Mellon

FX Daily

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08.15 BST Thursday October 5 2006

Key Points

- **JPY steadier ahead of today's ECB meeting and possible comments from Trichet about the JPY.**
- **Market has dovish take on Fed comments, although the steady policy message was essentially unchanged.**
- **MPC meeting also features today – unchanged rates should see EUR-GBP upside.**

Diary

	Data/event	BST	Consensus*
GB	MPC rate announcement	12.00	4.75%
EU	ECB meeting outcome 12.45, press conf 13.30		3.25%
CA	Building permits (Aug) m/m	13.30	+1.0%
US	Initial claims (w/e Sep 30)	13.30	314k
US	Continuing claims (w/e Sep 23)	13.30	2444k last
CA	PMI (Sep, nsa)	15.00	60.0
US	Fed's Plosser on econ and policy	17.30	
	* Consensus unless stated		

Market Outlook

The **JPY** has slightly stabilised with the market a little apprehensive ahead of today's ECB meeting and the BoJ's Muto generally reaffirming the approach to gradual policy tightening. Muto was generally non-committal on the likely course of policy, but the fact that there was no real softening of the BoJ's prior stance modestly supports the notion of a possible rate hike before year-end. The ECB meeting will be significant for Trichet's attitude to the JPY, which he will no doubt be questioned on at the press conference (see below for preview). In the absence of a strong protest the JPY is likely to weaken fresh and this could see the recent highs on EUR-JPY (around 150.75) being threatened.

Comments from Bernanke and others confirmed current thinking on Fed policy. The central point was their expectation of a moderation in price pressures going forward and this led to a moderately dovish reaction in the money market. However, while they acknowledged the downside risk from the housing market, they also noted that current readings on core inflation were not consistent with their idea of price stability and that there was a still a risk that price moderation would not happen. In this regard, they see the upside risk to inflation as a greater issue than the downside risk to growth.

EUR-USD remains deadly quiet. The minimal reaction seen to yesterday's much weaker than expected non-manufacturing ISM highlights the lack of investor interest in this rate at the current time. However, as we have been noting, recent oil price declines may be providing some protection to the current US data weakness, as weaker oil should support economic activity over coming months. It will take something unusual out of today's ECB meeting or tomorrow's US employment report to shake things up in the short-term.

GBP has retained good support going into today's MPC meeting, although the likelihood is that they do nothing and the disappearance of event risk would suggest EUR-GBP upside (see below for MPC preview).

Day Ahead

UK – the market has been somewhat concerned about this week's MPC meeting (outcome due today) after having suffered the surprise of a rate hike in August. There is a sense that if November is a done deal, then why not hike now - why wait? There is clearly some logic to this argument, although not all of the data has been hawkish since the last meeting. Average earnings growth has softened for example and the ONS has significantly revised down the nominal GDP number for Q2. A rate hike today cannot be ruled out but in the circumstances most members may prefer to wait until next month, when they have the opportunity to revisit their GDP and inflation forecast as part of the Inflation Report preparation. The MPC seems to feel more comfortable in changing policy after having completed the due diligence of re-examining their forecasts. In other words, why hike rates now when they can do so more confidently in a month's time.

Eurozone – a 25bp rate hike seems assured at today's ECB meeting and the main focus will be on Trichet's press conference to see a) what he says about CPI after the recent fall, b) whether he attempts to give any signals on rates beyond the hike already discounted for December and c) whether he mentions the JPY. He is likely to express some satisfaction with the CPI weakness, but will also point out that lower oil prices help to support economic activity and that the German VAT hike will boost CPI in January. On rate expectations, there would seem to be no real need to upset market expectations at the current time. The ECB is probably quite happy with the rate profile currently discounted inasmuch as it provides them with much room for manoeuvre.

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It is the subject of the JPY that is perhaps the most interesting. As a rule, Trichet very rarely comments about exchange rates, so when he does say something he is clearly trying to send a message (e.g. the ‘brutal’ comment about EUR-USD two years ago). However, a major protest seems unlikely today and the most that can probably be expected is a reiteration of the comments he made at the recent G7 meeting i.e. G7 were agreed that the JPY would eventually reflect Japan’s economic recovery.