restrictions on cross-border capital outflows and on making the yuan convertible under the capital account are part of the content of the reform."

Guan denies "The improvement of the nation's current account is the cause of the sharp appreciation of the yuan. And the pressure for appreciation is not due to imbalances in the current account, but from large net capital inflows, he said." Besides, "The overvaluation of Chinese stock and property prices compared with those overseas has created the possibility of a depreciation of the yuan... The market conditions for two-way flows in the yuan (exchange rate) are ripe. To increase the yuan's flexibility without clearing the roadblocks to cross-border capital flows would likely lead to excessive appreciation of the yuan." Meanwhile, the cost of controlling hot money inflows is higher but becoming less efficient. Really? Why?

Okay, so China is ready to have the market set the price of the yuan instead of the state, but hot money inflows would make it too strong and yet it faces depreciation if capital were to flow out of overvalued property and other assets. What does China really want? A weak yuan, of course, and so we deduce that the next step will be to allow Chinese residents to sell yuan to buy foreign assets. This is exactly what the IMF feared 5 and 10 years ago, not doubting for a minute that residents would chose to diversify (or flee, whichever way you want to look at it). A large part of Hong Kong and other Asia is funded by money leaking out of China.... which can easily become a flood. Hmm, hot foreign money pouring in, domestic hot money poring out. Interesting picture, sounds like Thailand circa 1997.

Outlook: We are very impressed by Rogoff's statement that European leaders mistake the current strength of the euro as a sign of confidence. It's "more accurate to say that rightly or wrongly, markets are more worried about the US's lack of a plan A than Europe's lack of plan B." Wow. We don't usually get such punchy clarity from Harvard economics professors. It is not Rogoff's purpose to derive a forecast from this observation, but we say it means that once the US has a Plan A—raising the debt ceiling and some kind of political agreement on making debt more sustainable—the dollar should get much stronger and very fast. The US will still lack the impressive Maastricht principles (debt at a max 60% of GDP, etc.) but honestly, hardly anyone within the EMU was obeying the principles, anyway. Wait a minute—isn't this what we said yesterday? Yes. In Europe, the emperor has no clothes. The EMU is failing. The fixes for Greek indebtedness are the wrong policy choices and directed at saving the banking elites and the bond-holding wealthy, not the country. And yet the euro rises. This is the triumph of hope over experience.

Similarly, Chinese trash-talking the dollar and promises to shove the yuan into a leading role as trade numeraire and eventually a reserve currency are not new, and usually followed by somebody standing up and saying China is stuck with the dollar and doesn't really want to take the risk of making the yuan a convertible currency just yet. We say floating the yuan would be a very good thing for the dollar, especially if it is accompanied by ending restrictions on residents' capital outflows. If currencies are in competition, it's not at all clear that the dollar will necessarily lose. And if it were to lose, it's a good thing for US residents who have to repay all that debt. It would fuel the Chinese bubble and hasten the day of a financial crisis in China (although that can and probably would spread globally). No matter how you look at it, floating the yuan is a win-win for the US. If the dollar falls, we improve exports and have cheaper debt to pay. If the dollar rises on capital outflows from China, the US "wins" on the sovereign reputation front. Confidence is a good thing (ask the Europeans). We should cheer when a Chinese official talks about floating, however obliquely.



On a chart basis, we see plenty of room for a pullback. So many currencies making new highs yesterday but closing lower is surely a warning. But we lack any real evidence that a pullback is brewing and this morning's action puts a kybosh on that idea for the moment. Still, caution is a good idea.



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) or MACD.

Bottom Box: Previous Trading Day Open-High-Low-Close.

9-day or 10-day moving average in Dark Blue.

20-day moving average in Red

55-day moving average in Turquoise.

