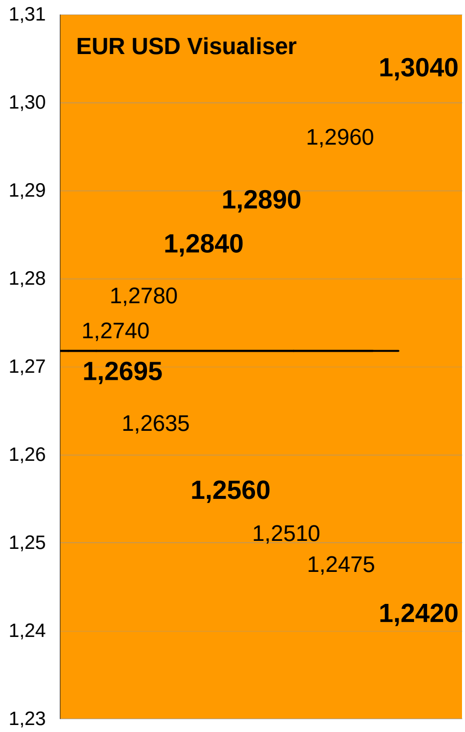
Daily Forex Outlook

Talk of yen-intervention re-emerges

4th October 2006

EUR USD (**1.2720**) The popular debate about a hard- or soft-landing in the US and, therefore, the likely direction of the Fed Funds rate, continues to rage. With every new data, for example between Friday's releases and Monday's, each camp seems to find some information to support their view. Even ambiguous information, like the slide in the oil price, is treated by both the warring parties as supportive of their stance: one cites fading demand and declining inflationary pressures; the other claims that lower fuel prices will support US consumption. The debate on the street is little more than a reflection of the one that is currently underway at the heart of the Federal Reserve itself. The view of some of the more hawkish regional presidents is well known – Lacker, for instance. But strategists are now questioning the extent to which non-voting members like Hoenig, who believes that Fed policy is already restrictive and that the worst inflation news is behind us, is representative of the FOMC.

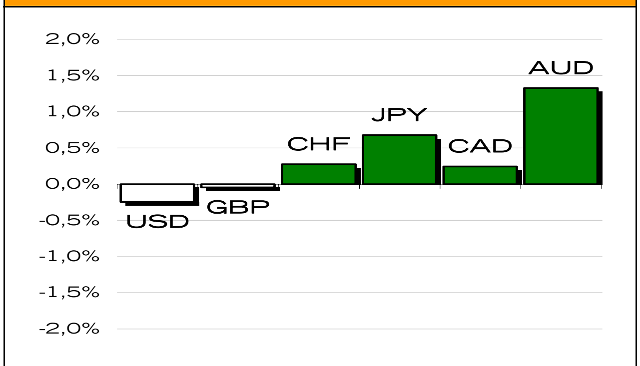
Under these circumstances it is perhaps not too surprising that the dollar is still holding to familiar ranges. We consider the borders of the current trading band to be **1.2635** – **1.2890**. The lower boundary of this range is weak and susceptible to a *false break*. This means that a violation would not give a meaningful signal to future price developments.



Market Bias Index™

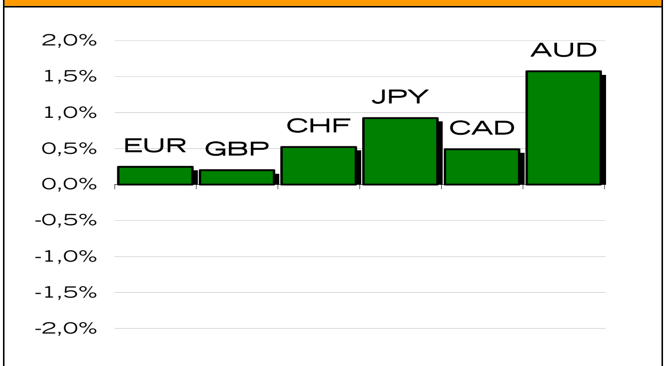
Monday's correction in the AUD was clearly not enough to allow too many wrong positions to escape unscathed. Traders are still likely to perceive both the USD and the EUR as overvalued against the Aussie.

