Interest Rate & FX Strategy

Daily Currency Briefing

EUR/USD: Downside risk from Trichet

- **OPEC has agreed informally to cut output, oil back above $60**
- **Japanese investors sold $7.4bn in foreign bonds last week**
- **Bernanke: Housing to take 1 pct pt off GDP in H2, however, Fed remains concerned about inflation**

The EUR view: While we continue to believe weaker US data has the upper hand in being a more sustainable force to drive the dollar, today's ECB press conference represents a not insignificant downside event risk for EUR/USD. After delivering the expected 25 bps rate rise to 3.25%, markets will be primed for a hawkish Trichet and standard phrases at such times. He will stress the need to "monitor very closely" price stability risks and will point out the likelihood of further withdrawal of monetary policy accommodation if ECB baselines scenarios pan out. Given these expectations and not withstanding the fact that markets have been skeptical of an even more hawkish sounding ECB of late, we think there could be outsized market reactions from any hint by Trichet that the US economic slowdown could impact Europe and/or that EU indicators are show signs of peaking. In such a scenario EUR/USD could challenge key support at 1.2625/30 – a break of which threatens to set off a series of stops that could take the pair to 1.2550, even 1.2475 or 1.2340 in time – such is the long nature of the market. We do not see such a move as being sustainable and would look to re-establish EUR longs in what would be a less one-sided market and as US data weakens towards the year-end. The possibility that the US economy receives a shot in the arm from the decline in energy prices, higher stocks and low bond (mortgage) yields has the capacity to lengthen the period of the aforementioned dollar rebound.

GBP Today's MPC meeting will be a non-event, but inflation continues to face upside risks from tuition fees, while money supply and housing remain strong. We continue to expect a 25 bp hike in November, which should help limit any sell-off in GBP today after the confirmation of steady rates. That said, GBP/USD could be vulnerable to broader USD strength should Trichet give any indication the ECB is more conscious of the US slowdown.

Today's events

Major Markets		Period	Market	CBCM	Previous	Impact
13:30 USA	Initial claims	Sept 30	314k	315k	316k	Neutral
13:30 CAN	Building permits	Aug, Vm	1.0%		-2.3%	Positive
15:00 CAN	Ivey Purchasing Managers Index	Sep	60.0		55.7	Positive

UK: BoE interest rate decision, unchanged at 4.75% expected (12:00)
EUR: ECB interest rate decision, +25bp to 3.25% expected (12:45), press conference (13:30)
USA: Fed member Moskow speaks in Chicago (15:40)
USA: Fed member Plosser speaks on the economy (17:00)
USA: Fed member Pianalto speaks in Ohio (22:00)

Local Markets The Southafrican rand remains under selling pressure. In three years, the record surplus of the current account balance has turned into a record low in Q1 due to strong consumer spending, and in Q2 the deficit didn't see a noticeable relief. Patchy FDIs don't improve the picture either. Credit growth rose 25% in August, reflecting the undampened spending spree of the Southafrican consumer. Due to falling commodity and precious metal prices, the rand suffers from additional pressure. Hence, in the short term, a test of the 8.00 level in USD/ZAR remains on the cards. We expect the SARB to raise rates by 100bp next week, since further tightenings haven't had major dampening effects on household spending, since the two-month intervals between rate meetings rahter call for a proactive policy and since the depreciation of the rand increases additonal inflationary pressures.

Currencies		Percent
EUR/USD	1.2703	-0.17
EUR/CHF	1.5872	0.08
EUR/GBP	0.6735	-0.27
EUR/JPY	149.34	-0.55
USD-Index	85.85	0.07
10-year yields		Basis points
USA	4.57	-4.8
Euroland	3.70	-3.8
UK	4.53	-2.8
Japan	1.74	3.6
Stock markets		Points
DOW	11850.61	123.27
EuSTOXX50	3914.73	34.59
FTSE 100	5966.50	29.40
Nikkei	16474.81	392.26
Commodities		Dollar
Crude oil, Brent in $	58.88	1.85
Gold, ounce in $	564.20	-12.93

Event risk calendar

6 Oct	US September Unemployment report
11 Oct	FOMC Minutes
11/12 Oct	BoJ Interest rate meeting
12 Oct	US trade balance
12 Oct	Fed Beige Book
13 Oct	BoJ monthly report

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