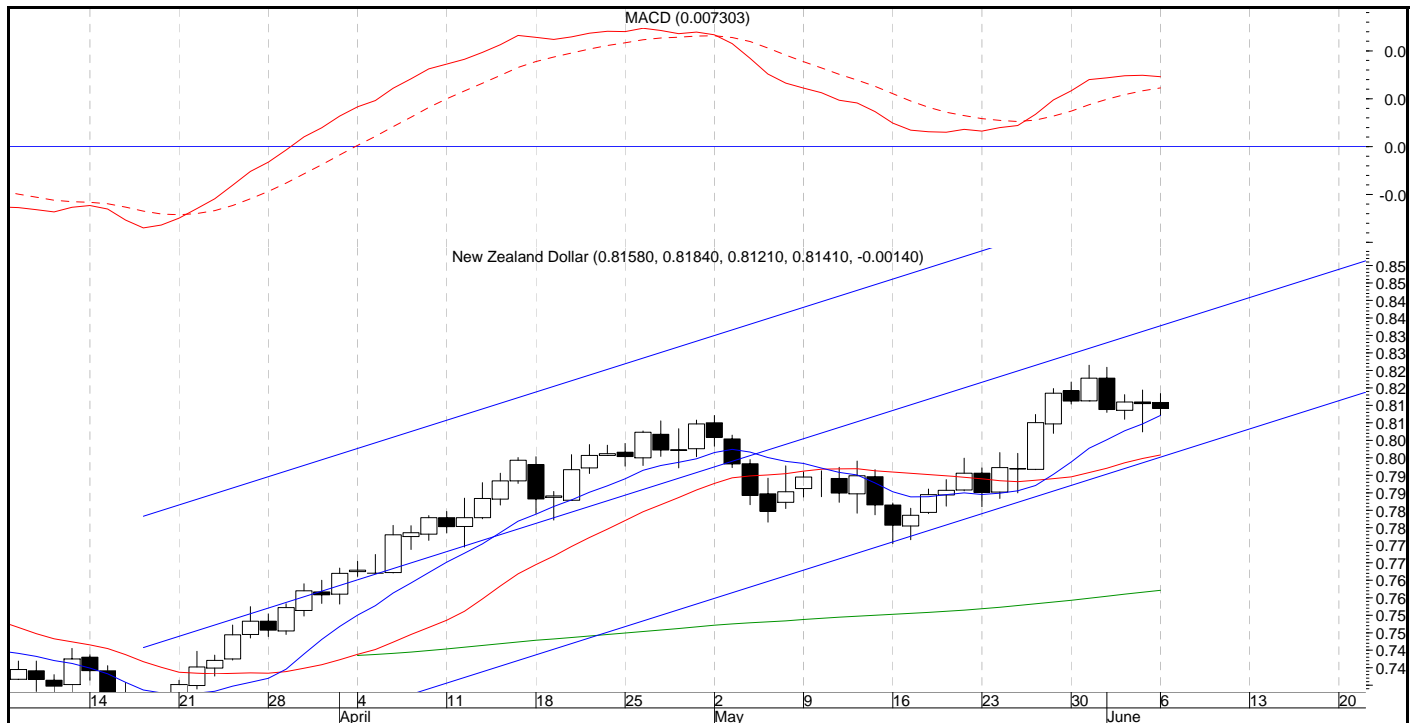
100-day moving average in Dark Red

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 at 6 pm close, except EUR, GBP, JPY, CHF, CAD and AUD, whose prices are from 4 pm. Futures data courtesy of Reuters. Charts prepared in Metastock.

