

FX INsights

Includes daily analysis of financial policies and economic development of different countries to forecast the short-term movement of major currencies and their support and resistance levels. Plus macro economic and international policy analysis to identify factors that influence currency movements

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Daily FX Views

EUR stabilized, wait to high sell again

The Upper and Lower Houses of Germany had passed the funding part of the 750 billion euros European stability mechanism last Friday, which became a booster to EUR. EUR rose to as high as US\$1.2672. Although there was some retreat afterwards, it could still reverse from its five weeks of continuous fall. In addition, the EU finance ministers agreed to impose more severe penalties upon the member states which broke the rules. Investors were hopeful that the financial situation of Euro zone would become more stable in future, which was also a positive factor for EUR.

However, the Spanish government announced on Saturday to take over a savings bank called Cajasur. This had reignited the market concerns about the soundness of the European banking system. Banks in various countries held different amounts of Euro-zone government bonds, and the European countries in financial difficulties were forced to cut costs. Investors were worried whether this would endanger the economic growth and more banks would experience financial instability. Hence EUR faced selling pressure immediately as the market opened on Monday. EUR/USD even fell through US\$1.25 mark again.

According to figures from the Mercantile Exchange (CFTC), as of last Wednesday, the amount of short put positions of EUR retreated from its record highs in the previous week, reflecting that some investors were reaping the harvest. With the spreading of the European debt crisis, there were some buying for the cross trade of EUR/AUD, which had been rather active earlier. This had also led to the rise of EUR and the plunge of AUD. According to statistics, many investors

borrowed EUR to buy currencies like AUD, NZD, Brazilian real and the Norwegian krone, carrying high interest rates. The return of such carry trades was as high as 10% over the past six months. If choosing USD or JPY as the financing currency by mistake, then one would not only fail to win but also lose some, reversing to a loss of about 7.5%. EUR against a basket of currencies had fallen by 5.9% so far this year, which was one of the worst performing currencies, whereas USD and JPY rose 9.3% and 13% respectively.

The Sino-US strategic economic dialogue is under way, and Europe is still lingering with the debt problem, which is believed to help alleviate the pressure of RMB appreciation, and the impact upon the foreign exchange market is only limited. Yet, there is evidence from South Korea showing that the shipwreck in March was caused by artillery from North Korea, which made the geopolitical situation increasingly tense. Both USD and JPY also rallied due to their safe heaven functions. The market focus would shift to the content of the 6 billion pounds deficit reduction program of UK, but taking reference from the falling of EUR instead of rising amid the recent cutting of fiscal deficits in Greece, Spain and Portugal, one had still better not have too high hopes on GBP.

Germany had just approved a loan of 123 billion to support the European stability mechanism, but one still could not see the capability of EUR turning from weak to strong. EUR should still be sold upon rebound. The proposed entry level is US\$1.2540, with target at 1.2280. Stop loss when breaking last Friday's high of US\$1.2673. Good luck!