Base currency: **EUR** 08:00 CET



Source: Cognitrend

Base currency: **USD** 08:00 CET



Source: Cognitrend

The Cognitrend Market Bias Index seeks to measure the extent of the perceived over-/under-valuation of the given base currency against other major currencies. This is important for estimating the behaviour of the losers as this is also the inverse of the price change that must be recorded for their breakeven to be reached. The greater the loss, the greater will be the bias. To exploit it, one should favour a base currency position when the bias is positive and vice versa.

USD JPY (118.00) The dollar violated our tight downside risk-limit on Monday (apologies). It still maintains the same bullish potential that we identified at the start of the week – to **119.15/20** – but this modest potential could not be exploited with a 30-pip risk. Instead, therefore, we would wait for deeper correction to **117.00** to retry a bullish strategy. There not only would the risk-reward by sharply improved, but the strategy could also be attempted with a tight, 20-pip downside limit.

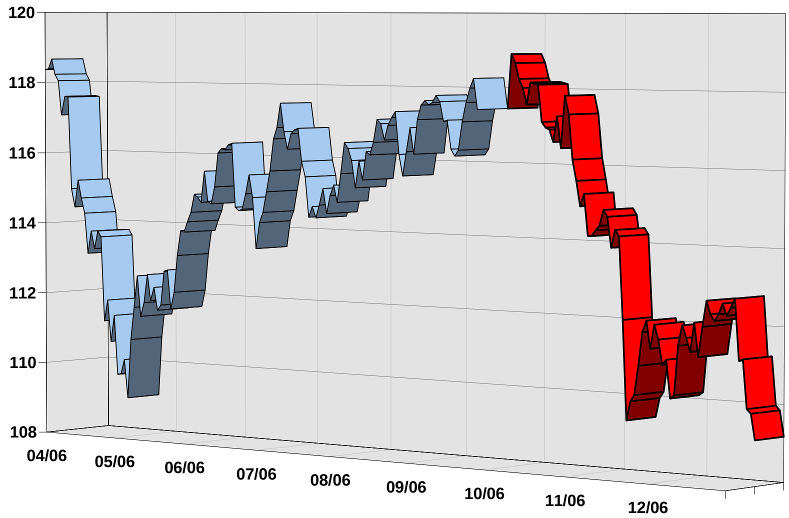
EUR JPY (150.15) Talk of possible central bank intervention in favour of the yen is again making the rounds. There was also a suggestion that the new Japanese Prime Minister would endorse the view that 'deflation is dead'. Whether this was the reason why the cross was rejected from our initial overhead resistance yesterday is not clear, but this point (now at **150.40/50**) remains the trigger for more gains to **152.40**. The risk-limit for an eventual bullish view would be set at **149.70**, a level that already represents the first support.

GBP USD (1.8840) Cable's recovery over the last couple of days has brought it back into a region where it will encounter increasing supply – practically in the middle of its broad sideways range. For today, the toughest of these resistances stands at **1.8920**. To the downside, demand ought to have improved now at **1.8780**. But a violation of this initial support would be an early sign of renewed weakness. Additional support stands at **1.8635**.

AUD USD (0.7440) In tandem with weakness in the precious metals market, the AUD declined yesterday and was even able to undercut our initial support. It is now exposed to further weakness, which could extend at any time to **0.7380** (too little for a strategy). Resistances are at **0.7475** and at **0.7540**. The latter would need to be overtaken before any bullish signal would be generated.

	USD CHF	USD CAD	NZD USD	EUR CHF	EUR GBP	EUR SEK	EUR NOK
Supply	1.2590	1.1330	0.6705	1.6010	0.6845	9.3975	8.5000
	1.2490	1.1260	0.6640	1.5910	0.6800	9.3640	8.4240
Demand	1.2395	1.1175	0.6545	1.5810	0.6735	9.2965	8.3300
	1.2255	1.1125	0.6495	1.5770	0.6665	9.2690	8.2550

Pattern Recognition Forecast Model



USD JPY
Goodness-of-fit = 84%
(best results above 90%)

** Closest representation of the last six months of activity in the historical database. The price forecast is the actual historical outcome adjusted for volatility.*

The objective of this model is to explore the possible future developments by basing a forecast on past movements in a purely mechanical way. The outcomes are therefore unrelated to the analysis otherwise contained in this document.

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