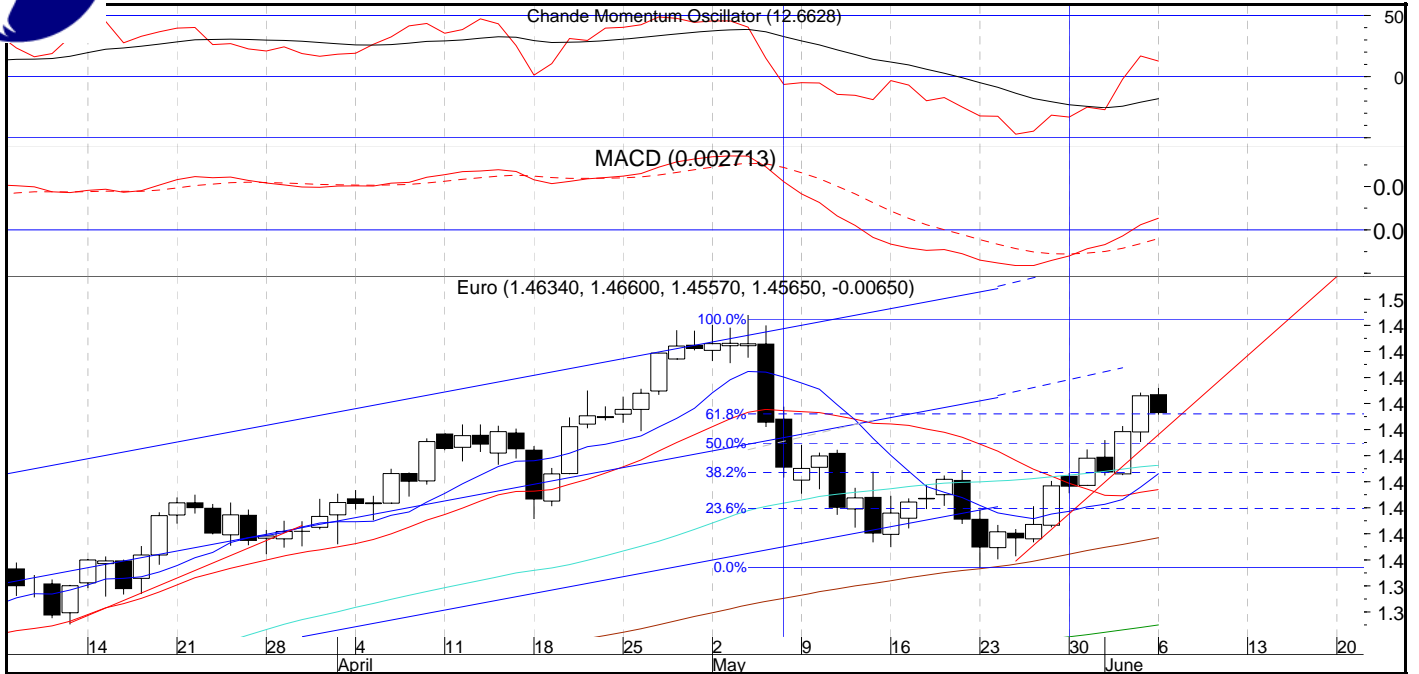
New Zealand Dollar



The NZD closed lower on an inside day ahead of a central bank policy meeting on Thursday (no change expected).



EURO/USD



The euro made a higher high but closed a bit lower. It may pull back to red support around 1.4565.

USD/SWISS FRANC



The USD made a lower low but curiously, closed higher. It would be premature to call for a pullback and yet one is sorely needed—the Swiss franc is overbought.



UK POUND



The pound made a higher high and lower close, and looks consolidative. Watch for choppiness.

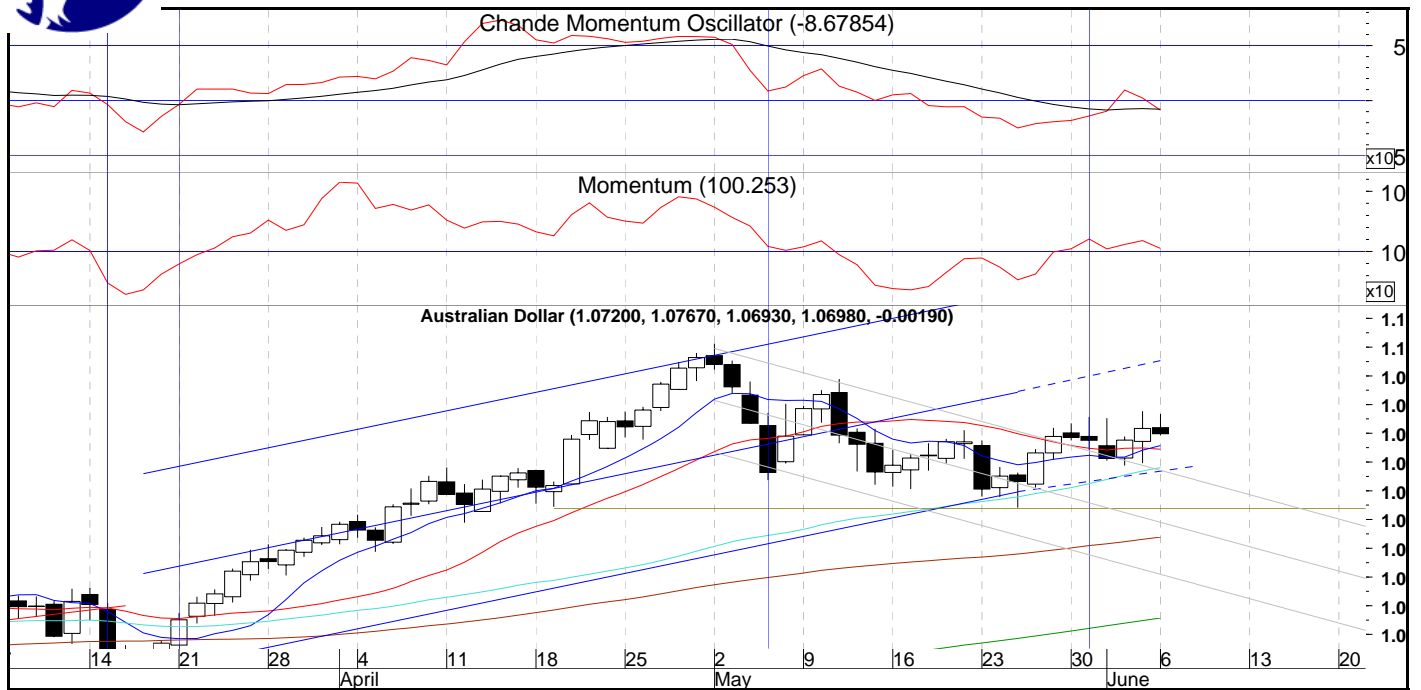
USD/JAPANESE YEN



The USD/JPY closed lower and was under the intervention warning level of 80 at one point. Expect unhappy noises from Japanese officials any day.

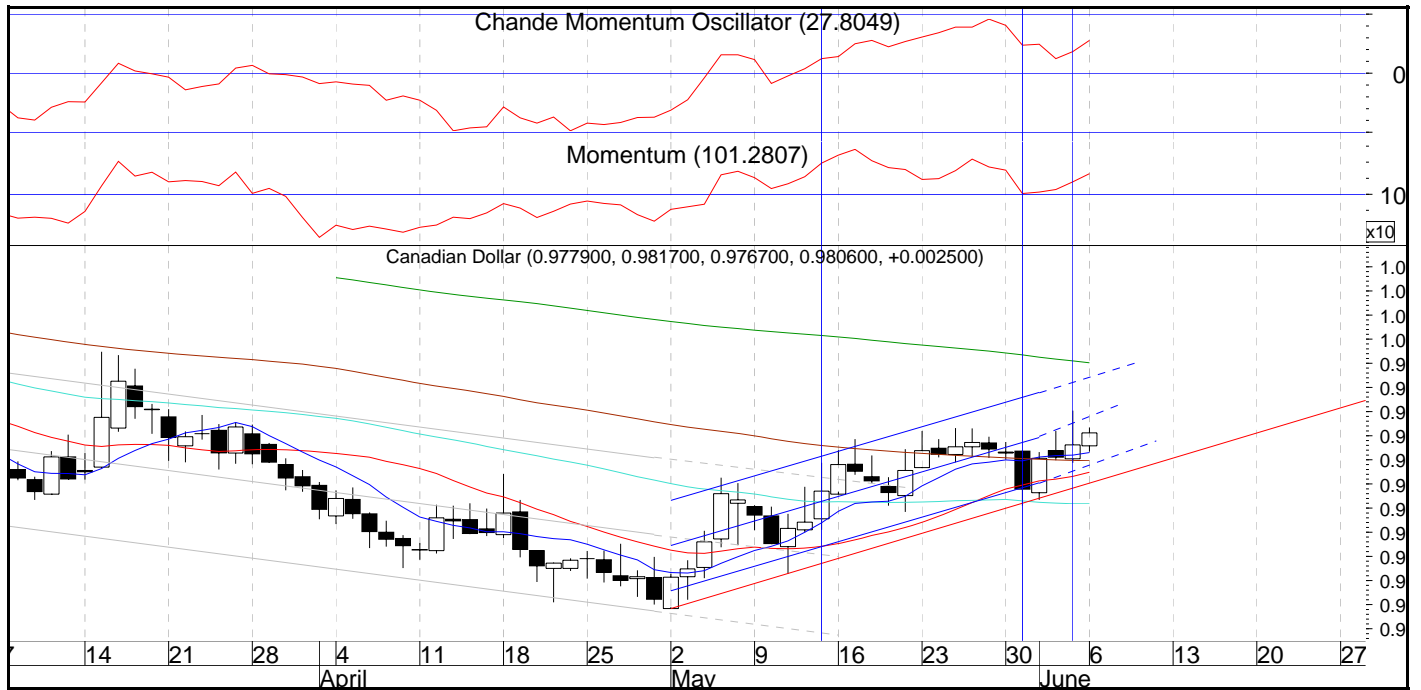


AUSTRALIAN DOLLAR/USD



The AUD made a higher high but lower close, and seems to be struggling to maintain upward momentum. A double dip would not be surprising.

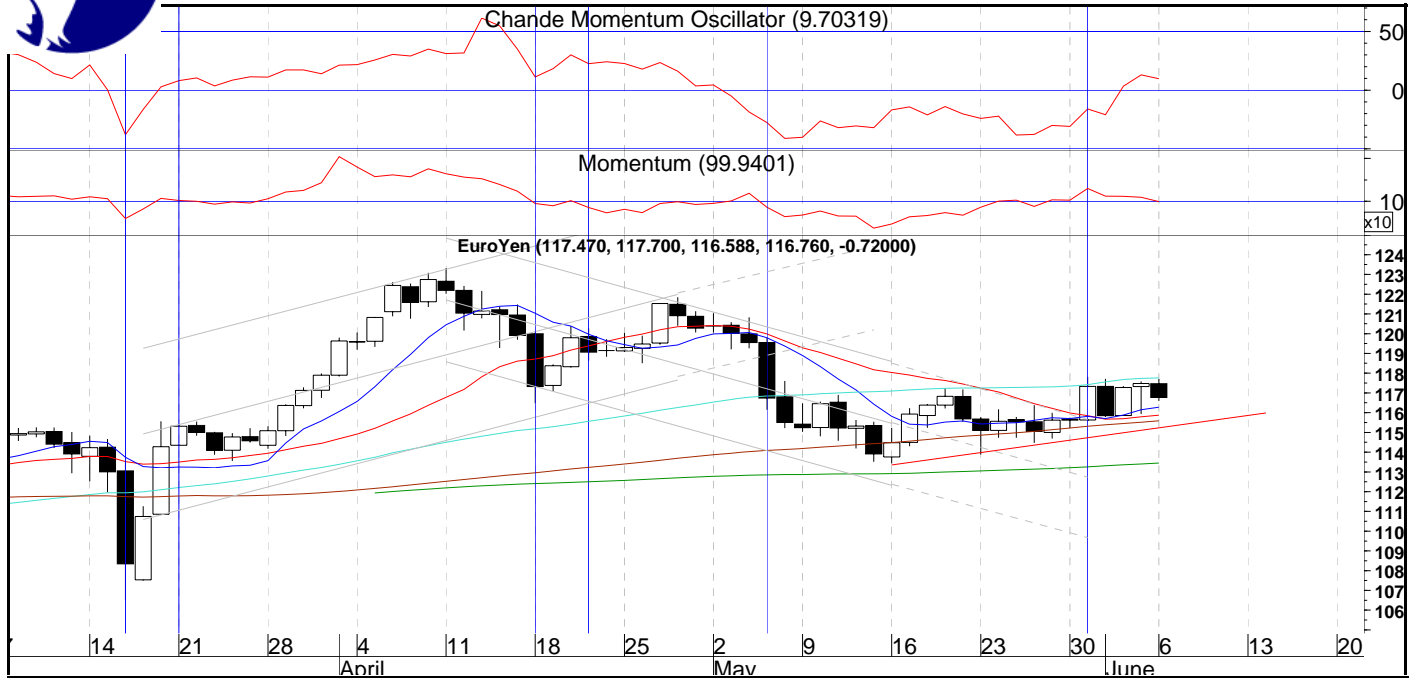
USD/CANADIAN DOLLAR



The USD/CAD made a higher high and higher close.



EURO/YEN



The euro/yen closed lower and under the 55-day. It has no momentum.

EURO/POUND



The euro/pound closed higher, if by only 3 points and on a doji bar.



GBP/JPY



The pound/yen closed lower and at the linear regression as well as fully under the green 200-day. The blue 10-day remains over the red 20-day, although the buy signal looks horribly wrong today.

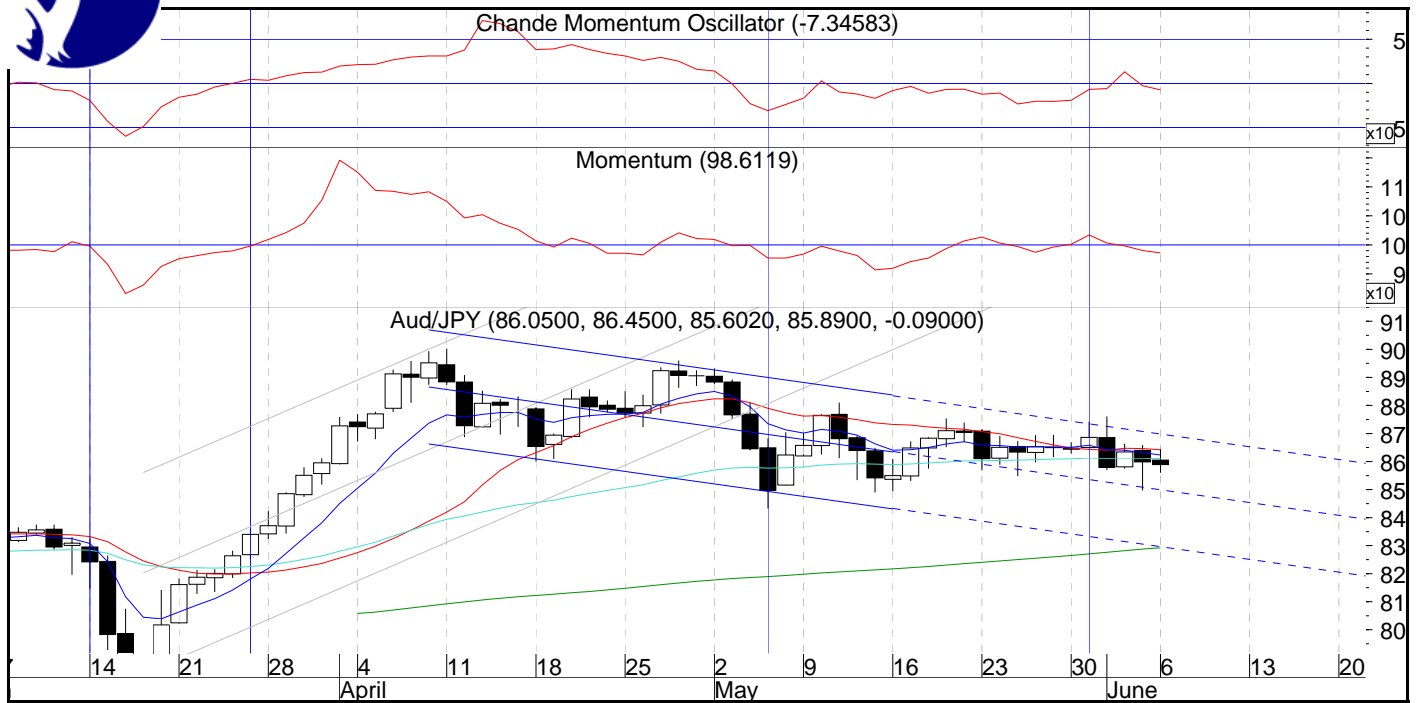
MEXICAN PESO



The dollar closed higher on a big bar and over the 55-day, with momentum going positive. This is a bit of a surprise. Over the 4-5 week timeframe, it's actually consolidative, if in a wide range.



AUD/JPY



The AUD/JPY closed lower on a doji bar and with negative momentum. The buy signal has (probably) failed but we await Japanese complaints about a too-strong yen.

Reuters 10-Year Note Index



The index closed at 3.02%—where it opened—from 2.99%. The new high couldn't hold but note that RSI is rising. The bottom may be in.

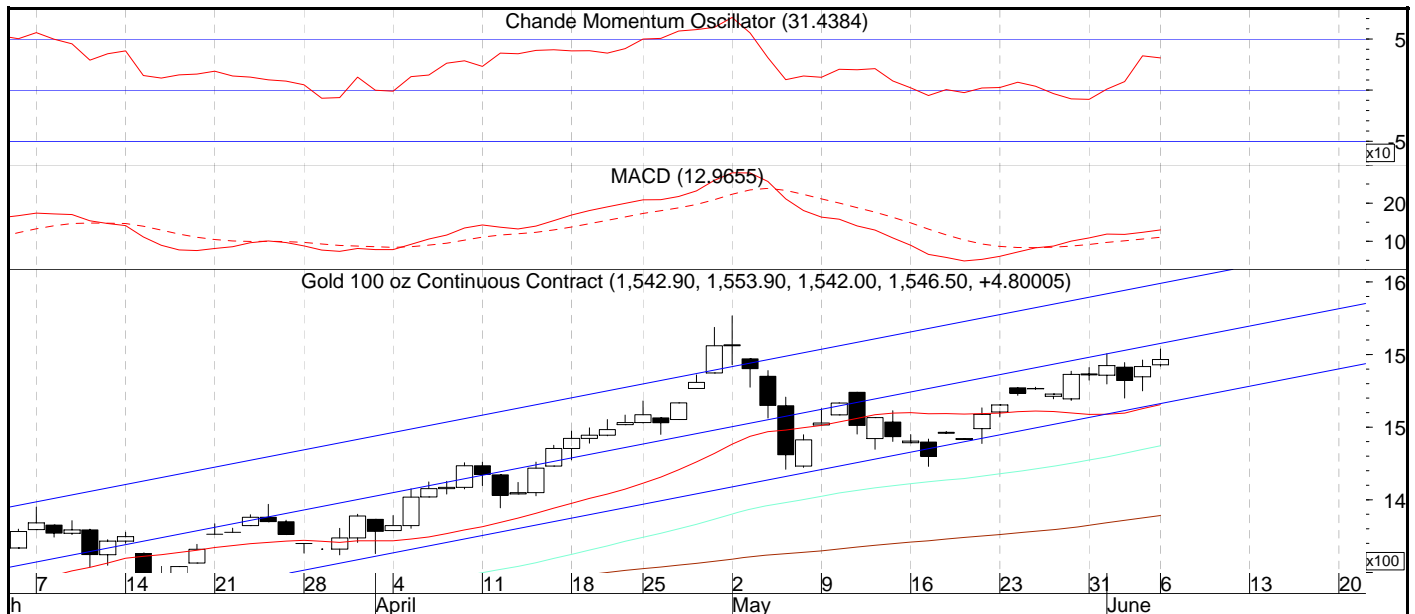


NYMEX Light Crude Oil (Continuous Futures Contract)



Oil closed lower at \$99.01 from \$100.22 on an inside day and under the 20-day moving average. The chart says traders are paralyzed with uncertainty.

Reuters Gold Continuous Futures Contract



Gold inched higher to close at \$1546.50 from \$1541.70 and note the close is not at or near the high (\$1553.90).

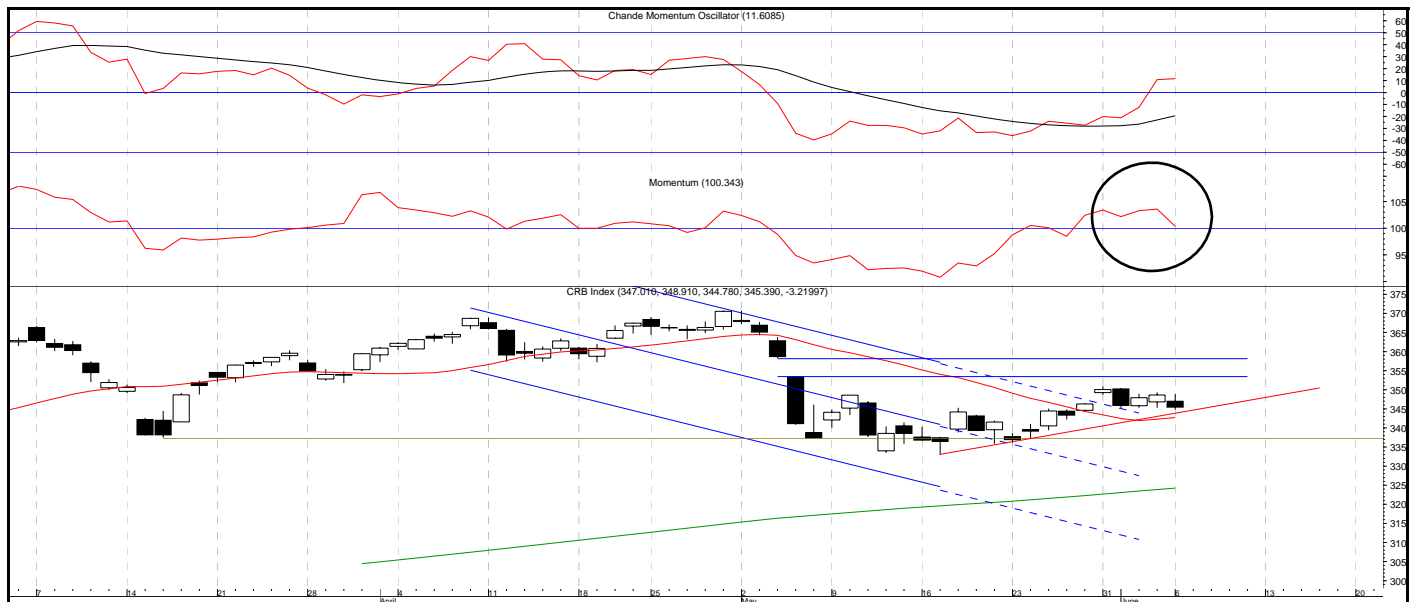


S&P 500



The S&P closed down at 1286.17 from 1300.16, breaking the last intermediate low from April 18 and probably about to test the earlier low from March 16 at 1249.05—which converges to the green 200-day.

CRB Commodities Index



The index closed lower at 345.39 from 348.61 and is nearing red support. See momentum falling.